Dominant Capital and the New Wars [1]

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ABSTRACT

The recent shift from 'global villageism' to the 'new wars' revealed a deep crisis in heterodox political economy. The popular belief in neoliberal globalization, peace dividends, fiscal conservatism and sound finance that dominated the 1980s and 1990s suddenly collapsed. The early 2000s brought rising xenophobia, growing military budgets and policy profligacy. Radicals were the first to identify this transition, but their attempts to explain it have been bogged down by two major hurdles: (1) most writers continue to apply nineteenth century theories and concepts to twenty-first century realities; and (2) few seem to bother with empirical analysis.

This paper offers a radical alternative that is both theoretically new and empirically grounded. We use the 'new wars' as a stepping stone to understand a triple transformation that altered the nature of capital, the accumulation of capital and the unit of capital. Specifically, our argument builds on a *power* understanding of capital that emphasizes *differential* accumulation by *dominant* capital groups. Accumulation, we argue, has little to do with the amassment of material things measured in 'utils' or 'dead labour.' Instead, accumulation, or 'capitalization,' represents a *commodification of power* by leading groups in society. Over the past century, this power has been restructured and concentrated through two distinct regimes of differential accumulation – 'breadth' and 'depth.' A breadth regime relies on proletarianization, on greenfield investment and, particularly, on mergers and acquisitions. A depth regime builds on redistribution through stagflation – that is, on differential inflation in the midst of stagnation. In contrast to breadth which presupposes some measure of growth and stability, depth thrives on 'accumulation through crisis.'

The past twenty years were dominated by breadth, buttressed by neoliberal rhetoric, globalization and capital mobility. This regime started to run into mounting difficulties in the late 1990s, and eventually collapsed in 2000. For differential accumulation to continue, dominant capital now needs inflation, and inflation requires instability and social crisis. It is within this broader dynamics of power accumulation that the new wars need to be understood.

[1] The first draft of this paper was presented in October 2002 at the *YPE Seminar Series* at York University. It was submitted to the *JWSR* in June 2003 and accepted for publication in March 2004. During this process, we have received comments from many people, far too numerous to list here, as well as from two anonymous referees of the *JWSR*. We thank them all for their insights. We accept the paper's shortcomings as our own and hope that readers will find them sufficiently important to debate.

The new wars of the early 2000s mark a significant turning point in world affairs. During the previous period of the 1980s and 1990s, it was popular to talk about the return of 'unregulated capitalism.' It was the dawn of a new era, many said, the era of '*neo*liberal globalization.' The hallmarks of this new-old order appeared unmistakable. Falling budget deficits, tight monetary policy, deregulation, free trade and capital decontrols became the new orthodoxy. The ideological rhetoric spoke of 'democracy,' 'global villageism' and 'peace dividends.' The welfare-warfare state was on its way out. *Laissez faire* was back in fashion. The trajectory seemed so obvious that some were even tempted to announce the 'end of history.'

In the early 2000s, though, the tables suddenly turned. Fiscal and monetary policies were 'loosened,' 'protectionist' measures were reintroduced and the tidal wave of capital flow turned to a trickle. Talk of a 'global village' quickly disappeared and was replaced by a global 'war on terror.' Democracy has given way to Homeland Security. Expectations for peace dividends have dissipated in favor of 'war profits.' History was back with a vengeance.

The purpose of this paper is to situate this broad transition within an alternative understanding of capital accumulation. There have been many insightful explanations for this transition in recent years, but the one presented here is different in two important respects. First, whereas most explanations attempt to reconcile the new trajectory with existing theories of accumulation, ours is based on a new framework altogether. Second, in contrast to most accounts, which are largely polemic, ours is empirical throughout.

1. THE ARGUMENT IN A NUTSHELL

We start with capital. Contemporary students of capitalism, hamstrung by nineteenth-century biases, continue to think of accumulation in the 'material' terms of labor, production and consumption. In our opinion, this emphasis has become insufficient and misleading. Over the past century, capital has grown increasingly politicized in nature and financial in form. 'Free competition' and the formal separation of 'state' and 'capital' – where they existed – have given way to a far more complex interaction of 'dominant capital' groups and 'big government.' Accumulation, which during the nineteenth century was anchored largely in proletarianization and technical advances, has come to depend more and more on corporate amalgamation and inflationary pricing.

To deal with these new dimensions, this paper offers an alternative conceptualization of capital, understood not as a material entity but as a power institution. What gets accumulated, we argue, is neither 'utility' nor 'dead labor,' but financial claims on expected future earnings. These expected earnings, in turn, represent neither the 'marginal productivity' of capital nor 'surplus value,' but the way capitalists view the future structure of power in society.

A power understanding of accumulation leads to different units of analysis. Marx differentiated between three 'types' of capital owned by three corresponding 'fractions' of the capitalist class – 'industrial,' 'commercial' and 'financial.' This division is no longer tenable. All modern ownership is financial, and only financial. It is a claim on pecuniary earnings. And pecuniary earnings reflect not production or consumption, but power, and only power. This central role of power means that it is no longer enough to think in terms of capital 'in general' and 'individual capitals' in competition. Instead, the attention should be focused on *dominant capital* – namely, on the largest power coalitions at the centre of the political economy. Different coalitions within dominant capital sometimes are associated with different 'types' of business activity, such as oil, weapons, telecommunication or financial intermediation. But these differences are only partly, and sometimes not at all, related to the nature of 'production' per se. Business is a matter of profit, and profit comes not from production, but from power – the *power to reshape the trajectory of social reproduction as a whole*. Different segments within dominant capital are differentiated by the nature of their power. Production, narrowly defined, is merely an aspect of that power.

Driven by the quest for power, the goal of these dominant capital groups is not absolute accumulation, but *differential* accumulation. They try not to maximize profit, but to beat the average and exceed the normal rate of return. There is a big difference between these two goals. Profit maximizers focus on their own earnings. By contrast, differential accumulators also benefit, sometimes greatly, by lowering the earnings of others.

This difference is reflected in the 'mechanisms' of accumulation. Traditional analysis of accumulation emphasizes the importance to accumulation of overall growth and price stability. But for dominant capital, differential accumulation works best through mergers and acquisitions and through the redistributional effects of stagflation (stagnation combined with inflation). And, indeed, during the twentieth century, with the progressive spread of dominant capital and differential accumulation, there emerged an almost stylized cycle of differential accumulation 'regimes,' oscillating between relatively long periods of corporate amalgamation and shorter periods of stagflation.

The year 2000 seems to mark the beginning of yet another such oscillation: a long upswing of corporate amalgamation had just ended, and as these lines are being written (early 2003) there are signs that stagflation may be ready for a comeback. It is in this context that the current shift from neoliberalism to the new wars should be understood.

Traditional analyses of imperialism emphasized the benefit for accumulation of territorial conquest, access to raw material and the expansion of markets. But with capital becoming increasingly political in nature and financial in form, the link between imperialism and accumulation has grown more complex and subtle. Dominant capital has fabricated a whole new arsenal of accumulation techniques. This arsenal allows it to increase its profits immensely without military conquest. New

populations, new workers and new consumers are now brought under its ambit not through war, but through global corporate mergers. And when war does break out, dominant capital often supports it not for the added territory or the pacification of a rival, but for the mere turmoil it creates. As it turns out, turmoil provides the breeding ground for stagflation, and stagflation fuels differential accumulation. Mainstream economists think of inflation as a 'neutral' phenomenon, but the evidence suggests otherwise. Not only does inflation tend to come together with stagnation, but it also works to redistribute income – from workers to capitalists and from small firms to large ones.

The current shift toward war, and in particular the rekindling of conflict in the Middle East, is intimately connected with this new arsenal of accumulation. Of course, the reasons for war are always complicated and never singular, and the present historical junction is no exception. But as far as dominant capital is concerned, the 'battle lines' are relatively clear. For the leading accumulators, success and failure are a matter of differential profit. Their goal is to 'beat the average,' and that makes them judge the world based on relative earnings. In their eyes, the key question is how war will affect their *differential accumulation*, immediately and in the longer run. And that is the question we need to begin with.

Consider first the military contractors and oil companies. The interest of weapon companies in renewed conflict is pretty obvious, particularly after a decade of peace dividends, curtailed war budgets and dwindling arms exports. The interest of the oil companies, however, is more complicated and often misunderstood. Contrary to popular belief, since the 1970s the oil companies, taken as a group, have become relatively impartial to 'access rights' and 'drilling concessions.' As long as they remain the principal off-takers of crude oil, it does not matter much whether or not they own it. The key to their profit is not volume, but price. A higher price of crude oil means higher input costs for them; but it also means a much higher price for refined products, and therefore much higher profits at the bottom line. When crude oil prices go up, so do their profits, and vice versa when the price of oil drops.

And what makes the price of oil go up and down? According to popular conception, the blame rests either with the 'oil sheiks' of OPEC or with the market forces of 'supply and demand.' The reality of the oil business, however, is rather different. As it turns out, over the past thirty years the single most important factor affecting the price of oil was the ebb and flow of conflict in the Middle East.

Tension and war brought higher oil prices, which in turn led to higher oil revenues for OPEC and surging profits for the oil companies. Local governments, flooded with petroleum earnings, used those earnings to buy more weapons, and their purchases helped enrich the arms exporters in the industrialized countries. Furthermore, as the region's arsenals swelled, the groundwork for the next conflict was put in place. Thus, if the oil and armament groups surrounding the current Bush Administration have a broad interest here, clearly it is an interest in some measure of instability and war, not peace.

Of course, the armament and oil companies are not the only ones that need to be considered. Most big companies have little to do with the sale of either weapons or oil, and practically all are users of energy. So are these companies not set to lose from war and higher energy prices? The answer is 'yes and no.' If oil prices were to continue rising, the Microsofts, General Motors and Vivendis of this world would likely fall behind the ExxonMobils and Lockheed Martins. And indeed, the prospect of such loss of primacy has already contributed to some squabbling between and within Western governments on precisely how much violence should be inflicted on the Middle East. However, considering the stakes involved, the struggle so far has been rather muted. One possible reason is that most large companies believe that the new wars will indeed contribute to world stability and lower oil prices. But there is another possibility, namely, that these companies expect greater instability and higher prices, but view this outcome as desirable – even if it causes them to lose primacy to the oil and armament firms.

The logic behind this preference is as follows. Presently, the biggest danger facing dominant capital as a whole is deflation. The global debt burden is heavier than at any previous point in history, roughly twice what it was on the eve of the Great Depression. Corporate pricing power, however, has been declining for more than twenty years and is now the weakest it has been since the late 1950s. Under these circumstances, if disinflation were to give way to *falling* prices, the specter of chain bankruptcies and debt deflation could make the Great Depression look like child's play. Given this risk, any move toward higher inflation – even when accompanied by stagnation – is the lesser evil and would be welcomed with a sigh of relief.

A likely trigger for higher inflation is higher oil prices. That, at least, has been the pattern since the late 1960s. Over the past forty years, higher oil prices have *always* led to higher inflation, and if they do so again dominant capital will likely find the outcome desirable. Furthermore, once the deflation threat is defused, the icing on the cake would be the reinvigoration of differential accumulation. As noted, inflation tends to redistribute income from labor to capital and from small firms to larger ones. And if this pattern continues to hold, the net effect on dominant capital would end up being positive.

Oil producing countries in and outside OPEC obviously are more ambivalent. The explicit shift toward interventionism on the part of the United States and its Western allies must be worrying for them. OPEC is the only international cartel that managed to obtain some degree of 'autonomy' from Western influence, and now this autonomy is in great danger. At the same time, however, part of the cartel's lingering weakness stems precisely from its inability to keep prices high – something which a new era of conflict 'managed' by direct U.S. intervention may help remedy.

Needless to say, these arguments leave many questions open. For example, does dominant capital understand its interests in this way, and therefore quietly support the new wars? Are the oil and armament companies sophisticated enough to 'engineer' such roundabout accumulation strategies? Do they have the necessary muscle

to stir the U.S. government into such adventures? What is the opposition standing against them – from within dominant capital and from the underlying population more broadly? What are the consequences of these developments for the broader 'functioning' of contemporary capitalism? And how should we embed these considerations in the larger context of regional and global politics, cultural change and religious conflict? These are all important questions that deserve a study far more extensive than what can be attempted here. But, then, our purpose is not to write the final word on the issue, but rather to outline an alternative approach and invite others to debate it.

2. CAPITAL ACCUMULATION[2]

What do we mean by the term 'accumulation'? Most people would probably consider this a trivial query: you accumulate when you become richer, you decumulate when you become poorer. And that is certainly part of the answer – but not the whole answer. Suppose your dollar assets grew by 10 percent last year. Suppose further that the overall price level – measured by the GDP price deflator – also grew at the same rate of 10 percent. Since, on average, everything cost 10 percent more, your 'purchasing power' remained the same even though the nominal value of your assets had risen. Clearly, your 'wealth,' measured in terms of what you can acquire, has not changed. In this sense, you have *not* accumulated. For this reason, economists – conservative and radical alike – argue that accumulation should be measured not in nominal dollars and cents, but in '*real terms*.'

Unfortunately, this is easier said than done. Of course, national statisticians produce measurements of the 'real' capital stock as a matter of course, but the *meaning* of these measurements is anything but clear. The statistical procedure itself is simple enough. You take the overall value of capital equipment and structures denominated in dollars and cents – for instance, the dollar value of all factories in the automobile industry – and divide this value by the price index for automobile factories. On the face of it, the effect is to 'purge' from the nominal value of capital the impact of changing prices. For example, if the dollar value of automobile factories in our example rose by 20 percent, and if 5 percent of the increase was due to a rise in the price of a typical factory, the statistician, after subtracting the latter from the former, could tell us that the 'real' rate of accumulation was 15 percent; in other words, that the 'quantity' of factories, as distinct from their 'nominal' value, expanded by 15 percent. A clean, simple computation, no doubt. But does it really measure the rate of 'accumulation'?

Consider the following facts. An 'automobile factory' – and any other factory for that matter – is made of many different tools, machines and structures. Over time, the

[2] For detailed expositions of our view on capital, power and differential accumulation covered in Sections 2-4, see Nitzan (1998), Nitzan and Bichler (2000a) and Bichler and Nitzan (2001b: Ch. 2).

'nature' of these items tends to change. They may take less time and effort to produce; they may become more productive due to technical improvement or less productive because of wear and tear; their composition may change with new machines replacing older ones; they may be used to produce different and even entirely new output; etc. The result of these many changes is that today's automobile factories are *not the same* as yesterday's, or as last year's. The price index of automobile factories, however, is supposed to track, over time, the price of the *very same* factories. The obvious question, then, is how such an index could be computed when the underlying factories – the 'things' whose price the index is supposed to measure – keep changing from one year to the next?

Clearly, in order to measure the price of capital, we must first denominate its underlying 'substance' in some homogenous units. Neoclassical economists have solved the problem by saying that machines, factories and structures could all be reduced to universal units of 'productive capacity,' counted in terms of the utility they generate. In this way, an automobile factory capable of producing 1,000 utils is equivalent to two factories each producing 500 utils. As factories change over time, we can simply measure their changing 'magnitude' in terms of their greater or lesser 'util-generating capacity.'

In contrast to the neoclassicists, Marx approached the problem from the input side, arguing that capital, like any other commodity, could be quantified in terms of the socially necessary 'abstract labor' required to produce it. So if we begin with an automobile factory that takes, on average, 10 million hours of abstract labor to construct, and add to it another factory that takes, on average, only 5 million hours to build, we end up with an aggregate capital whose 'magnitude' is equivalent to 15 million hours of abstract labor.

Do these 'procedures' solve the problem of separating price from quantity? Not in the least. Indeed, had we known the 'productivity' or 'abstract labor contents' of capital, that knowledge would already tell us what the 'real' magnitude of capital is, making the whole statistical exercise redundant. Will political economists ever come to 'know' these universal units, so that they can dispense with the make-believe process of separating price from quantity? Perhaps. But so far they have not, and until they do – which we think will be never – the meaning of all statistical measures of 'real' capital will remain unclear.[3]

[3] In order to denote the 'substance' of capital in universal units, political economists would need to overcome three obstacles, all of which are insurmountable. First, they would have to explain how we can convert qualitatively different outputs into universal 'utils' (in the neoclassical case), or qualitatively different forms of concrete labor into homogenous units of 'abstract labor' (in the Marxist case). Second, they would have to identify the particular utils produced by a particular type of capital (neoclassical), or the exact number of abstract labor hours that went (on average) into making a particular type of machine (Marxist). And, third, they would have to show that the capital measurements they came up with were indeed unique; in other words, that the 'substance' we call a factory, when measured as 'capital,' has one quantity, and *one quantity only*. On the impossible 'conversion' of quality into quantity, see

Ironically, even if we could somehow come up with a 'real' measure of capital, that would not really matter for our purpose. The reason is simple: the real interest of capitalists has nothing to do with the so-called 'real' rate of accumulation. The Ford family, Bill Gates, the Bronfmans, George Soros – and, for that matter, all contemporary capitalists, including the managers of mutual funds and the directors of the large corporations – do not care about the 'purchasing power' of their capital. Similarly, they do not care about the 'productive capacity' of their machines. And they do not care about how much 'abstract labor' went into producing what they own. Of course, they do care very much about the nominal value of their assets. Under the price system of capitalism, says Thorstein Veblen, 'men have come to the conviction that money-values are more real and substantial than any of the material facts in this transitory world' (Veblen 1923: 88). And there is a reason for this conviction.

Present-day capitalists own not 'means of production,' but a financial claim on corporate earnings. [4] This fact is true for all capitalists, whether they own an automobile company, a software firm, a bank, a media conglomerate or a diversified financial portfolio. In this sense, we can no longer differentiate between 'industrial,' 'commercial' and 'financial' capitalists. The emergence in the late nineteenth century of the corporations as the principal form of ownership turned all capitalists into financial capitalists. Furthermore, with extensive conglomeration and crossholdings it is no longer possible to apply the categories of 'industry,' 'commerce' and 'finance' even to the corporations themselves. Finally, and crucially, even *within* the corporation we cannot know how much profit comes from 'industry' as opposed to 'commerce' or 'finance.' It is true that many large companies provide data on sales and profits broken by 'business segment' and 'line of activity.' But these breakdowns, based as they are on intra-company transfer pricing, are forever arbitrary. They could be made as large or small as desired and therefore give us no definite insight as to the ultimate 'source' of profit. [5]

In short, there is a decisive 'break' between the material facts of production and the financial reality of accumulation. This break was well understood by Marx already in the middle of the nineteenth century (Cf. Marx 1909: Vol. 3, Part V). But in order to defend his notion of 'actual capital,' which he believed was made of surplus abstract labor, financial accumulation had to be classified as 'fictitious.' More than a century

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for example Castoriadis (1984), Nitzan (1989) and Bichler and Nitzan (2001a). The issue of input-output indeterminacy was pointed out by Steadman (1975; 1977). The problem of providing a unique measure of 'real' capital was first identified by Veblen (1904; 1908) and Wicksell (1935), and later gave rise to the 'Cambridge Controversies' of the 1950s and 1960s (Cf. Robinson 1953-54; Sraffa 1960; Harcourt 1969).

[4] Note that that the 'objects' owned by the corporation, such as factories and structures, are merely instrumental to profit: they derive their capitalization not from their 'productivity' or their cost of production, but from the earnings they are expected to generate.

[5] These problems are well known to national accounting statisticians. The U.S. Department of Commerce, for instance, warns users that its profit data are based on *company* reports, and that their classification by *industry* is 'inaccurate' to an unknown extent (U.S. Department of Commerce. Bureau of Economic Analysis 1985).

later, though, the dialectics of capitalist development have completely inverted his classification. These days, the only 'actual' capital is finance. It is readily observable and measurable, it is the only capital capitalists care about, it moves the world. By contrast, capital counted in abstract labor is entirely 'fictitious.' It cannot be observed, it cannot be measured, and it is of no interest to capitalists or their managers. It cannot tell us anything about the actual process of accumulation.

And, so, although 'production' in its narrow sense matters a great deal for capitalism, it does not – and indeed cannot – provide either the *quantitative* code for accumulation or the *benchmark* against which accumulation should be assessed. Accumulation is a matter of power, and, accordingly, the yardstick capitalists use to assess their success or failure cannot be absolute. It has to be *relative*. Capitalists compare their accumulation not to articles of utility or hours of labor, but to the 'normal' rate of accumulation itself.

