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Power – The *bête noire* in much of modern economics

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Abstract

Despite being a pervasive phenomenon in the economy and society, power has been and still is the bête noire in much of modern economics. In the main parts of contemporary mainstream economics, no attempt is made to come to grips with what power means and what its effects are. Against this backdrop, this paper attempts to bring to the fore ideas of past economists and social and political philosophers, who basically saw socio-economic affairs and outcomes as driven by, and reflecting, power relationships. Starting with the writings of late mercantilist and early classical economists, the paper analyses how the attention in economics shifted away from the problem of power from the latter part of the nineteenth century, with the rise to dominance of marginalist economics.

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capital, classical political economy, economic law, economic power, free competition, general equilibrium theory, information and knowledge, labour commanded, manufacture of consent, marginalist economics, perfect competition, private property, sources of power, state power, technical change and unemployment, value and distribution.

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1. Introduction

In 1971, the late Austrian economist Kurt Rothschild published a widely circulated Penguin modern economics reader entitled *Power in Economics* (Rothschild 1971), which contained a fervent plea to take power seriously in economics. Alas, the book's success was modest, to say the least (see Rothschild 2002). Numerous other economists expressed similar views. The philosopher Bertrand Russell (1938) had even maintained that economics ought to be a "science of power"—to no avail. Power has been and still is the bête noire in much of modern economics.[1]

There are, of course, exceptions to the rule. It suffices to mention especially Industrial Organization and Game Theory.[2] In non-mainstream economics, in the classical, the Marxian, the Kaleckian and the Post-Keynesian currents of thought, power is an important, and frequently, a central analytical category.[3] However, in the main parts of contemporary mainstream economics, especially in much of conventional micro- and macroeconomics, the concept of power hardly ever makes an appearance and no attempt is made to come to grips with what power means and what its effects are with respect to crucial economic relationships and important economic magnitudes. And when power is dealt with at all, it is typically done in a partial equilibrium framework, focusing attention on single markets or agents, leaving out the systemic importance of power relationships in the economy and society at large.

This neglect should be enough to justify an attempt that brings to the fore ideas of past economists and social and political philosophers, who basically saw socio-economic affairs and outcomes as driven by, and reflecting, power relationships. They would therefore in all probability have received with astonishment and disbelief the view that economic matters are best studied as if people lived in a "powerless vacuum".

If economics is an *Inquiry into the Nature and Causes of the Wealth of Nations* (Smith [1776] 1976), as its sung hero Adam Smith put it, and if according to Thomas Hobbes "wealth is power", a judgement Smith expressly shared, then power should indeed be a central concept in economics and the study of power relationships should permeate large parts of its analyses.

Things have not always been like this. At the time of the advent of systematic economic analyses in the seventeenth and eighteenth centuries, with the writings of late mercantilist and early classical economists, from William Petty to James Steuart, from François Quesnay to Anne-Robert-Jacques Turgot, and from Adam Smith to David Ricardo, the argument often revolved around the problem of power.[4] Krishna Bharadwaj rightly stressed this in her *Themes in Value and Distribution: Classical Theory Reappraised* (1989). The relationship between landlord and tenant, master and worker, moneyed man and investor, she observed, was typically seen first and foremost as a power relationship, with one side possessed of a superior socio-economic position that may even imply the domination or subjugation of the other side.[5]

However, power is often difficult to see: it is hidden and works secretly. There are two common responses to this. Its low visibility is mistaken to mean that power is unimportant or even absent. Its secret character gives rise to conspiracy theories of various sorts. How to separate the wheat from the chaff in all this? How to find out the power that pulls the strings (see Figure 1)?[6]

Fig. 1: The power that pulls the strings

The questions asked in this paper include the following: What is the meaning of power in economics? What are its sources and its effects? How did some of the early authors take into account the role of power in socio-economic affairs? How did later authors elaborate on their analyses and which findings do we owe them? Why did the attention in economics shift away from the problem of power in the latter part of the nineteenth century with the rise to dominance of marginalist economics? Do recent events, such as the redistribution of income and wealth, crises in the banking and financial sector of the economy that carry over to the real part, and the ensuing tendency towards economic stagnation provide arguments in favour of taking power seriously again in economics?

It hardly needs to be stressed that in this paper I can deal only with a small subset of authors and contributions to the problem under considerations. For obvious reasons, no comprehensive account of the literature on power in the history of economics is intended. It is to be hoped, however, that many of the most important aspects and facets of the problem at hand will be touched upon.

The composition of the paper is the following. Section 2 deals briefly with what some people still consider to be the core of modern economics—general equilibrium theory and the methodological individualism it endorses. According to the latter, society must not be taken as we encounter it, but ought to be reconstructed in terms of the interaction of self-seeking, independent individuals. It is shown that on the basis of the usual assumptions, or axioms, entertained by the theory, society in any meaningful sense does not exist. This spells trouble for the research programme of methodological individualism and the promises associated with it. Section 3 deals with the concept of power, drawing the reader's attention to its multifaceted nature, and has a closer look at Bertrand Russell's view on the issue. In addition, an analogy between Piero Sraffa's distinction between basic and non-basic commodities, on the one hand, and differently powerful agents in a power structure or network, on the other, is drawn. Section 4 turns briefly to Thomas Hobbes' treatment of power in *Leviathan* and the social theory he erected thereupon. Hobbes' advocacy of the absolutist state involved a major challenge to scholars opting in favour of a social order based on the principles of "equality, liberty and justice", as Adam Smith famously put it. Section 5 therefore provides a detailed account of the Scotsman's sophisticated approach to the problem of power and the reasons for his rejection of Hobbes' social theory. In Smith's alternative view, asymmetries in the distribution of wealth and in the access to information and knowledge amongst people belonging to different strata of society assume centre stage. But in a well-governed society, Smith insisted, the worst dangers emanating from such asymmetries can be contained. It is shown that Smith suggested that power be measured in terms of the difference between the labour commanded by a commodity and the labour embodied in it. Interestingly, Sraffa pointed out that his Standard commodity amounted to basically the same thing as Smith's labour commanded standard. Section 6 has a quick look at David Ricardo, who corrected certain propositions of Smith and deepened the analysis in important respects, especially as regards the impact of technical change on the balance of power between the different social classes. Section 7 provides a brief summary account of Karl Marx's view, focusing attention on the "silent compulsion of economic relations". According to Marx, capitalism is characterised by "commodity fetishism", which involves a false consciousness about things that supports the given social conditions and makes it appear as natural and immutable. Rudolf Hilferding developed Marx's ideas of the rise of joint stock companies and finance capital. Antonio Gramsci elaborated the concepts of "hegemony" and the "manufacture of consent". Michal Kalecki saw the power of capital rooted in the economic system's generation of unemployment, which keeps workers' aspirations in check. Section 8 turns briefly to the views of those economists, who saw private property of land as the ultimate source of power and advocated its abolition. The authors dealt with include major marginalists such as Herrmann Heinrich Gossen and Léon Walras. Section 9 discusses Eugen von Böhm-Bawerk's highly influential essay "Macht oder ökonomisches Gesetz" (Power or economic law), in which he argued that economists do not go significantly astray when basing their reasoning on the assumption of perfect competition, which involves an economy in which nobody is possessed of any power whatsoever. This view appears to still dominate important fields in mainstream economics. However, already at the time when the essay was published, its message looked anachronistic vis-à-vis the trend towards monopolisation and trustification stressed by the American institutionalists from Thorstein Veblen to John Maurice Clark. Section 10 shows that Arthur Cecil Pigou and Abba Lerner assumed a less extreme position and sought to demonstrate the impact of power via its effect on demand and supply functions and a fortiori on the resulting economic equilibria. The impact of power is to be discerned, they argued, in deviations of the prices of products from their marginal costs and of the rates of remuneration of factors of production from (the value) of their marginal productivities. The argument presupposes, of course, that the marginalist theory of value and distribution can be sustained, a view which according to its critics, especially Piero Sraffa, is unfounded. Section 11 turns to Friedrich von Wieser, one of the main architects of marginalist theory, who however later in his life distanced himself from it and put forward a view that contradicted the one entertained by his brother-in-law, Böhm-Bawerk. Echoing inter alia the ideas of the social psychologist Gustave Le Bon in his treatise *Das Gesetz der Macht* (The law of power), Wieser saw the ultimate source of power as residing in an elite's capability to capture the minds of people (Wieser 1926). Section 12 contains some concluding observations.

