

# Economics from the Top Down

new ideas in economics and the social sciences

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## Unemployment and the Maturity of Capitalism

**Blair Fix**

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In my last post, I discussed the underwhelming relation between [interest rates and unemployment](#). In this post, I'll look at a better way to connect unemployment to interest income.

It turns out that if you take US net interest and divide it by corporate profit, you get a ratio that closely tracks unemployment. It's a measure that Jonathan Nitzan and Shimshon Bichler call the '[maturity of capitalism](#)'.

If this language sounds odd, that's because Nitzan and Bichler see capitalism differently than your average economists. So before we get to the data, let's review some of their thinking.

### Equity vs. debt

To understand Nitzan and Bichler's ideas, we need to start with investment. When you invest your money, what exactly are you buying?

At first glance, it seems like investment confers ownership of things. So when I invest in a house, I own that house. But this begs the question — what does it mean to 'own' something?

To many people, ownership simply means 'possession'. For example, when I own a car, that means I get to 'possess' it by driving it. But as political economist Jesús Suaste Cherizola notes, [possession is not the same as ownership](#). A thief can possess your car, but not own it. And a rental agency can own a car while the renter possesses it.

So if ownership is not possession, what is it? Nitzan and Bichler argue that ownership is a negative social relation: it is the *institutional right to exclude*.

For example, by owning a car, the rental agency has the right to exclude me from using it. Similarly, I have the right to exclude a thief from using my car — a right that, if need be, is enforced by the police. In short, ownership is a set of exclusionary rights conferred to the owner.

That said, different forms of property come with different sets of rights. In capitalism, the two most important forms of property rights are *equity* and *debt*. Here's how the two investments differ.

When you purchase equity in a firm, you are purchasing legal command. In other words, if you buy a controlling share in a firm, you gain the right to hire/fire employees at your whim. And you have the right to distribute any profits that the firm might receive.

Notice the word 'might'. The thing about equity is that there is no guarantee of income. If a firm fails to earn a profit, equity owners receive no dividends. And if a firm goes bankrupt, equity owners lose everything.

Not so with debt. When you buy debt, you're not purchasing ownership of any specific firm. Instead, you're buying ownership of a legally guaranteed stream of income. So when you purchase a corporate bond, the firm in question is obligated to send you interest payments each year.

Does that obligation mean you'll absolutely get your money? No. There's always the risk that the firm will go bankrupt. But this risk is mediated by bankruptcy law, which is essentially a way of codifying how assets get paid out to various creditors in the event of business failure.

Viewed this way, the distinction between equity and debt is largely about different sets of rights. When you buy equity, you get the right to actively command a firm, and the potential for a fat return. When you buy debt, you get passive ownership that pays a legally obligated return.

## **Unemployment as a strategy**

So far, we haven't talked about unemployment. Let's do that now.

To mainstream economists, unemployment is a malfunction — a failure of the free market. The debate is then over how frequently (and how severely) the failure occurs.

Jean-Baptiste Say famously argued that free-market failure would be rare. The idea (dubbed [Say's law](#)) was that production should create its own demand, ensuring that free markets tend towards full employment. Unfortunately, the idea turned out to be less of a 'law', and more like wishful thinking. So when the Great Depression struck, economists, looked for better ideas.

Enter John Maynard Keynes. Unlike Say, Keynes realized that free markets gave no guarantee of full employment. Since busts were always on the horizon, Keynes argued that governments needed to stabilize the economy. What Keynes did *not* say, however, is that unemployment is a purposeful business strategy.

Such an idea sounds odd, until you consider that the power to create unemployment is baked into property rights. Keynes didn't have much to say on this topic. But Thorstein Veblen did. For Veblen, capitalists' right to 'sabotage' production was the basis for their returns:

[W]ithout the right to keep the work out of the hands of the workmen and the product out of the market, investment and business enterprise would cease. This is the larger meaning of the Security of Property.

([Veblen, 1923](#))

Clearly, Veblen wasn't trying to make friends with elites. Nor are Nitzan and Bichler, who have extended Veblen's thinking into the 21st century.

So when Nitzan and Bichler look at capitalist income, they see the strategic sabotage of 'industry' by 'business'. And one way of measuring this sabotage, they argue, is by looking at unemployment. The more unemployment, the more business sabotage.

## The maturity of capitalism

With sabotage in mind, let's return to the difference between equity and debt. For Nitzan and Bichler, these two investment strategies represent different tactics for inflicting sabotage.

When you buy *equity*, you are investing in what Nitzan and Bichler call 'differential' sabotage. The idea is that the firm you (partially) own, will wield its property rights to your advantage, letting you beat the average

rate of return. In contrast, when you buy *debt*, you're not purchasing any specific firm. Instead, you're buying access to the average rate of return — the 'average sabotage'.

