The Power of Economics vs. The Economics of Power

I recently attended an important conference in which virtually all of the participants were very market friendly. Their papers were all very thoughtful and made a great deal of sense. Besides being very intelligent, I was pleasantly surprised to learn that the presenters were unusually open to exchanges with people whose ideas differed from their own.

One extraordinary paper gave an in-depth analysis of the development of Ronald Coase's influential suggestion for environmental regulation through negotiation. I found nothing in the paper with which to disagree: so long as all affected parties could negotiate a mutually satisfactory solution, Coase's procedure seemed thoroughly unobjectionable. Besides the obvious problem of identifying who should have standing to enter into such negotiations, one serious problem remained: the absence of any consideration of power.

If I have a beef with a company that wants to locate a toxic waste dump that will affect my property values or even my health, it might be conceivable (though unlikely) that a mutually acceptable solution might exist. In reality, lacking power, I would be unlikely to get major corporations to sit down to negotiate with me, let alone receive satisfactorily compensation for their destructive activities. Even taking such businesses to court is virtually impossible. In the unlikely case that I would 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.

Most of the other papers at the conference were of a similar bent, showing how markets evolve naturally and work efficiently. Nowhere was there any consideration of power. The participants clearly understood the discipline of economics very well, but that was their problem. Part of the training of economists is the development of an instinct to avoid any consideration of power, other than presumptive abuses of government, which 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.

This exclusion of power from economics has a long history. In researching The Invention of Capitalism, a study of classical political economists' attitude regarding primitive accumulation, I was struck by their cavalier treatment of this abusive exercise of raw power. Over and above outright dispossession, the state allowed feudal lords 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 until the early 17th century as modern capitalism was taking hold in England. Punishment for killing animals, was harsh, to say the least, even when the purpose was to prevent the creatures from destroying one's crop. Infractions of the law ranged from the death penalty, to incarceration, which was more common, or transportation to Australia, which was even more common.

Besides the resulting loss of crops devoured by potential game, hunters were free to ride roughshod through farmers' fields, creating even greater crop losses. One might have expected the political economists at the time to have taken notice of the violation of rights that had become traditional, not to mention the economic costs associated with neo-feudal fox hunts. Although they were silent about such abuses, the Corn Laws, which levied a tariff on imported grain, were a matter of grave concern for the early political economists even though the Corn Laws had a much smaller effect on economic efficiency. The difference was that the Corn Laws interfered with the efficient exploitation of labor by raising the cost of a subsistence wage. In contrast, the Game Laws, one of the most egregious practices of primitive accumulation, prevented self-provisioning, forcing people to enter the labor market in order to subsist. In other words, both the enforcement of the game laws and the abolition of the Corn Laws were framed in terms of making labor more economical. Besides, the Game Laws probably did much more to raise the cost of food. Seen in the context of coercive power, however, both the abolition of the Corn Laws and the continuation of the Game Laws served to strengthen capital's position.

Although the political economists were too much concerned with showing the justice of markets to address such obvious exercises of power, in their more private writings -- diaries and letters -- they applauded the forces that pushed workers off the land and into wage labor. Contemporary economists generally follow this tradition describing the evolution of markets as a purely voluntary phenomenon, virtually universally understood as beneficial to all.

As a partial corrective to this problem, I recently published a book, The Invisible Handcuffs of Capitalism: How Market Tyranny Stifles the Economy by Stunting Workers. As the title suggests, an important part of the book is to show how both business and economic theory have destructive consequences. The other main thread of the book describes how economists have gone out of their way to create a theory that excludes all considerations of work, workers, and working conditions. 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 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.

This 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 passes, power quickly becomes invisible again. What is most remarkable is that a clear consideration of mainstream economic theory should be enough to alert economists to the inherent contradictions of the capitalist economy. Such a perspective, might, at least, be capable of moderating some of the more destructive results of untrammeled capitalism.

In Railroading Economics: The Creation of the Free Market Mythology, I used the example of the relationship between power and marginal cost pricing. Let us enter into the world of conventional price theory and assume a world of perfect competition where 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, so much so that it might ruin the entire economy.

As the logic of microeconomics suggests, 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.

Most economists, indoctrinated with a theory of market efficiency, had little to say about this problem. However, at the 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 United States, 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 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 those who sympathized with them. These economists were attempting to show them that workers' meager earnings were just rewards, according to their 'scientific' theory of economics. In effect, the power of competition should be allowed to collapse the level of wages, while the state would condone the limitation of market power to weaken the power of competition in product markets.

Power is also very relevant in analyzing monetary policy. In fact, it was once briefly considered 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.

In conventional economics, monetary policy is just a technical matter, unrelated to power. The goal is 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 or 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 Invisible Handcuffs, 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." [Anon. 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, p. 429]

Volcker tightened the money supply so extremely that the United States 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 U.S. banks, seemed to be on the brink of bankruptcy, threatening the U.S. 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, p. 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, p. 112]

What would the response have been 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 21st 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, p. 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, p. 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 still 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, p. 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, p. 36).

Although the use of power to take advantage of workers is important, power under capitalism has numerous dimensions. For example, Schumpeter made the case that large firms often act as corespectors; i.e., they both compete and cooperate. Such cooperation may be intended to wield power against competitors, suppliers, distributors or the public.

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 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.

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 Wal-Mart. The boutique pickle company wanted to take advantage of the marketing scope of Wal-Mart. The giant retailer, however, made increasingly difficult demands of Vlasic, which destroyed its reputation as a premium brand. Similarly, Charles Kernaghan has documented the damage done when, Wal-Mart demands increasingly low prices from its sweatshop suppliers, who have no choice but to squeeze more out of the young girls who work in subhuman conditions.

In other cases, power lies with the producer rather than the distributer, imposing conditions on the distributer. 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 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. 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.