Before I turn to the main argument, a few provisos are in place. First, it hardly needs to be mentioned that several other authors and currents of thought in economics, and the social sciences more generally, would deserve to be dealt with in some detail and not only in passing. These include, for example, institutionalists such as Thorstein Veblen and John Maurice Clark, psychologists and philosophers such as Georg Wilhelm

Friedrich Hegel, Friedrich Nietzsche, George Lukács and Michel Foucault, and sociologists such as Émile Durkheim, Max Weber and Pierre Bourdieu. Secondly, power manifests itself in different ways in different stages of socio-economic development—in a society of gatherers and hunters differently from a feudal society, in the latter differently from a capitalist one, and so on. In this paper, the focus will be on capitalist societies characterised, *inter alia*, by private property in the means of production and by wage labour. However, even capitalist societies differ from one another both across space and time. Financialisation, for example, has deeply affected capitalism and has substantially changed economic and political power in favour of the banking and financial sector of the economy. A close analysis of such changes and structural breaks is beyond the scope of this paper. Third, economic policy is an effective tool to change the balance of power between different strata of society. The tax system, the inheritance law, the access to high schools and universities, the pattern of public investment, to name but a few, have been and are being used to redress that balance in favour of some such strata and against others, workers and employees, financial or industrial capital, landowners or manufacturers and so on, as the late Tony Atkinson and Thomas Piketty have shown with regard to long periods of time and numerous countries. Finally, with structural socio-economic transformation, power relations also change. A major change in Western capitalist societies in recent decades has been the remarkable rise of the service and information and communication industries, and very recently, the beginning of the revolutionising of the manufacturing sector and the economy as a whole by means of what is frequently called the "digital revolution", that is, cyber-physical systems, artificial intelligence and the like. These can be expected to affect in fundamental ways how the economy works and it also affects power relations, personal identities, culture and politics. For lack of space, in this paper many of the fascinating aspects of the theme under consideration and the contributions of its foremost investigators can be mentioned only in passing, if at all.

2. The "competitive economy" in general equilibrium theory

In much of 21st-century economics, power plays hardly any role whatsoever.[7] The neglect of power is epitomised in the concept of "perfect competition", which presupposes a state of affairs in which no agent has any market power whatsoever. It is a society in which liberty and equality rule the roost and there is typically no room (and, as we shall see in a moment, no need) for fraternity. This is clearly regarded as an abstract and highly ideal state of affairs, but the majority of its advocates insists that it tells us something important about the real world.[8] However, the question is close at hand whether we can meaningfully speak of a "society" made up of such powerless agents. An answer can be sought by first addressing the issue of what guarantees the survival of all agents, because if their number changes, the theory or rather model has to be changed as well. In order to guarantee the constancy of the number of agents, some bold assumptions regarding the initial endowments of agents have to be invoked.[9] Since no a *priori* reason can be given why it should always be preferable for an agent to engage in economic transactions with other agents, the survival condition requires that each agent must be able to live exclusively on his or her initial endowment until the end of the arbitrarily given time horizon of the model. Kenneth Arrow and Gérard Debreu in their 1954 paper expressed this condition in the following unwieldy way: "Impossible combinations of commodities, such as … the consumption of a bundle of commodities insufficient to maintain life, are regarded as excluded from [the set]" (Arrow and Debreu 1954: 269). There are no exits from and entries to the given population within the given time horizon (which in later contributions to general equilibrium theory surprisingly even became infinite). General equilibrium theory formalises this ideal state and speaks of a "competitive economy". An aspect of the solution of the model then is, whether and which agents engage in trade and which do not.

Within this framework, social relations may be relatively unimportant and economic interaction weak. Depending on the set of givens or data of the theory—(i) preferences of agents, (ii) their initial endowments and (iii) the set of technical alternatives from which they can choose to produce the various goods—an equilibrium may exist in which several agents (in the extreme: all of them) remain in a state of autarky and only a few (none) get involved in what a commentator once called "a little trading on the side" (McKenzie 1981). Interestingly, as David Starrett (1978) demonstrated, social cohesion vanishes entirely when one takes the spatial dimension of economic activity into account in the simplest case possible. Then the competitive price mechanism formalised by Arrow and Debreu can explain neither the emergence of spatial economic concentration nor extensive trade streams. In fact, with constant returns to scale, economic activity will be evenly distributed across a homogeneous plain, carried out by autarkic units of production and consumption. There is no society in any meaningful sense.

This runs counter to the challenge assumed by methodological individualism to reconstruct society *as it is*. Apparently, without "contaminating" the usual assumptions of general equilibrium theory with crucial features of the desired result, it cannot be excluded that the entire exercise amounts to little more than abstraction mongering.[10] Assumptions apparently do matter: some can sharpen our understanding of the world, whereas others can obstruct it. According to the physicist John Wheeler, "space is what prevents everything from happening to me", and "time is what prevents everything from happening at once." We might add that the exertion of power is what prevents a number of things from happening in a just and fair way.

This brings us to a brief discussion of the concept of power and the view that power ought to be a central analytical category in the social sciences.

3. The multifaceted concept of power

(a) Several meanings of power

There are several meanings of "power" encountered in economics and in the social sciences more generally. However, all of them boil down to the concept of power as an asymmetry or disproportion in human relations, whether the reference is to pairs of individuals or to different groups or social classes. Max Weber (1972: 28) defined power as "the opportunity that one actor within a social relationship will be in a position to carry out his own will despite resistance, regardless of the basis on which this opportunity rests."[11] In a similar vein, Herbert A. Simon wrote: "influence, power and authority are all intended as asymmetric relations" (Simon 1957: 4). With Robert Dahl (1957) we can express the asymmetry under consideration in a causal way as follows: to say that person *i* exerts power over person *j* is equivalent to saying that *i*'s behaviour causes *j*'s behaviour, not the other way round.

We shall see below that while these definitions are useful, they are also somewhat narrow, because they do not really touch upon the socio-economic institutions, the legal, political and cultural systems that support a given power structure and the mechanisms by means of which this power structure is reproduced.[12] These institutions and mechanisms have an influence on the perceptions, aspirations and mind-sets of people and cause the dominated strata of society to acquiesce to the situation. Couched in marginalist verbiage, one might say that frequently, power allows some people to affect some other people's preferences: those dominated then optimise with regard to different preferences from those they originally had and different constraints that they now face. In this case, the distinction between preferences and constraints gets blurred. The impact of power may also extend to the kind of technical and organisational knowledge that can be employed by certain groups, whereas other kinds of knowledge are denied to them. The set of data typically invoked by general equilibrium theory thus loses much of its appeal as providing a solid platform to stand on.[13]

As regards the origins or sources of power, numerous have been identified, as we shall see below in some detail. They go from physical strength via various means and devices to enforce one's will, to the capability of capturing other people's minds.

Is power ubiquitous in human relations, or is it a rare occurrence that can be neglected without greatly distorting our perception of the facts? (And what are "the facts"?) The latter view underlies much of economic theory and was most forcefully advocated by Eugen von Böhm-Bawerk (see Section 9 below). Bertrand Russell, the author of Power, a New Social Analysis (Russell 1938), amongst others, formulated the opposite standpoint and insisted that power, not wealth, should be "the basic concept in social theory", because the "love of power" is said to "outweigh" all other motives of human action ([1961] 2009: 449). Russell criticised the classical economists and Marx for focusing on wealth rather than power. However, as we shall see below, this is a misconception on Russell's part, because the classical authors and Marx insisted that wealth and power are intimately intertwined. The love of wealth may thus be considered a version of Russell's love of power. Russell (2009) argued:

> Love of power is closely akin to vanity, but it is not by any means the same thing. What vanity needs for its satisfaction is glory, and it is easy to have glory without power. ... When Blücher, in 1814, saw Napoleon's palaces, he said: "Wasn't he a fool to have all this and to go running after Moscow." Napoleon, who certainly was not destitute of vanity, preferred power when he had to choose. To Blücher, this choice seemed foolish. Power, like vanity, is insatiable. Nothing short of omnipotence could satisfy it completely. And as it is especially the vice of energetic men, the causal efficacy of love of power is out of all proportion to its frequency. It is, indeed, by far the strongest motive in the lives of important men.