3. DIFFERENTIAL ACCUMULATION

A capitalist investing in Canadian 10-year bonds typically tries to beat the *Scotia McLeod* 10-year benchmark; an owner of emerging market equities tries to beat the *IFC* benchmark; investors in global commodities try to beat the *Economist* index; owners of large U.S. corporations try to beat the *S&P 500*; and so on. Every investment is normally stacked against some benchmark. To seek 'absolute' returns in our day and age is to be exotic indeed.[6] Neoclassical economists never tire of talking about 'profit maximization,' although real investors would not know what that meant even if they cared.[7] Their own goal is *differential accumulation*.

On the face of it, this emphasis on differential financial gain may seem overblown. Present day capitalists certainly think in nominal terms; and, yes, they do try to beat the average. But in so doing, are they not simply chasing their own tail? And why should studying this game be important for political economy? After all, everyone knows that financial markets are a 'bubble' of hype and deflation whose booms and busts are pretty much 'delinked' from the 'real' processes of production and profit.

[6] Peter Martin, a *Financial Times* columnist, clearly is sailing against the wind when he calls on fund managers to abandon their 'fetish' for relative performance in favor of absolute returns (Martin 1999). Some hedge funds have tried to do just that – i.e., achieve a pre-determined rate of return – but as another *Financial Times* commentator explains, their strategy is tantamount to having their cake and eating it too. In the end, 'absolute return strategies' are attractive only insofar as they manage to beat the average. . . . (Anonymous 2002).

[7] The idea of profit maximization was first challenged during the Great Depression by the empirical works of Means (1935) and Hall and Hitch and (1939). Initially, their studies stirred up considerable controversy and debate, but with the post-war victory of the 'neoclassical synthesis' of Keynesian macroeconomics and neoclassical microeconomics, the issue was ceremoniously swept under the carpet (see Lee 1984; Lee *et al.* 1990-91).

Looking at how investors behave may be interesting, even entertaining, but how much can it tell us about the *underlying* social reality?

The short answer is: plenty. Finance and differential accumulation are not a sideshow. Finance is the main 'language' of capital, while differential accumulation is its principal 'generative order.' Together, they produce many of the 'explicate' phenomena of contemporary capitalism and offer a key to understanding some of its most fundamental processes.[8]

Finance and 'Reality'

Take the popular 'delinking thesis.' According to this theory, equity prices have no basis in 'reality.' In buying and selling stocks, investors are simply trying to guess what other investors think, in infinite regress, a process which inevitably makes them lose sight of anything related to the 'real' economy. As John Maynard Keynes put it, 'We have reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be. And there are some, I believe, who practice the fourth, fifth and higher degrees' (Keynes 1936: 156). This view has become popular, and it certainly rings true if you spend too much time observing 'day trading' and the stock market floor. But as an explanation of the market's long term trajectory it is dangerously misleading.

Consider Figure 1. The chart shows the long-term development of the Standard and Poor's 500 index (*S&P 500*), which measures the average stock price of the 500 largest companies listed in the United States. The figure also plots the average earnings per share of these companies. Evidently, the two series have not moved together exactly, showing marked discrepancies in their year-to-year fluctuations (note the log scale). But over the longer term their correlation – measuring 0.95 out of a maximum value of 1 – is nothing short of remarkable. In other words, the stock market may be based on subjective speculation (which it certainly is), but it is *a speculation tightly correlated with the capitalist reality of profit*.

[Figure 1. S&P 500: Prices and Earnings]

Should this long-term correlation surprise us? Not really. When a capitalist buys a share in a company, she buys a portion of that company. But what she pays for are not the machines, structures, or workers of the company. Rather, she pays for the *company's ability to generate profit*. And how much she pays for this ability is proportionate to how much profit the firm is expected to generate.[9] This relationship can be symbolically stated, so that:

[8] On the notions of explicate and generative orders, see Bohm and Peat (2000) and Bohm (2002).

[9] We are abstracting here from the other dimension of stock pricing – namely, risk perceptions, the rate of interest and investors' hype (the later denoting the ex-post ratio of expected to actual profit). These factors are largely cyclical and therefore important mostly in the short and medium term. In the longer run, they are necessarily secondary to the exponential growth of profit.

(1) *rate of accumulation* ≈ *expected rate of growth of future profit*

We can further simplify this expression by noting that, over the longer haul, profit expectations tend to oscillate around the path of actual profit, so that:

(2) *rate of accumulation* ≈ *rate of growth of profit*

In other words, what we see in Figure 1 is not a fluke correlation between the so-called 'speculative' fervor of finance and the 'reality' of profit, but *a relationship deeply grounded in the inner logic of accumulation*. Over the longer haul, the 'delinking thesis' is wrong, not only empirically but also theoretically.

Differential Accumulation: Passive and Active

Now, let us think of what it takes to achieve differential accumulation; that is, to have the capitalist's own capital, measured in dollars, expand faster than the average. Suppose, for the sake of illustration, that the capitalist invests in equities, and suppose further that he systematically beats the *S&P 500* benchmark. To enjoy such a feat, the profits of the companies he owns must grow faster than the average profit of the 500 firms included in the *S&P 500* index.[10] And as his own profits rise faster than the average, his relative share of total profit grows as well. In other words, to *accumulate differentially* and to *increase your distributive share of profit* are two side of the same process.

There are two basic ways to beat the average: the 'passive' and the 'active.' The passive method, typical of minority owners, is to buy those assets whose profits you expect to grow faster than the average – but whose prices are presently 'undervalued' relative to this 'eventual' outcome – and wait. In due course, or so you hope, other investors will come around to think as you do, bid up the price of your stocks relative to the average, and in the process cause you to accumulate differentially. Two glaring examples of this strategy are George Soros' Quantum Fund and Warren Buffett's Berkshire Hathaway. Between 1969 and 1997, Soros recorded annual total returns averaging 33 percent, compared with 13 percent for the *S&P 500,* while Buffett, nicknamed the 'Sage of Omaha,' scored an annual average of 22 percent over the 1965-2002 period, compared with 10 percent for the *S&P 500.*[11]

And yet, as they grow bigger, successful 'passive' investors increasingly find themselves compelled to pursue more 'active' methods. In the 1960s, Soros and Buffett were small enough to buy and sell without significantly affecting the price of their underlying assets. That was no longer true in the 1990s. Systematic differential accumulation

[10] Again, we are abstracting from shorter term variations in differential risk and hype alluded to in footnote 9.

[11] Total return comprises capital appreciation and reinvested dividends. Figures computed from Reier (2000), Buffett (2003: 2) and *Global Financial Data* (http://www.globalfindata.com)

had made them too big for a strictly passive strategy. As a capitalist, it is no longer easy to 'buy cheap' when your large purchases quickly drive up the price, or to 'sell dear' when unloading assets *en masse* quickly depresses their price. At that point, you are more or less forced to become active, which is what gradually happened to Soros, Buffett and scores of other large fund mangers and institutional investors.

The active method, typical of majority, or 'effective' owners, contains the added ingredient of *direct* intervention. Instead of merely waiting in the hope that profits will grow differentially, you take deliberate action in order to make sure they do grow differentially. Individually, dominant capital groups engage in both methods. But it is the latter method – namely, the active attempt to affect profit – that makes systematic differential accumulation possible in the first place. Without someone being 'active,' there could be no systematic growth in differential profit; and without such growth the passive method becomes untenable.

Capital and Power

The emphasis here on active 'human agency' is crucial, and all the more so since existing theories of accumulation tend to ignore it. For the neoclassicists, capitalists can try to increase their profit until they are blue in the face. It will not help them. In a competitive market, profit is equal to the productive contribution of capital, not to the effort of its owner. Karl Marx ridiculed the notion that capital could be 'productive.' Only labor was productive. The source of profit was the institution of private ownership, which left the means of production in the hands of capitalists and forced workers to settle for wages lower than the value of their output. In this scheme, Marx recognized the power foundations of capital – the power of capital over labor. Paradoxically, however, beyond this abstract recognition, his analysis of accumulation left little room for *concrete* power.

Of course, Marx was the first to note the growth of big business and the formative role of the state in the genesis of capitalism, themes that were later developed by neo-Marxist state theorists and the analysts of monopoly capitalism. But to emphasize these aspects of power was to undermine the labor theory of value. This latter theory relied heavily on the Newtonian assumptions of atomistic competition, the free mobility of capital and labor, and the lack of 'intervening' factors such as governments – all of which assumptions were compromised by the ascent of giant corporations and big government. The result was an increasingly sophisticated explanation of capitalist power built on an increasingly shaky theory of capital accumulation.

Monopoly Capital theorists took a step forward, by emphasizing the role of centralized power in mature capitalism and by recognizing that such power made labor values more or less irrelevant for the actual trajectory of *prices and profits*. But they failed to take the next logical step, namely to rethink the implication of power for the *concept of capital itself*. This failure was candidly acknowledged by Paul Sweezy in his assessment of *Monopoly Capital*, a book which he wrote together with Paul Baran twenty-five years earlier:

> Why did Monopoly Capital fail to anticipate the changes in the structure and functioning of the system that have taken place in the last twenty-five years? Basically, I think the answer is that *its conceptualization of the capital accumulation process is one-sided and incomplete*. In the established tradition of both mainstream and Marxian economics, we treated capital accumulation as being essentially a matter of adding to the stock of existing capital goods. But in reality this is only one aspect of the process. Accumulation is also a matter of adding to the stock of financial assets. The two aspects are of course interrelated, but the nature of this interrelation is problematic to say the least. The traditional way of handling the problem has been in effect to assume it away: for example, buying stocks and bonds (two of the simpler forms of financial assets) is assumed to be merely an indirect way of buying real capital goods. This is hardly ever true, and it can be totally misleading. This is not the place to try to point the way to a more satisfactory conceptualization of the capital accumulation process. It is at best an extremely complicated and difficult problem, and I am frank to say that I have no clues to its solution. But I can say with some confidence that *achieving a better understanding of the monopoly capitalist society of today will be possible only on the basis of a more adequate theory of capital accumulation*, with special emphasis on the interaction of its real and financial aspects, than we now possess. (Sweezy 1991, emphasis added)

4. CAPITAL *AS* POWER

In our view, the alternative is to think not of accumulation *and* power, but of accumulation *as* power.[12] The Marxist belief, according to which surplus value is first 'produced' by industrial capitalists and then 'redistributed' through intra-class power struggle among the different fractions of the capitalist class, is a grand myth which has run its course. Instead, we argue that *all* capitalized earnings, regardless of their 'source,' are reflections/expressions of power – the power of capitalists to shape and transform the course of society to their own ends. What is being 'capitalized,' always, is not abstract labor, but *power itself*. And since power, by its very nature, is differential, so is accumulation. This is the crux of the matter.

[12] Our 'equating' of capital to power is metaphorical, of course. But as Arhtur Koestler (1959; 1964) amply demonstrates, metaphors, or 'bisociations,' as he calls them, are essential for creativity, including in science. 'Metaphoric perception,' say David Bohm and David Peat, 'is, indeed, fundamental to all science and involves bringing together previously incompatible ideas in radically new ways' (2000: 35).

Capitalizing Power

Consider the example of Microsoft. In 2000, the company earned $9.4 billion in net profit – roughly 70 percent of all global software profit – and boasted a market capitalization of some $310 billion (Anonymous 1999b; Moody's Online). This profit and capitalization, though, bore little relation to the 'productivity' of the company's workers or to the cost of producing software. Instead, they were *entirely* dependent on intellectual property rights, on the state sanction that backed up these rights, and on Microsoft's ability to harness this sanction to its own differential ends. For this reason, it does not matter whether Microsoft spent billions of dollars to 'invent' its programs, or instead appropriated them *gratis* from others. Either way, the programs take only a few dollars' worth of CDs to 'reproduce,' to the byte. The only barrier preventing this latter act is the law. Remove the threat of penalty for such 'procreation,' and Microsoft's profit and capitalization would quickly collapse to zero. Microsoft may be a 'knowledge company,' whatever that means. But its differential profitability depends squarely and solely on the *politics* of knowledge.[13]

Or take Citigroup. The relative profit growth of this financial conglomerate, like that of similar companies, depends, among other things, on interest rates. And interest rates, as we know, are affected by monetary policy. This 'symbiosis' between private profit and state action makes Citigroup's differential accumulation depend on its ability to affect monetary policy; and to the extent that it does, part of Citigroup's assets represents a 'capitalization of the state.'

Or think of General Motors. GM, together with seven other automobile companies, controls the world market for cars and trucks. The differential profit of GM depends on its tacit and open collusion with these other companies. But it also depends on much more. It depends on the highway system provided by the government, as well as the convenient lack of alternative public transportation; it depends on environmental regulation or lack thereof; it depends on the ups and downs in the price of oil; it depends on tax arrangements with various governments and on a complicated global system of 'transfer pricing'; it depends on a sophisticated propaganda war which creates wants and shapes desires; it depends on the relative strength of its labor unions; and so on and on. GM's differential profit also depends on its huge credit operations, and therefore on monetary policy; and it depends on the company's military business, and therefore on the global politics of armament and the 'threat' of conflict. In this context, the 'production' of automobiles as such is not the 'source' of accumulation, but rather one dimension of a complex order through which GM develops and expands its relative social power.

Another illustration: advertising firms. Companies such as the Interpublic Group, Omnicom and Publicis bypass the sublimations of liberal ideology altogether.

[13] Not surprisingly, Microsoft earns most of its profits from sales in developed countries such as the United States, where software piracy could cost you up to five years in jail. Most developing countries haven't yet perfected the penal system for such acts, and until they 'develop' in that direction, their contribution to Microsoft's bottom line is likely to remain negligible.

They do not sell a product; they sell power – the power to shape the minds of human beings. The more effective their brainwashing, the greater their relative profit and differential capitalization. Their capitalization, quite literally, is the capitalization of differential power.

A final example – the oil companies. As we shall see later, over the past thirty years the differential profits of these companies have had little to do with the production of oil – and almost everything to do with its price. And the price of oil in turn has had little to do with 'supply and demand' and everything to do with the global political economy in general and the political economy of the Middle East in particular. So here, too, profit is a matter of politics, which means that assets capitalize power.

What these examples serve to illustrate is simple. The so-called 'process of production,' narrowly understood, constitutes one of several explicate 'media' through which profit is generated. But that medium alone still tells us very little about profitability and accumulation as such. In order to decipher these latter processes, we have to go beyond the narrow understanding of 'production' and unpack the *general and concrete nature of capitalist power and its oppositions*.

Our own starting point is to recognize that contemporary capitalism is obsessed with the differential accumulation of financial values. Individual capitalists can accumulate differentially simply by gambling on 'undervalued' assets whose underlying profit they expect will grow differentially. But somebody has to make these profits grow differentially in the first place, and that requires power. Power, in other words, lies at the very heart of accumulation. To understand accumulation is to understand power under capitalism, and vice versa.

Politics, Ruling Class and Accumulation Through Crisis

The double-sided nature of power and accumulation is important for many reasons, of which we should highlight three. First and foremost it forces us to think of accumulation itself as a political process. From this viewpoint, the 'political' dimension is not some sort of a superstructure built on top of 'material' accumulation, a mechanism for the redistribution of values previously created in the productive sphere. Instead, *politics, broadly understood, is the very crux of accumulation*. Making politics the focus of our attention enables us to defuse the anonymity of 'capitalist forces,' demystify 'competition,' and go beyond the vagueness of 'the state,' 'the capitalist class' and 'the capitalist system as a whole.'

More specifically within this context, the second reason for the focus on power is that it helps us to think of capital accumulation and ruling class dynamics as *two sides of the same process*. Differential accumulation implies the existence of a 'dominant capital' group which accumulates faster than the average. And the fact that this group generally succeeds in achieving differential accumulation in turn implies its intimate involvement in central power processes – including government, the law, ideology, mass persuasion, international organizations, etc. In this sense, dominant

capital, by its very nature, must become increasingly fused – although never entirely synonymous – with the ruling class in contemporary capitalism. The 'extent' to which dominant capital is able to shape the social process is imprinted on the annals of the stock and bond markets in the form of relative financial performance. This differential performance is not an 'objective' measure of power. Rather, it is a measure of how the ruling capitalist class conceives of and universalizes such power in its own mind, how it assesses its own success and failure, and how it tries to impose this understanding on the rest of society. These features make differential accumulation a highly 'symbolic' process. But it is a very real symbol, with very real causes and very real consequences.

From this viewpoint, to understand present day capitalism is to articulate the 'link' between the *qualitative* quest to shape capitalism on the one hand and the *quantitative* trajectory of differential accumulation on the other. This bridge, of course, is forever speculative. But we can certainly use it to tell a compelling story, based on a consistent framework, supported by evidence, and subject to some standards of refutation.

The third reason for emphasizing the duality of accumulation and power concerns the issue of crisis. Radical theories deal extensively with accumulation crises. But with differential accumulation there emerges the mischievous possibility of accumulation *through* crisis. If capital is taken to denote an amassment of material things or dead labor, it is only natural to equate its accumulation with 'economic growth.' But if what gets accumulated is power measured through differential ownership titles, it is clear that the process can take place with production decreasing as well as increasing, and with price inflation as well as price stability. The language of power and domination is not the same as the language of production and livelihood. And sometimes – indeed often – power can be greatly augmented precisely by undermining production.

5. REGIMES OF DIFFERENTIAL ACCUMULATION[14]

How can dominant capital achieve differential accumulation? Analytically, there are two methods of doing so, which we call *breadth* and *depth*. To illustrate the meaning of these concepts, think of the dollar level of corporate profit as a product of two components: (i) the size of the corporate organization, measured by the number of employees; and (ii) profit per employee, measured in dollars, so that:

(3) $profit = (employment) \cdot (profit / employment)$

[14] For a fuller theoretical and empirical discussion of differential accumulation regimes, see Nitzan (2001) and Nitzan and Bichler (2002: Ch. 2).

Labeling the first brackets 'breadth' and the second 'depth,' we have:

(4) *profit = breadth · depth*

Now, think about this equation in relative, or differential, terms. As a dominant capitalist you increase breadth in absolute terms by increasing your employment; you increase breadth in relative terms by increasing your differential employment – that is, by increasing your own employment *faster than the average*. For example, if average employment growth is 5 percent, and dominant capital expands its labor force by 7 percent, we say that differential breadth is 2 percent (the difference between the two).

Following the same logic, to increase depth is to raise your profit per employee; to increase your differential depth is to raise your profit per employee *faster than the average*. If the average profit per employee grows by 10 percent and dominant capital achieves 14 percent, differential depth is 4 percent.

Each of these methods – breadth and depth – can be further subdivided into *external* and *internal* avenues, leading to a four-way classification illustrated in Table 1.

Table 1
Regimes of Differential Accumulation

	External	**Internal**
Breadth	***Green-field***	***Mergers & Acquisitions***
Depth	***Stagflation***	***Cost-cutting***

External breadth takes place when you hire new workers and create new, green-field capacity faster than the average. *Internal breadth* occurs when you take over existing capacity and workers through mergers and acquisitions; that is, by buying other companies. Individually, large firms engage in both methods; but as a group, their differential breadth is determined almost entirely by the latter. 'One capitalist always kills many,' observed Karl Marx in the nineteenth century (1909: Vol. 1, p. 836). And, indeed, the twentieth-century growth of big business was achieved mostly by amalgamation, with large firms buying existing capacity rather than building it (see for instance, Scherer and Ross 1990: Chs. 3 and 5).

Internal depth refers to the ability of large firms to increase profit per employee by cutting cost faster than the average. *External depth* denotes the capacity of large firms to do the same by increasing prices faster than the average. Again, individually, dominant capital firms try to do both, sometimes simultaneously. But over the longer haul it is mostly the latter method that matters for differential depth. Cost cutting, of course, is pursued relentlessly by both large and small firms. However, since it is difficult to exclude others from using new production techniques and from taking ad-

vantage of cheaper input prices, the net impact of cost cutting is mostly to meet the average rather than beat it. Historically, the main gains in differential depth have come from dominant capital raising its prices faster than the average, a process which at the aggregate level appears as stagflation.

Now, to most readers, these claims would seem counterintuitive, if not preposterous. In the popular conception, growth often is used as a synonym for accumulation, and inflation is considered poisonous for profit. Capitalism, goes the conventional wisdom, abhors stagnation and loves price stability.

