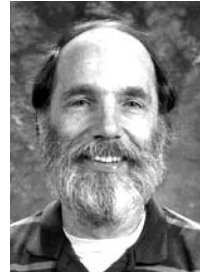


THE POWER OF ECONOMICS vs THE ECONOMICS OF POWER

INTRODUCTION

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Abstract: This article analyzes the systematic absence of power in economic analysis, beginning with early economist's almost universal denial of the process of primitive accumulation. Microeconomics also excludes considerations of power, except for what it considers to be abuse of power by government and labor unions. Monetary theory also avoids the application of Federal Reserve power to create unemployment in order to reduce wages. Businesses also employ power in competing with other businesses. Economists ignore such use of power, emphasizing the benign consequences of competition: lower prices, improved quality, and even entirely new products. Business wields power against workers, the power that might be limited by labor unions, which themselves are limited because of business' application of political power. Not only can business use monopolistic power in order to increase prices, as buyers, business can use monopsonistic power to reduce the prices it pays. Business can also apply power in order to hamper competitors. The final form of power is the power of economists to exclude power from their theory, except for the two exceptions mentioned.

Key words: power; ideology; economics

While attending a conference of mostly very conservative economists, I heard a sophisticated and in-depth analysis of the development of Ronald Coase's influential suggestion for environmental regulation through voluntary negotiation published as "The Problem of Social Cost." I found nothing in the paper with which to disagree—within the context of conventional economics. In Coase's setup, because voluntary arrangements can necessarily lead to efficient outcomes, regulatory power is an unnecessary intrusion that serves no purpose.

In reality, lacking power, I would be unlikely to get major corporations to sit down to negotiate with me, let alone satisfactorily compensate me or anyone else (save a few friendly politicians) for their destructive activities. Even taking such businesses to court is virtually impossible. In the unlikely case that I could be able to get a hearing at court, any legal help that I might afford is almost certain to be outgunned by the corporation's powerful legal team.

In short, within the context of economic theory, Coase's suggestion makes sense, but only because of the exclusion of any consideration of power. In a utopian society in which universal consent was required for permitting such investments, all affected parties could arrive at a mutually satisfactory solution.

Most of the other papers at the conference discussed how markets evolve naturally and work efficiently. Nowhere was there any consideration of power. The participants clearly understood the discipline of economics, but perhaps that was also their problem. Their training conditioned them to instinctually avoid any consideration of power, other than those presumptive abuses of government that interfere with the functioning of markets. In conventional economics, power is reduced to a metaphor. We have the power of the market or the power of competition, but corporate power is nowhere to be found.

A few days later at another conference, I heard another interesting paper about the problems created by the so-called experts working for the government in the area of financial regulation.

The idea of the paper was that regulators relied upon experts, whose expertise may be either limited or contaminated by what Schumpeter called a pre-analytic vision—what less academically inclined people might call bias. The inefficiencies resulting from flawed expertise reflect the misapplication of ill-advised government power, which could only gum up the works of an otherwise efficient economy.

This paper posed an interesting challenge. Obviously, expertise can be abused—even economists' expertise. Given that expertise is a very important factor in shaping many aspects of the economy as well as society as a whole, some kind of expertise on the subject of expertise might be useful, except no one could be sure that those experts would be any more objective or informed than the existing universe of experts.

I want to consider how a different treatment of power might affect these two papers. Begin with the example of the so-called Coase theorem. Suppose a large corporation locates a toxic waste dump, which threatens my property values or even my health. The profits from this venture might well be sufficient for the company to offer me enough sufficient compensation to agree to the establishment of the toxic waste dump. If so, both the company's management and I could be made better off by the creation of the toxic waste dump, ignoring, of course, the effects on others.

Why in the world would the corporation bother to sit down and negotiate with me? Many economists believe that corporations have the legal and moral obligation to maximize profits. I could threaten to sue, but the corporation could easily find experts who could undermine my claim to have been harmed. Lacking standing, I would be unlikely to have my case heard before a jury. Even if legal proceedings are a possibility, I am unlikely to be able to mount a legal team capable of matching the power of the high-priced attorneys representing the corporation. Previously, individuals like me could sometimes band together in the form of a class action suit, but recent court decisions make that option virtually impossible. The best an individual like me can hope for is probably a relatively inexpensive settlement conditioned on secrecy in order that others will not follow my example. However, that outcome is exceedingly unlikely.