He continued: "Love of power is greatly increased by the experience of power, and this applies to petty power as well as to that of potentates." (Russell 2009: 449)

Russell was critical of basically all traditions in economic thought, because in his view they had not understood the overwhelming importance of power in socio-economic life. He was most critical of marginal utility theorists with their endorsement of methodological individualism, which prevented them from fully grasping the significance of power in explaining social facts.

However, according to Russell, power has many faces and is not always a bad thing: "Curiosity and the pursuit of knowledge should [also] … be regarded as a branch of the love of power. If knowledge is power, then the love of knowledge is the love of power" (Russel 2009: 331–2).[14] Hence in Russell's view, the love of power by one person is not of necessity detrimental to some other person: "Love of power can be satisfied in many ways that involve no injury to others" (*ibid*. 2009: 343). He stressed: "It would be a complete mistake to decry love of power altogether as a motive. Whether you will be led by this motive to actions which are useful, or to actions which are pernicious, depends upon the social system, and upon your capacities" (*ibid*. 2009: 450).

The reference to the "social system" as a whole as an abode of the production and reproduction of power relationships will be encountered time and again below, most notably in the writings of Hobbes, Smith and Marx. In his autobiography, Russell (1967–69: 14) summarised the implications of *Power, a New Social Analysis:*

> In this book I maintained that a sphere of freedom is still desirable even in a socialist state, but this sphere has to be defined afresh and not in liberal terms. … It was intended as a refutation both of Marx and of the classical economists, not on a point of detail, but on the fundamental assumptions that they shared. I argued that power, rather than wealth, should be the basic concept in social theory, and that social justice should consist in equalisation of power to the greatest practicable degree. It followed that State ownership of land and capital was no advance unless the State was democratic, and even then only if methods were devised for curbing the power of officials. A part of my thesis was taken up … but otherwise the book fell rather flat. I still hold, however, that what it has to say is of very great importance if the evils of totalitarianism are to be avoided, particularly under a Socialist regime.

The reference here is to the perils of state power. Interestingly, Thomas Hobbes had argued that without a strong state and ruler—an absolute monarch—things would be worse for the members of a nation or commonwealth. While a state is necessary to contain the powers of individuals, it is at the same time itself a potential source of the abuse of power. Friedrich August Hayek ([1979] 1982: 128) aptly described the dilemma in the following words:

> The effective limitation of power is the most important problem of social order. Government is indispensable for the formation of such an order only to protect all against coercion and violence from others. But as soon as, to achieve this, government successfully claims the monopoly of coercion and violence, it becomes also the chief threat to individual freedom. To limit this power was the great aim of the founders of constitutional government in the seventeenth and eighteenth centuries.

He added:

> But the endeavour to contain the powers of government was almost inadvertently abandoned when it came to be mistakenly believed that democratic control of the exercise of power provided a sufficient safeguard against its excessive growth.

The fear of state power suffocating individual freedom is a dominant theme in Austrian economics and economic philosophy. This is understandable in view of the experience of totalitarianisms of various sorts in Europe and elsewhere in the twentieth century. It deserves to be mentioned that Austrians, surprisingly, devote much less attention to the power amassed in the private sector of the economy, whether in industry or finance or any other business. This is not the least due to the widespread view amongst their ranks that (lasting) monopolies etc. are the result of state intervention and not the result of the normal working of the market system. The latter would activate forces that tend to erode the concentration of economic power and undermine monopolies, as Böhm-Bawerk had argued (see Section 9 below). This view was adopted by Ludwig von Mises and his acolytes (see, for example, Rothbard 1970). The focus of attention is the state and its institutions, the central bank that controls the money supply and trade unions.

(b) Power structures: a simple conceptualisation

When we talk about power in the economy, we mean power structures or networks amongst heterogeneous agents. Some agents may strictly depend on others (such as children on their parents) or they may be interdependent (as traders in the stock market). Some power structures are fairly resilient and stable, while others are short-lived. But none of them is everlasting. Therefore it is important to study both the factors supporting and preserving given power structures and the factors undermining them and giving rise to new ones.

In order to describe a given power structure, we have recourse to an analogy that hopefully is of some use.[15] In his analysis of production structures, Sraffa (1960: 7–8) distinguished between "basic" and "non-basic" commodities. This means that commodities are not all ranked equally: while basic commodities enter directly or indirectly into the production of all commodities, non-basic commodities do not. One group of non-basic commodities enters into the production only of itself and all other non-basics, another group of non-basics enters into itself and all other non-basics except the group mentioned before, and so on. There is also the case of pure consumption goods that play no role whatsoever as inputs in production. In the case of single production, this means that the (square) matrix of material inputs $\mathbf{M} = [m_{ij}]$, where m_{ij} gives the amount of commodity j needed to produce one unit of commodity i, is decomposable and can be reduced to its canonical form

$$\begin{bmatrix} \mathbf{M}_{11} & 0 & \cdots & 0 \\ \mathbf{M}_{21} & \mathbf{M}_{22} & \cdots & 0 \\ \vdots & \vdots & \vdots & \vdots \\ \mathbf{M}_{s1} & \mathbf{M}_{s2} & \cdots & \mathbf{M}_{ss} \end{bmatrix}$$

$\mathbf{M}_{11}$, $\mathbf{M}_{22}$, …, $\mathbf{M}_{ss}$ are non-decomposable square matrices, though not necessarily of the same order. In the case of pure consumption goods, matrix $\mathbf{M}_{ss}$ is the zero matrix. The block triangularisation brings out the fact that there is a hierarchy of commodities, with basics at the top in terms of productive importance and pure consumption goods at the bottom.

The analogy is close at hand: people are also not all ranked equally. Think, for example, of a dictatorship. In this case $\mathbf{M}_{11}$ would consist of a single element only and represent the self-sameness of the dictator.

Matrices $\mathbf{M}_{21}$, $\mathbf{M}_{31}$, …, $\mathbf{M}_{s1}$ would also consist of single elements only, whose weights may, however, be different, reflecting differences in the dictator's (deliberate or constrained) impact on other people. This impact would be "filtered" through intermediate agents of the first order (ministers, generals and so on), represented by items $\mathbf{M}_{22}$, $\mathbf{M}_{32}$, …, $\mathbf{M}_{s2}$, who communicate with, give orders to, and control intermediate agents of the second order, and so on.

At each step of a hierarchy, that is, any kind of hierarchy and not just the one in a dictatorship, what matters are the means of the various ranks of people to exercise their power and enforce their will. Power, the German sociologist Heinrich Popitz ([1986] 1992: 22) maintained in accordance with Max Weber, "is the capability to prevail over other forces". He distinguished between various fundamental forms of the exercise of power, the most important of which are the following three:

(1) "Power of action" (*Aktionsmacht*) is rooted in the fact that people can hurt others and can also be hurt. It often involves the use of violence and need not seek to change other people's behaviour (for example, in the case of acts of revenge). Power of action is typically short-lived and disappears the moment it is used.

(2) "Instrumental power" is employed to influence the behaviour of other people by means of promises or threats and generally positive or negative sanctions. Instrumental power is more durable than the power of action, because it is applied with regard to a longer time horizon.

(3) "Authoritative power" relies on the need of people to be respected by their peers. Such respect, whether real or imagined, increases a person's self-esteem and ties it to its peers. This kind of power can be used to affect not only the observable behaviour of people, but also their unobservable attitudes and mind-sets, the norms they follow and possibly even the unconscious. It typically does not employ force or violence, but suasion, manipulation and professional excellence in the field under consideration.