Unfortunately, these conventions do not sit well with the facts. The mismatch is largely the result of a theoretical fixation on 'material' accumulation measured in absolute terms. If instead we think of accumulation as a differential power process, mergers and acquisitions suddenly become as important as growth, if not more so, and stagflation turns from foe to friend. Indeed, as we shall see below, these two accumulation paths – amalgamation and stagflation – have become so paramount that they now appear as broad social 'regimes,' each with its own unique characteristics. But then we are running ahead of our story.

6. Mergers and Acquisitions

So far, we have argued that differential accumulation by dominant capital – namely, the ability of dominant capital to have its profit and capitalization grow faster than the average – is sustained mainly though merger and through stagflation. Let us now look more closely at the historical evolution of each path – beginning with merger in this section and stagflation in the next. Figure 2 shows the long-term progression of corporate amalgamation in the United States. The bottom series provides an 'amalgamation index,' or a 'buy-to-build' ratio. It measures the ratio between the dollar amount put into mergers and acquisitions and the dollar amount put into green-field investment. According to the data, in 1895, for every $100 of green-field investment in plant and equipment there were roughly 60 cents' worth of mergers and acquisitions. Over the next century, however, this ratio has grown by a multiple of 350 (!), so that by 1999, for every $100 of green-field investment there were $215 spent on corporate amalgamation (note the log scale).

[Figure 2. Corporate Amalgamation in the United States]

The reason for the exponential increase in this ratio is hardly mysterious. Over time, the pace of green-field investment is limited by the overall growth of the market. To expand productive capacity faster than the market is to create 'glut' and ensure business ruin. Not so for mergers and acquisitions. Since mergers and acquisitions merely 'fuse' existing corporations, they can expand many times faster than the market without ever 'spoiling' it. And indeed, this is one of the main incentives for buying rather than building. By taking over other firms, capitalists augment their

profit stream and reduce potential competition without the risk of 'overcapacity' and falling profit margins.[15]

The merger process tends to be self-limiting, however. If dominant capital buys faster than it builds, sooner or later it is bound to 'run out' of takeover targets. At that point, the only way for dominant capital to keep merging is to 'break the envelope' and go beyond its existing corporate universe. Figure 2 shows this imperative unfolding in the United States. The first, 'monopoly' merger wave, straddling the end of the nineteenth and the beginning of the twentieth centuries, saw the emergence of big business in the United States and the formation of large monopolies in the leading industries. In the second, 'oligopoly' wave, which lasted through much of the 1920s, firms broke their original industry envelope to create vertically integrated firms in the various business sectors (for instance, oil refineries expanding upstream to exploration and drilling and downstream to transportation and marketing). The third, 'conglomerate' wave, building up during the late 1950s and 1960s, saw big firms diversifying their activity (for example, branching from automobiles to finance, to weapons, to computers). And the fourth, 'global' wave, which occurred during the 1980s and 1990s, set in motion the process of creating truly global companies (a shift from U.S.-based multinational firms to transnational organizations).

This successive breaking of 'envelopes' was not continuous, however. It unfolded in waves, and there was a reason for that as well. Merger booms tend to 'hype-up' investors and make market conditions increasingly fragile as the boom progresses. Eventually, negative sentiment sets in, making the market inhospitable for merger till the next reversal in mood (Nitzan 1995b, 1996). Furthermore, breaking each 'envelope' involves major legal, institutional and political realignments, and that takes time. The consequence is that the whole process is susceptible to major interruptions. And since merger is a form of differential accumulation, periodic ruptures in the process mean periodic reductions or even reversals in differential accumulation. It is here that stagflation enters the picture.

[15] Standard analysis often is perplexed by the seemingly 'illogical' drive to merge – a drive which seems to persist even when takeover targets are 'too expensive' relative to green-field investment, and to continue despite 'disappointing' post-merger performance (see for example, Brealey *et al.* 1992: Ch. 36). The problem with this type of analysis is that it focuses on the individual firm, failing to appreciate the macro consequences of *all* firms choosing to build rather than buy. If instead of merger, the funds were ploughed back into building new factories, glut and losses would make green-field – not takeover – look like an expensive mistake (the first to understand this 'dilemma' was Veblen 1923; for a critical analysis, see Nitzan and Bichler 2002: Ch. 2).

7. STAGFLATION[16]

'Neutrality'

To begin with, there seems to be a general neglect, including among radical political economists, of the historical significance of inflation for capitalist development. On the face of it, this neglect is rather surprising. Inflation – commonly defined as a general rise in the price of commodities – is hardly new. According to David Hacket Fisher (1996), since the thirteenth century there have been no less than four major inflationary waves, or 'price revolutions' as he calls them. Figure 3 illustrates the pattern of these waves in the U.K., a country whose price indices go back the farthest. The first wave occurred during the thirteenth century; the second during the sixteenth century; the third in the latter part of the eighteen century; and the most recent one in the twentieth century. Furthermore, each of these price revolutions, Fisher claims, was accompanied, particularly toward the latter part of the wave, by a deepening socio-economic crisis. In other words, the phenomenon of *stagflation* – that is, of stagnation together with inflation – is not new either. The term 'stagflation' was coined by Paul Samuelson only in the mid-1970s, but the reality of stagflation goes back many hundreds of years.

[Figure 3. Consumer Prices in the U.K.]

Despite its long history and intimate connection to stagnation, political economists continue to view inflation as 'neutral.' Following David Hume's 'classical dichotomy,' they insist on distinguishing between the 'real' and 'nominal' spheres of economic life. Of these two realms, the 'real' sphere of production, consumption and distribution is considered primary, whereas the 'nominal' sphere of money and absolute prices is thought of mostly as a lubricant, a mechanism that merely facilitates the movement of the 'real economy.'[17]

Now, to be fair to the classical political economists, the backdrop against which they were writing was largely one of price stability and even deflation, not inflation. As shown in Figure 3, U.K. consumer prices had hardly changed between 1600 and 1750. In the second half of the eighteenth century, they rose relatively quickly, but then fell again throughout the nineteenth century. In that context – which by no means was unique to Great Britain – it was only natural to concentrate on production and the coercive discipline imposed by 'market forces,' and to spend less time thinking about the role of inflation.

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[16] For a fuller theoretical and empirical analysis of inflation and stagflation, see Nitzan (1992; 2001), Bichler and Nitzan (2001b: Ch. 5) and Nitzan and Bichler (2000b; 2002: Ch. 4).

[17] This view is pervasive. 'There cannot, in short, be intrinsically a more insignificant thing, in the economy of society, than money,' tells us John Stuart Mill (1848: Book 3, Ch. 7). Money is simply a 'veil,' says Irvin Fisher, as does Nobel Laureate Franco Modigliani: 'Money is "neutral", a "veil" with no consequences for real economic magnitudes' (Papademos and Modigliani 1990: 405). And, since, according to Milton Friedman (1970), 'inflation is always and everywhere a monetary phenomenon,' rising prices, although a nuisance, are ultimately neutral in the grander scheme of things.

However, the historical backdrop changed dramatically during the twentieth century. First, inflation has risen to unprecedented levels. As Figure 3 shows, U.K. prices rose by almost 5,000 percent between 1900 and 2000, compared with less than 800 percent in the previous six centuries combined. Second, there was a clear change in pattern. During pervious inflationary waves, prices oscillated around their uptrend, but in the twentieth century – with the notable exception of the 1930s – they always moved upwards.[18] The classical political economists, writing in a different era, perhaps could be forgiven for not paying too much attention to inflation. But having lived through the experience of the twentieth century, contemporary observers cannot ask for similar leniency.

So why do most economists continue to believe that inflation is 'neutral'? The reason begins with the way they define it. There are two common definitions of inflation: (1) a continuous increase in the *average* price level; and (2) an ongoing increase in 'liquidity'; that is, an increase in the *total* amount of money relative to the *total* volume of commodities. These two definitions often are seen as equivalent: if we derive the average price level P as the ratio between the total amount of money M and the overall quantity of commodity Q (ignoring the velocity of circulation), it is obvious that in order for P to rise (or fall), the ratio M/Q has to rise (or fall) at the same rate, and vice versa.

The crucial thing to note here is the *aggregate* nature of the definition: it focuses wholly on averages and totals. This fact is important, since to define inflation in this way is to miss the point altogether. Inflation certainly involves a rise in the average price of commodities; but that is like saying that the 'average' outcome of a game between two basketball teams is always a draw: one team's win is another's loss. Although mathematically correct, the statement is irrelevant to the reality of basketball games. If these games always ended up in a draw, players would soon be looking for another game – one which they could actually win. Similarly with inflation. If all prices rose at the same average rate, inflation definitely would be 'neutral' as mainstream economists say. But it would also serve no purpose whatsoever, and would most likely cease to exist.

Redistribution

The crux of inflation is not that prices rise in *general*, but that they rise *differentially*. Inflation is never a uniform process. Although most prices tend to rise during inflation, they *never all rise at the same rate*. There is always a spread, with some prices rising faster than the average and others more slowly. And since prices change at differ-

[18] The story of the 1930s actually is more complicated than it seems. As Gardiner Means (1935) showed in his study of the U.S. experience, most of the price drop happened in competitive industries (where employment and output dropped only moderately), while in the highly concentrated industries prices hardly moved at all (but employment and output fell dramatically).

ent rates, we can paraphrase Milton Friedman's famous maxim and state, categorically, that 'inflation is always and everywhere a *redistributional* phenomenon.'

The difference in definitions here is crucial. For those who believe that inflation is an aggregate 'nominal' process of 'too-much-money-chasing-too-few-commodities,' indeed there is little reason to look any further into the so-called 'real' world of production and distribution. The only relevant questions are, first, how much money is created and, second, how increased liquidity is 'transmitted' to higher prices. But if inflation is merely the aggregate appearance of an underlying distributional struggle, the way to understand it is to begin from that very struggle. In this case, the important questions are: who gains, who loses, and how?[19]

Inflation redistributes income in many different ways, of which we would like to highlight two.[20] The first is redistribution between workers and capitalists. Figure 4 plots the pattern of this redistribution and the rate of inflation in the United States over the past half-century. The rate of inflation is measured by the annual percent change in the wholesale price index. Income distribution is presented here as the ratio of *S&P 500* earnings per share and the average hourly wage in the private sector. The specific focus on earnings per share and the wage rate is intended to emphasize the income of *individual* owners – the owner of capital and the owner of labor power , respectively (both series are smoothed as 3-year moving averages).

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[19] Note that mainstream economists would readily admit that in reality prices do not all change at the same rate, and that relative price variations may even be positively correlated with the rate of inflation (see for instance, Parks 1978). But these relative variations, they would add, have little to do with the cause of inflation, nor do they bear on its long term consequences. First, in a competitive market relative price variations reflect changes in consumer preferences (marginal utility) and technology (marginal productivity), and in that sense have little to do with overall inflation. Second, 'disequilibrium' prices – namely, those which do not reflect the underlying logic of utility and productivity – may exist, but only temporarily. Soon enough, the market would force them back to their 'proper' equilibrium levels. And finally, during inflation deviations from equilibrium prices arise mostly from misguided expectations and therefore are never systematic in their pattern. These deviations could make some 'agents' richer and other poorer, but only by fluke. Disequilibrium prices could also arise from 'government intervention' and 'monopoly practices' (mainly by labour unions), but the redistributional effect is nullified once agents become aware of these 'imperfections' and 'discount' them into their demand and supply. Moreover, regardless of their redistributional impact, these 'imperfection' cannot translate into inflation unless validated by increases in overall liquidity.

Unfortunately, this line of defense is persuasive only to those who erect it. First, marginal utility and productivity are never observable, so how could we know what is the equilibrium price which equates them? Second, equilibrium prices, as their name suggests, hold only in equilibrium. But since we never know whether we are in equilibrium or disequilibrium, how can we know which prices are 'out of line'? And finally, why should we *assume* that inflation does not systematically redistribute income? To say that market forces prevent such systematic redistribution from happening could be an explanation for an observed outcome. But should we not first establish that this, indeed, is the outcome?

[20] Inflation is related to the distribution of *assets* through its impact on relative hype and relative risk, as well as through relative profit – a complicated process that has received inadequate attention and whose study is part of our current research project.

[Figure 4. U.S. Inflation and Capital-Labor Redistribution]

Now, if mainstream economics is right and inflation indeed is 'neutral,' the rate of inflation should have no systematic correlation with the distribution of income between workers and capitalists. But the facts show otherwise. As Figure 4 illustrates, there is a fairly tight positive correlation between the two processes. The correlation is not perfect, of course, but that is to be expected given the many factors involved.[21] For our purposes, the crucial point is the fact that such a systematic correlation exists in the first place. Simply put, this correlation tells us that during rising inflation, corporate profit has tended to rise relative to wages, and vice versa when inflation has dropped.

The second redistribution is between large and small firms. Figure 5 plots the ratio between the profit markup of the Fortune 500 and the profit markup of the U.S. business sector as a whole. The profit markup is defined here as the percent of net profit in sales. The ratio between the two markups, reminiscent of Kalecki's (1943) 'degree of monopoly,' indicates the relative 'profit power' of large firms. In this sense, it provides a proxy for differential depth.[22] As expected, the Fortune 500 enjoy stronger pricing power (over the past half-century, the ratio between the markups averaged 1.6). But the crucial points for us here are that this relative pricing power has tended to fluctuate and that *the fluctuations have been positively and tightly correlated with the rate of inflation* (as before, inflation is measured by the annual percent change in the wholesale price index, and both series in the chart are smoothed as 3-year moving averages).

[Figure 5. U.S. Inflation and Differential Accumulation]

This positive correlation is rather remarkable, particularly in light of the common belief, popular since Means (1935) and Hall and Hitch (1939), that large firms aim at maintaining a long-term 'target rate of return,' and that their prices are relatively 'inflexible' when compared with those of small firms whose own markups are set by 'market conditions.' Note, however, that this belief was substantiated by evidence derived mostly from the first half of the century, and particularly from the deflationary 1930s. The second half of the century, though, gives a totally different picture. As Figure 5 suggests, since the 1950s, increases in U.S. inflation were associated with – and probably driven by – large firms *actively pushing up* their profit markups faster than smaller firms. And the exact opposite happened on the way down, with falling inflation associated with large firms seeing their markups drop relative to

[21] The sharp spike in the ratio of earnings per share to wages during the 1990s was probably exaggerated by WorldCom- and Enron-like accounting practices. Current 'guesstimates' suggest that throughout that happy decade, legal creativity and plain fraud helped overstate U.S. corporate profits by 10 to 30 percent relative to 'conventional' accounting standards.

[22] This proxy for depth, based on relative profit shares, is slightly different from the one based on relative profit per employee as defined in equations (3) and (4) in Section 5. In 1994, Fortune stopped publishing aggregate employment data for its 500 listing, making the latter proxy difficult to compute. It should be noted, however, that until 1993, the two measures were very tightly correlated.

the average. In other words, inflation provided a powerful engine of *differential accumulation*.[23]

Clearly, U.S. inflation has not been 'neutral' in the least. On the contrary, it has been associated with a *systematic* redistribution of income from workers to firms, and from small firms to large firms. That in itself is already a good enough reason to doubt conventional inflation theory. But what is really remarkable here is that the *direction* of these two correlations has remained the same for half a century or more.

Patterns

Redistribution is a matter of power, and power can shift over time. So even if we accept that 'inflation is always and everywhere a redistributional phenomenon,' there still is no inherent reason to expect it *always* to work in favor of capital in general and in favor of dominant capital in particular. For instance, in Israel, much like in the United States, workers tended to lose from inflation and large firms tended to gain at the expense of smaller ones (Nitzan and Bichler 2002: Ch. 4). By contrast, in Germany and France, two countries where labor is relatively strong, the impact of inflation on labor/capital redistribution has been far less clear (the highly aggregated nature of OECD data makes it difficult to draw conclusions regarding the performance of large versus small firms).

Evidently, then, the link between inflation and redistribution has no preset pattern. Inflation itself is a tricky process; its consequences in the cases examined here depend on the power of dominant capital vis-à-vis labour and relative to capital in general – neither of which can be determined a priori; and the distributional outcome can change over time. In this light, the fact that the U.S. experience has been so systematic in one direction is highly significant.

The implication of this systematic pattern is that, in the United States (as well as in other countries with a similar pattern), inflation has become a very potent – and fairly 'reliable' – engine of differential accumulation. With a long history to learn from, companies know that inflation helps them raise their profit faster than it helps workers raise their wages. They know that it helps them more if they are large than if they are small. And they know that there is a certain regularity to the process. In short, *they know more or less what to expect*.

Accumulation Through Crisis

But, then, if all of these claims are true, why does dominant capital not support indefinite inflation? The basic reason is that inflation, although usually effective in generating differential accumulation, is also socially destabilizing and often difficult

[23] For similar evidence and analysis of the relationship between inflation and differential accumulation in Israel and South Africa, see Nitzan and Bichler (2000b; 2001).

to manage and contain, and therefore causes capitalists to perceive the world around them as more 'risky.'[24]

As we claimed earlier in the paper, over the long run inflation tends to coincide with stagnating production and high unemployment. This claim is certainly unconventional. Indeed, the facts notwithstanding, most economists would probably reject it outright. As a monetary phenomenon, they would counter-argue, inflation can have no lasting impact on the 'real' world. They would concede that inflation could be *triggered* by 'real' variables – but certainly not by stagnation. To the contrary, the popular macroeconomic canon stipulates that inflation is triggered by growth and that it decreases with recession.

Unfortunately, here too the facts refuse to obey the theory. Figure 6 shows the long-term relationship between inflation and economic growth in the United States, going back to 1890 (with the series smoothed as 20-year moving averages). The data show quite clearly that the relationship between the two phenomena is not positive, but negative. Low inflation is associated with high growth, whereas high inflation is commonly accompanied by stagnation – the *exact opposite* of what conventional theory wants us to believe. Inflation tends to appear as *stagflation.* And this 'perverted' relationship is hardly limited to the United States. In fact, during the postwar period the negative correlation between growth and inflation has become the rule rather than the exception, reproducing itself in country after country, developed as well as developing (see for example, Nitzan 1995a; Nitzan and Bichler 2002: Figure 2.8, p. 71).

[Figure 6. United States: Long Term Inflation and Growth]

Why do these facts differ so dramatically from popular convention and economic theory? The reason has much to do with the timeframe. The argument that rapid growth triggers inflation can make sense only in the very short term and under the very stringent assumption that capacity is already fully utilized and cannot be immediately expanded to meet runaway demand.

This latter situation, however, is both rare and transitory. First, under so-called 'normal' conditions, physical capacity is never fully utilized. To illustrate, over the past century the average rate of unemployment in the United States has stood at 7 percent, and that excludes the categories of part-timers and the underemployed (not to mention those who choose not to work, are discouraged, or are incarcerated, and therefore considered 'not in the labor force'). Various estimates of the utilization of *actual* capacity range from 25 percent to 50 percent.[25] Second, as overall growth con-

[24] Insofar as the perceived increase in 'risk' exceeds the increase in expected income, the net effect will be lower asset prices. The impact on *relative* asset prices, however, is far more complicated (see footnote 20).

[25] Conventional capacity measures consider what is feasible *under the existing social order of business enterprise and production for profit*, and they usually estimate normal utilization to be in the 70 to 90 percent range. Alternative measures based on a *material/technological* limit, however, suggest a far lower utilization of capacity. At the turn of the twentieth century,

tinues, green-field investment and capacity tend to rise even faster, causing 'bottlenecks' to give way to 'glut.'[26]

The question, though, is, why, in the absence of any real 'shortage,' are buyers willing to pay higher prices? The short answer is that usually they are not willing; they are *forced*. And the way to force them is by creating, imposing and maintaining various forms of social crisis, apparent or real. Military hostilities during the First World War, the reparation crisis of Germany in the 1920s, the global oil crises of the 1970s, rising unemployment in Israel during the 1980s, political instability in Russia circa 1990s, debt default in Argentina in the 2000s are all illustrations of such inflation-triggering crises. The effect of these crises on inflation is twofold. On the one hand, they undermine the power of most people to resist price increases. On the other hand, they enable a 'consensus' to emerge within dominant capital that inflation can be used with 'impunity.' In this sense, stagflation is the macroeconomic appearance of 'accumulation through crisis.' Stagnation and unemployment, along with other forms of instability, conflict and force, constitute the necessary backdrop for differential accumulation through differential inflation.

But the process is highly perilous. More inflation usually requires a more intense crisis and therefore implies mounting hazards. Those who lose from inflation begin to oppose it, and even if they fail to stop it, instability heightens. And, so, although the potential gains from inflation are huge, they are commensurate with the risks – risks to differential accumulation specifically, and risks to the hegemony of capital more generally. From the viewpoint of dominant capital, therefore, inflation is forever a double-edged sword. Effective but highly dangerous, it is *not* the weapon of first choice. It tends to emerge only when there is 'no alternative.'