Based on this thinking Nitzan and Bichler [argue](#) that the ratio between interest (debt income) and profit (equity income) is an important indicator of capitalist behavior. As capitalism becomes more 'mature', investment strategies shift: "perceptions of risk decline, trust rises and debt becomes an increasingly acceptable form of accumulation." And because capitalist income is ultimately about sabotage, Nitzan and Bichler conclude that the shift between interest and profit ought to relate to unemployment.

Now, by Nitzan and Bichler's own admission, these ideas are fairly loose. And for what it's worth, I'm not sure that the word 'maturity' is the best descriptor for the growth of interest relative to profit. ('Maturity' implies a forward direction, whereas Nitzan and Bichler point out that the interest-to-profit ratio has no preset path.)

Linguistic qualms aside, what's important is the evidence that Nitzan and Bichler marshal. Let's look at it now. [Figure 1](#) shows the undeniable connection between US unemployment and the interest-to-profit ratio. Compared to the [paltry correlation](#) between unemployment and interest rates, this pattern is quite impressive.

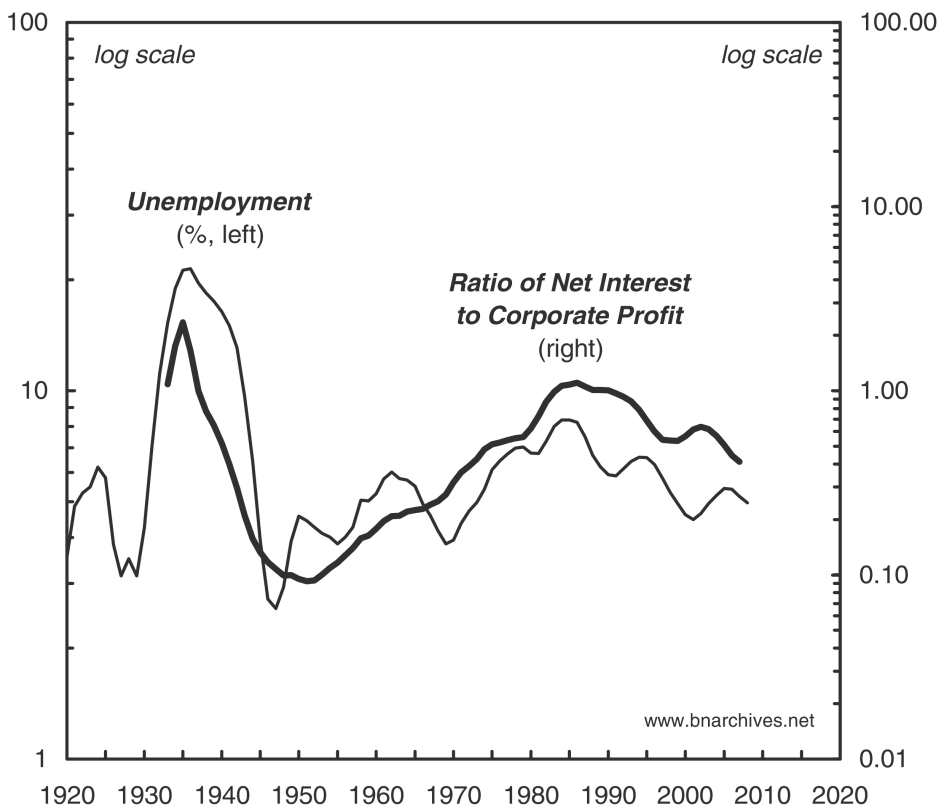
## The income hierarchy

Looking ahead, I'm going to update Nitzan and Bichler's evidence, and see if I can expand it to other countries. But first, I'll add my own take on why the balance between interest and profit relates to unemployment.

In my mind, the key difference between profit and interest is that interest payments are *non-negotiable*. In other words, companies can run at a loss (if they choose, or if they must). But companies cannot avoid paying interest. To do so is to risk having their assets seized.

Now this observation is banal, in the sense that everyone with business experience knows it is true. But it's curious in the sense that few people ask *why* it is true. Why can a business run at a loss, but not shirk its interest payments?

The answer is that these are the rules of capitalism. When you play the game, you agree to a hierarchy of income, enforced by the government.



**Figure 1: The interest-to-profit ratio and unemployment in the United States**

This is Nitzan and Bichler's chart, taken from [Chapter 12](#) of *Capital as Power*. The thick curve shows the US interest-to-profit ratio. The thin curve shows the US unemployment rate. Both series are expressed as 5-year moving averages.

