

## **Lecture from John K. Galbraith, "Power and the Useful Economist"**

### **I. General Criticisms of Current Neo-Classical Economics**

Economics is insufficiently normative. Model building has become an end and not a means. This is because mainstream theory has hit the point of diminishing returns on model building - what is a graduate student to do? If mainstream doesn't watch out, we will evolve into simply being applied mathematicians.

Galbraith shares these criticisms, but wants to add to them a concern over assumptions. He argues we are no longer dealing with general or accepted theory. We are simply looking at behavior and interpreting it. We are not successful at prediction because events lead us rather than the other way around.

The problem is we have lost our ability to be useful. Yet, amazingly, the textbooks and courses we teach still carry the orthodoxy. Early watchdogs in this regard were the rising businesses that required we establish the principles of private property, profits, free trade, etc., and that would fight against unions, government regulations, etc. (classical liberals). This censorship is, by and large, gone. It is replaced by the notion that scientific excellence is any belief or method used by people that are already there. So, we ignore our problems or call for simple free market solutions to most of them. But the problems won't go away.

### **II. The biggest flaw in neoclassical assumptions is the way in which they totally ignore power in economic relationships**

We assume the business firm to be a slave of the impersonal market - assuming away all potential power and content. We even assume that the state is subordinate to the wishes of the citizens, or at least the citizen's acquiescence. The role of the firm is, therefore, to service the market. As such, the firm has only limited power to influence the market and no power to influence the state. Even the monopolist reacts to demand - monopoly power is an ability to influence price. The consumer still has the power to restrict that degree of influence.

In ignoring the political world, the neoclassical economist ignores the real world altogether. In microeconomics, power is only the ability to influence price, as I said before. In macroeconomics, power is found only in the government's ability to influence aggregate demand.

Look at what we can't explain:

1. Economics argues that monopoly power tends towards underproduction.
2. Yet, most agree that we tend to overproduce automobiles, chemicals, plastics, alcohol, tobacco, defense, and space exploration.

3. If there are deficiencies in resource uses, they tend to occur in competitive industries, like in medicine, housing, local transportation, etc.

Now, the apologists say that the over-production in some of the industries mentioned is a matter of public choice and that under production in the others is due to their regional monopoly powers. But that begs the question of why the public makes insane choices and why little, regional monopolies perform so much worse than their national big counterparts.

Which leads us to the biggest question of all, "Why do we have a highly unequal development as between industries of great market power and industries of slight market power ... greatly favoring the first?" When we apply that microeconomic question to macroeconomics, we are even more embarrassed. We have applied various versions of macro policy with it in mind that markets will adjust in appropriate manners. Yet, we have had inflation, unemployment, stagflation, etc., for the past twenty years. We have not cured the business cycle, cured unemployment, or cured inflation. At best, we have only had small periods of relative prosperity, usually on our way to some new disaster. Now, we have come to a most disconcerting set of theories that state that expectations run the economy. Therefore, we should not engage in any macro policies at all - expectations will undo any policy we attempt. This is the extreme of, "let the market do it" types of philosophies - as if pure competition really existed.

So, what are the alternatives?

### **III. Let's replace the market assumptions with the realization that at least half of the economy is controlled by a planning system.**

The planning system consists of the 2000 largest corporations who have powers that transcend the market. It seems unreasonable to think that the power of the modern corporation along with the associated power of large labor unions would be a central part of our set of economic theories were it not for the vested interests discussed earlier.

The modern corporation has extensive control over its prices and its costs, and, even its ability to control (or at least influence) the tastes of its customer. They even have substantial influence over the sources of their supplies. And even major control over finance and their ability to attract credit.

Finally, only a fool would fail to recognize the substantial influence the corporation exerts over the state, including the agencies of the state that are there to control the corporation itself. The state provides research, technically qualified people, emergency financial support, etc. The state also provides an artificial market when others can't be found. We tax the population to buy MX missiles. The two organizations even regularly exchange executive personnel.

Finally, the corporation exerts power over all in terms of its legitimacy and respectability. Those that guide the corporation are among the most influential and prestigious people in

the nation. They exert more influence than congress people, vice-presidents, and many suspect, even the president. They **are** the establishment.

The corporation's interest is in power. Not to the exclusion of profits. But power itself assures the autonomy of management to seek profits. They also provide management with the ability to pursue their most important goal of growth. That the corporation really chooses profits over influence and growth is believed by none - but it is the cornerstone of neoclassical theory.

Recognize that there are, at the same time, many small firms that are subject to the market. There, profit maximization is necessary for survival. These are not just pure competitors. They run the full range of possibilities described by the neoclassical system. They represent the neoclassical model at work! We have these two systems existing side by side. One is subject to the powers of the market. The other has power unto itself that extends into every facet of our lives. The coexistence of these two should be the subject of our investigations.

#### **IV. This should dissuade us from our attempts to separate politics and economics.**

The modern corporation is much like the state itself. This is not to say that economics should become a part of political science.

But that politics should become a part of economics.

What difference does this make? It eliminates the "invisible hand." No longer are the interests of the firm and the community always in harmony. Divergence of interests predominate in predictable ways:

Growth is the principal goal of the planning system. This is the source of overproduction in the industries mentioned before. Neoclassical theory says they should expand even more. Don't forget, we then talk about socializing the competitive sector in housing, medicine, transportation, etc.

When we introduce power into this equation, we clean up the seeming contradiction in the micro sphere.

#### **V. In the macro sphere, a similar improvement is found.**

Increases in costs are passed forward to the consumer. The neoclassical model doesn't work because the corporation holds power over the consumer. Anti-inflationary policy has to be quite severe to offset this. We permit these policies because they do not hit the system itself. Monetary policy only hits those that don't have control over credit. Highways, defense, industrial research, etc., aren't hit by budget cuts because they have a higher purpose. Taxes will be cut for investment and raised for persons. Any really new taxes for corporations are, again, passed on to the consumer.

If things get too out of control, costs will be cut, but at the expense of the resource owners, not the planning system itself.

Other effects are as follows:

1. Systematic differences in income between the planning and the market system.
2. Resource immobility between these systems so that rates of return are not equalized.
3. This leads to differing wage rates between the two systems in favor of the planning system.
4. Policies to help out, like minimum wage legislation, are hot topics in the market system. They are of little interest in the planning system.
5. The environmental problems we face are not due to externalities, they are due to the single minded pursuit of growth.

Growth will generally win over environmental concerns. We will generally use the power of persuasion to discuss environmental problems, rather than spend the same resources on cleaning the environment. Finally, if the consumer is the ultimate source of authority, his or her abuse is an occasional fault.

There can be no fundamental disagreement between consumer and the system. But if the producing firm has comprehensive power, conflict becomes inevitable. Technology is then subordinate to consumer persuasion. Products are changed, not to make them better, but to make them new and to create new markets. "Can it be sold?" is much more important than "Is it better?".

## **VI. The real conclusion deals with the state**

When we make power politics a part of our system, we can't escape the contradictory character of the modern state. The state is the prime object of economic power. Yet, restrictions against abuse are to come from the state. The fox is the manager of the coop.

The greatest question then becomes, "Can we free the state from the control of the planning system?" No one knows the answer. The first step would be to realize that the planning system exerts this power and that they are not, in fact, slaves to the market.