8. THE NEW ARSENAL

To recap, the twentieth century fundamentally altered the nature of accumulation. The emergence of big government and big business gave rise to a new consolidation, 'dominant capital.' The new institution of incorporation, which for Marx signaled the 'abolition of capital as private property within the framework of capitalist produc-

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Veblen (1919: 81) put the actual rate of utilization at less than 25 percent, a figure not much different from later estimates reported in Blair (1972: 474) and Foster (1986: Ch. 5). Interestingly, though not surprisingly, U.S. military contractors, engaged in the most destructive form of business enterprise, sometimes operate at as little as 10 percent of their 'capacity' (U.S. Congress 1991: 38).

[26] To illustrate, think of East Asia during the 1990s, where annual growth rates of 8 to9 percent were associated with *falling* export prices. Was there anything mysterious behind this combination of growth and deflation? Hardly. Despite the rapid growth (or rather because of that growth), the investment-to-GDP ratio kept rising, while East Asian companies kept undercutting each other in a hyper-competitive trench war. It is no wonder that their prices kept falling.

tion itself,' along with the rise of big government, helped create massive power coalitions that further intertwined business owners and state organs. In parallel, the 'larger use of credit,' whose significance was first studied by Thorstein Veblen, gave capital the infinitely malleable form of finance.

Accumulation in the nineteenth century was thought of – certainly by theorists – largely in *absolute* terms. As such, it depended on economic growth and relative price stability; it was led by imperial conquest; and it was backed by a gold standard. In the twentieth century, and particularly after the Second Word War, the emphasis shifted toward *differential* performance. Furthermore, the arsenal of accumulation expanded to incorporate two brand new techniques – corporate amalgamation and stagflation.

Thus, instead of economic growth, dominant capital resorted more and more to corporate merger, and in lieu of geographic conquest it relied increasingly on foreign investment and the spread of business ideology and standardized accounting. The use of force in accumulation was not abandoned, of course, although it was greatly refined. Whereas previously force was often used for straightforward 'material' confiscation, now it was utilized in a more roundabout way. Instability, conflict and stagnation were now denounced as being 'bad for accumulation.' But behind the façade, they enabled a stealthy process of accumulation through inflation. The gold standard, incompatible with this new accumulation technique, was doomed. Sooner or later it had to give way to the more flexible power of purely fiat money and unbounded credit. And indeed, differential inflation, invisibly mediated through stagnation and crisis, brought a surprisingly 'orderly' redistribution of income from workers to owners and from small firms to dominant capital.

Historically, the new accumulation arsenal of amalgamation and stagflation worked with increasing precision and surprising regularity. Figure 7 illustrates the evolution of this pattern in the United States (with series smoothed as 5-year moving averages). The bottom series in the chart is our amalgamation index, measuring the buy-to-build ratio introduced in Figure 2. The top series provides a 'stagflation index.' The construction of this index is relatively straightforward. We begin with two basic series: the annual rate of unemployment, which is a proxy for stagnation, and the annual rate of change of the Implicit GDP Deflator, which is a proxy for inflation. We then express each of these series in terms of standard deviations from its own historical average (for 1890-2001), add up the two standardized series and divide the sum by two.

[Figure 7. Amalgamation and Stagflation in the United States]

Now note that, over the past century, the United States has always had some unemployment (read stagnation), along with a positive rate of inflation (with the exception of the Great Depression, when differential inflation was hidden by aggregate deflation; see footnote 18 above). With the exception of the 1930s, then, the *entire period was one of stagflation*. The purpose of the stagflation index is to describe the changing 'intensity' of that process. An index reading of zero represents

the average, or 'normal' intensity of stagflation over the past century. A positive reading for the index means a combination of above average stagnation and/or inflation; that is, above average stagflation. Similarly, a negative reading on the index means a combination of below average stagnation and/or inflation; namely, below average stagflation.

Of the two differential accumulation weapons – merger and stagflation – the former has proven more effective and less risky. As we have already seen in Figure 2, the ratio of merger to green-field investment has risen exponentially over the past century. And since corporate amalgamation, almost by definition, contributes to differential accumulation, it is no surprise that merger and takeover were enthusiastically endorsed by dominant capital, government organs and academic ideologues – all in the name of productive 'efficiency' and national 'competitiveness.'

A merger boom is largely incompatible with stagflation. Corporate takeover thrives on investors' hype and an open takeover pool, which in turn require some measure of growth, proletarianization, capital mobility and relative political stability – the exact opposite of the crisis atmosphere needed for inflation. In other words, differential breadth through corporate amalgamation and differential depth via stagflation are *contradictory paths*, each depending on an opposite set of social circumstances. In this sense, we can treat each path as a distinct 'regime' of differential accumulation. Of these two regimes, merger is the path of least resistance, and when it prevails, stagflation is likely to be dormant. But as noted in Section 6, amalgamation is sometimes difficult, and when its pace declines, the door opens for the crisis-ridden but highly effective path of stagflation.

It is crucial to emphasize, again, that our argument here is neither 'economistic' nor 'deterministic.' Differential accumulation is not about 'economics.' It is about power and opposition to power. The symbolic form of this power is financial, but its content is political in the broadest sense of the term. Differential accumulation is evidence – certainly in the mind of accumulators – of growing social power. Indeed, without power, there could be no differential accumulation. This emphasis on power and resistance to power also suggests, and here we come to the issue of determinism, that the process does not have to follow a preset pattern – or *any* pattern for that matter. Simply put, differential accumulation *does not have to happen*. It will happen if there are mergers. It will probably happen if there is stagflation. But mergers and stagflation themselves do not have to happen. Dominant capital may seek mergers or stagflation, but it could fail to achieve them – fail because of opposition, inner conflicts, or its own incompetence. And if neither merger nor stagflation prevails, the likely result is differential *decumulation.*

In this light, the stylized pattern evident in Figure 7 is remarkable, to say the least. The chart shows the amalgamation and stagflation cycles moving almost as mirror images of each another. And what is more, the negative correlation between

them seems to have grown tighter over time.[27] Given that both regimes serve to boost differential accumulation, it is clear that, *de facto*, dominant capital has been increasingly effective in securing its power. But none of this was 'automatic.' The power of dominant capital is conscientiously constructed against opposition. It is replete with conflict and besieged by contradictions. It can fail.

9. DEFLATION

The conjectural nature of the process is all too clear at the present moment, as is illustrated by the last few data points in Figure 7. In 2000, corporate amalgamation collapsed, bringing the twenty-year global merger wave to an end (see also Figure 2). In parallel, the long downtrend in stagflation seems to have bottomed out.

This apparent swing of the pendulum – should it materialize – has been long in coming (and indeed predicted -- see for instance Nitzan 1999; 2001). Over the past twenty years, the prolonged process of breadth expansion, particularly the opening up for business and green-field investment of 'emerging markets' in Asia and Latin America, has created a massive global glut. Although mergers worked to contain these centrifugal forces to some extent, they could not stop them. And as a result, the intensity of stagflation declined more or less continuously since the mid-1980s, and in 2001 reached its lowest level in 70 years, according to Figure 7.

By the end of the twentieth century, corporate 'pricing power' had weakened to its lowest point since the Great Depression. CPI inflation in the industrialized countries declined throughout much of the 1980s, reaching 1 percent in 1999 – its lowest since the 1950s (see Figure 10 below). Similarly, in 2000, with the 'new economy' hype having been punctured, corporate earnings – both globally and in the U.S. – took a nose-dive, showing their steepest drop since the 1930s.

Clearly, the current situation is not the best for dominant capital. Indeed, with mergers having entered a deep freeze and unlikely to revive any time soon, and with pricing power in the doldrums, there is a real threat of differential *decumulation* taking hold.

The Risk

The negative sentiment is most vividly captured by the sudden reappearance of a new-old threat: *deflation*. For much of the postwar era, the policy and academic rhetoric was focused almost exclusively on inflation. This preoccupation began in the early 1940s. Within a few years after the Great Depression, deflation had already become a distant memory. John Maynard Keynes, who had just published the seminal text on how to fight unemployment, quickly shifted his attention to the threat of

[27] The 25-year moving correlation between the stagflation and amalgamation indices (with the amalgamation index measured as natural log and expressed as deviation from its own trend) rose from a +0.08 in 1914, to –0.94 in 2001.

rising prices. His subsequent book, aptly titled *How to Pay for the War* (1940), set the tone. From then on, the goal was to stop inflation. Forty years later, theorists and central bankers finally saw light at the end of the tunnel: in the 1980s, inflation began to ease. The rhetoric, though, had not changed much. The experts became less fearful of the (neutral) beast, and there was a lot of self-congratulating analysis for winning the anti-inflation 'battle.' But the discourse was always qualified by a call for vigilance. The monster was indeed caged, but it could always escape. When it came to inflation, you could not be overly cautious.

And then, suddenly, the tone changed. The reversal is starkly illustrated in Figure 8. The data in the chart are derived from a text search of EBSCO's *Business Source Premier*, a database covering more than 2,800 scholarly business journals in English. For every year since 1980, we counted the number of articles that contained the word 'deflation' and the number of articles that contained the word 'inflation,' and we computed the ratio between them.

[Figure 8. The Threat of Deflation]

The result points to 1998 as a clear watershed. Till then deflation was not even on the radar screen: the ratio of deflation-to-inflation articles averaged 2.5 percent and rarely exceeded 3 percent. But in 1998, with fear of glut finally triggering the Asian Crisis, and with 'contagion' beginning to infect the major stock markets, concern for deflation skyrocketed and the index jumped more than fourfold, to over 10 percent. Initially, the unfolding high-tech mania helped camouflage the problem, making the 1998 episode look like false alarm. But the high-tech mania was coming at the cusp of the long breadth regime of corporate mergers. And when, in the early 2000s, the floor finally fell out and the stock market collapsed, the deflation-to-inflation index jumped to nearly 8 percent in 2001, rising further to 12 in 2002, and to 16 percent in the first four months of 2003. The ghost of deflation came back with a vengeance.

The current fear of deflation is not unfounded. Falling prices obviously are a threat to differential accumulation. With mergers stuck in neutral, dominant capital now needs to kick-start inflation, not combat deflation. But the problem runs much deeper. Over the past half-century, and particularly since the early 1980s, debt loads measured relative to GDP have soared to unprecedented levels.[28] The increase in debt has taken place in the context of continuously rising prices, which, by inflating nominal GDP, have worked to partly mitigate the rising debt burden. This mechanism of lessening the debt load no longer works if prices stabilize; and it goes into reverse if prices start falling. Indeed, under the latter circumstances, central bankers

[28] The increase in debt loads reflects a combination of several factors, including rising 'multiple counting' of chained obligations, fresh capitalization of previously non-capitalized incomes, increases in expected future income, a willingness to accept a lower 'normal rate of return,' and, paradoxically, a drop in perceptions of risk. The overall extent of the surge in the debt-to-GDP ratio is probably understated by the explosive growth over the past twenty years of 'off-balance sheet' obligations.

may find it difficult to lower 'real' interest rates (since depositors generally refuse to accept negative nominal rates); overextended debtors may become unable to service their debt; and some of these debtors may be forced into bankruptcy. If the process unfolds into a chain reaction, it could conceivably lead to a runaway debt deflation, not unlike the one experienced during the 1930s.[29]

As illustrated in Figure 9, the magnitude of this threat is serious indeed, to put it mildly. The chart shows, for the period of 1919 to 2002, the value of U.S. total credit market debt expressed as a percent of GDP. It also depicts, for both developed and developing countries since the early 1960s, the growth of bank credit to the private sector relative to GDP.

[Figure 9. The Debt Load]

All three series suggest that debtors have become extremely leveraged. In the United States, the current debt load is nearly twice as high as it was in 1929, on the eve of the Great Depression. As the Great Depression unfolded, falling nominal GDP caused the debt-to-GDP ratio to soar to over 270 percent. A comparable decline in nominal GDP today would push the debt-to-GDP ratio to over 400 percent. The data for the broader aggregate of countries cover only the private sector, but it is obvious that here, too, there is extreme stress. In the developed countries, the ratio of private credit to GDP is three times what it was in the early 1960s, whereas in the developing countries it is nearly four times as high.

The 'Solution'

There are two basic 'solutions' to this threatening 'imbalance.' One is to cut the amount of outstanding debt through default (debt forgiveness being a non-option). The other is to increase nominal GDP through price inflation, while keeping 'real' interest rates relatively stable ('real' GDP growth being too slow for this purpose). Most practical economists consider the first solution far too painful to contemplate, so their preference naturally gravitates toward the second.

'Ignore the Ghost of Deflation,' recommends *Financial Times* columnist Samuel Britton. 'Apart from Japan,' he observed, 'the world has not seen deflation for 70 years' (as if the world's second largest economy can be treated as an anomaly, and '70 years' as a magic threshold beyond which deflation can never return). 'Deflation is an overblown worry,' declares James Grant, editor of *Grant's Interest Rate Observer*. 'Believe in Ghosts, Goblins, Wizards and Witches if you will,' concurs financial expert Adrian Douglas, 'but don't believe in deflation occurring any time soon.' There

[29] The first to analyze the process of debt deflation in some detail was the American economist Irving Fisher (1933). Fisher wrote his analysis after the 1929 Crash wiped out much of his own fortune of $10 million (over $100 million in today's prices), a fortune which he invested under the sound assumption that money was 'neutral' and that debt loads did not matter.

is little to worry about, says Fed Chairman Alan Greenspan: 'The United States is nowhere close to sliding into a pernicious deflation.'[30]

Of course, denying the problem does not solve it. And, so, for those who remain fearful, the experts promise that whatever the risk, it could easily be defused. 'The good news,' announces former member of the Federal Reserve Board, Angell Wayne, 'is that monetary policy never runs out of power.' 'There's a much exaggerated concern about deflation,' laments Nobel Laureate Milton Friedman. 'It's not a serious prospect. Inflation is still a much more serious problem than deflation. Today's Federal Reserve is not going to repeat the mistakes of the Federal Reserve of the 1930s. The cure for deflation is very simple. Print Money.' The same assumption underlies the soothing speech by Fed Governor Ben Bernanke, given in 2002 to the National Economist Club. In his address, properly titled 'Deflation: Making Sure "It" Doesn't Happen Here,' Bernanke explained that 'Deflation is always reversible under a fiat money system.' 'The U.S. government,' he assured his audience, 'has a technology called the printing press that allows it to produce as many U.S. dollars as it wishes at essentially no cost' (Bernanke 2002).

Unfortunately, the matter is not that simple. The central bank can certainly print as much 'high-powered money' as it wants. But that act in itself does not necessarily mean higher prices, nor does it defuse the concerns of creditors. On its own, it is like 'pushing on a string,' as Keynes would have put it. For loose monetary policy to 'translate' into inflation you need to have individual companies and workers *actually* raise their prices – and that may or many not happen. Japan after its 1989 market crash is a case in point: interest rates have fallen to zero and money has been made practically free – and yet deflation, not inflation, has prevailed. Alternatively, and as pointed out correctly by Robert Prechter (2003), simply opening the monetary flood gates when debt loads are extremely high could easily create panic, leading to distress selling among bond holders and loan calling by creditors. The result of this scenario is to trigger the very debt deflation that policy loosening was meant to prevent.

10. THE OIL FACTOR

Differential Profits and the Inflation Outlook

Inflation cannot simply be 'kick-started' by having central banks print money. As we said, it has to start by having firms and/or workers charge higher prices for the goods and services they sell. Now, unlike corporate mergers, which individual firms can pursue more or less unilaterally, no single corporation can start inflation 'on its own.' Raising your prices when no one else does is business suicide. A similar limitation restricts workers' wage demands, especially in a global context where production can be relocated easily. For prices to start rising, particularly after a long period of rela-

[30] All quoted statements in this paragraph and the next were made in 2002, and except the one

tive stability and under conditions of perceived 'glut,' the stronger groups in society must share a *common outlook* that inflation is indeed coming. And this collective outlook is most likely to emerge when these dominant groups feel that inflation is not only 'inevitable,' but also *in their differential interest*.

In this sense, rising inflation is not very different from an investment-led boom. There is little to prevent any individual firm from building new capacity. But for firms to actually go ahead and build new factories, they need to believe that this new capacity will increase profit in the future; and that belief is most likely to trigger action when it is commonly shared. In other words, it is only when *many* firms begin to view green-field investment favorably that *individual* companies begin to spend money on new plant and equipment.[31] Once the process is set in motion, increases in production, income and spending make these profit expectations self-fulfilling, but the initial spark usually requires a change in the *broad outlook of companies*.

A similar process unfolds when inflation begins to accelerate. As more and more firms start raising prices, and as income begins to be redistributed from workers to firms (Figure 4) and from smaller firms to larger ones (Figures 5), expectations for differential inflationary profits are 'validated,' leading to even more price hikes. But like with investment, here, too, in order for the process to begin, there needs to be a common expectation, a shared view among the dominant groups in society that inflation will boost their differential profit.

Note our emphasis here on *profit expectations* rather than *price expectations*. The difference is crucial. In mainstream economic theory, according to which everyone is powerless, price expectations can only be part of a *passive mechanism* in which 'agents' simply react to expected changes, their sole purpose being to *sustain* their existing equilibrium income. In the context of differential power, however, profit expectations become part of an *active strategy* to *enhance* one's relative position.

But first there must be the *initial* change in differential profit expectations, and, as these lines are being written (early 2003), it seems that this change may have begun. Dominant capital already feels its back pressed against the wall. As we have seen, merger activity has dried up and deflation increasingly is viewed as a threat. There is now a yearning among large firms for some 'pricing power,' even at the cost of stagflation and social instability. 'Greenspan must go for higher inflation,' insist Bill Dudley of Goldman Sacks and Paul McCulley of Pimco in a recent *Financial Times* article. 'Inflation is too low, rather than too high,' they warn, and 'the Fed should welcome a modest rise in inflation' (Dudley and McCulley 2003). And it is not as if the Fed has not been trying. Over the past two years Alan Greenspan has cut interest rates to levels last seen in the happy 1960s, making money cheaper and

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by Bernanke, all are cited from Prechter (2003: 11)

[31] Note the fundamental difference between boosting current production to meet current increases in sales and building new factories whose profitability will depend on conditions that will prevail a few years down the road. In the first case, the impact on profit is nearly certain, in the latter highly conjectural.

cheaper. Fear of deflation is finally creeping into the Fed's own statements. In a recent announcement, Greenspan warned of 'unwelcome substantial fall in inflation' (Press Release, May 6, 2003). That is probably the first time since the Great Depression that the U.S. central bank has said that lower inflation is 'unwelcome.' And a few days later, Treasury Secretary John Snow extended another invitation for inflation when he suggested that his government would abandon its eight-year 'strong-dollar policy.'[32] Clearly, the circumstances have become ripe for a regime change. The only thing missing is a 'spark.'

Inflation and the Price of Oil

In principle, many events could trigger a change in the collective mindset of dominant capital. A declaration of war, a sudden devaluation, massive riots, etc., could each do the trick. Over the past quarter-century, however, the most effective inflation spark, undoubtedly, has been a *rise in the price of oil*.

The statistical correlation between oil prices and overall inflation is illustrated in Figure 10. The thick line shows the annual CPI inflation in the industrialized countries (measured as the percent rate of change between the same months in successive years). The thin line denotes the so-called 'real' price of oil, denominated in 2002 U.S. dollars (computed as the dollar price of crude oil divided by the U.S. CPI). A rise in the 'real' price of oil means that the U.S. dollar price of oil increased faster (or fell more slowly) than the U.S. consumer price index, and vice versa when the 'real' price of oil dropped. As the chart shows, until the early 1970s the 'real' price of oil had little relationship with inflation. From the mid-1970s onward, however, oil clearly became a 'leading indicator' for inflation. It 'led' inflation on the way up, it 'led' it on the way down, and, apparently, *it still leads it today*.

[Figure 10. Inflation and the Price of Oil]

Note that we emphasize here oil prices as a 'leading indicator' rather than a 'direct cause' of inflation. The relationship between oil prices and inflation is only partly anchored in the role of oil as a key production input.[33] The more important reason for the correlation is that the leading capitalist groups tend to view the price of

[32] Incidentally, this announcement flies in the face of suggestions that the U.S. attack on Iraq was partly motivated by a desire to 'defend' the dollar. According to that argument, OPEC was allegedly planning to denominate its business in Euros instead of dollars, a move which would have weakened the dollar; hence the U.S. conquest of Iraq to prevent that switch from happening. Snow's announcement puts a big dent in this thesis.