In the above matrix, re-interpreted properly, it is clear that each agent is typically in contact with several other agents. Those we may call "basic agents" are bound to deal with one another, being exposed to reciprocal influences. At the same time, they exert some influence, directly or indirectly, via other agents, on all "non-basic" agents, without being influenced by them. Agents belonging to distinct groups of non-basic agents, that is, those constituting matrices along the diagonal ($\mathbf{M}_{22}$, $\mathbf{M}_{33}$, …, $\mathbf{M}_{ss}$), are exposed to reciprocal influences by all other agents in the group and exert some influence, directly or indirectly, on all non-basic agents of lower orders, and so on. The basicness or non-basicness of some agents may be more or less closely related to whether, for example, the firms they control produce basic or non-basic products. A business leader in the energy sector, for example, can be expected to be possessed of greater economic power than a business leader in the industry producing napkins. The degree of concentration and monopolisation within an industry also matters a great deal and affects the weight to be attributed to the business leader. This weight may differ as between agents he does business with.[16]

Within a given power structure, the location of a particular agent, that is, whether he or she is a basic or a non-basic agent, and if the latter, whether a non-basic agent of the first, second and so on order, is obviously a factor co-determining his or her power. Another factor is the kind of means at the agent's disposal relative to those at the disposal of his or her counterparts or opponents. A third factor is the institutional setting, the channels of communication, the rule of law and the rules of the game, the opportunities to build coalitions or monopolies, the social security system and so on, which have an impact on the outcome of the socio-economic process.

A specification of the power structure in terms of matrix **M** can be the starting point of an inquiry both into the reproduction of this structure and into its erosion and eventual abandonment in favour of some new structure. As in the theory of innovations, technical change and economic growth, important movers and shakers of a given power structure are breakthroughs in technical and organisational knowledge. These may have various effects. First, they may affect the rows of matrix **M** by changing the magnitudes of its coefficients, leaving the structure intact. Second, they may elevate a non-basic agent of a given order to some higher order or even to the position of a basic one, or, conversely, downgrade the agent in a variety of ways.[17] Third, disruptive changes may affect the dimension of the matrix: some rows may disappear entirely from the scene and others may enter it. The increase in variety (new goods and the emergence of new industries) need not be exactly matched by a parallel decrease in it (the obsolescence of certain goods and the shutting down of old industries). Hence the dimension of the matrix cannot be expected to remain the same. As regards types of agents, they may change their positions in the power network, moving down from basic to non-basic positions or climbing up the power ladder to basic ones. Or they may lose their positions because of their elimination, or occupy entirely new positions brought into existence by technological and organisational change, the formation of monopolies and the like.

We now turn to the investigation of power relationships by one of the most influential political philosophers ever: Thomas Hobbes. We shall see that many of the aspects mentioned above recur in Hobbes' work.[18]

4. Thomas Hobbes and the absolutist state

In Chapter X, "Of Power, Worth, Dignity, Honour and Worthiness", of Part I, "Of Man", of his *Leviathan*, published in 1651, Hobbes defined "the power of man, to take it universally, as his present means to obtain some future apparent good"; this power, he added, "is either original or instrumental." (Hobbes 1651: 53). He distinguished between "Natural Power" possessed by people with extraordinary qualities, such as intellectual eloquence, physical strength, prudence and so on, and "Instrumental Power", which refers to means or devices used to increase one's personal power and includes especially wealth, but also reputation, influential friends and networks. The quest for power, Hobbes was convinced, is ultimately *a quest for command over the power of others*. If a person can get another person to use his or her power on behalf of the first person's interests, then the latter can add this power to his or her "arsenal". Hobbes observed:

> The greatest of human powers is that which is compounded of the powers of most men, united by consent, in one person, natural or civil, that has the use of all their powers depending on his will; such as is the power of a Commonwealth … Therefore to have servants is power; to have friends is power; for they are *strengths united*. (Hobbes 1651: 53–4; emphasis added)

Hobbes then enumerated the following sources of instrumental power: riches, reputation, popularity, to be loved or feared, success, affability if already in power, reputation of prudence, nobility, eloquence, form and appearance (Hobbes 1651: 54). The sciences, he added, "are small powers; because not eminent, and therefore, not acknowledged in any man … For science is of that nature, as none can understand it to be, but such as in a good measure have attained it" (Hobbes 1651: 54). Instruments of war, fortifications and so on contribute to a sovereign's power. Wealth and riches are seen as an important source of power (see Hobbes 1651: 57).

One way of increasing one's power is to buy the compliance of others. Hobbes stressed: "The value or worth of a man is, as of all other things, his price; that is to say, so much as would be given for the use of his power" (Hobbes 1651: 54).[19]

Hobbes insisted that power is a *relative* concept—relating the powers of several people. If one person has less power than another one, then the former person is effectively powerless in the presence of the latter. This was, in his opinion, the origin of a perpetual struggle for power amongst men, initiated by "puer robustus", a troublemaker, always vying for greater power and seeking to acquire the power of others on his behalf. The condition of men, Hobbes insisted, "is a condition of war of every one against every one, in which case every one is governed by his own reason, and there is nothing he can make use of that may not be a help unto him in preserving his life against his enemies." He concluded:

> it followeth that in such a condition every man has a right to every thing, even to one another's body. And therefore, as long as this natural right of every man to every thing endureth, there can be no security to any man, how strong or wise soever he be, of living out the time which nature ordinarily alloweth man to live. (Hobbes 1651: 80)

According to Hobbes, there is only one possibility to escape the state of nature and perpetual war, the *bellum omnium contra omnes*: in the interest of peace, man is to cede all power to a central authority. This leads to a monarch or absolutist state endowed with absolute power—Hobbes' "Leviathan" (see Figure 2), the monstrous and fearsome sea creature in the book of Job that ends the state of nature and brings about a condition of social equilibrium by keeping the "children of pride" in check.

Fig. 2: Leviathan

Numerous authors after Hobbes took up his view that wealth is an important source of power. For example, Sir James Steuart (1713–1780) in his *Inquiry into the Principles of Political Economy* published in 1767— ten years before Adam Smith's *Wealth of Nations*—supported Hobbes' conviction by stating: "wealth will give power" (Steuart [1767] 1966: 213). With the rise of nation-states in Europe, the discovery of new worlds, the expansion of long-distance trade and the growing tensions amongst nations over their overseas dominions, a major concern of mercantilist authors was with a nation's performance in foreign markets and its capability to prevail in the case of conflict and war. This directed the attention to a nation's economic and military power. In addition, these authors were often concerned with the relative power of the monarch and the great lords of the country. The dispersion of power within a nation and struggles over it could weaken the position of a nation relative to that of its competitors in the dispute over spheres of influence abroad.

We now turn to Adam Smith, who took issue with Hobbes' doctrine. The richness of his argument and the influence he had on Ricardo and Marx justify a detailed treatment of his ideas.