Moreover, the judiciary has become increasingly pro-business, minimizing the chance of legal redress even more. For example, Lee Epstein, William M. Landes, and Richard A. Posner ranked the 36 justices who served on the Supreme Court between 1946 and 2011 according to their proportion of their pro-business votes; all five of the current court's more conservative members were among the top 10. But the study's most striking finding was that the two justices most likely to vote in favor of business interests since 1946 are the most recent conservative additions to the court, Chief Justice Roberts and Justice Samuel A. Alito Jr (Epstein, Landes, and Posner 2013).

The charge about the harmful effects of incompetent or biased expertise made sense. I confess that I took special pleasure in listening to that paper because I imagined changing a few nouns to write a paper about the way that abusive expertise is a powerful weapon in the arsenal of regulatory capture.

For example, in the current controversy of the Keystone XL Pipeline, the State Department, which has authority over the project because of its transnational character, recently published a report, which found no fault with the project. This conclusion should not have been a surprise to anybody because the report came from companies which had a commercial interest in a more intensive reliance on energy derived from tar sands.

Obviously, I could be wrong about my suspicions about this report. I have not read it. Even if I had, I am not sure that I have the expertise to make a definitive judgment about it. However, government regulators frequently do heavily rely on the expertise of those whom they regulate.

Both papers serve as a reminder that conventional economics tends to overlook the role of power, in large part because it emphasizes voluntary transactions. The exception to this rule is a willingness to single out destructive interference of government powers.

Like you, I would appreciate a world in which publicly spirited business would try to find mutually beneficial outcomes for all concerned parties. I would also agree that the abusive use of expertise is inexcusable. Finally, all of us have examples of heavy-handed regulation. Like me, you also are probably able to identify areas of insufficient regulation. However, power has a pervasive influence on the world we inhabit.

To say that economics has completely ignored power would be a gross exaggeration. Economists are often quick to criticize union power or government power. Besides, the institutionalists addressed the subject of power. More recently, John Kenneth Galbraith, himself a neoinstitutionalist of sorts, titled his 1973 presidential address to the American Economic Association, "Power and the Useful Economist" (Galbraith 1973). Of course, Adam Smith, primarily responsible for starting economic theory on its transactional path, also offered trenchant critiques of business proclivity to engage in "conspiracy against the public," including the way business wielded power to both extract monopolistic rents and to dominate workers. Since then, economists have been hesitant to take issue with business power.

Forgive me, but in the examples that follow I am going to bend the stick even further in discussing power, although I am neither unaware nor uncritical of equally abusive government power.

Primitive Accumulation

Classical political economists' cavalier attitude regarding what Marx called primitive accumulation offers an excellent example of the avoidance of the subject of the abusive exercise of raw power (see Perelman 2000). Over and above outright dispossession, the state allowed the aristocracy to enforce the Game Laws. These remnants of feudalism granted exclusive property rights in wildlife to the King, but the law had long fallen into disuse, at least until the early 17th century when modern capitalism was taking hold in England.

A commoner's punishment for killing animals was harsh, to say the least, even when the purpose was to prevent the creatures from destroying a farmer's crop. Infractions of the law met with penalties, which ranged from execution, to incarceration, which was more common, or transportation to Australia, which was even more common.

Besides the significant crop losses that the protected game caused, hunters were free to ride roughshod through farmers' fields, creating even greater destruction. One might have expected the political economists at the time to have taken notice of the Game Laws' violation of traditional rights, not to mention the economic costs associated with neofeudal fox hunts.

Although economists were silent both about such abuses and the resulting economic losses, the Corn Laws, which levied a tariff on imported grain, were a matter of grave concern for some early political economists, even though these tariffs had a much smaller effect on economic efficiency than the Game Laws. The difference was that the Corn Laws interfered with the efficient exploitation of labor by raising the cost of a subsistence wage. Ironically, the Game Laws probably did much more to raise the cost of food than tariffs on imported grain.

