POWER AS CENTRAL IN EXPLAINING ECONOMIC CHANGE: CAN KEYNES HELP?

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> 'The day of the small unit is over, partly for technical reasons, even more for marketing reasons ... we need the maximum degree of decentralisation which is compatible with large units and regulated competition'
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> J. M. Keynes, **The Nation,** 1927

> 'The coal industry has ruined itself by uncontrolled overproduction ... the cotton industry, on the other hand, has ruined itself by organised short-time'
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> J. M. Keynes, **The Nation,** 1927

> 'Keynes' insight was to point out that there was good reason to believe that, as industrial society grew older, revenues would be less certain, future innovation more certain and interest rates relatively slow to move down ... for Keynes, like Ricardo, the person who ultimately decided over production ... feels besieged by circumstance and yet still makes crucial decisions for society.'
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> Cole, Cameron and Edwards, **Why Economists Disagree,** 1992

1 THE MYTHS OF FREE-STANDING NEO-CLASSICAL ECONOMICS

All economics is based on fundamental assumptions that are not examinable from within the discipline of economics itself. The sphere of the economic in life has never been exhaustively, internally explained by economics. Notably, assumptions about power underpin the subject of economics in all its variants.

Neo-classical economics, virtually hegemonic in social (and increasingly, political) theorizing in the 1980s, freely admits assumptions of atomistic individualism and asserts axiomatic principals of rational choice. It may appear to be unconcerned with power. The non-testability of the explicit assumptions, though much criticized by sceptics, is defended by neo-classical proponents on the basis of appeal to Karl Popper's falsification version of logical positivism. The use of individualism as a basic assumption is linked with an implicit concept of social power, albeit restricted to the state and reduced to a matter of crude choice between a state's allowing liberty or a state's enforcing tyranny.

To gain from trade, market forces require a strong state determined and resourced enough to restrain claims not based on individual voluntary contract. **Laisser faire** was a sound-bite phrase of anti-feudalism. In actuality, running a market system effectively requires a narrow but deep state willing to act with total determination to enforce voluntary contract in current transactions, independent of the origins of the distribution of social wealth.

The implications for development strategies of this view of the power agenda of neo-classical economics are profound. To achieve whatever degree of advancement may be offered by market forces in the late twentieth century, requires not a diminution of the state but its enhancement though with an element of re-direction. Coercion is implicit in the neo-classical power agenda as in all variants of economics, but arguably the need for direct coercion may be reduced not the more individualist the general consciousness of socio-economic actors, but rather the more collectivist.

'Modernization' development theory offered a crude cultural anthropology and political project to neo-classical economics based upon the construction of a national entrepreneurial spirit. But with its broad sociological perspective, 'modernization' theory questioned the 'apolitical naturalness' of market systems and the hegemony of neo-classical economics over all other forms of social thinking.

Current efforts in the development field to associate neo-classical economics, electorally pluralist politics, and the so-called 'social' dimensions of structural adjustment represent an important concession to multi-disciplinarity in practice. Unfortunately, they do not appear to have involved any advance in thinking about development. An alternative perspective is needed which is capable of seeking **market forces operating as an aspect of power**, rather than seeing power merely as a matter of allowing autonomous market forces to operate so as to reveal

the efficient, equitable and stable outcomes inherent in the sum of individual choices and actions.

2 THE NON-MARXIAN ECONOMICS ALTERNATIVE

There is a well-established, alternative line of thinking in main-stream 'Western' economics - putting the Marxian tradition with its explicit emphasis on power to one side. David Ricardo was happy to assume that technology and the fundamental pattern of distribution between the great classes of landlords, capitalists and labourers were both determined prior to the operation of market forces. Following in the line of Ricardo's thinking, John Stuart Mill asserted that the basic pattern of distribution was determined in the political sphere and technology in the engineering sphere as self-evident facts, preceding the operation of market forces.

The notion of surplus, to which there is no individual right on efficiency or equity grounds, was seen by Ricardo as a 'natural bounty' which only arbitrary rules of distribution allocated to landowners. Since Ricardo, the concept of 'rent' has received a virtually universal bad press across economics, passing through colonial 'founders' benefit' and culminating in 'bureaucratic rent-seeking' in the 1980s. The history of economic thought on rent has separated the concept from land and associated it with power - at the cost of insulating the rest of economics from explicit reference to power.

Keynes was typically awkward in finding some virtue in rent, drawing on Malthus' praise of the high spending propensity of landowners, as a source of effective demand. But he also widened the idea of undue rewards to include elements of interest payments. Keynes barely considered the claim that interest payments were a natural reward for abstention from consumption in mid-twentieth century Britain - probably due to the relatively high level of average wealth and little sign of abstention among the 'savers'. He also treated technological change as an autonomous process arising from the search for greater knowledge, which could thus be seen as generating a potential surplus on which those with titles to interest payments have a primary claim (which is naturally neither equitable nor efficient). Keynes saw the processes surrounding interest payments as socially irrational and appealed for the exercise of state power over them. It is only an extension of his argument to suggest that the significance of interest payments in any economy is directly related to the power exercised by interest receivers, a point we shall return to in the conclusion to this paper.