5. Adam Smith and the well-governed society

The problem of power—economic, political, institutional—permeates Adam Smith's *The Wealth of Nations*.[20] The characteristic features of his perspective on the problem are the following. Smith saw power rooted in various kinds of asymmetries especially regarding wealth, education, information, and the ease or difficulty with which groups of people can organise and defend their interests. He was perfectly aware of the problem of collective decision and action large groups (for example, workers) face vis-à-vis smaller ones (for example, employers). His point of view was first and foremost systemic: it concerned the working of the socio-economic system as a whole. The power relationships in any such system are typically expressed in the existence and continual reproduction of social classes. These are defined in terms of the roles of their members in the process of the production and appropriation of the social product, their different degrees of information about and understanding of what is going on in the economy and their very uneven participation in public life and capability of defending their interests. The persistence of social classes and the low rate of circulation of elites reflect a remarkable persistence of power asymmetries, which often erode only slowly, if at all. At the root of such asymmetries Smith saw differences in property, political power, access to information and knowledge. Society moulds people, and while people also mould society, the latter is hardly noticeable in the short and medium run. The social backgrounds of people and how they have been brought up shape their motives, mind-sets and economic opportunities. Needs for achievement, attitudes and behaviours, consumption patterns and so on reflect in no small degree the particular social stratum to which a person belongs. Treating tastes and preferences as givens that deserve no further examination, as in marginalist theory, mistakes the effects of the social fabric for its ultimate cause. The widespread idea that marginalist economics is deeply rooted in the Smithian tradition cannot be sustained.[21]

(a) Smith on Hobbes

Smith advocated a socio-economic order in which large parts of economic life are coordinated via interdependent markets in conditions of free competition. Such an order, he was convinced, was not only economically fairly efficient, by favouring "equality, liberty and justice" (WN IV.ix.3) in society it was also to be welcomed from an ethical point of view. He was convinced that pursuing one's interests did not necessarily lead to chaos and anarchy–at least not in a well-governed society. *The Wealth of Nations* was explicitly designed to elaborate a "science of the legislator" that showed the way towards good government. Smith was decidedly not of the opinion that is frequently, but wrongly, ascribed to him, that nothing but selfishness was needed to yield socially beneficial outcomes (see the discussion in Kurz 2016). This view was exactly the opposite of the one Hobbes had advocated. To Smith both were fundamentally flawed: the former shut its eyes before the dark sides of man, whereas Hobbes ignored the bright sides. In *The Theory of Moral Sentiments*, published in 1759, Smith frontally attacked Hobbes' doctrine by calling it "odious" and "offensive to all sound moralists, as it supposed that there was no natural distinction between right and wrong; that these were mutable and changeable, and depended upon the mere arbitrary will of the civil magistrate" (TMS: 504). In order to refute Hobbes' doctrine, Smith stressed, "it was necessary to prove that, antecedent to all law or positive institution, the mind was naturally endowed with a faculty, by which it distinguished, in certain actions and affections, the qualities of right, laudable, and virtuous, and in others those of wrong, blameable, and vicious" (TMS: 504). In short, Smith disputed Hobbes' philosophical anthropology and the social theory erected upon it. Hobbes is said to have advocated a fundamentally wrong view of man's dispositions and features. Peace and an agreeable state of social affairs, Smith was convinced, could not be attained by means of a Leviathan, who would spell trouble for most of his subjects, but rather by good government that did not unduly limit the freedom of action of agents.

While Smith rejected Hobbes' overall construction, there is an element in it, which in *The Wealth of Nations* he firmly endorsed:

> *Wealth, as Mr. Hobbes says, is power*. But the person who either acquires, or succeeds to a great fortune, does not necessarily acquire or succeed to any political power, either civil or military. His fortune may, perhaps, afford him the means of acquiring both, but the mere possession of that fortune does not necessarily convey to him either. The power which that possession immediately and directly conveys to him, is the *power of purchasing*; a certain *command over all the labour*, or over all the produce of labour, which is then in the market.

This echoes Hobbes' concept of the price that would be given for the use of someone else's power. Smith went on:

His fortune is greater or less, *precisely in proportion to the extent of this power*; or to the quantity either of other men's labour, or, what is the same thing, of the produce of other men's labour, which it enables him to purchase or command. *The exchangeable value of everything must always be precisely equal to the extent of this power which it conveys to its owner.* (WN I.v.3; emphases added)[22]

(b) Labour commanded vs. labour embodied: Smith's measure of power

The difference between the amount of labour embodied in a commodity and the amount of labour that can be commanded by the owner of a unit of it is Smith's measure of the owner's power. (Here we put on one side the fact that Smith included in the concept of labour also, for example, the labour of horses and oxen). Let us expound his idea with the help of some formal analysis. Assume a classical system of "natural prices" (or "prices of production" as David Ricardo, Robert Torrens and Karl Marx called them) in the simple case of circulating capital only (and abstracting from scarce natural resources),

$$\mathbf{p} = (1 + r)(\mathbf{Ap} + w\mathbf{l}),$$

with $\mathbf{p}$ as the n-dimensional price vector, $\mathbf{A}$ as the material input matrix, $\mathbf{l}$ as the n-dimensional vector of (homogeneous) labour inputs, r as the general rate of profits and w as the wage rate (see Kurz and Salvadori 1995: chap. 4). All value magnitudes are expressed in terms of some standard of value, a single commodity or a bundle of commodities $\mathbf{d}$**;** that is,

$$\mathbf{d}^T\mathbf{p} = 1$$

(Vectors are here defined as column vectors; superscript T indicates a row vector). Labour commanded prices, $\mathbf{p}°$, equal prices of production divided by the wage rate, $\mathbf{p}° = \mathbf{p}/w$, and thus

$$\mathbf{p}° = (1 + r)(\mathbf{Ap}° + \mathbf{l})$$

Solving for $\mathbf{p}°$, gives

$$\mathbf{p}° = (1 + r)[\mathbf{I} – (1 + r)\mathbf{A}]^{-1}\mathbf{l},$$

with **I** as the n x n identity matrix.

The vector of quantities of labour embodied in the different commodities, **v**, is instead given by

$$\mathbf{v} = \mathbf{Av} + \mathbf{l} \quad \text{or} \quad \mathbf{v} = (\mathbf{I} - \mathbf{A})^{-1}\mathbf{l}$$

Comparing the last two systems of equations, one can see at a glance that when the rate of profits happens to be equal to zero, labour commanded and labour embodied magnitudes coincide:

$$\mathbf{p}^{\circ} = \mathbf{v}, \ \text{iff} \quad r = 0$$

Yet when the rate of profits is positive, labour commanded prices exceed labour embodied values:

$$\mathbf{p}^{\circ} > \mathbf{v}, \ \text{iff} \quad r > 0,$$

where 0 d” *r* d” *R*, with *R* as the maximum rate of profits of the given system of production corresponding to zero wages. Given that, as can be shown (see, for example, Kurz and Salvadori 1995: chap. 4), labour commanded prices are positive functions of the rate of profits, i.e.,

$$\frac{d\mathbf{p}^{o}}{dr} > 0,$$

the higher is *r*, the larger is the difference between labour commanded and labour embodied.

This corresponds to Smith’s conviction that all property incomes, here profits (but also rents), indiscriminately imply a “deduction from the produce of labour” (WN I.viii.7). This “deduction” is caused by the existing asymmetry with regard to the economic power of capitalists relative to that of workers. The size of the deduction reflects the magnitude of the asymmetry.

The measure of power that Smith suggested found an echo in Piero Sraffa’s concept of the Standard commodity.[23] While the latter evolved from a reformulation of David Ricardo’s concept of an invariable measure of value (invariable, that is, with regard to changes in income distribution), Sraffa (1960: 94) pointed out that it “should be found to be equivalent to something very close to the standard suggested by Adam Smith, namely ‘labour commanded’”. With the Standard commodity employed as the measure of value and wages taken to be paid post factum (at the end of the production period), the constraint binding changes in the rate of profits, r, and the share of wages in national income, t , or wage frontier, is given by