What could cause the different treatment of the Corn Laws and the Game Laws? The Game Laws were an important tool of primitive accumulation, preventing self-provisioning, thereby forcing people to enter the labor market in order to subsist. This pressure increased the supply of labor and lowered wages. In contrast, the Corn Laws put upward pressure on wages by increasing the cost of food. Seen in the context of coercive power, however, both the abolition of the Corn Laws and the renewed enforcement of the Game Laws served to strengthen capital's position.

Political economists of the time were too much concerned with demonstrating the justice of markets to address such obvious exercises of power. However, in their more private writings, diaries, and letters, they applauded the use of power to push workers off the land and into wage labor. Contemporary economists generally follow this tradition in presenting the evolution of markets as a purely voluntary phenomenon, beneficial to all.

In order to emphasize the voluntary nature of markets, economists have generally gone out of their way to create a theory that excludes all considerations of work, workers, and working conditions (Perelman 2011). The main benefit of this exclusion is that it conveniently eliminates all considerations of power from the discipline of economics. In this sense, the participants at the conference I described were blameless. They did exactly what “good” economists are supposed to do. The problem is that “good” economists do not make good economics, except to the extent that their work provides useful ideological cover.

That cover, however, is incapable of covering up all of the intractable problems of capitalism. Once the damage becomes obvious, power may briefly enter into the picture. After the crisis subsides, power quickly returns to its previous state of invisibility. What is most remarkable is that a clear consideration of mainstream economic theory should be enough to alert economists to the inherent contradictions in this view of the capitalist economy. Such a perspective might, at least, be capable of moderating some of the more destructive results of untrammelled capitalism.

Power and Microeconomics

Power enters into microeconomic theory. According to the standard assumptions of conventional microeconomics, prices tend to move toward marginal costs (or even marginal revenue if you allow a teensy bit of market power to creep into

the picture). In a small village economy based on handicrafts, this arrangement might work satisfactorily, but what happens when marginal cost pricing operates in a modern economy in which fixed costs are very high and marginal costs are insignificant? With a little thought, one can easily see that corporations could not cover their fixed costs. Bankruptcy would become common because marginal-cost pricing cannot cover costs.

By the 19th century, the introduction of modern technologies with low marginal costs led to widespread bankruptcies, especially in the capital-intensive railroad industry. Other industries with low marginal costs also suffered a similar fate, leading to the Great Depression, which began in 1873 (see Perelman 2006).

Most economists, indoctrinated with a theory of market efficiency, had little to say about this problem. However, at that time, many of the most promising economists went to study in Germany, which was the only source of graduate education at the time. These German-trained economists, who returned to the USA, had no problem identifying the nature of these bankruptcies, in part because they were steeped in a tradition similar to that which Karl Marx experienced. Given this training, these economists were discouraged by irrelevance of much of the merchant-oriented simplicity of conventional economics. To promote their more holistic Germanic orientation, they formed the American Economic Association.

Given their more realistic understanding of economics, these economists recognized the need for some kind of countervailing power to blunt the destructive power of competition. They advocated trusts, cartels, and monopolies as a way to give corporations enough power to prevent the market from self-destructing. Nonetheless, perhaps motivated by careerism, the leaders of this new organization then turned around and wrote textbooks praising the wonders of perfect competition. John Bates Clark was the most egregious example of this duplicitous form of economics.

In effect, these economists carried on two separate and disconnected dialogues. One was with the rich and the powerful, telling them how it was in their interest to blunt the power of market forces. The other was intended to communicate with the working classes and their sympathizers. Work, workers, and working conditions were no part of their concern. According to their “scientific” theory of economics, wages were a mutually beneficial transaction and workers’ meager earnings were their just rewards. While the power of competition should be allowed to collapse the level of wages, the state should take measures to increase profits by weakening the power of competition in product markets.

Power and Monetary Theory

Power was once briefly considered as a factor in monetary policy in studies coming out of Latin America. The Latin American experience suggested that

inflation reflected the response of the state to a stalemate in which it was incapable of satisfying the demands of both powerful business interests and militant labor organizations. To appease both powerful interest blocks, the state adopted policies that created significant inflation.