Let's look at this hierarchy, starting with profit. Despite being the most celebrated form of income (in capitalism), profit comes with few legal guarantees. Yes, the law bends over backwards to protect corporate property rights. But it doesn't protect corporate profit itself. In other words, if a company runs at a loss, equity investors are largely out of luck.

Moving up the income hierarchy, we come to employment income. It's secure in the sense that once hired, employees have many legal rights, including the right to be paid. So if a firm cuts costs by not paying its employees, it risks legal trouble. But the flip side is that firms have virtually no responsibility to actually employ workers. So if a rich capitalist buys a social media company, he has the right to fire half its workers.

Continuing up the income hierarchy, we get to taxes. Now taxes are often heralded as the most reliable income. (Think ‘death and taxes’.) But in a modern setting, that’s not really true. Sure, kings of old may have forced their subjects to pay tribute, even if it meant starvation. But that’s not how modern taxes work. If a corporation earns no profit, it pays no (corporate) tax. And so with sufficient accounting prowess, taxes can be avoided.

Not so with interest. Despite often being treated as the least sexy form of income, interest is the most legally secure. That’s because interest bearing debt comes with a nuclear option: *asset seizure*. If creditors are not paid their due, they have the legal right to deconstruct a firm’s property rights and divide the assets amongst themselves. Think of it as the capitalist death penalty.

Unsurprisingly, firms bend over backwards to pay interest. If it means running at a loss, so be it. If it requires a wave of pink slips, no problem. Profit and payroll are both optional expenses. Interest payments are not.

So in an important sense, interest is the modern equivalent of kingly tribute. It is a non-optional expense backed by the full weight of the state. In short, interest is the most sacred form of sabotage. So when interest payments rise and profits decrease, bad things happen.

## The interest share of capitalist income

That’s my take, anyway. Now let’s get back to the data. I’m going to update Nitzan and Bichler’s interest-to-profit ratio, but with a slight twist. Instead of comparing interest to profit, I’m going to measure the interest share of capitalist income:

$$\begin{aligned} \text{interest share of capitalist income} &= \frac{\text{net interest}}{\text{capitalist income}} \\ &= \frac{\text{net interest}}{\text{net interest} + \text{profit}} \end{aligned}$$

The advantage of this measure is that it doesn't turn negative when profit goes into the red. Instead, as profits are reduced to losses, the interest share of capitalist income continues to grow, exceeding 100%.<sup>1</sup>

When we compare the interest share of US capitalist income to unemployment, we get a pretty tight relation. Figure 2 shows my revision of Nitzan and Bichler's evidence.

Looking at Figure 2, the most striking feature is the pattern during the Great Depression. In 1933, unemployment hit a high of 23%, and the interest share of capitalist income peaked at 140%. (Yes, it was more than 100%, because profit was negative.)

The message here is that when interest approaches 100% of capitalist income, business sabotage becomes extreme.

## Adding more countries

Whenever we find a striking pattern, we want to know if it's a one-off result or a general trend. The way to tell the difference is to broaden the evidence.