$$r = R\,(1 - \Omega),$$

with R as the maximum rate of profits. Solved for Ω, we get

$$\Omega = \frac{R - r}{R}$$

The inverse gives the labour commanded value of the net social product,

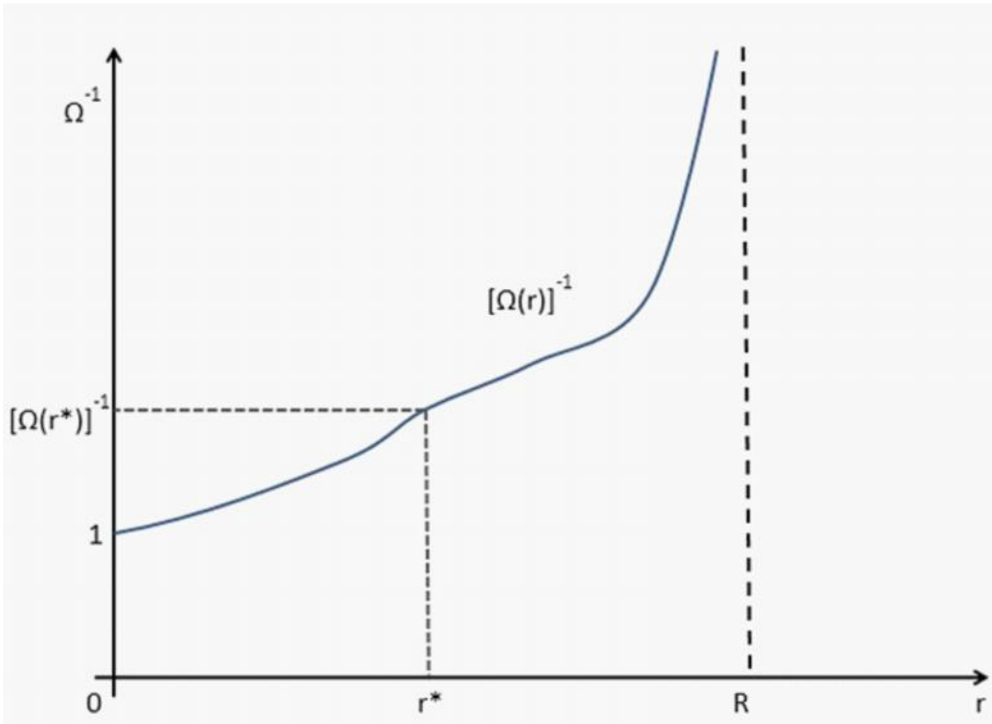
$$\Omega^{-1} = \frac{R}{R - r}$$

Obviously,

$$\mathrm{d}\,\frac{(\Omega^{-1})}{\mathrm{d}r} > 0$$

With r approaching its finite maximum value R (and correspondingly, the share of wages vanishing), the labour commanded value of the net social product tends to infinity. In Figure 3, the abscissa gives the rate of profits and the ordinate the labour commanded value of the net social product. At $r = 0$, the share of wages equals unity, $= 1$, and so does the labour commanded value of the net social product, $^{-1} = 1$, which for $r = 0$ equals also its labour embodied value.[24] If r approaches its upper limit R, the labour commanded value rises without limit. The upward bending curve $[\ (r)]^{-1}$ illustrates the relationship. Following Smith's suggestion, for any given value of r, such as, for example, $r = r^*$, the difference between $[\ (r^*)]^{-1}$ and 1 is a measure of the power of capital relative to labour.

Fig. 3: A measure of the power of capital



(c) Different stages of society and the "dispute" over income distribution

It is remarkable how large a role Smith attributed to power in each of the three stages of society he distinguished with regard to the distribution of the product amongst the various claimants. The three stages are defined in terms of whether or not the objects and instruments of labour are in private ownership and are unevenly distributed amongst people. In the "original state of things", there are no significant means of production employed by men and land is not yet privately appropriated. In this case, "the whole produce of labour belongs to the labourer. He has neither landlord nor master to share with him" (WN I.viii.2). All economic power is in the hands of producers, that is, labourers.

As soon as land becomes private property in the hands of only a few members of society, the situation changes markedly. Now there is a two-class society with workers and landlords, the latter demanding and obtaining a rent for the use of land, which "makes the first deduction from the produce of the labour which is employed upon land" (WN I.viii.6). Smith explicitly called rent a "monopoly price" (WN I.xi.a.5) to be paid to the feudal aristocracy. A rent has to be paid, because landlords could otherwise withdraw their lands from productive use by others. The more concentrated the property of land is, the larger is the economic power of the landed gentry and the higher will be the rents.

With regard to the third stage, in which produced means of production play a significant role and are in private and concentrated ownership, Smith provided a first reason why the workers' bargaining position in the conflict over the distribution of the product is weak: "It seldom happens that the person who tills the ground has wherewithal to maintain himself till he reaps the harvest" (WN I.viii.7). The same applies essentially also to "all arts and manufactures", to which masters, that is, the proprietors of "stock" (plant and equipment and all kinds of means of production and subsistence), "advance the materials of their work, and their wages and maintenance till it be completed" (WN I.viii.8). This leads to a "second deduction" from the produce of labour, which constitutes profits.

Smith then asked what determines the "common wages of labour". These depend, he observed, "every where upon the contract usually made between those two parties, *whose interests are by no means the same*", which is shown by the fact that "The workmen desire to get as much, the masters to give as little as possible. The former are disposed to combine in order to raise, the latter in order to lower the wages of labour" (WN I.viii.11; emphasis added). Smith insisted that

> It is not, however, difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the *dispute, and force the other into compliance with their terms*. [1] The masters, being fewer in number, can combine much more easily; and [2] the law, besides, authorises, or at least does not prohibit their combinations, while it prohibits those of the workmen. … [3] In all such disputes the masters can hold out much longer. A landlord, a farmer, a master manufacturer, or merchant, though they did not employ a single workman, could generally live a year or two upon the stocks which they have already acquired. Many workmen could not subsist a week, few could subsist a month, and scarce any a year without employment (WN I.viii.12; emphasis added).

Because of reasons [1] to [3], the bargaining position of the "labouring poor" is weak and they must typically accept the conditions dictated by employers in the "dispute" over wages. "Masters", Smith added, "are always and every where in a sort of tacit, but constant and uniform combination, not to raise the wages of labour above their actual rate. To violate this combination is every where a most unpopular action, and a sort of reproach to a master among his neighbours and equals." He went on: "*We seldom, indeed, hear of this combination, because it is the usual, and one may say, the natural state of things which nobody ever hears of*" (WN I.viii.13, emphases added).

We might say: *power walks on silent paws*.[25]

To summarise: workers are at a disadvantage on three counts: they find it difficult to organise their interests, which weakens their capability to engage in collective action; the law and political bodies discriminate against them; and they lack the wherewithal that would support them in case of strikes or lockouts by employers.

(d) Power due to information asymmetries

Workers, Smith observed, are typically little educated, they often do not know what their interests really are and how these can most effectively be pursued, and they hardly understand the working of the socio-economic system. They are thus easily the victims of others who deliberately mislead them in favour of their own interests.

Information asymmetries permeate *The Wealth of Nations*. Interestingly, Smith's classification of people as landlords, workers and capitalists corresponds not only to whether or not they possess some property, and which, but also to their access to information and knowledge. Landlords, as we have already heard, "love to reap where they never sowed": they receive revenue (rent) that "costs them neither labour nor care, but comes to them ... independent of any plan or project of their own". This makes them indolent and "renders them too often, not only ignorant, but incapable of that application of mind which is necessary in order to foresee and understand the consequences of any publick regulation" (WN I.xi.p.8).

The situation is a great deal worse with respect to the great majority of people, its second order: the worker's "condition leaves him no time to receive the necessary information, and his education and habits are commonly such as to render him unfit to judge even though he was fully informed". The worker, Smith stressed, is most in danger of being manipulated: "In the publick deliberation, therefore, his voice is little heard and less regarded, except upon some particular occasions, when his clamour is animated, set on, and supported by his employers, *not for his, but their own particular purposes"* (WN I.xi.p.9, emphasis added). The idea entertained in much of economic theory that people are well (and often even perfectly) informed and capable of sound judgement is entirely alien to the Scotsman's view. The concept of rationality—maximisation of expected utility, given a well-defined utility function, with respect to given and well-perceived constraints—may apply to some members of society, but clearly not to workers.

According to Smith, the people that are best informed about economic and political matters are merchants and master manufacturers, who "during their whole lives ... are engaged in plans and projects" and who therefore "have frequently more acuteness of understanding than the greater part of country gentlemen" (WN I.xi.p.10). These men, possessed of a "superior knowledge of their own interest", are on the one hand the source of economic development. Their selfishness may, on the other hand, harm the interests of the other classes and society at large. Smith emphasised with special reference to the "dealers" or market intermediaries that their interest is always in some respects different from, and even opposite to, that of the publick. To widen the market and to narrow the competition, is always the interest of the dealers. To widen the market, they may frequently be agreeable enough to the interest of the publick; but *to narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens*.