In conventional economics, however, monetary policy is just a technical matter, unrelated to power. The goal of monetary policy is simply to ensure price stability, which can allow the economy to follow an equilibrium path. What has been fairly obvious since the recent market crash is the class-oriented distortion of the prevailing concept of price stability.

The outlandish fees that banks and credit card companies charge do not even merit a comment. Increasing prices of financial assets appear as a sign of economic health; however, capitalization of financial assets may more properly be taken as an indicator of economic power. In contrast, wages must, by all means, be kept in check. The disconnect between the need to hold down wages and the lack of concern about other kinds of prices suggests that concern about price stability is nothing more than a cover for class warfare. In the second chapter of *The Invisible Handcuffs* (Perelman 2011), I included a remarkably vivid discussion of monetary policy as a form of class warfare. The principles in this exchange were absolutely clear about monetary policy as a crass exercise in power. In fact, they pushed the rhetoric far enough to make the role of power in monetary policy self-evident.

In 1979, shortly after taking the reins at the Federal Reserve, Paul Volcker voiced his determination to hold inflation in check. At first, many powerful people doubted whether Volcker would be willing to follow through with his plans, which were sure to create enormous casualties. A front-page story in the *Wall Street Journal*, entitled, “Monetary Medicine: Fed’s ‘Cure’ is Likely to Hurt in Short Run by Depressing Economy, Analysts Say” expressed this sentiment. The paper noted,

Among those who are skeptical that the Fed will really stick to an aggregate target is Alan Greenspan, . . . who questions whether, if unemployment begins to climb significantly, monetary authorities will have the fortitude to “stick to the new policy.”
(*The Wall Street Journal* 1979)

Around this time—possibly in response to the article—Volcker invited the editor of the *Wall Street Journal* editorial page, along with his deputy, and the features editor, to a lunch at the New York branch bank of the Federal Reserve. Volcker asked his guests, “When there’s blood all over the floor, will you guys still support me?” The deputy editor responded affirmatively, later proudly recollecting, “There was blood indeed, as overextended Latin borrowers and American farmers were caught out by a return to a sound dollar. But we held fast” (Melloan 2003).

Volcker's militaristic analogy (expressed privately to the staff of the *Wall Street Journal*) let the cat out of the bag. The effort to tame inflation was, in reality, little more than an exercise in class war. In fact, Volcker himself had intended to spill blood. Volcker also visually expressed his intentions:

[Volcker] carried in his pocket a little card on which he kept track of the latest wage settlements by major labor unions. From time to time, he called various people around the country and took soundings on the status of current contract negotiations. What is the UAW asking for? What does organized labor think? Volcker wanted wages to fall, the faster the better. In crude terms, the Fed was determined to break labor. (Greider 1987, 429)

Volcker tightened the money supply so extremely that the USA experienced what was then the worst economic downturn since the Great Depression. Volcker only let up when the collateral damage became too great. Mexico, which owed a great deal of money to US banks, seemed to be on the brink of bankruptcy, threatening the US banking system. Citibank was effectively bankrupt.

Later, Michael Mussa, Director of the Department of Research at the International Monetary Fund, looked back fondly at Volcker's accomplishment. Mussa continued the military analogy, praising Volcker's victory in vanquishing "the demon of inflation" (Mussa 1994, 81):

The Federal Reserve had to show that when faced with the painful choice between maintaining a tight monetary policy to fight inflation and easing monetary policy to combat recession, it would choose to fight inflation. In other words to establish its credibility, the Federal Reserve had to demonstrate its willingness to spill blood, lots of blood, other people's blood. (Mussa 1994, 112)

What would have been the response if unions had gloated about using their power to spill capitalists' blood in the streets? Even if unions merely suggested the imposition of serious hardships on the capitalists, an angry response would have been followed by strong anti-labor measures. Instead, monetary policy continues to appear as a bloodless technological policy to ensure the smooth operation of voluntary markets. Power has no place in such matters.

Interestingly, the intended enemy of this war—the workers—went unmentioned in this recollection, as did the collateral damage to farmers and the Latin Americans. But what had workers done to make the state treat them as enemies? Were these people culpable of some evil act for daring to expect more than a pittance?

