The Gods Failed, the Priests Lied: A Clarification

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Following the publication of our Hebrew paper, 'The Gods Failed, the Priest Lied' (May 2007), we received the following request for clarification from a reader. The correspondence follows.

26 May, 2007

Thank you for this piece.

I have one substantive comment on your text. You dispense convincingly with the official doctrine that the price of a firm's shares is somehow related to the real value of its assets. However, you say little or nothing about the other common official doctrine: that the price of a firm's shares is the capitalized value of its expected profits.

It fact, it seems that you tend to conflate the two when you equate the real value of the assets with their 'productiveness.' As far as I can see, these are not at all the same. For example, if I wish to acquire a firm for asset-stripping purposes, then I value its assets according to their market price. On the other hand, the 'productive' value of the assets is related to their capacity to yield profits.

Have I got it wrong?

27 May, 2007

Thank you for the comment. Below we try to summarize briefly the logic of our argument. Hopefully that will help clarify our claims.

1. The liberal view is that capital has two faces. The 'real' face is made of productive assets whose quantity is proportionate to their future productivity – i.e., to the future utility they will generate, properly discounted to its present value. This claim is deeply problematic: since utility cannot be measured, there is no direct way to measure the quantity of 'real' assets. Economists 'solve' the problem by assuming that the 'price is right': they assume that the current replacement cost of an asset is proportionate to its 'quantity.' According to this reverse logic, a company whose replacement cost is $10 billion must be 10 times more productive – and therefore must possess 10 times more capital – than a company whose replacement cost is only $1 billion.

2. The 'nominal' face of capital consists of the price of shares and bonds. This price is given by the discounted value of the company's future profit & interest payments.

3. The nominal and real worlds are united through following assumption:

   utility of capital = profit & interest capital generates

   In a fully commodified world, with perfect rationality and no uncertainty, the discounted utility of the 'real' capital must be equal, by assumption, to the discounted profit & interest of the 'nominal' asset.

4. The imperfect reality, argue liberals, frustrates this equality in two ways. (i) Reality makes it difficult to account for intangible assets, hence the deviation of the temporal mean of Tobin's Q from the assumed value of 1. (ii) Uncertainty and irrationality introduce spurious considerations that cause the market price of the assets to deviate from the strict discounted value of future profit & interest, hence the wide swings of Tobin's Q around its mean value.

5. Our point in the article is that this conventional logic is impossible to sustain. As we demonstrate, the so-called 'real' and 'nominal' faces of capital do not simply deviate from one another; they move in *opposite* directions. This inverse movement is possible since, contrary to the conviction of economists, replacement cost has no inherent relationship to productivity (which cannot be measured in the first place), and since productivity – however measured – has no inherent relationship to profit (which depends on power).

6. This last point leads to our own view, which we do not develop in this article. (We outline this view in our Hebrew book *From War Profits to Peace Dividends* (2001), in 'New Imperialism or New Capitalism?' (2006) and in 'Elementary Particles of the Capitalist Mode of Power' (2006).) In our opinion, the distinction between nominal quantities and productive/utilitarian quantities is fundamentally false. As we see it, capitalism generates only one universal quantity: price. And this quantity represents not the quantities of production and utility, but the qualities of power. From this viewpoint, the hierarchy of capitals – their differential capitalizations – is the architecture of capitalist power. It denotes the ability of capitalists to direct and shape the course of social development.

This is the logic in a distilled form. We hope it helps elucidate our argument.

Shimshon and Jonathan

27 May, 2007

Thank you for this clarification. It is precisely this bit that was not made clear (at least not to me. . .) in your Hebrew article, namely that conventional economics equates the replacement cost of a firm with its 'productivity' i.e., its discounted expected profits. Of course, this is baseless.