[33] Over the past twenty years, the role of crude oil as a key input has declined dramatically. Energy efficiency has doubled, while the 'real' price of oil has fallen by almost two thirds. As a result, the dollar value of oil produced in 2001 accounted for only 2.1 percent of world GDP, compared to 7.5 percent in 1980. And yet, despite this massive decline in the input role of oil, the relationship between oil prices and inflation has remained practically unchanged (figures computed from British Petroleum Annual; World Bank Annual).

oil as a 'barometer' of future inflation and adjust their overall pricing strategies in line with its fluctuations.[34]

In 1999, when falling crude oil prices approached $10 a barrel, *The Economist* of London confidently predicted further declines. 'The world is awash with oil,' it stated, 'and it is likely to remain so' (Anonymous 1999a). In that same year, the more cautious U.S. Energy Information Administration predicted that oil prices would rise by a modest 2.5 percent annually for the next seven years.[35] With the breadth regime seemingly in full swing, happy scenarios of this type seemed perfectly plausible. Dominant capital was busy taking over other firms and hyping up its high-tech assets. It wanted to hear nothing of oil shocks and inflation.

But the world was changing rapidly. In 2001, differential breadth came crashing down. Dominant capital, which till then had insisted on neoliberal 'sound finance,' suddenly became thirsty for depth-driven inflation. And then, with little warning and in open defiance of both 'market forces' and the experts, the price of oil tripled. As before, consumer prices followed suit. Yet, as Figure 10 shows, so far the increase in consumer prices remained muted.

That dominant capital has an interest in higher inflation right now seems beyond doubt. In the absence of inflation, it faces the dual risk of debt deflation and differential decumulation. The way out of this predicament is a change in differential accumulation regime – from breadth thorough merger to depth through stagflation. And the most likely trigger for the shift is a significant – and sufficiently persistent – increase in the price of oil.

This last requirement is worth elaborating. Dominant capital presently has an interest in inflation, but judging by its hesitant response to the recent oil price hikes, it is not yet sure that such inflation is coming. In order for the collective mindset of dominant capital to decisively shift toward depth and inflationary profit, the 'oil spark' probably needs to be both stronger and longer. And that strong and long spark requires agency.

To reiterate, there is nothing 'inevitable' about this chain of events. As we said, differential accumulation may or may not happen. Likewise, there is no historical 'law of motion' dictating a timely shift from breadth to depth. The social and politi-

[34] In fact, the greater the extent to which higher oil prices are 'passed on' to final prices, the *less* the correlation should be between the 'real' price of oil and the rate of inflation. This situation seems to have prevailed until the early 1970s: the nominal price of oil rose; overall prices increased at roughly the same rate; and, as a consequence, the 'real' price of oil remained more or less flat. From the early 1970s onward, however, the 'real' price of oil became positively correlated with inflation, which means that changes in oil prices were only *partly* 'passed on' to consumer prices. It is clear, then, that the post-1970 mechanism was neither 'automatic' nor 'neutral.' It involved redistribution in favor of owners of oil when oil prices rose and redistribution in favor of owners of other commodities when the price of oil fell.

[35] Computed as the compounded annual growth rate which would make the EIA 1999 benchmark price rise from its actual level of $17.26 in 1999 to its forecast level of $20.15 in 2006 (http://eia.doe.gov/oiaf/analysispaper/pdf/table13.pdf).

cal changes involved in bringing about such a shift are huge, as are the consequences. Furthermore, the processes are both highly complicated and subject to multiple forms of opposition which may or may not be overcome. But to overcome that opposition will probably require a dose of *purposeful human action*.

Differential accumulation is the *financial form* of *increasing capitalist power.* It cannot happen without such power. And power has no meaning in the absence of free will: the freedom to exert it or not to exert it; the freedom to chose its particular form; and, of course, the freedom to oppose it by those on whom it is imposed. If everyone were an automaton in the grand 'structure' of capitalism, there would be no capitalism. The 'structure,' or 'logic' of capitalism is articulated primarily by those who dominate it. Those who dominate it are those who profit the most. And those who profit the most often are those who experience the fastest differential accumulation. If we look for purposeful action in the current historical conjunction, they are the ones we should start with.

11. THE WEAPONDOLLAR-PETRODOLLAR COALITION[36]

The groups that stand to gain the most from higher oil prices and the pendulum shift into depth are the transnational armament and oil companies, and, to some extent, also the oil producing countries. To explain why, it is worth taking a step back and considering some basic aspects of the oil business.

Making the Price Go Up

In a world 'awash with oil,' as *The Economist* put it, oil prices have little reason to rise. And the world is indeed awash with oil. According to the *BP Statistical Review*, current global proven oil reserves are equivalent to 40 production years, up from 30 years in 1960. Of course, these reserves are finite, so, ultimately they will be exhausted. But the exhaustion process has been going on for a century and half, and so far it has had *no systematic impact* on the price of oil.

Similarly with current production. The argument that oil prices fluctuate with 'excess demand' and 'excess supply,' although popular, does not hold much water. If oil prices were indeed responsive to 'market conditions,' we would expect to see inventories rise when the price of oil fell and vice versa when the price dropped. In reality, though, the exact opposite has often happened. During the massive price increases of the 1970s and early 1980s, for instance, inventories actually *rose* instead of

[36] The theoretical arguments in this and the remaining sections, along with extensive empirical evidence, were first published fifteen years ago, before the 1990-1 Gulf War (Bichler, Rowley, and Nitzan 1989; Nitzan, Rowley, and Bichler 1989; Rowley, Bichler, and Nitzan 1989). This work was further extended and updated in Nitzan and Bichler (1995), Bichler and Nitzan (1996), Bichler and Nitzan (2001b: Ch. 6) and Nitzan and Bichler (2002: Ch. 5).

fell; and when the price of oil dropped during the 1980s, inventories *fell* instead of rose (Nitzan and Bichler 2002: Figure 5.5, p. 230).[37]

So the price of oil has little to do with physical scarcity. That is obvious enough. But it has everything to do with *perceived* scarcity, and perceived scarcity has everything to do with the Middle East. Although the region currently accounts for only 30 percent of world oil production, it is the only place where production is permanently 'under threat.' These threats vary greatly: there is the threat of war; the threat of internal strife; the threat of Islamic fundamentalism; the threat of coups; you name it. So far, though, none of these threats has ever affected the *physical* availability of oil at the global level. There were of course occasional reductions in the region's output, but these reductions were always compensated for by increases elsewhere, keeping the world total on an even keel. Yet, as we said, considerations of actual supply are beside the point. What counts for the price of oil is risk – or rather, the *perception* of risk – and of this exotic commodity the region has always had ample supply.

Conflicts and Profits

How have these Middle East 'risks' served the large weapon and oil companies? Consider first the armament contractors. After the end of U.S. direct military involvement in Vietnam, domestic military spending fell sharply – from over 10 percent of GDP during Johnson's presidency to less than 6 percent at the end of Carter's (see Figure 16 below). The drop was compensated for to some extent by a sharp increase in military exports, which, by the end of that period, accounted for an estimated one third of all U.S. military-related profit.[38] The bulk of these exports were now going to the Middle East, which, since the early 1970s, had replaced South-East Asia as the world's leading market for exported weapons and accounted for over one third of the global trade. The relative significance of Middle East sales for the profits of the armament companies declined somewhat during Reagan's military buildup of the early 1980s. But with the armament boom beginning to fizzle out in the late 1980s and turning to bust with the fall of communism, the Middle East once more became a major source of military profits. It seems clear, therefore, that renewed conflict in the region, particularly with direct U.S. involvement, is very much in the interest of the weapon contractors. Their differential profits are likely to rise – partly from rising sales to the region, but mostly from increased spending at home.

The impact of renewed conflict in the region on oil profits should be equally large – although for a reason different than most people think. The prevailing view, popular among leftwing and rightwing analysts, is that the U.S. invasions of Afghanistan and Iraq are part of a larger strategy whose goal is to gain *direct control* over

[37] A note of caution. According to the logic of neoclassical economics, an increase in inventories is a sign of 'excess supply' only insofar as the inventory buildup is undesired. If the buildup is intentional, it should be counted as part of desired demand, not excess supply. Unfortunately, conventional economics cannot tell us how to distinguish between the two.

[38] For the precise computation, see Nitzan and Bichler (2002: 214-6).

the region's oil reserves. This view may be true. But controlling the region's reserves will not, in itself, make the oil companies richer.

Individually, each oil company of course is concerned with access to crude reserves. But for the oil companies *as a group*, the 'access issue' is passé. It is rhetoric which belongs to the breadth order of the 1950s and 1960s, a period when oil was in a 'free flow,' when a barrel sold for $2, when royalties were low or non-existent, and when profits depended mostly on production volume – that is, on 'access.' This situation changed fundamentally in the 1970s. Global differential accumulation swung into depth, crisis replaced prosperity, OPEC made the headlines, and the oil business shifted from a 'free flow' to a 'limited flow.' From then on, oil profits came to depend not on output, but on price. During the following three decades, world oil production increased continuously. But the growth in volume was moderate, roughly 1.5 percent a year, and was practically insignificant when compared to the wild swings in prices, which often doubled or halved in a single year.[39]

The consequences for the oil companies of their business shifting from a 'free flow' to a 'limited flow' are illustrated in Figure 11. The thicker line denotes the relative share of integrated oil companies in net corporate profit worldwide. The thinner line measures the 'real' price of oil, derived by dividing the dollar price per barrel by the U.S. CPI, and lagged one year.[40] The correlation between the two series leaves little to the imagination. For the oil companies, differential accumulation was, and still is, a matter of differential price: the higher the relative price of oil, the higher their share of global profit.[41]

[Figure 11. The Price of Oil and the Global Distribution of Profit]

On the face of it, this relationship seems counterintuitive. For the oil companies, crude oil is the principal input, not output. It is the raw material which they refine into gasoline, diesel, petrochemicals and other derivatives. Consequently, should they not *lose* when crude oil becomes more expensive? The answer is negative. If the price of refined products were fixed, higher crude oil prices would probably mean lower profit. But the price of refined products is not fixed. On the contrary, it tends to move up and down with the price of crude oil, causing profit and cost to move not inversely with each other, but together.[42]

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[39] World oil production – including crude oil, shale oil, oil sands and natural gas liquids – rose from 48.1 million barrels a day in 1970, to 74.5 million a day in 2001. The price of crude oil over the same period fluctuated between a low of $2.2 per barrel and a high of $40.5 when measured in current dollars, and between $9.4 and $82.8 when measured in 2002 dollars (production data from British Petroleum Annual; price data from International Monetary Fund Annual).

[40] Since reported corporate earnings represent the sum of the past four quarters, the full impact on profit of a change in the price of oil will be felt only after a year.

[41] The correlation coefficient between the two monthly series measures 0.80 (out of 1) for the period since January 1974, and 0.92 for the period since January 1979.

[42] For the mathematically inclined, assume for simplicity that the oil companies buy all their crude oil from others; that they refine the oil into final products; and that they sell those prod-

During the early 1980s, crude prices expressed in 2002 dollars exceeded $80 a barrel. For the world, this was the height of the 'energy crisis.' For the oil companies, it was the peak of the 'energy boom': their earnings reached nearly 19 percent of all global corporate profit. Since then, however, the 'real' price of oil tumbled, and so did the profit share of the oil companies. The nadir was reached in 2000, toward the end of Clinton's presidency, when oil profits were reduced to a mere 3 percent of the world's total. The last couple of years show a sign of reversal. With the Bush family again in the White House and the newspeak of 'globalism' giving way to the old rhetoric of 'imperialism,' oil prices have recovered and oil companies have seen their global profit share rising to between 6 and 8 percent. Of course, if this reversal is to continue, the price of oil will have to keep on rising. And for oil to become more expensive, the Middle East must be kept in 'turmoil.'

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ucts for profit. By definition, the companies' dollar profit (Π) is the multiple of their output volume (Q), the dollar cost per unit of output (C) and the decimal profit markup (K), such that:

(1) $\Pi = K \cdot C \cdot Q$

Using lower case notations to represent rates of change, we have:

(2) $\pi \approx k + c + q$

Suppose now that the price of crude oil goes up, so that $c > 0$. Assuming that the other costs of production remain unchanged, what happens to profit depends on the relationship between c and $(k + q)$. Profit will fall if, and only if, $(k + q) < -c$; in other words, if, and only if, the multiple of the markup and output $(K \cdot Q)$ falls *by more* than the rise in C. Although possible, this outcome is very unlikely for two reasons. First, rising crude prices tend to both 'fire up' the profit expectations of oil companies and galvanize their cooperation. This closer cooperation, tacit or otherwise, usually works to keep profit markups from falling, and often helps them go up. (Technically, there is nothing to prevent oil companies from changing their markups as they see fit. But in the absence of an external 'shock,' such as a hike in the price of crude oil, raising the markup significantly is too blatant an act to contemplate politically, and one which often is difficult to coordinate and maintain.)

Now, since higher costs and higher markups lead to higher prices, one would expect to see output fall. Oil products were made more expensive, so it is only natural for consumers to use less energy overall, as well as to substitute to alternative, non-oil sources. As it turns out, however, this negative impact usually is very small (in the jargon of economists, oil is 'price-inelastic'). To illustrate, between 1970 and 2001, the annual growth rate of crude oil consumption varied between a low of –3.9 percent in 1980 and a high of 8.4 percent in 1970 – an overall range of only 12.3 percent. By comparison, the range of price changes during the same period was 230 percent – prices fell by as much as 53 percent in 1986, and rose by as much as 267 percent in 1974 (computed from British Petroleum Annual). Moreover, there was no clear correlation between the two movements, with higher prices often coinciding with higher rather than lower consumption. To sum up, then, higher prices for crude oil ($c > 0$) tend to be associated with stable or even higher markups ($k \geq 0$), as well as indeterminate but very small changes in output ($q \approx 0$). The net impact of higher crude prices on oil company profits therefore is almost always positive.

The position of OPEC on the issue of conflict is inherently schizophrenic. On the one hand, conflict could be a very risky business, particularly when you are part of it. On the other hand, from the narrow viewpoint of *earnings*, the interest of oil producing countries is pretty much the same as that of the oil companies. This convergence is illustrated in Figure 12. The thick line in the chart shows the net profit of the 'Petro-Core,' made up of the world's six leading non government oil companies: British Petroleum (BP-Amoco since 1998), Chevron (Chevron-Texaco since 2000), Exxon (ExxonMobil from 1999), Mobil (till 1998), Royal-Dutch/Shell and Texaco (till 2000) (all changes are due to mergers). The thin line displays the value of OPEC's petroleum exports. The correlation between the two series is both positive and tight (correlation coefficient of 0.83). And the meaning of this correlation is simple enough: Middle East conflict, through its impact on the price of oil, has worked to boost OPEC's income (as well as the income of non-OPEC producers), just as it has raised the profits of the oil companies.

[Figure 12. OPEC and the Oil Companies]

So let us recap again. Dominant capital is now in need of inflation. With mergers and acquisitions in low gear and the world toying with deflation, the prospects are for differential decumulation and possibly debt deflation. For deflation to be averted and for differential accumulation to continue, there needs to be a shift from breadth and disinflation to depth and inflation. This shift requires a change in the mindset of 'price makers.' The most effective trigger for such change is a return to 'energy crises' in the Middle East, with sizeable increases in the price of oil leading to higher inflation. Within dominant capital, the groups that stand to benefit the most from this shift are the oil and armament companies. Also likely to gain, at least from the viewpoint of earnings, are oil producing countries in and outside OPEC. The only question is whether or not those who stand to gain from the shift can actually make it happen.

The Coalition

The answer remains to be seen. What does seem clear, though, is that the 'political machinery' necessary to bring this shift is presently in place. As we have described elsewhere at great length, this political machinery first emerged in the early 1970s in the form a *Weapondollar-Petrodollar Coalition* between the large armament, construction, oil and financial corporations, in conjunction with OPEC and key Western governments. The key feature uniting this coalition was a common interest in some measure of conflict in the Middle East and in high oil prices.

Representatives and owners of key companies within this coalition have grown increasingly intertwined with the hawkish administrations of Richard Nixon, Gerald Ford, Ronald Reagan and George Bush Sr. Even Jimmy Carter, who adopted a more conciliatory approach towards Middle East affairs, did not manage to significantly restrict their leverage.

One result of this 'capital-state symbiosis' was to keep U.S. energy policy conveniently fuzzy. 'For many decades now,' complained the authors of the Baker Report, 'the United States has been without an energy policy' (Morse and Jaffe 2001: 4). Indeed. According to Daniel Yergin's analysis of over one thousand State Department cables and papers obtained under the Freedom of Information Act, between 1974 and 1981 the U.S. government in fact objected to higher oil prices, but it didn't want to see those prices lowered either. . . . (Yergin 1991: 84, 643).

Officially, of course, the government of the United States was 'fundamentally, irrevocably committed' to maintaining the free flow of oil, and 'the interest in the United States is bound to be cheap energy prices.' That, at least, was how Vice President George Bush Sr. put it 1986 (*New York Times*, 7 April 1986). Interestingly, though, Bush made this declaration during his emergency trip to the Saudi Arabia, a trip whose explicit purpose was to persuade the kingdom to *cut* output in order to *raise* the price of oil! The 'free market' was all good and dandy, but there was a limit. As Bush articulated it to the Saudis: 'There is some point at which the national security interests of the United States say, "Hey, we must have a strong, viable domestic interest"' (*ibid*.).

Unlike with oil, the policy position on armament seemed unambiguous. The various U.S. administrations, along with the Soviet Union and countless other countries, did their best to arm the Middle East to the teeth. Israel, Saudi Arabia, Iraq, Egypt, Iran under the Shah, Iran under Khomeini, Kuwait, Jordan, the Gulf Emirates – all received massive weapon shipments. These shipments, of course, were all made in the interest of 'stabilization,' as Secretary of State William Rogers put it (cited in Engler 1977: 242). 'The balance of power,' explained the quintessential go-between, Henry Kissinger, 'is a kind of policeman, whose responsibility is to prevent peaceful countries from feeling impotent and aggressors from becoming reckless' (Kissinger 1981: 81).

Unfortunately, or fortunately, depending on the viewpoint, the 'balance of power' provided little stability to the region. In fact, it seems safe to conclude it has done the exact opposite. Since 1967, the region has had numerous major conflicts, all fought with imported weapons, and all connected directly or indirectly to oil.

12. 'ENERGY CONFLICTS'

The connection between oil and conflict in the Middle East is hardly a novelty. Some conflicts – for instance, the 1990-91 war between Iraq and the U.S.-led coalition – have been attributed partly to a struggle over the control of crude reserves, whereas others – specifically the Arab-Israeli wars of 1967 and 1973 and the Iran-Iraq conflict of 1980-88 – were seen as having aggravated ongoing energy crises. Most of those studying the subject have concentrated on the link between conflict on the one hand

and oil prices and exports on the other. Few if any, however, have paid attention to the more subtle relationship between conflict and oil *profits*.

Figure 13 and Figure 14 provide summary statistics on the relative financial performance of the 'Petro-Core' referred to earlier. Figure 13 displays two measures of return on equity – one for the Petro-Core, the other for the Fortune 500 group of companies. Comparison of these two measures gives an indication for the relative performance of the Petro-Core. When the Petro-Core's rate of return 'beats' the Fortune 500 average, it accumulates differentially. When it falls short of that average, it decumulates differentially. In the figure, these latter instances are darkened in black, and are labelled 'danger zones' for a reason which we shall explain shortly.

[Figure 13. Return on Equity: The Petro-Core vs. the Fortune 500]

[Figure 14. The Petro-Core's Differential Accumulation and Middle East 'Energy Crises]

The same information is presented somewhat differently in Figure 14. Here we measure the rate of differential accumulation, first, by taking for each year the difference between the rate of return of the Petro-Core and the average rate of return of the Fortune 500, and then expressing this difference as a percent of the Fortune 500's (in order to 'standardize' the result). Here, too, instances of differential decumulation by the Petro-Core are darkened in black and labelled as 'danger zones.'