By the end of the 20th century, the Chairman of the Federal Reserve, Alan Greenspan, was confident that the war was already won. The Fed need not take

any aggressive actions. Greenspan believed that the psychological state of the workers, what he referred to as the “traumatized worker,” meant that the threat of increasing wages had been annihilated. Instead, the monetary authorities could rely on what George Orwell called “the haunting terror of unemployment” (Orwell [1943] 1968, 265).

As the journalist Robert Woodward reported, Greenspan saw the traumatized worker as

someone who felt job insecurity in the changing economy and so was resigned to accepting smaller wage increases. He had talked with business leaders who said their workers were not agitating and were fearful that their skills might not be marketable if they were forced to change jobs. (Woodward 2000, 163)

With wages held in check while the economy boomed, inequality soared during the late 1990s. In 1997, responding to a question from Representative Patrick Kennedy, Greenspan, who made a science of public evasiveness, blamed the resulting growth in inequality on technology and education, excusing his own contribution:

It is a development which I feel uncomfortable with. There is nothing monetary policy can do to address that, and it is outside the scope, so far as I am concerned, of the issues with which we deal. (Greenspan 1997b)

I do not believe that Greenspan ever used the expression, “traumatized worker” in his public pronouncements. He always chose his words carefully, and he perfected a language that was legendary for its obscurity. Still, his less inflammatory words conveyed the same message. For example, he testified before Congress,

The rate of pay increase still was markedly less than historical relationships with labor market conditions would have predicted. Atypical restraint on compensation increases has been evident for a few years now and appears to be mainly the consequence of greater worker insecurity. (Greenspan 1997a, 254)

Greenspan was correct in his assessment of the situation facing workers. He had numbers to back him up, reporting

As recently as 1981, in the depths of a recession, International Survey Research found twelve percent of workers fearful of losing their jobs. In today’s tightest labor market in two generations, the same organization has recently found thirty seven percent concerned about job loss. (Greenspan 1999)

Greenspan was not the only official at the Federal Reserve who appreciated the benefit of low unemployment without wage increases. One of the governors of the Federal Reserve, Edward W. Kelley Jr, spoke up at a meeting of the Open Market Committee about “the good results that we are getting now.” He went on to say

I don't know how much, (sic) has to do with the so-called traumatized worker. How long is the American workforce going to remain quiescent without the compensation increases that it thinks it should get? When employment is as strong as it is right now, I don't think we can depend on having permanently favorable results in that area. This has been a rather big key to the present happy macro situation where we have a high capacity utilization rate and a relatively low inflation rate. We all feel rather good about that. (Kelley 1995)

Economists also realized what was happening to labor. Not long after Greenspan's comments about identifying speculative bubbles, Nobel Laureate Paul Samuelson told a conference sponsored by the Federal Reserve Bank of Boston that “America's labor force surprised us with a new flexibility and a new tolerance for accepting mediocre jobs” (Samuelson 1998, 36).

Briefly: Power and Labor Economics

Contemporary economists have gone further to rule out the role of an imbalance of power between workers and employers. Instead, economics represents the job market as a voluntary arrangement. Two highly respected economists—one of whom was the instructor in my freshman class in economics—compared the relation between employer and employee to that between shopper and grocer:

The firm has . . . no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people. . . . He [an employer] can fire or sue, just as I can fire my grocer by stopping purchases from him or sue him for delivering faulty products . . . To speak of managing, directing, or assigning workers to various tasks is a deceptive way of noting that the employer continually is involved in renegotiation of contracts on terms that must be acceptable to both parties. Telling an employee to type this letter rather than to file that document is like my telling a grocer to sell me this brand of tuna rather than that brand of bread. (Alchian and Demsetz 1972, 777)

Business Power over Workers and Consumers

Although the use of power to take advantage of workers is important, power under capitalism has other numerous dimensions. For example, Schumpeter made

the case that large firms often act as corespectors; i.e., they both compete and cooperate. Such corporate cooperation may be intended to wield power against suppliers, distributors, the public, or even competitors, which are not involved in the collusion.