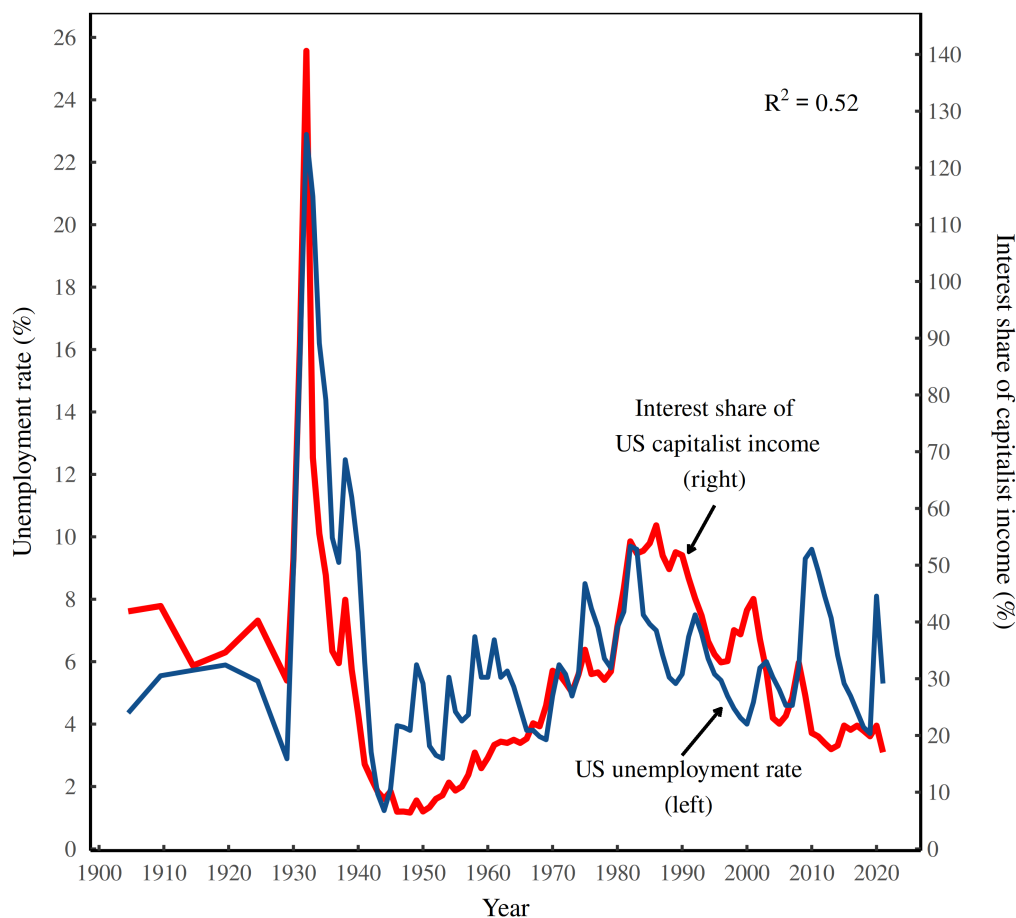
To that end, Figure 3 brings more countries into the fold, comparing the unemployment rate to the interest share of capitalist income. The black triangles show the US relation (the data plotted in Figure 2). The colored points show data from a handful of OECD countries, observed between 1999 and 2019. The caveat is that this extended sample is neither geographically expansive nor historically deep. But at least it's more data.

Looking at Figure 3, we see that adding data from more countries weakens the relation found in the US. That's disappointing, but not unexpected. In mathematical terms, the OECD data mostly adds noise to the left side of the scatter plot, weakening the statistical relation between unemployment and the interest share of capitalist income.

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<sup>1</sup>By 'negative profit', I mean that on average, all businesses run at a loss. That scenario sounds unlikely, but it has happened. In 1932 — during the depths of the Great Depression — US corporate profit was negative. (In Figure 1, Nitzan and Bichler avoid the problem of negative profit by using a 5-year moving average.)

Note that it's conceivable that capitalist income could itself turn negative, in which case the interest share of capitalist income would also have a negative number problem. But for that to happen, corporate losses would have to exceed net interest. Although there may be historical examples of such extreme losses, they don't occur in any of the data used here.



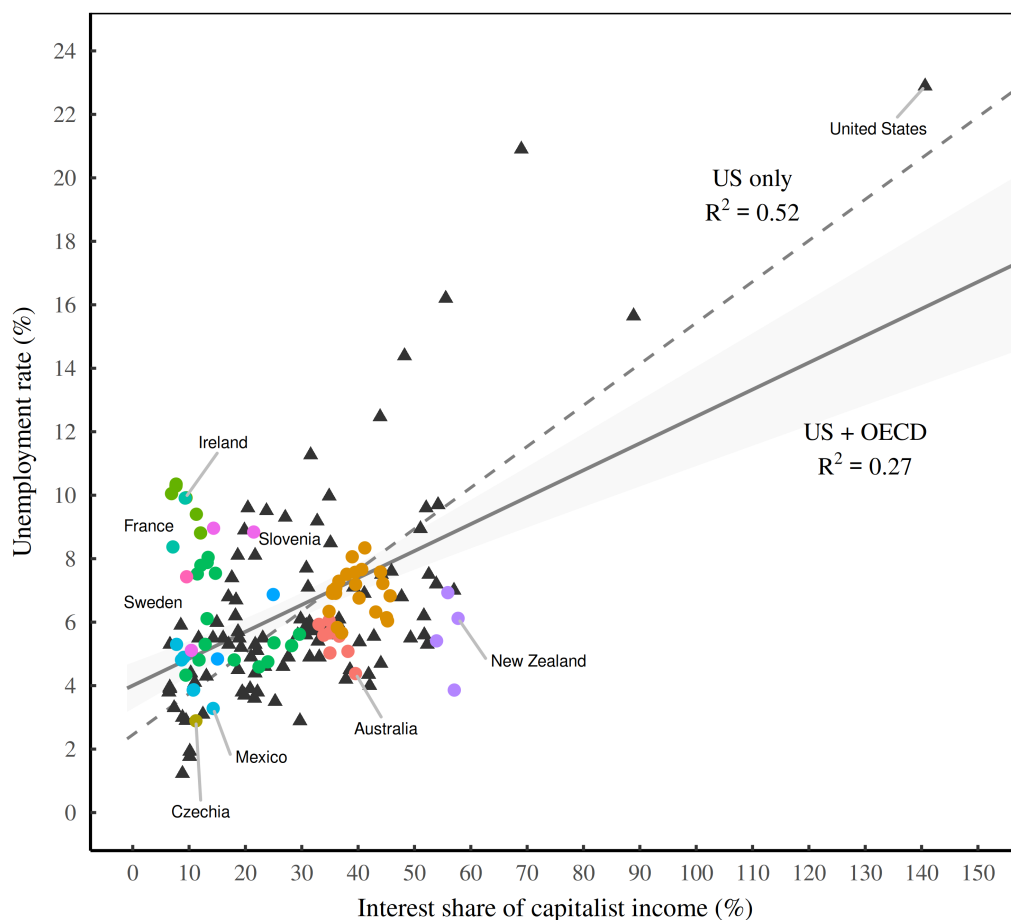
**Figure 2: Unemployment and the interest share of US capitalist income**