Explicit rigorous development of Ricardo's analytical principles received a great boost in the late 1960s when Piero Sraffa finally published the catchily titled 'Production of Commodities by Means of Commodities' - a book begun in the 1920s. In constructing a model of an economy capable of producing a surplus above subsistence, Sraffa explicitly assumed fixed methods of production and social rules of distribution. Sraffa assumed that distribution only involved a single wage rate and a uniform rate of profit. He was then able mathematically to demonstrate that a set of market prices existed that would merely **reflect** the distribution between wage receivers and profit receivers in existence before the operation of market forces, given the state of technology. Institutional arrangements embodying power relationships were primary.

Sraffa's work resonated with the perspective on underdevelopment centred on the concept of dependency. Sraffa's neo-Ricardian assumptions were totally compatible with assertions that the exercise of power in colonial and neo-colonial structures had produced basic rules governing the distribution of technology and sources of income - for instance depressed wage rates and primary commodity prices. Starting from assumptions of crucial inflexibilities, conclusions can be logically derived showing that market forces may act merely to reproduce the fundamental power inequalities.

This basic framework for understanding the economic aspect of life with power as a central concept exists and has been applied to the explanation of international inequalities. Neo-Ricardian economics has a capacity for contributing to a broadly defined 'world system' research programme integrating its own insights with those derived from the politics of inter-state relations, neo-Marxian cultural anthropology, and the ecological analysis of environmental change.

Unequal power mean that the outcomes of voluntary contracts between agents seeking market survival can be characterized as unequal exchange. The outcome of unequal exchange distributes the accumulation opportunities arising from surplus in the global system in a manner tending to confirm a

historical pattern of power relationships. Claims against that pattern can be made legitimately on the basis that the historical exercise of power does not confer rights. Unfortunately enforcing claims to a New International Economic Order requires more than legitimacy; it also requires the anti-systemic forces to construct a power base themselves and that power base has proved very difficult to construct, as the experience of OPEC and UNCTAD suggests.

An important challenge for the contribution which economics could provide to this research programme is to take the lead in providing insights into the behaviour of **meso-economic** agencies, which might be broadly categorized by the more familiar term 'industries' - though that term has no precise empirical meaning. The challenge is to find a theoretical approach that neither collapses into the agglomerations of perfectly competitive, powerless entrepreneurs characteristic of neo-classical economics, nor usurps the whole theoretical terrain with each industry being a single monopolistic bloc of invulnerable trans-national corporations. The remainder of this paper will attempt to indicate how this gap in a 'world system' research programme may be filled; demonstrating how power operates at the level of an industry drawing on the work of J.M. Keynes.

3 KEYNES AND INDUSTRIAL STAGNATION

Contrary to the impression that Keynes only dealt in theories of whole economies, he actually devoted considerable effort to understanding economic change at the level of the industry. In the **General Theory of Employment, Interest and Money**, he introduces the concept of 'user cost' to describe how a manager decides whether to utilize a piece of existing machinery or purchase a piece of new machinery, that is to make the decision to invest.

For Keynes, the manager is forced to be continually aware of the economic life of machinery - the appearance of a durable piece of equipment is an illusion. Machinery is both more durable and more fluid than its physical appearance suggests. It is more durable since its physical life may be extended through active maintenance, which also makes the machinery a potential carrier of value. It is more fluid as changes in technology lower potential unit costs, which can leave the manager the embarrassed possessor of a fossil. The manager has to assess user cost, balancing the impetus to use equipment immediately at maximum capacity due to the risk of its economic redundancy against reasons to postpone use if demand is expected to rise and machinery is a more effective way of storing productive potential compared to stocks of final output.

The parameters of this decision owe little to the physical nature of the machinery or current prices of inputs and outputs, but much to perceptions of the possible behaviour of other agents. At the level of an industry, these perceptions focus on the behaviour of managers active in markets for the same machinery and outputs. On the edge of the broadly defined industry, moreover, can be found financial institutions which move in and out of commitments in a manner which may appear arbitrary to the individual manager.

An appropriate metaphor for the manager's position would be that of a minor lord in a besieged castle rather than a confident entrepreneur at the centre of a network of enforceable, voluntary and assured contracts. The conventional neo-classical language of marginal costs and revenues would only be usable if subjective perceptions, notably on 'user cost', were introduced to an extent that any claim to analytical objectivity and the possibility of falsification would be totally undermined. Thus the language of power is as relevant to the analysis of the behaviour of managers, including deception through bluff and double-bluff, and virtual coercion through collusion. For Keynes, an industry appears as much defined by an uneasy clustering of power relationships as by common outputs/inputs or shared markets and it was this perspective he brought to industrial crises in the United Kingdom in the 1920s.