Smith inferred from this:

> The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. *It comes from an order of men, whose interest is never exactly the same with that of the publick, who have generally an interest to deceive and even to oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it.* (WNI.xi.p.10, emphases added)

Those who are better informed and able to assess the facts—business people of all kinds—can be expected to use their superior knowledge to the disadvantage of others, whether in discussions of political or commercial matters. Their counterparts—consumers and workers—are exposed to what nowadays is called “moral hazard”. Smith did not use the notion, but he was perfectly familiar with the concept and illustrated it in terms of numerous examples. He also stressed variously that asymmetric information in combination with moral hazard can lead to what is now called “adverse selection”. An important case in point is the banking sector, as was evidenced by then recent events in Scotland and France: bankers are willing to take risks, knowing that in case of failure the potential costs of their decisions will be borne by others (see Kurz 2016a: section 6).

Smith left no doubt that the banking trade ought to be regulated. The question was, which regulations would look after “the security of the whole society”, and at the same time, leave enough room for the pursuit of self-interest and allow banks to provide the needed credit for doing so. He was clear that a regulatory framework installed at one time could not settle the matter once for all, but had to be adjusted in response to innovations carried out in the banking trade, many of which were designed to circumvent the regulations (see, e.g., Minsky 1986). To the extent to which the law, social institutions, regulations etc. accomplish their tasks or fail to do so, they tend to diminish or strengthen existing power asymmetries.[26]

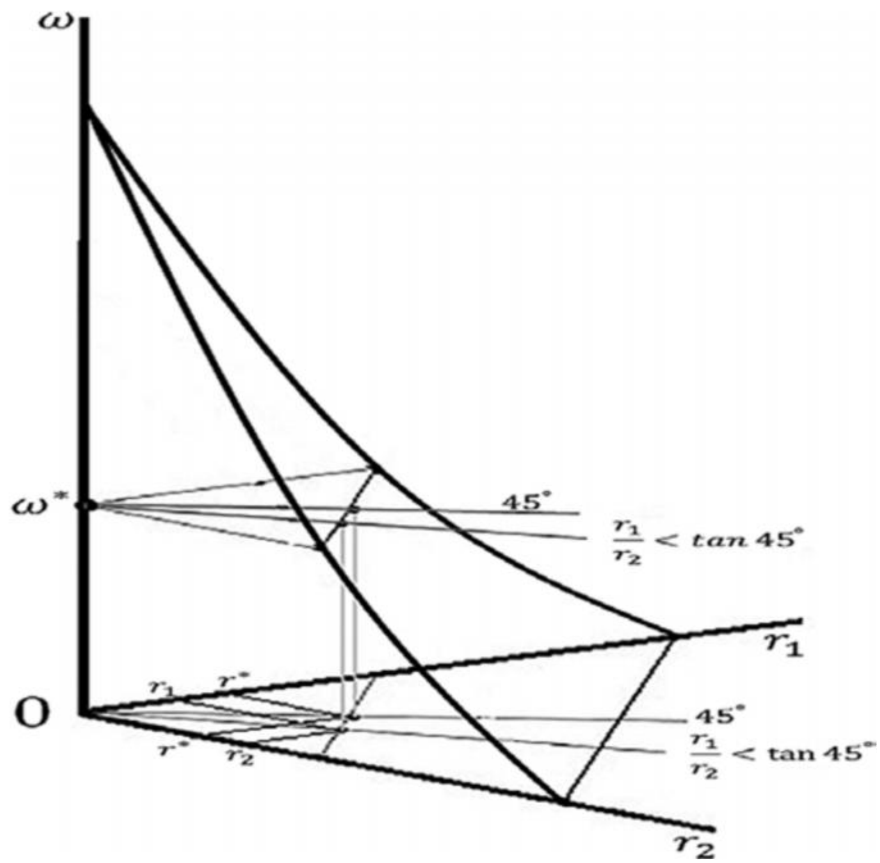
The importance of power in classical economics can be put in sharp relief by contrasting the classical concept of “free competition”, on the basis of which Smith, Ricardo and many others developed the main parts of their analyses, with the marginalist concept of “perfect competition” (see also Salvadori and Signorino 2013). In the literature, the two are frequently confounded, although they ought to be strictly kept apart. The system of equations giving natural prices in the above reflects a situation of free competition, but not a state of affairs in which none of the agents is possessed of economic power. Free competition means that there are no significant barriers to entry into or exit from any market. In such a state of things, there will be a tendency towards a uniform rate of profits throughout the economic system and hence across all industries, and towards a uniform wage rate for each kind of labour (and a uniform rent per acre for each quality of land). It does *not* mean that there will be a tendency for profits (and rents) to vanish: the resulting prices exceed costs of production and include a positive rate of profits as an expression of capital’s power.[27]

(e) Wages and the general rate of profits

Whether the rate of profits is high, and the real wage rate correspondingly low, depends on a number of factors, including those mentioned above in the context of the discussion of the dispute over wages. Two important factors are now added. They concern, first, the pace at which capital accumulates in the economy and, secondly, the rate at which population grows. Smith stressed that it is only in conditions of rapid economic expansion, when the growth rate of the demand for hands exceeds that of supply, that masters tend to violate their combination: "The scarcity of hands occasions a competition among masters, who bid against one another, in order to get workmen, and thus voluntarily break through the natural combination of masters not to raise wages" (WN I.viii.17). Concerned predominantly with the causes that improve the living conditions of the "labouring poor", it comes as no surprise that Smith would focus attention first and foremost on the factors affecting capital accumulation and economic growth.

This concern also explains Smith's repeated attacks on what he called the "wretched spirit of monopoly" that was constantly seeking to restrict competition and establish monopolistic conditions. The monopolist does not have to fear competitors, who underbid his price, reduce his market share and curtail his profits. Monopolies are able "to keep up the market price, for a long time together, a good deal above the natural price" (WN I.vii.20). This allows them to pocket the difference as supernormal or extra profits. Restricting competition, Smith was convinced, is another device for single firms or entire sectors of the economy to increase their profitability (and can thus be compared to improvements in the productive apparatus).[28] We may illustrate the argument with the help of the wage frontier (see Kurz and Salvadori 1995: 50–51) in the case in which there are only two industries, one of which manages to reap supernormal profits. The wage frontier in the example under consideration gives the constraint binding on changes in the distributive variables, the real wage rate, μ, and the rates of profit in the two industries, r_1 and r_2, where $r_j > 0$, $j = 1, 2$. Each set of (feasible) rates would typically be accompanied by a different set of relative prices.[29] In Figure 4, the real wage rate (in terms of one of the commodities or a bundle of them) is measured along the vertical axis, whereas the industry-specific profit rates are measured along the two axes on the bottom plane. In conditions of free competition, at a given natural wage rate μ^*, the rate of profits would tend to be uniform, that is, $r_1 = r_2 = r^*$. It would be given by the intersection of the 45° line and the intersection of the wage frontier and the plane parallel to the level μ^* of the real wage rate.

Fig. 4: The wage frontier



Clearly, if in one industry because of a monopolistic privilege or position a higher rate of profit than the natural one can be obtained, and if the real wage rate happens to be unaffected by this, then the rate of profit in the other industry will have to be smaller than the natural one. In the figure $r_2 > r^* > r_1$ represents such a constellation. Obviously, the three distributive variables are not independent of one another: given any one of them, the other two are inversely related. Smith showed some awareness of this (although there are passages in *The Wealth of Nations* that shed doubts on the depth of his understanding). He also saw that changing income distribution, that is, hypothetically moving along the surface of the wage frontier, would typically be accompanied by changes in relative prices (see Kurz and Sturn 2013: Section 2.6.3).