The reason for using the term 'danger zone' has to do with the 11 'explosion' symbols in Figure 14. Each of these symbols represents the breakout of a major Middle East conflict – the 1967 Arab-Israeli War, the 1973 Arab-Israeli War, the 1979 Islamic Revolution, the 1979 Soviet Invasion of Afghanistan, the 1979 Israeli invasion of Lebanon, the onset of the 1980-8 Iran-Iraq War, the 1982 Israeli invasion of Lebanon, the 1990-1 Gulf War, the 2000 Palestinian *Intifada,* the 2001 U.S. invasion of Afghanistan and, finally, the 2002-3 second Gulf War. As it turns out, this string of conflicts has been intimately connected to the differential accumulation of the oil companies, and in more than one way.

First, since the late 1960s, *all* major Middle-East conflicts were followed by a period during which the Petro-Core beat the Fortune 500 average. In this sense, and whatever their ultimate 'cause,' these were all *'energy conflicts.'* Now, that finding, although striking, should not surprise the reader: as we have already seen, differential oil profits are intimately correlated with the relative, or 'real' price of oil; the 'real' price of oil in turn is highly responsive to Middle East 'risks,' real or imaginary; these 'risks' tend to jump in preparation for and during armed conflict; and as the 'risks' mount, they bring higher 'real' oil prices and therefore differential accumulation for the oil companies. The important thing to note here, though, is that 'energy conflicts' have led not to higher oil profits as such, but to higher *differential* oil profits. As Figure 13 shows, in 1969-70, 1975, 1980-82, 1985, 1991 and 2001-2, the rate of return on equity of the 'Petro-Core' actually fell; but in all cases it fell *more slowly* than the average rate of return of the Fortune 500, enabling the 'Petro-Core' to comfortably 'beat the average.'

A second remarkable fact is that, with the exception of 1996-7, the Petro-Core *always* 'needed' a conflict to pull itself of a the 'danger zone.'[43] This fact should already be highly disturbing. It is one thing for war to help the oil companies beat the average. It is another matter when the oil companies can beat the average *only* through war.

But the most important fact is that *all* of the conflicts indicated in the chart were preceded by a period during which the Petro-Core suffered differential decumulation.[44] The first fact, although striking, may be dismissed as coincidence. The second fact is a bit more disconcerting, yet still in the realm of remote possibilities. But what should we make of the third fact? How could it be that differential *decumulation* by a few large oil companies *always* 'triggers' wars in the Middle East? Or is this a fluke as well?

Perhaps it is. But in passing judgment on this matter, it is important to note that most of these conflicts were endorsed, and sometimes openly supported, by various U.S. governments, and that these governments were never at arm's length from the Weapondollar-Petrodollar Coalition (Cf. Bichler and Nitzan 1996; Nitzan and Bichler 2002: Ch. 5). Thus, in the months leading to the 1967 Israeli-Arab War, the United States actively supported Israel's plan to 'break Nasser's bones asunder.' In 1973, Nixon and Kissinger had been warned by the oil companies and Saudi Arabia of the pending attack on Israel, but chose to do nothing about it, not even notify the Israelis. In 1979, President Carter, under the advice of Kissinger, contributed to the post-Revolution turmoil in Iran by offering asylum to the Shah and freezing Iranian assets in the United States. The United States gave the green light to both of Israel's invasions of Lebanon – the first in 1979 and the second in 1982. The U.S. government financed and supplied the Mujahedin after the Soviet invaded Afghanistan in 1979. The U.S. government encouraged Iraq to attack Iran in 1980, and then supplied armaments to both sides in order to prolong the conflict. The 1991 Iraqi invasion of Kuwait was a classic 'sting' operation. The U.S. gave Saddam Hussein reason to believe that Washington would do nothing if he invaded Kuwait, only to reverse its stance the moment he attacked. The Administration of George Bush Jr. supported Ariel Sharon from the moment he walked on the Temple Mount in 2000 and throughout the resulting *Intifada*. Finally, the background to the September 11 attacks is still engulfed in mystery if not secrecy; but the enthusiasm of Bush Jr. to use these attacks as a pretext for invading Afghanistan and Iraq is hardly in doubt.

Of course, these observations themselves do not mean that Middle East wars were 'premeditated' in the boardrooms of the Weapondollar-Petrodollar Coalition

[43] Although there was no 'official' conflict in 1996-7, there was plenty of violence, including an Iraqi invasion of Kurdish areas and U.S. cruise missile attacks.

[44] In the late 1970s and early 1980s, and then in the early 2000s, differential decumulation was sometimes followed by a string of conflicts stretching over several years, with the result being a longer period between the initial spell of differential decumulation and some of the subsequent crises.

and that the U.S. government simply 'followed orders,' triggering conflict whenever it suited the Coalition. It is almost a cliché to say that conflict and war are never mono-causal. They always occur within a highly complex historical context, and that context can never be reduced to a 'functional' relationship between several 'variables.' But in the case of the Middle East, the context of conflict cannot be comprehended solely from the narrow perspective of the warring factions; it cannot be understood without reference to its own continuities and apparent 'regularities'; and it cannot be analyzed separately from broader world developments.

Our own view is that Middle East conflicts were integral to the power processes of global accumulation. During the 1970s and 1980s, these conflicts helped trigger and sustain a global depth regime of stagflation – which in turn contributed to the differential accumulation of dominant capital in general, and of the Weapondollar-Petrodollar Coalition in particular. In the process, this coalition had become increasingly fused with its 'parent' governments on the one hand and its OPEC 'hosts' on the other, leading to a growing 'capital-state symbiosis' between them.

Whether or not there was 'conspiracy' here, and what the precise nature of such a 'conspiracy' was, remains an open question. Unfortunately, these types of issues are not the usual staple of primetime television. Occasionally, however, the truth does come to light, albeit with a little delay. The 1971 publication by Daniel Ellsberg of the *Pentagon Papers*, for example, revealed the clandestine story behind the Vietnam War (Chomsky, Zinn, and United States Department of Defense 1971). Similarly, the 1975 declassification of the 1950 National Security Council Memorandum 68 (NSC 68) showed that the military buildup of the Cold War was explicitly designed, at least partly, as a 'Keynesian stimulant' (National Security Council 1950). Perhaps in due course someone will publish the secret 'Exxon Papers' or a declassified 'NSC Report on Energy and War in the Middle East,' thereby opening a window into the backroom story of Energy Conflicts in the region.

One way or another, it is clear that during the 1970s and early 1980s the general context was highly favorable to conflict. The differential interests of the various groups described above fit nicely with the realist rhetoric of the 'Cold War,' 'spheres of influence,' the 'national interest' and 'access' to raw materials. The net result of these converging interests, institutions and organizations was to make conflict look more 'natural,' which in turn strengthened the hand of those who benefited from such conflict and weakened those who opposed it. In short, it was 'open season.' War was less likely to be prevented, more likely to erupt (sometimes with active encouragement), and less likely to be stopped once under way.

13. BREADTH AND THE RISE OF 'NEOLIBERALISM'

The importance of differential accumulation regimes for understanding Middle East conflicts is all the more evident when considering the relative 'pause' in these con-

flicts during the late 1980s and 1990s and the way this pause was connected with the shift from depth to breadth. Since the late 1980s, the Weapondollar-Petrodollar Coalition was running into increasing difficulties. The profit share of oil companies tumbled to unprecedented lows (Figure 11). Differential decumulation by the Petro-Core also proved far more difficult to resolve (Figure 13 and Figure 14). During the earlier period of the 1970s and early 1980s, drops in its differential performance were short. Every drop was quickly followed by conflict, which in turn allowed the oil companies again to beat the average. From the mid-1980s onward, however, wars became fewer and farther between, and their effect on differential performance usually was disappointing. Worse still, in 1991, George Bush Sr., a Weapondollar-Petrodollar loyalist who had just finished orchestrating a major international war, was more or less forced to announce the dawn of a 'New World Order' of peace. His successor, Bill Clinton, was already a declared 'peacenik' who moved swiftly toward resolving the Arab-Israeli conflict. World military budgets during the 1990s fell sharply, arms exports went into a tailspin and the large armament contractors were reduced to a mere shadow of their past glory. 'War profit' and conflict were evidently out. Everyone was talking about 'peace dividend,' 'globalization,' 'emerging markets' and the 'end of history.'

The change certainly was influenced by the collapse of the Soviet Union and the disintegration of communism. But that disintegration itself was intimately connected to the expanding frontiers of differential accumulation. The last 'envelope,' which till then had separated the First World from the Second and Third, was finally broken, triggering a swift shift from depth to breadth. With communism gone, developing countries were more or less compelled to become 'emerging markets' open to Western investment. For dominant capital, corporate merger had finally gone global. Civilian high-tech was promoted as the new panacea, investors' optimism was relentlessly hyped up, and market indices and equity valuation were sent into the stratosphere. The winds of 'neoliberalism,' 'deregulation' and 'openness' began blowing stronger and stronger.

By the early 1990s, dominant capital *as a whole* shifted from relying on depth through stagflation to emphasizing breadth through corporate amalgamation. But the shift also involved a realignment *within* dominant capital. The Weapondollar-Petrodollar Coalition that had led the earlier depth regime was now challenged by a new 'Technodollar-Mergerdollar Coalition' geared toward civilian high-tech, global expansion and corporate mergers.

Although there is some overlap between the two coalitions, their characteristics are fairly distinct. The top defense contractors are mostly high-tech companies, but they rely largely on military orders. By contrast, the large high-tech companies of the Technodollar-Mergerdollar Coalition sell mostly to the civilian market.[45] Similarly,

[45] Global data on the 'military dependency' of large companies are difficult to collate, but the situation in the United States, which is probably indicative of the broader picture, seems fairly clear. The 16 leading U.S. defense contractors typically get 20 to 40 percent of their revenues

while both coalitions went through massive corporate consolidation during the 1990s, in the former case the process was largely defensive, whereas in the latter it was highly aggressive.

The reversal of fortune of these coalitions is evident in Figure 15. The chart shows the net profit of two corporate clusters, both expressed as a percent of total world profit: integrated oil and defense companies which proxy the Weapondollar-Petrodollar Coalition, and information technology hardware, telecom hardware and computer software and services, which together proxy the new Technodollar-Mergerdollar Coalition.

[Figure 15. Shares of Global Net Corporate Profit]

As the data indicate, the Weapondollar-Petrodollar Coalition reigned supreme till the early 1980s. At the peak of its power, in 1981, it scooped over 20 percent of the global profit pie. Then came a long decline, with the slack picked up, particularly since the early 1990s, by the Technodollar-Mergerdollar Coalition. Toward the end of the 2000s, the former's share was reduced to nearly 3 percent, whereas the latter's soared to 14 percent.

For the new coalition, high energy prices were a mortal threat. More expensive oil would have spoiled business confidence and growth in 'emerging markets,' upset capital mobility and merger prospects and interfered with the hyping up of the stock market. And since breadth accumulation benefited dominant capital as a whole, both rhetoric and policy tilted toward supporting the new regime. Experts began to sing the praises of a 'new economy' of technical progress and inflationless growth. Government deficits were made smaller and economies were deregulated. Borders were opened and military spending was reduced. The Middle East was put on a fast track toward becoming the next 'emerging market,' with peace deals popping up all over and frequent conferences recounting the wonders of regional cooperation and development. Even Israel's dominant capital, which had made its greatest differential fortunes during the depth regime of conflict and stagflation, bought into the dream of a 'New Middle East' with Israel as its 'Silicon Waddi.' Breadth accumulation was clearly the way to go.

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from prime contract awards with the Department of Defense (Nitzan and Bichler 1995: 459-63). In 2001, the comparable figure for the 30 leading civilian high-tech companies based in the United States was a mere 0.7 percent (computed from the Fortune 500 directory and from U.S. Department of Defense Annual). The latter companies often act as subcontractors to the leading defense firms, but the magnitudes involved are small relative to their overall sales and do not change the overall picture.

14. THE CURRENT CROSSROADS

Regrouping

The Weapondollar-Petrodollar Coalition did not die, however. Far from it. During the 1990s, it was busy regrouping its organizations, realigning its politics and reworking its ideology. The first task was amalgamation. By the end of the decade, merger had fused many of the Petro-Core giants, formerly known as the 'Seven Sisters,' into even larger entities. Similarly with the armament companies. Clinton's government and the EU encouraged them to bundle up, and within several years there emerged a new leading group of companies, the 'Seven Angels of Armageddon,' all intricately tied through joint development projects.[46]

In the meantime, the policy hawks were busy drafting future plans. In 1996, The Institute for Advanced Strategic and Political Studies in Jerusalem tabled a report entitled 'A Clean Break: A New Strategy for Securing the Realm' (Perle *et al.* 1996). The study, written under the auspices of the Netanyahu government, called for a drastic change in Israeli policy. The 'New Middle East' had been a complete failure, the paper argued. Comprehensive peace was a mirage and paying for it with land was suicidal. Instead, Israel should strive for a 'balance of power.' Forging an alliance with Turkey and Jordan, Israel should contain, destabilize and roll back Syria, its strongest foe. If needed, Israel should not shy from openly attacking Syria, militarily, both in Lebanon and on its own soil. Furthermore, 'Since Iraq's future could affect the strategic balance in the Middle East profoundly,' the effort to roll back Syria 'can focus on removing Saddam Hussein from power in Iraq – an important Israeli strategic objective in its own right – as a means of foiling Syria's regional ambitions.'

Interestingly, the team that wrote the report was entirely American, and many of its members would soon become key figures in the government of George Bush Jr. The leader of the team was Richard Perle, former assistant secretary of defense for international security policy and future chairman of the Pentagon's Defense Policy Board under Bush. Other members included lawyer Douglas Feith, who became Bush's under secretary of policy at the Pentagon; Meyrav Wurmser and her husband, David Wurmser, who became special assistant to John Bolton, Bush's under secretary for arms control and international security at the State Department; and James Colbert of the neo-conservative Jewish Institute for National Security Affairs in Washington, whose advisory board included future vice-president Dick Cheney, John Bolton and Douglas Feith (Whitaker 2002).

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[46] By the late 1990s, the world's leading oil companies were Exxon-Mobil (with 1999 profits of $7.9 billion), Royal-Dutch Shell ($8.9 billion), BP-Amoco ($5 billion), Total Fina Elf ($3.9 billion), Chevron-Texaco ($3.3 billion) and ENI ($3.1) billion. The 'Seven Angels of Armageddon,' a nickname suggested to us by Gibin Hong, consisted of Lockheed-Martin (with 1999 defense sales of $18 billion), Boeing ($16 billion), BAE Systems ($15 billion), Raytheon ($15 billion), General Dynamics ($9 billion), EADS ($6 billion) and Northrop Grumman ($6 billion) (figures from Nitzan and Bichler 2002: Table 5.4, p. 269).

In 1998, the chorus of 'realist' voices grew louder and the focus on Saddam Hussein sharper. A group of 42 prominent public figures, led by Donald Rumsfeld, wrote an open letter to President Clinton, calling for a 'comprehensive political and military strategy for bringing down Saddam and his regime' (Rumsfeld 1998). In a few years, many of the letter's signatories would assume key positions in the Bush government, ready to make good on their recommendations.

The broad blueprint for how to carry out these recommendations was meticulously laid out in a 90-page report, 'Rebuilding America's Defenses,' (Donnelly 2000). The report was published by the Project for the New American Century (PNAC), whose founders included future vice-president Dick Cheney, future defense secretary Donald Rumsfeld, future deputy defense secretary Paul Wolfowitz, Cheney's future chief of staff Lewis Libby, and Bush's future ambassador to Afghanistan Zalmay Khalilzad. The principal means of promoting 'American global leadership,' argued the report, was higher military spending. '[T]he extended paying of the "peace dividend" and the creation of today's federal budget surplus, the product of increased tax revenues and reduced defense spending – has [sic] created a severe "defense deficit," totaling tens of billions of dollars annually' (Donnelly 2000: 69). Indeed, according to the report, the postwar decline in military spending as a share of GDP, illustrated in Figure 16, was pushing America toward a moment of truth. The trend had to be reversed before it was too late. To this effect, America needed a major 'military transformation' – although such transformation, the report observed, was 'likely to be a long one, absent some catastrophic and catalyzing event – like a new Pearl Harbor' (pp. 50-51).

[Figure 16. U.S. Military Spending as a Share of GDP]

In order to effect this 'transformation,' whether long or short, the Weapondollar-Petrodollar Coalition first had to reclaim the White House. This was an important task, and the efforts put into it were commensurate with the stakes. Massive financial support, legal pressures, electoral maneuvers, deceit and outright forgery were all brought to bear. And the strategy worked. In January 2001, the Coalition had George Bush Jr. safely installed in the Oval Office.

The End of Breadth

In retrospect, then, all seemed ready for a 'new Pearl Harbor': the oil and armament sectors had been centralized, their corporate members all eager for higher oil prices and larger military budgets; an ultra-hawkish ideology had been articulated and aggressively peddled to policy makers, intellectuals and the masses; and the new U.S. Administration seemed prepared to go to war on a moment's notice. But these conditions alone, although necessary, were not sufficient. It was also essential to have dominant capital on board, and that condition, too, was fulfilled in 2001. With mergers having collapsed and the drop in stagflation apparently reversed, the pendulum of differential accumulation has began to swing (Figure 7). The collective mindset of dominant capital has finally started to shift from breadth to depth.

In our view, without this change in the outlook of dominant capital, September 11 probably would *not* have become America's 'new Pearl Harbor.' Had the attacks on the Twin Towers and the Pentagon occurred not in 2001, but in the mid 1990s, at a time when the stock market boom was still in full swing, when 'emerging markets' were still red hot, and when high-tech mergers were reshaping the corporate landscape, it is doubtful that a U.S. administration – even one headed by George Bush Jr. – would have been able to substitute 'infinite war' for 'neoliberal globalization.' In this sense, the 2001 timing of the attacks was 'perfect' (if that is the proper word). The attacks came after the stock market had been punctured, after the merger boom had collapsed, after the neoliberal rhetoric had begun to backfire in 'emerging markets,' and after deflation had emerged as a threat. When the Twin Towers came down, the Technodollar-Mergerdollar Coalition was already in tatters, its profits melting, its neoliberal vision tarnished. Dominant capital was finally ripe for a 'regime change' in the nature of differential accumulation, ready to accept the resurrected Weapondollar-Petrodollar Coalition as its new locomotive, ready to shift from 'peace dividends' back to 'war profits.'

The New Wars

It was against this background that George Bush Jr., on the night of September 11, could confidently dictate to his diary: 'The Pearl Harbor of the 21st century took place today; We think it's Osama bin Laden. . . . We cannot allow a terrorist thug to hold us hostage. My hope is that this will provide an opportunity for us to rally the world against terrorism' (Balz and Woodward 2002). The next day, secretary of defense Donald Rumsfeld suggested that the United States use the opportunity to go after Iraq. The suggestion had many supporters, but, in the end, on the counter advice of secretary of state Colin Powell, it was decided to cater to 'American public opinion' and, instead, begin with Al Qaeda in Afghanistan (Woodward and Balz 2002).

Officially, the new wars are against 'terrorism.' Unofficially, they are about securing cheap oil. And, so far, they have 'failed' on both counts. Terrorism remains unabated, and oil, instead of becoming cheaper, has grown more expensive. And, yet, to the surprise of many, despite this double failure, the 'business community' remains quiet: 'why is Wall Street silent on the war?' asked Bloomberg commentator Michael Lewis (2003). Obviously, the reason is not lack of interest. If anything, the new wars are probably the most 'commodified' in history, with every move and development on the ground immediately reverberating thought the entire grid of financial markets. Furthermore, the few commentators who do make their opinions known show that dominant capital is well aware of the issues at hand. Thus, George Soros (2003) openly blamed Bush for his 'inflated sense of supremacy,' warning that 'war on terrorism cannot be the guiding principle of U.S. foreign policy.' The dangers inherent in such policy were explained by Bill Gross of PIMCO, one of the world's largest bond management companies: 'Investors must know that perpetual

containment [of terrorism] entails costs – not just monetary but those involving potential policy reversals that have formed the backbone of America's economic hegemony for nearly seven decades.' Free trade, open capital markets and a strong dollar now were all at risk. 'Because of 9/11 and our necessity to fight a new kind of war,' says Gross, 'America is losing its peace dividend at a time when – because of high debt, over consumption, and reflective trade deficit – we cannot afford to' (Gross 2003). Clearly, then, dominant capital understands full well that the new wars could mark the end of neoliberalism, at least for the time being.