4 A CASE-STUDY OF AN INDUSTRY IN DECLINE: THE UK COTTON INDUSTRY IN THE 1920S

Keynes wrote on the Lancashire cotton-spinning industry around 1927 - about ten years before the publication of his **General Theory**. His interventions in the discussions about the crisis in the industry initially took the form of a relatively detached, overview article in **The Nation** before he was drawn into the practicalities of reorganizing the industry. Keynes first article started from the assumption that the Lancashire cotton-spinning industry was working at well above potential minimum unit-cost due to widespread short-time working in which high 'overhead' costs were financed by bank advances for

recurrent expenditure. Banks were willing to make such advances because the sheer size and long history of the industry with its substantial stocks of machinery appeared to make loans sound propositions, compounded by their desire to secure loans made earlier.

Keynes calculated that precisely equivalent spindles in Japan were working four to five times the hours of Lancashire's per week and this was a more significant explanation of relative competitiveness than relative wage rates. He concluded that the Lancashire industry and its financiers were locked into a very dubious common belief in a return to 'normal times'. Any market upturn was given undue weight as an indicator of rising long-term demand and a reason to retain the existing technological and distributional structures, not as a breathing space to undertake fundamental restructuring.

Given this common perception on the part of banks and industry, any reorganization of the industry would be brought about crudely and haphazardly through individual bankruptcies and consequent revaluing of machinery in receivers' auctions if purchasers could be found. However, bankruptcies would not eliminate the most economically ineffective managements if those managements were heavily indebted to major banks and thus least likely to be literally bankrupted by the banks. Any reduction in user cost of machinery per unit of output would put economic pressure on other firms whose machinery was still capitalized at previous values. There was a possibility that this process could continue until spinning firms, their machinery suppliers, and their financiers had all been forced to adjust to the economic reality demanded by international comparative costs.

But Keynes argued that there was a world-wide structural over-supply of cotton spinning capacity and there was no ultimate pricing solution on a world scale. Ultimate survival would depend upon the ability to move the power relationship within the industry from mutually enforced stasis to mutually supportive change. He thus advocated formal cartelization of the industry and wrote enthusiastically in 1929 supporting the idea of forming the Lancashire Cotton Corporation backed by the Bank of England. Cartelization for Keynes involved the created of a negotiating forum (replacing the conspiratorial and speculative agora of the Manchester Cotton Exchange) in which the whole industry would decide upon reducing physical capacity, some recapitalization of assets, improved flows of information, elimination of least effective managements, concentration on more promising, high quality market areas, and negotiating lower input prices.
In Keynes view, without such imaginative cartelization, the industry would continue to be dominated by powerful vested interests (centred on 'those professional deaf-mutes', the banks (Keynes 1981: 605)) concerned to maintain the financial value of large stocks of machinery. This alliance of vested interests (given that the industry's workers were excluded from the power structure) would confine the agenda for action to putting pressure on wage rates - a largely irrelevant issue for Keynes. No innovative, wide-spread break-out was likely in such a situation. On the contrary, a muddy, recriminatory drift towards the disappearance of the industry, as haphazard contraction removed external economies of scale, was more likely unless an initiative were taken to persuade and/or coerce a change in power relations which would underpin a commitment to sustainability.

5 CONCLUSION

Keynes can be seen as an errant figure in a long line of non-Marxian economists who have been happy to accept that the understanding of power relationships was a prior requirement for understanding the outcome of market forces. For such economists, the pattern of prices produced by apparently anonymous market forces merely reflect engineering patterns of technology and political parameters of income distribution.

At the level of the whole economy, Keynes placed interest rates under the critical scrutiny previously given to rents derived from land and found their claim to social legitimacy and worth equally suspect. His explicit argument was based on the social efficiency impact of interest rates on processes of change, rather than equity implications. But, if Keynes' argument is extended to conclude that the level of interest rates in any economy is significantly a product of the power exercised by international financial institutions, then both equity and efficiency arguments may prove relevant to constructing an ideological programme to guide local anti-systemic challenge to that world power system - Islam's critique of interest rates on *ribat* is clearly relevant here.

At the industry level, Keynes stressed the subjective, judgemental aspect of decisions about choosing productive capacity and how far to use it which were

crucial to economic development. For the manager, the equally subjective calculations of other managers in the industry and of financiers are crucial. A matrix of monetary flows containing subjective risks and uncertainties may be conceived in abstract terms and examined from the perspective of institutional economics by game-theory methods. But such methods are unlikely to provide unambiguous predictions except under very restrictive conditions. Keynes' approach was more direct, examining the observable pattern of power relationships to good effect - though the power was hardly being exercised to good effect in developmental terms.