This figure updates Nitzan and Bichler's analysis of the 'maturity' of capitalism. Instead of measuring the interest-to-profit ratio, I measure net interest as share of capitalist income (red line). The blue line shows the US unemployment rate. [Sources and methods](#)

What we really want to know is what happens when the capitalist share of income approaches (or exceeds) 100%. The US data gives us one answer. But the OECD data is maddeningly mute.

This type of knowledge void is a frustrating part of doing science. In economics, things are made worse by the fact that most data is curated by mainstream economists, who care little about the class-based composition of income. And so such data is difficult to find. (And when it does exist, it seems to be historically terse, as in the case of the OECD data used here.)





**Figure 3: Unemployment vs. the interest share of capitalist income — the pattern across countries**

This figure shows the cross-country relation between the unemployment rate and the interest share of capitalist income. Black triangles show the US relation (using data plotted in Figure 2). Colored points show data from a handful of OECD countries covering the years 1999 to 2019. Adding this larger sample weakens the trend found in the US alone. [Sources and methods](#)

## Keep your eye on the balls

One of the hardest parts of doing science is to understand a theory while also considering that it might be wrong. In other words, you have to keep your eye on two balls at once.

On that front, math is a tool for both enlightenment and delusion. Formalizing a theory pins down the logic, making it easier to see if/when things go wrong. But wrapping your ideas in algebra can also be a way to ignore evidence. Mainstream economics is a case in point. It's full of impressive math elucidating theories that are empirically vacuous.

Nitzan and Bichler's work is quite different, which is perhaps why it is reviled by mainstream economists. Nitzan and Bichler are empirical exacting. But for the most part, they prefer to keep their (incendiary) theories qualitative. And at least for me, that makes the ball-watching easier.

I think it's fascinating that the interest-to-profit ratio might be intimately related to business sabotage, as measured by unemployment. And in the US, the evidence is certainly strong. But is this pattern a general feature of capitalism? That's an open question.

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## Sources and methods

### Figure 2

Data for the interest share of US capitalist income:

- 1929 to 2021: US Bureau of Economic Analysis, [Table 1.12](#), National Income by Type of Income. (I divide net interest by the sum of net interest and corporate profit, without inventory or capital cost adjustment.)
- 1900 to 1929: Table 1 in Gale Johnson's paper '[The Functional Distribution of Income in the United States, 1850-1952](#)'.
- Note that Johnson's data is reported as averages over roughly 5-year intervals. To make this data comparable to the unemployment data, I average the latter over the same time intervals.

Data for US unemployment:

- 1947 to 2022: Bureau of Labor Statistics, series [LNU04000000](#)
- 1890 to 1946: Historical Statistics of the United States, [Table Ba475](#)

### Figure 3

For US data, see sources for Figure 2. Non-US data is from the following sources:

- Interest share of capitalist income is from the OECD [experimental distribution statistics](#)
  - profit: series B2, ‘operating surplus, gross’
  - net interest: series D41R, ‘interest’
- Unemployment data is from the World Bank, series [SL.UEM.TOTL.ZS](#)

### Further reading

Nitzan, J., & Bichler, S. (2009). *Capital as power: A study of order and creorder*. New York: Routledge.

Suaste Cherizola, J. (2021). From commodities to assets: Capital as power and the ontology of finance. *Review of Capital as Power*, 2(1), 1–29.

Veblen, T. (1923). *Absentee ownership: Business enterprise in recent times: The case of America*. Transaction Pub.