So why the silence? According to Michael Lewis, the reason is fear. The 'fear of saying the wrong thing,' which, in his opinion reveals the 'impotence of the putatively powerful.' And perhaps he is right. But there is another possibility, the one argued in this paper. The tentative reversal shown in Figure 7 – the fall of the amalgamation index and the coinciding upturn of the stagflation index – suggests that the pendulum of differential accumulation may have begun swinging from breadth to depth. In our view, dominant capital understands that the new wars may spell the end of neoliberal globalization. But unlike diehard 'peaceniks' such as George Soros and Bill Gross, most of its members feel that the new trajectory of conflict is presently better for accumulation, and therefore say little and do even less. In the current historical conjunction, this inaction allows the new wars to continue and the pendulum to swing from breadth to depth.

And yet this new trajectory remains precarious. The Weapondollar-Petrodollar Coalition, which once more occupies the driver's seat within dominant capital, needs an atmosphere of permanent threat. Military spending has just begun recovering from its abyss (Figure 16). These expenditures could continue rising – but only if the threats they are supposed to answer can be 'demonstrated' as significant and credible. And in a unipolar world, without an opposing superpower, those threats could only be 'demonstrated' through *open and continued conflict*.

From this perspective, the occupation of Afghanistan and Iraq provided a good start, with plenty of media coverage and no end in sight. But unfortunately for the NeoCons and the armament companies, so far the campaigns have proven far too 'efficient.' Their combined cost for 2002-3 is estimated around $100-120 billion. Spread over two years, this sum is equivalent roughly to 0.5 percent of U.S. GDP. A longer occupation of Iraq, including reconstruction and interest expenses, would cost much more – $418 over ten years according to a 'worst-case scenario' published by the House Budget Committee of the Democratic Party (Spratt 2003). But, then, even this inflated sum would represent a mere 0.3 percent of GDP. As illustrated in Figure 16, these ratios remain far smaller than the 'requirements' of past conflicts. And the Pentagon, aware of these limitations, projects military spending over the next five years to rise by only 4.1 percent annually, roughly in line with GDP. Of course, the situation would change dramatically if there were new conflicts in the pipeline, which perhaps explains the endless hype about the Axis of Evil and the need to 'spread democracy.'

The outlook for the oil companies is similar. For them, too, the war in Iraq was won way too easily. As these lines are being written (early 2003), the price of crude oil hovers at around $25 to $32 per barrel – higher than before the war, but still far below previous records (Figure 11). Unless conflict resumes – either through new campaigns or through more intense skirmishes with 'terrorists' and 'fundamentalists' – the likelihood is for oil prices to fall, and for the oil companies to again suffer differential decumulation. And so, here too the Axis of Evil has a role to play – although as far as the oil companies are concerned, that 'role' should not deviate too far from the oil regions.

Finally, so far the new wars and rising oil prices have managed to keep the world from sliding into deflation (Figure 10). But the danger remains. And it is on this issue that the fate of the Bush Administration, the Weapondollar-Petrodollar Coalition, and the nature of differential accumulation more broadly, all hinge. Many big capitalists, whose instincts remain Keynesian, believe that the new wars will be 'expansionary' and that expansion is inflationary. 'Keynesian theory might be old,' explain the analysts of *Stratfor Forecasting* to their clients, 'but it does teach us a basic truth, which is that the cure for deflation is economic stimulation through government spending. . . . So anyone who was concerned about deflation should be relieved that the Bush administration has adopted Keynes' (Anonymous 2003). Of course, since inflation tends to appear as stagflation, the Keynesian hopefuls may well be puzzled to see prices start rising in the midst of stagnation. But as long as inflation does rise and pricing power is restored, they will be happy to keep 'silent on the war.' However, if the new wars fail to deliver – because the conflicts are not sufficiently 'intense,' because the hostilities do not create enough 'scarcity' in the oil market, or because inflation does not 'respond' to higher oil prices – the opposition from within dominant capital will likely become much more vocal.

And, in this sense, perhaps little has changed. 'It is a sad world indeed,' commented Michal Kalecki at the height of the Vietnam War, 'where the fate of all mankind depends upon the fight between two competing groups within American big business. This, however, is not quite new: many far-reaching upheavals in human history started from a cleavage at the top of the ruling class' (Kalecki 1967: 114).

UPDATE (JUNE 2004)

Since this paper was submitted for publication in June 2003, the U.S. 'victory' in Iraq has proven illusive and the 'war on terror' rather difficult to win. Guerrilla warfare, terrorist attacks, counterattacks and reprisals have intensified in Iraq and elsewhere in the Middle East. The price of crude oil has risen further, and it currently hovers around $40 per barrel. In parallel, the 'risk' of deflation seem to have subsided. Despite the presence of ample idle productive capacity, inflation has picked up and the Federal Reserve Board recently announced it is ready to step on the monetary breaks should the need arise. For the first time since the 1980s, analysts have began con-

templating the prospects of renewed stagflation. Increasingly, this new reality seems obvious, and many experts, who until a year ago predicted the exact opposite, now know to tell us that they have 'anticipated it all along.'

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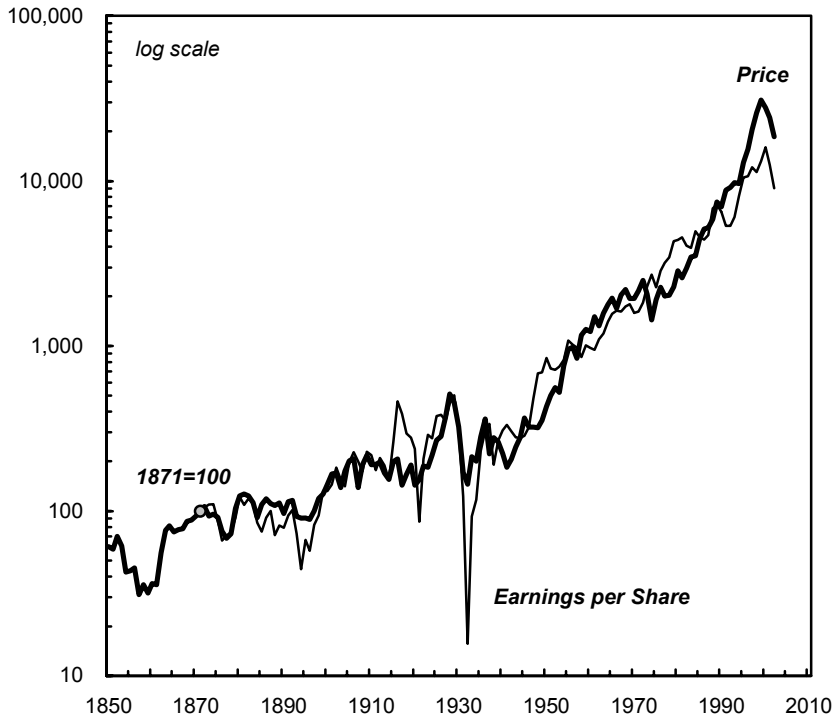

FIGURE 1. S&P 500: Price and Earnings

NOTE: The S&P 500 index splices the following three series: the Cowles/Standard and Poor's Composite (1871-1925); the 90-stock Composite (1926-1957); and the S&P 500 (1957-present). Earnings per share are computed as the ratio of price to price/earnings.

SOURCE: Global Financial Data (series codes: _SPXD for price; SPPECOMW for price/earnings).

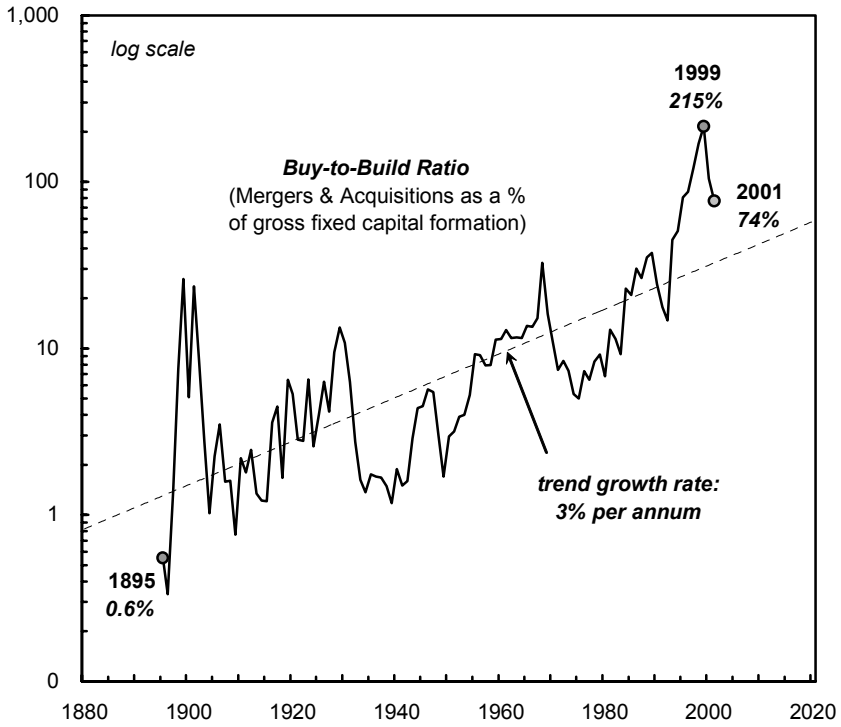

FIGURE 2. Corporate Amalgamation in the United States

SOURCE: Jonathan Nitzan and Shimshon Bichler, The Global Political Economy of Israel (London: Pluto Press, 2002), Data Appendix, pp. 82-3. Updated to 2001.

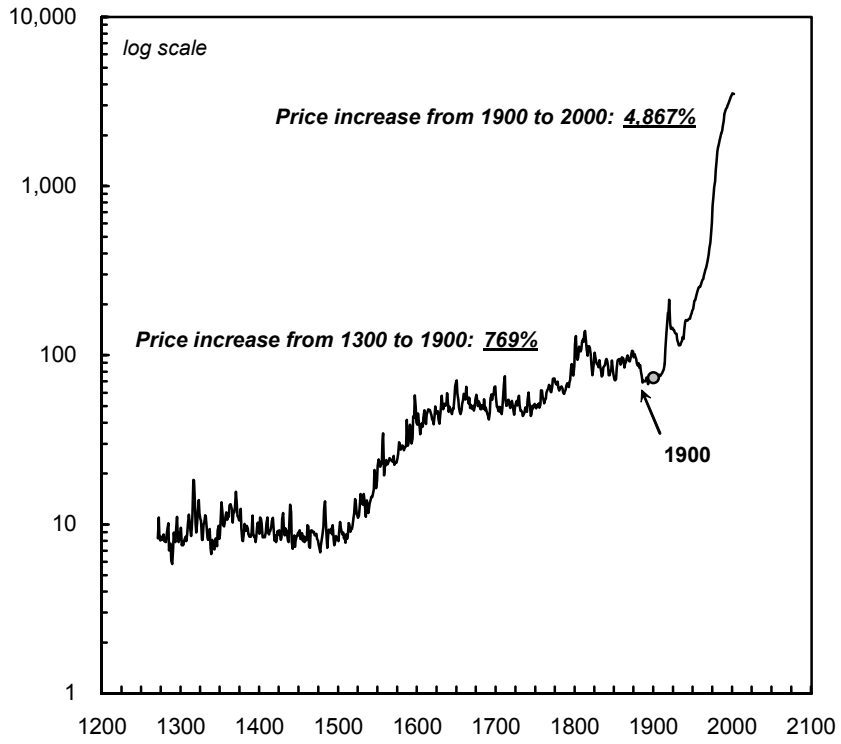

FIGURE 3. Consumer Prices in the U.K.

SOURCE: Global Financial Data (series code: CPGBRM); WEFA.

FIGURE 4. U.S. Inflation and Capital-Labor Redistribution

* Corporate earnings per share are for the *S&P 500* Index (ratio of price to price/earnings). The wage rate is the average hourly earning in the private sector.

NOTE: Series are smoothed as 3-year moving averages.

SOURCE: *Global Financial Data* (series codes: _SPXD for price; SPPECOMW for price/earnings); U.S. Department of Commerce and U.S. Bureau of Labor Statistics through *WEFA* (series codes: AHEEAP for the wage rate; WPINS for the wholesale price index).

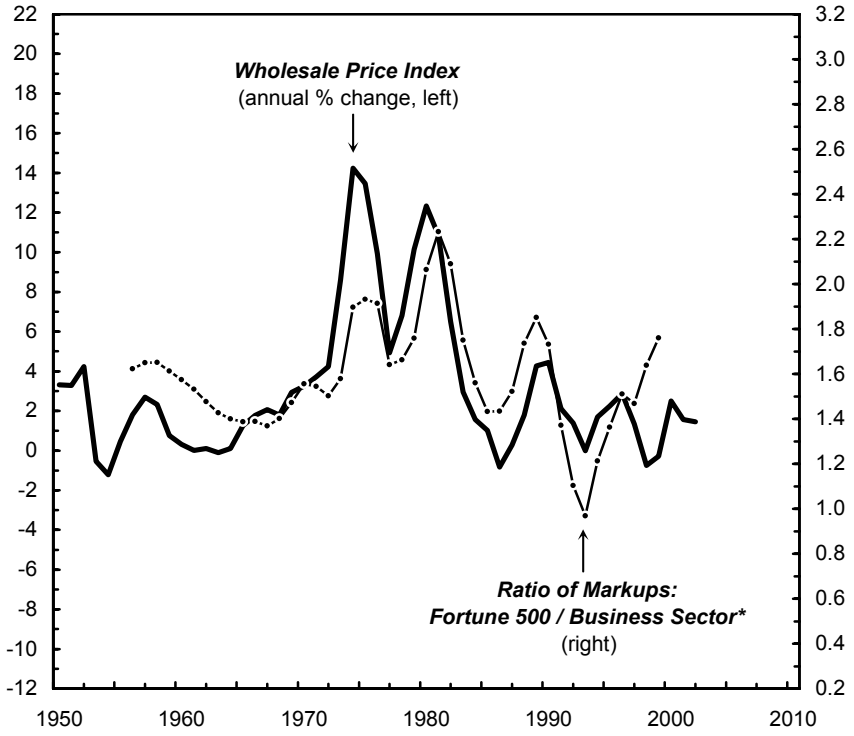

FIGURE 5. U.S. Inflation and Differential Accumulation

* The markup is the percent of net profit in sales. The Fortune 500 markup is the percent of after tax profit in sales revenues. The business sector markup is computed by dividing total corporate profit after tax, with IVA and CCA (from the national income accounts) by total business receipts (from the IRS). The 'Ratio of Markups' is giving by dividing the Fortune 500 markup by the business sector markup.

NOTE: Until 1993, the Fortune 500 list included only industrial corporations (firms deriving at least half their sales revenues from manufacturing and/or mining). In 1994, the list was expanded to include all corporations. For 1992-3, data for Fortune 500 companies are reported without SFAS 106 special charges. All series are smoothed as 3-year moving averages.

SOURCE: U.S. Department of Commerce through *WEFA* (series codes: ZAADJ for total corporate profit after tax with IVA and CCA; WPINS for the wholesale price index); U.S. Internal Revenue Service; *Fortune*.

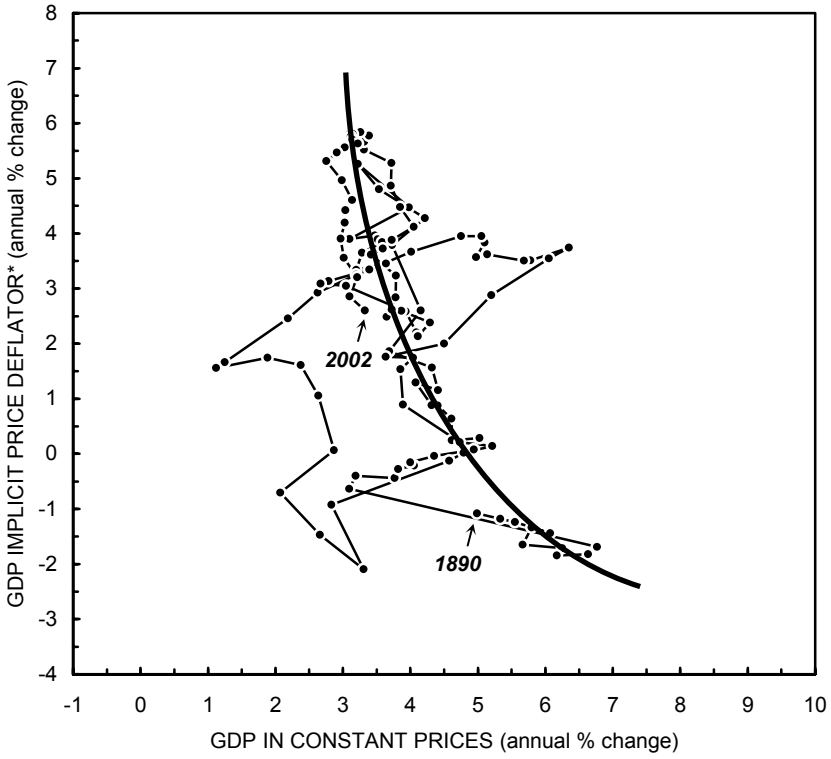

FIGURE 6. United States: Long Term Inflation and Growth

* Ratio of GDP in current prices to GDP in constant prices.

NOTE: Series are shown as 20-year moving averages. The smooth curve running through the observations is drawn freehand for illustration purposes.

SOURCE: Historical data till 1928 are from *The Bank Credit Analyst Research Group.* From 1929 onward, data are from the U.S. Department of Commerce through *WEFA* (series codes: GDP for GDP; GDP96 for GDP in constant prices).

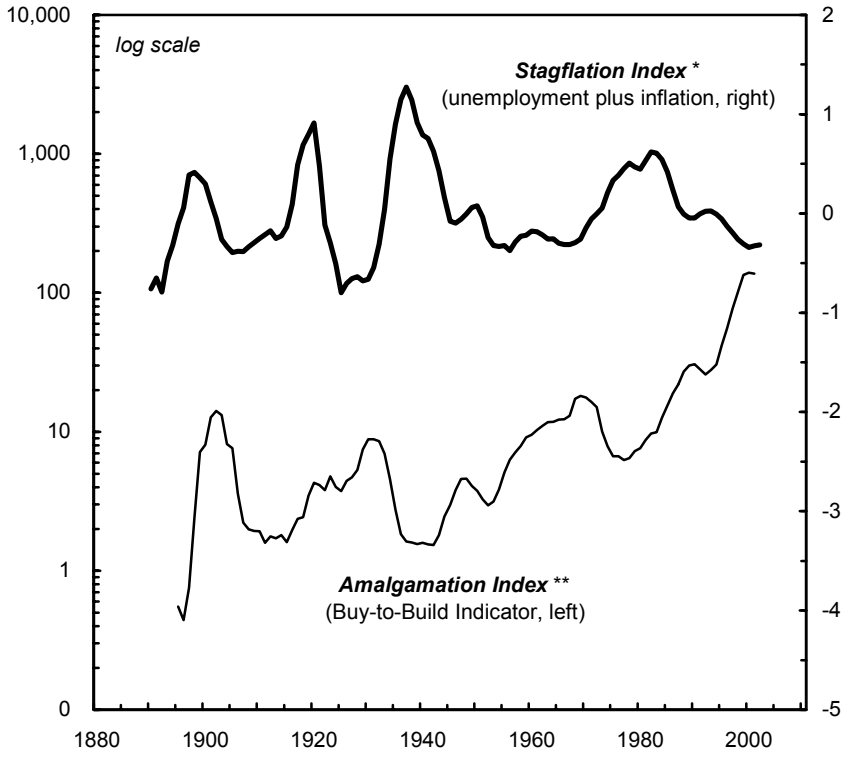

FIGURE 7. Amalgamation and Stagflation in the United States

* Computed as the average of: (1) the standardized deviations from average of the rate of unemployment, and (2) the standardized deviation from the average rate of inflation of the GDP implicit price deflator.

** Mergers and acquisitions as a percent of gross fixed capital formation.

NOTE: Series are shown as 5-year moving averages (the first four observations in each series cover data to that point only).

SOURCE: The stagflation index is computed from data from the U.S. Department of Commerce through *WEFA* (series codes: RUC for the rate of unemployment and GDP/GDP96 for the GDP implicit price deflator). The Amalgamation Index is from Jonathan Nitzan and Shimshon Bichler, *The Global Political Economy of Israel* (London: Pluto Press, 2002), Data Appendix, pp. 82-3 (updated to 2001).