Of course, businesses also wield power on their own. For example, business does everything possible to take advantage of consumers without losing too many customers. To avoid unnecessary controversy, I will ignore the use of advertising that saturates capitalist society. Although the sophisticated use of art, demographics, and psychology to control consumers' minds may be seen as an exercise in power, I will not make that case here.

One could also dismiss the requirement that consumers sign agreements before consummating a purchase as an exercise in power; however, such voluntary agreements often involve the purchasers waving any rights to sue the sellers. Instead, the consumer is typically compelled to accept the judgment of a supposedly impartial mediator of the company's choosing.

Classifying the seemingly arbitrary imposition of fees, which have no relationship to business costs, as exercises in power would seem to be less controversial, especially because the customer may not even be aware of the possibility of such fees.

The power over consumers is not unrelated to the power over workers. In the early 19th century, economists, such as Simon Patten, were explaining to workers that they should see themselves as consumers rather than as workers. This tactic made perfectly good sense for capital because workers, who labored side by side with other workers, were more likely to feel some sense of solidarity with each other. In contrast, consumption is an individualistic activity. Taken to extremes, consumers can even compete with each other in their consumption.

The propagandists of the time were clear that women, who were not in the workforce, would be easier targets for pushing this perspective. The hope was that they could push their husbands to make them work harder in order that they could enjoy more consumer goods.

Competitive Business Power

Businesses also use power in competing with other businesses. Economists tend to emphasize the benign consequences of competition: lower prices, improved quality, and even entirely new products.

Competition also has a dark side. The earlier discussion of the macroeconomic use of power to affect the level of wages is paralleled by a much more direct, microeconomic application of raw power in which business attempts to lower wages and intensify work. In business-to-business competition, power is used to

hobble competitors. Corporate chains will choose to open outlets strategically in order to stymie competitors' expected business strategies.

Businesses also engage in predatory pricing, meaning that they lower prices to a level that drives competitors out of business. Once the competition disappears, the predator can charge prices that take advantage of consumers who are deprived of alternatives.

One of the most effective competitive measures is to take advantage of the legal structure of intellectual property. Corporations sue one another in order to prevent them from carrying on business of one kind or another. Presently, companies are spending billions of dollars for the patents owned by defunct companies. They intend to use them either to sue other companies or defend themselves when other companies take them to court. While textbooks describe the beneficial results of competition, this sort of deadweight loss goes unmentioned. In the end, consumers will bear the cost of all this exercise in power.

Power is a factor in the relationship between businesses and their suppliers or distributors. A classic example is the relationship between Vlasic Pickles and WalMart. The boutique pickle company wanted to take advantage of the marketing scope of WalMart. The giant retailer, however, made increasingly difficult demands of Vlasic, which destroyed its reputation as a premium brand. For example, WalMart demanded that the pickles be packaged in gallon jars. Similarly, Charles Kernaghan has documented the damage done when, WalMart demands increasingly low prices from its sweatshop suppliers, who have no choice but to squeeze more out of the young girls who are already working in subhuman conditions.

In other cases, power lies with the producer rather than the distributor, imposing conditions on the distributor. Recall how Microsoft required that producers who installed the Windows operating system had to include Microsoft's Internet Explorer.

The state has remained in the background of this discussion of power because its role in many cases is self-evident, most obviously in the efforts to hold down wages. The use of the Federal Reserve in wage determination would be somewhat irrelevant in the absence of the ability of the state to restrain workers' collective action.

Alternatively the state might act to check corporate power, but such action typically awaits a crisis that temporarily discredits business. Once the crisis passes, such government regulation tends to erode.

Any discussion of the corrosive effects of intellectual property must take notice of the power of the courts to enforce even ridiculous intellectual property claims. In terms of competition among competitors, such as in the railroad example,

alongside J.P. Morgan's consolidations, state regulation served to further weaken the force of competition.

That this discussion would not be possible in most North American venues brings us to another dimension of power. As an economist, I am sensitive to the fact that radical analysis has been virtually banned from the discipline. In the process, the subject of power largely disappears. To the extent that monopoly exists, it does so only because of government favoritism. Of course, the systematic exclusion of economists, who might have any curiosity about matters of the exercise of power, is, in itself, an inexcusable exercise of power.

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