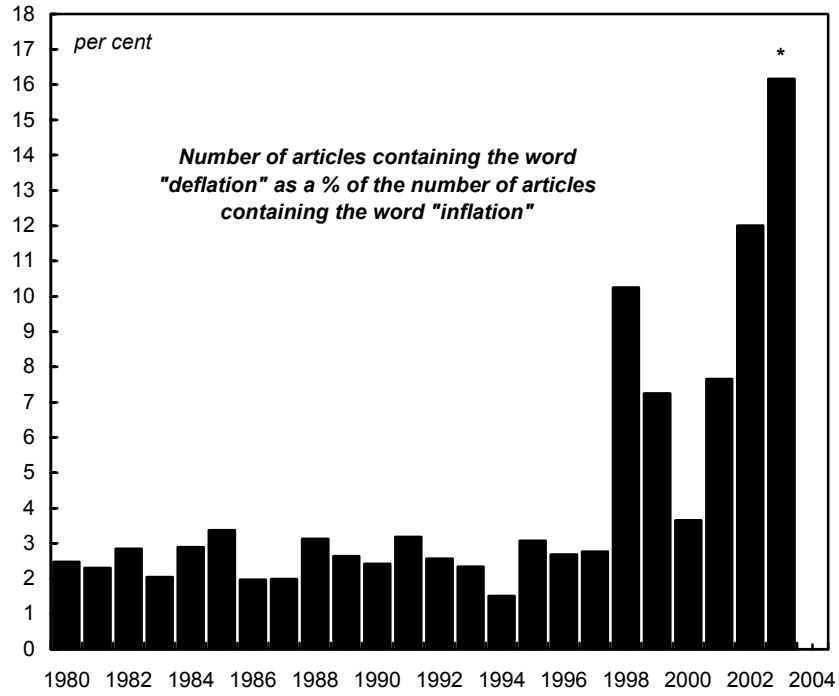

FIGURE 8. The Threat of Deflation

* January-April.

SOURCE: *Business Source Premier*.

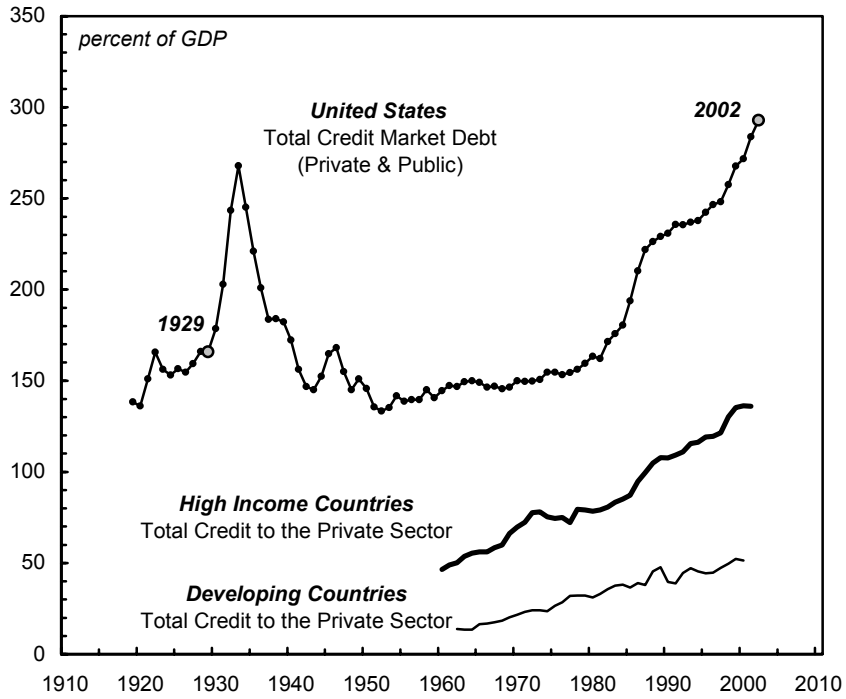

FIGURE 9. The Debt Load

SOURCE: *Bank Credit Analyst Research Group*; *World Development Indicators*.

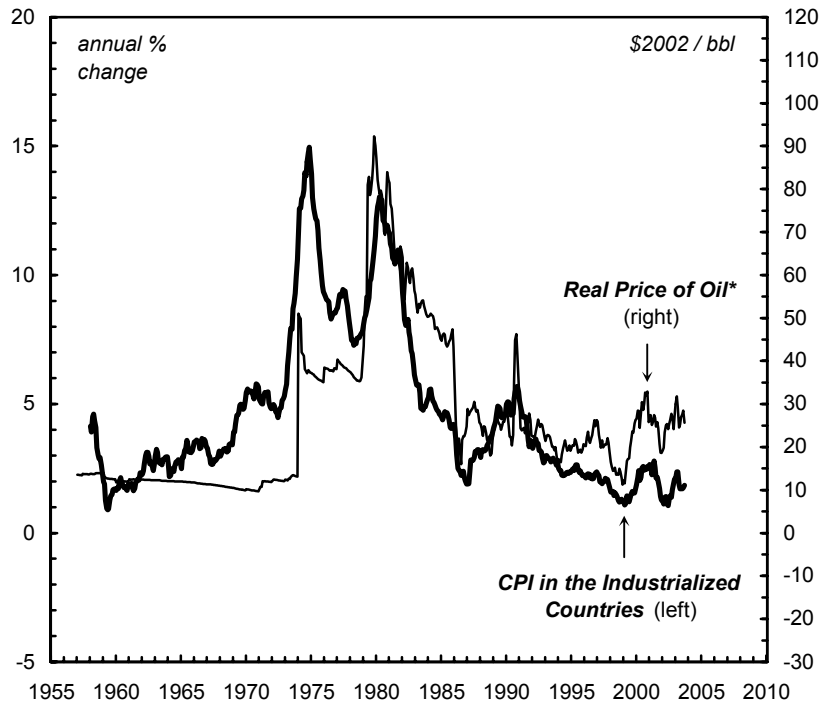

FIGURE 10. Inflation and the Price of Oil

* $ price of crude oil deflated by the U.S. CPI.

SOURCE: *International Financial Statistics* through *WEFA* (series codes: L64@C110 for CPI in the industrialized countries; L76AA&Z@C001 for the price of crude oil; L64@C111 for the U.S. CPI).

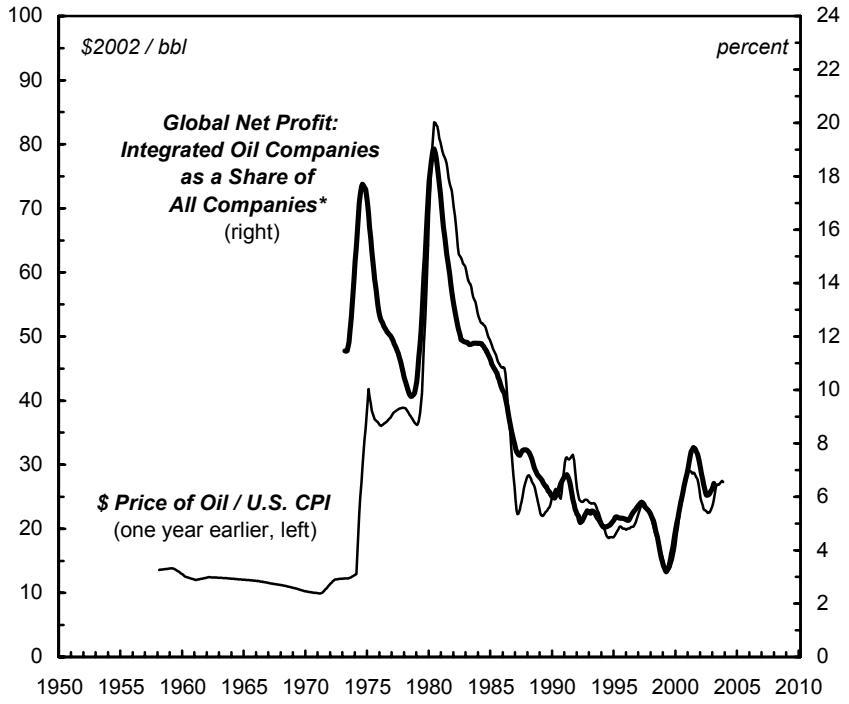

FIGURE 11. The Price of Oil and the Global Distribution of Profit

NOTE: Net profit is computed by dividing market value by the price/earning ratio. Data are restated to reflect changes in the series constituent companies. Series are smoothed as 12-month moving averages.

SOURCE: *Datastream* (series codes: OILNWD for the integrated oil companies; TOTMKWD for world total); *WEFA* (series codes L76AA&Z@C001 for the price of crude oil; L64@C111 for the U.S. CPI).

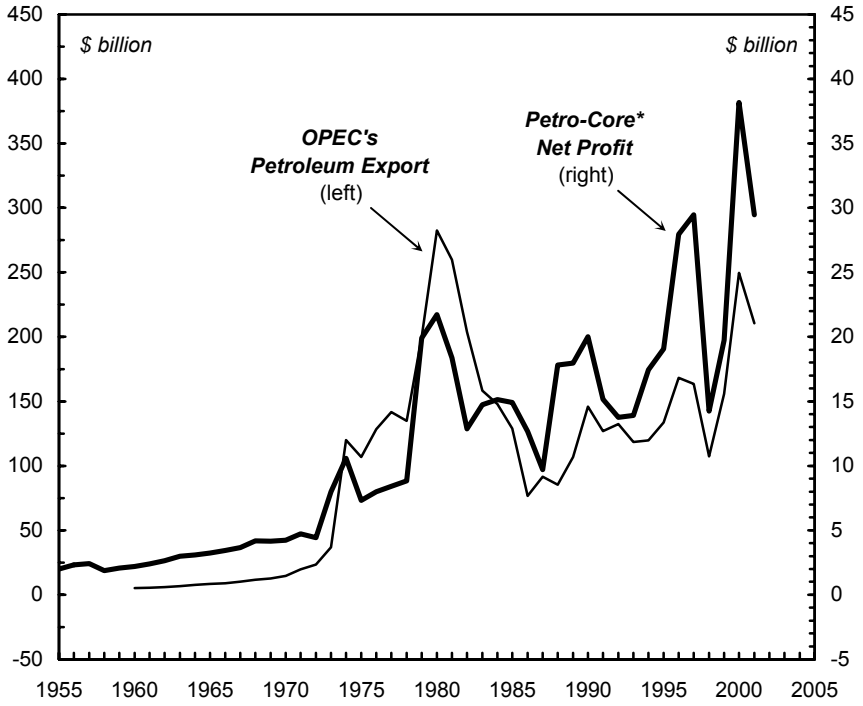

FIGURE 12. OPEC and the Oil Companies

* British Petroleum (BP-Amoco since 1998), Chevron (till 2000), Exxon (ExxonMobil since 1999), Mobil (till 1998), Royal-Dutch/Shell and Texaco (till 2000). Company changes are due to merger.

SOURCE: *OPEC Annual Statistical Bulletin*; *Fortune.*

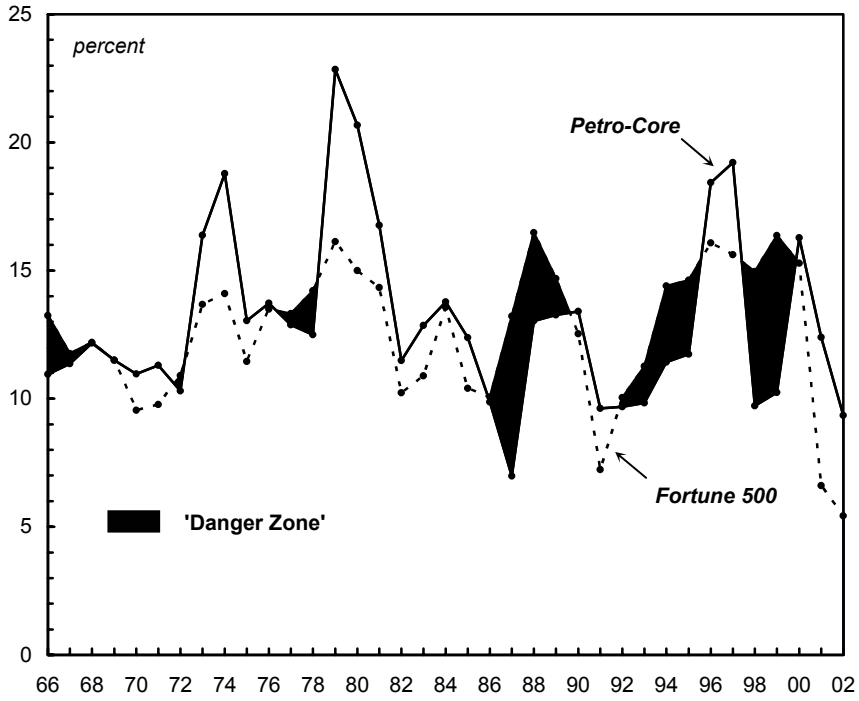

FIGURE 13. Return on Equity: The Petro-Core* versus the Fortune 500

* British Petroleum (BP-Amoco since 1998), Chevron (till 2000), Exxon (ExxonMobil since 1999), Mobil (till 1998), Royal-Dutch/Shell and Texaco (till 2000). Company changes are due to merger.

NOTE: Until 1993, the Fortune 500 list included only industrial corporations (firms deriving at least half their sales revenues from manufacturing or mining). From 1994 onward, the list includes all corporations. For 1992-3, data for Fortune 500 companies are reported without SFAS 106 special charges.

SOURCE: *Fortune*: Standard & Poor's *Compustat*.

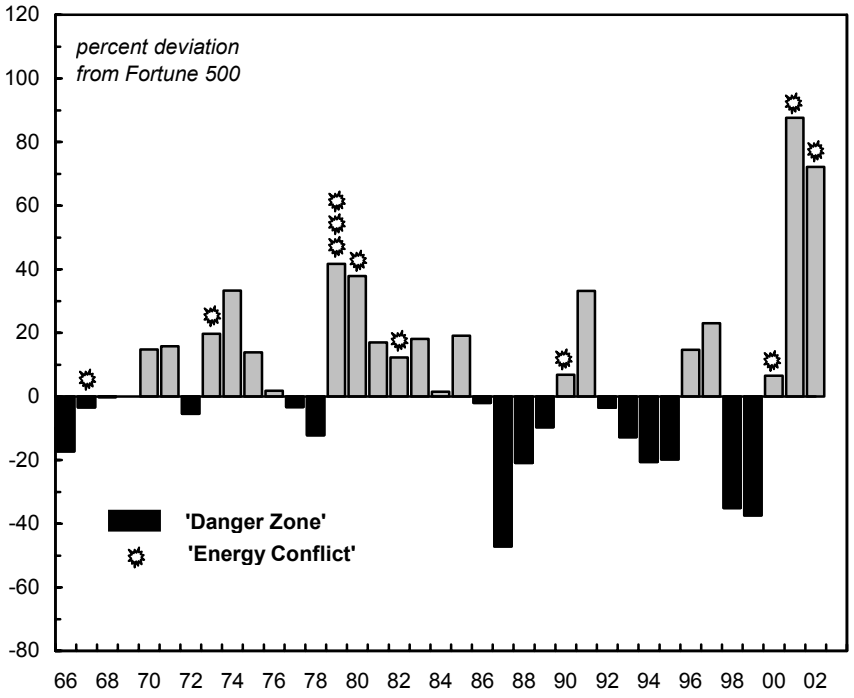

FIGURE 14. The Petro-Core's Differential Accumulation and Middle East 'Energy Conficts'

* British Petroleum (BP-Amoco since 1998), Chevron (till 2000), Exxon (ExxonMobil since 1999), Mobil (till 1998), Royal-Dutch/Shell and Texaco (till 2000). Company changes are due to merger.

NOTE: Until 1993, the Fortune 500 list included only industrial corporations (firms deriving at least half their sales revenues from manufacturing or mining). From 1994 onward, the list includes all corporations. For 1992-3, data for Fortune 500 companies are reported without SFAS 106 special charges.

SOURCE: *Fortune*: Standard & Poor's *Compustat*.

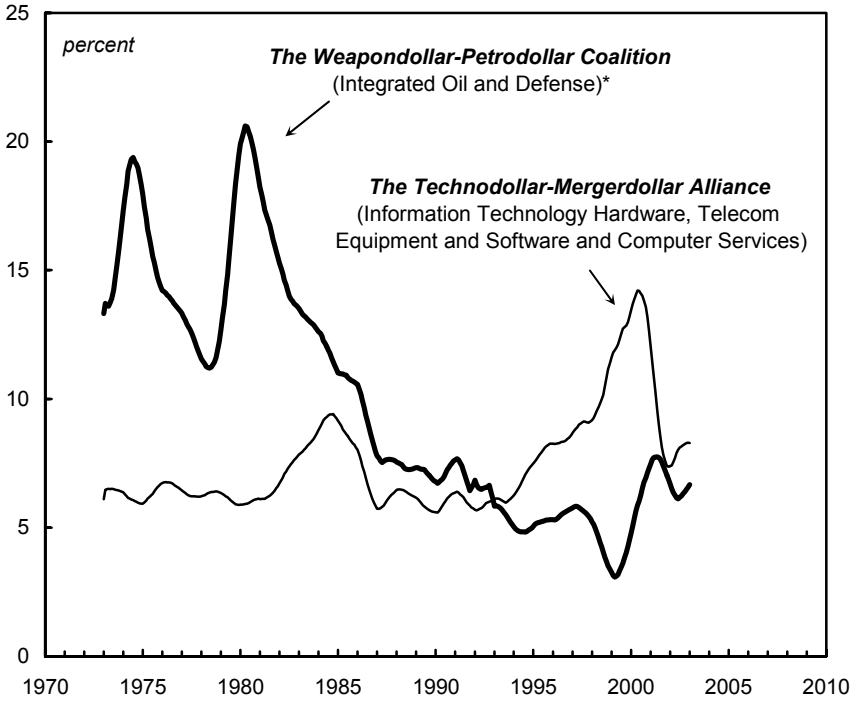

FIGURE 15. Shares of Global Net Corporate Profit

NOTE: Net profit is computed by dividing market value by the price/earning ratio. Series denote monthly data smoothed as 12-month moving averages.

SOURCE: *Datastream* (series codes TOTMKWD for world total; OILINWD for integrated oil; DEFENWD for defense; INFOHWD for information technology hardware; TELEQWD for telecom equipment; SFTCSWD for software and computer services).

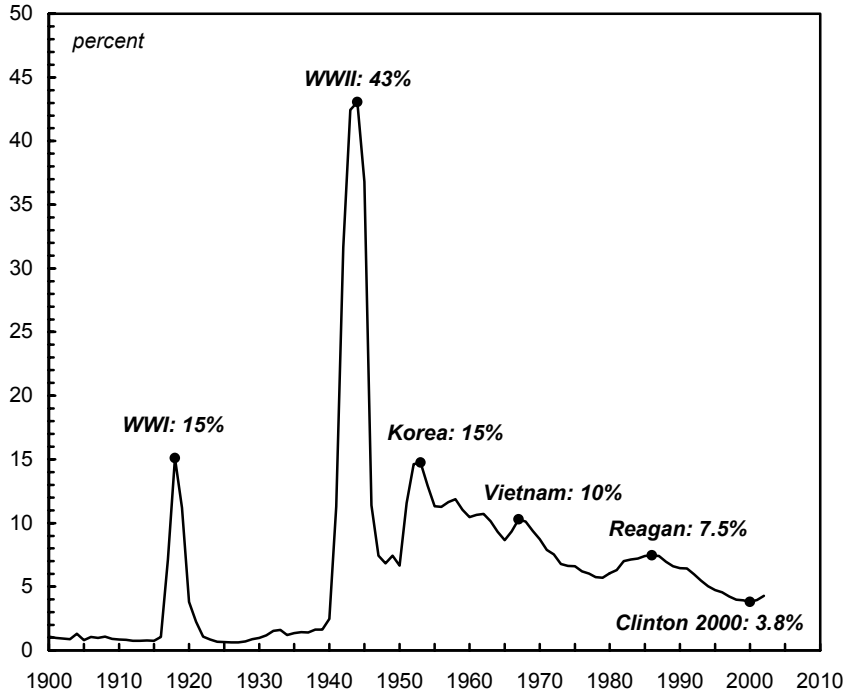

FIGURE 16. U.S. Military Spending as a Share of GDP

SOURCE: Nils Petter Gleditsch, *The Peace Dividend* (Amsterdam and New York: Elsevier, 1996); U.S. Department of Commerce through *WEFA* (series codes: GDP for GDP; GFML for military spending).

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