To Smith, the English East India Company and similar companies in the Netherlands and France were frightening examples of the enormous damage monopolies can cause. And while Smith was a fervent advocate of free trade, he left no doubt that his respective doctrine was incompatible with such monopolies, because they restricted free trade on behalf of one side. He deplored the fact that "The savage injustice of the Europeans rendered an event, which ought to have been beneficial to all, ruinous and destructive to several of those unfortunate countries" (WN IV.i.32).[30]

Smith's work had a huge impact on the subsequent discussion of the problem of power.[31] While some of his analytical propositions were shown to be untenable, others were approved of and adopted by later authors, often with some adaptation to their own analytical schemes.[32] Space constraints make us focus attention only on David Ricardo and Marx.

6. David Ricardo on the "mute agents" of production

David Ricardo thought highly of Smith's achievements and saw his own contribution as concerned essentially with correcting what in Smith was incorrect or based on too narrow a foundation, or adding what he felt was missing in the Scotsman's analysis. For the rest, he was in agreement with the doctrine of the Scotsman.[33] Here we will limit the discussion to just four aspects. The first one concerns Ricardo's theory of profits and rents, which was meant to rectify Smith's theory, the second Ricardo's criticism of the Corn Laws, which was based on his new theory of profits, the third Ricardo's sophisticated analysis of different forms of technical progress and their impact on workers, and the fourth his criticism of the Bank of England and its monetary manoeuvres. In each case, a few remarks must suffice.[34]

(a) The surplus approach to property incomes

Prompted by a move before Parliament to restrict the corn trade in early 1813, Ricardo began to study the impact of such a restriction on the rate of profits and on the rate of capital accumulation. He scrutinised critically Adam Smith's doctrine and swiftly saw that it was flawed. In February 1815 Ricardo published his *Essay on Profits*, which laid the ground for his theory of value and distribution that was further developed in his magnum opus, *On the Principles of Political Economy and Taxation*, which came out in April 1817. Like Smith, Ricardo saw all property incomes—rents, profits and interest—as originating from the surplus product that remains after all necessary costs of production, including the necessary wages of labour, have been deducted from gross outputs.[35] He insisted, for example: "Profits come out of the surplus produce" (*Works* II: 128). For a given system of production characterised by given outputs and given methods of production used to produce these outputs, different levels of proportional wages would be associated with different levels of the general rate of profits. This is Ricardo's "fundamental law of distribution"—the inverse relationship between the rate of profits (r) and the share of wages—arguably one of his most important analytical discoveries. As he put it in a letter of 13 June 1820: "The greater the portion of the result of labour that is given to the labourer, the smaller must be the rate of profits, and vice versa" (*Works* VIII: 194). Real wages and the rate of profits could not both rise, given the system of production in use, as some writers had erroneously contended. The harmonious view of society implicit in this contention was naïve and ignored the constraint binding changes in the distributive variables.

Smith had explained the rent of land as a "monopoly price" and had argued in a straightforward Physiocratic manner that rents reflect the "generosity" of nature: in agriculture, he opined, nature collaborates with labourers, but does so for free. This led him to the peculiar view that productivity in agriculture is higher than anywhere else in the economy, from which he concluded that economic policy should promote first and foremost the development of agriculture and not that of manufacturing and other sectors. Ricardo objected that all this was mistaken. First, rents reflect the "niggardliness" of nature and not its generosity: if land of the best quality was available in unlimited quantity, there could be no rent. Only because its quantity is limited, lands of inferior quality have eventually to be cultivated in case the effectual demand for wheat rises. The differences in unit costs between the least fertile quality of land that has to be employed in order to meet effectual social demand, later called "marginal land", and intra-marginal lands give rise to differential rents obtained by the proprietors of the latter. The price of wheat has to rise as the quantity produced of it increases, but since the price is determined on the no-rent bearing quality of land, rent "cannot enter in the least degree as a component part of its price" (*Works* I: 77), contrary to Smith's view. Rent was not the cause, but the effect of a high price of corn.

Ricardo developed his argument on the assumption of free competition and showed that no "monopoly price" concept was needed in order to understand the phenomenon of rent. He confirmed, however, Smith's proposition that the proprietors of (intra-marginal) lands "reap where they never sowed" and are the lucky beneficiaries of economic growth that tends to increase the relative scarcity of lands and swell the rents of land. Since the price of an acre of a given quality of land (an asset with infinite life) equals the rent divided by the rate of interest, also the price of land will rise (given a constant or even a falling rate of interest) and make landlords richer and richer, although they have done nothing at all for this to happen.

Rents are effortless incomes, tied to the legal institution of private property of land, and reflect the dynamism of the economic system as a whole. The institution of property in land gives power to landlords, which tends to increase together with the expansion of the system (in the case of insufficiently land-saving technical progress).

(b) Criticism of the Corn Laws

Ricardo developed his theory of value and distribution in a deliberate move to provide a solid foundation for his criticism of the Corn Laws, which, after having been suspended during the late eighteenth century, were reinstated again after the Napoleonic Wars in 1815. Against the background of Ricardo's new theory, the effects of the Corn Laws were straightforward. By reducing imports, the price of corn would rise on the English isle. This would be immediately favourable to landlords, whose money rents would increase, and it would be immediately detrimental to workers, whose real wages would decrease, given money wages, and to consumers at large. Eventually money wages would have to rise in case population growth happened to be negatively affected by a fall in real wages. (This may, but need not be the case). Rising money wages would in turn depress profitability, and a falling rate of profits decelerate the accumulation of capital and economic growth. Because of rising domestic costs of production, the Corn Laws would also negatively affect the international competitiveness of the manufacturing sector. Therefore the argument of those who in Parliament supported the reinstatement of the Corn Laws on the ground that it was in the interest of society as a whole could not be sustained: the only class that benefited from the laws were the landlords, whereas both workers and capitalists would suffer from it. The Corn Laws were thus a typical case in which private interests were misleadingly passed off as collective ones.

In Parliament, Ricardo belonged to a small minority of advocates of free trade.[36] He discussed the issues at hand *inter alia* with Thomas Robert Malthus, who did not share his, Ricardo's view. In a letter of 26 June 1814, Ricardo wrote:

> I cannot partake of your doubts respecting the effects of restrictions on the importation of corn, in tending to lower the rate of interest. … The rate of profits and of interest must depend on the proportion of production to the consumption necessary to such production [i.e. its physical costs of production including means of production and means of subsistence],—this again essentially

> depends upon the cheapness of provisions, which is after all, … the great regulator of the wages of labour.

Ricardo added:

> Nothing can tend more effectually to diminish the demand abroad for our manufactures than to refuse to import corn and all the commodities which we had usually taken in exchange for such manufactures. … I never was more convinced of any proposition in Polit: Economy than that restrictions of importation of corn in an importing country have a tendency to lower profits. (*Works* IV: 108-109)

Looked upon more closely, according to Ricardo the reinstatement of the Corn Laws was just an expression of the fact, as he emphasised in the *Principles*, that "the interest of the landlord is *always* opposed to that of the consumer and manufacturer" (*Works* I: 335; emphasis added)[37]. He insisted: "All classes, therefore, except the landlords, will be injured by the increase in the price of corn. … [T] he loss is wholly on one side, and the gain wholly on the other; and if corn could by importation be procured cheaper, the loss in consequence of not importing is far greater on one side, than the gain is on the other." (*Works* I: 336)[38]

(c) Changing the balance of power between capitalists and workers: machinery and unemployment

Ricardo had a much clearer understanding than Smith that technical change was an essential part of the development of modern society. He also saw that different types of technical change have to be distinguished because they typically entail different effects. The widespread view that Ricardo saw the stationary state lurking around the corner mistakes his method of counterfactual reasoning—What would happen in the absence of technical progress?—for a statement concerning the actual tendency towards a stationary state. While Smith had argued that the manufacturing sector produced essentially only luxuries for the rich, Ricardo can be said to have glimpsed its key role in economic development as an engine of growth.

Ricardo was also clear that certain forms of technical change were detrimental to the interests of workers. Under the impact of the Luddite movement, he re-considered his position on the question of improved machinery, and in the third edition of the *Principles* published in 1821, added a new chapter. In "On machinery" he recanted his previous view that "the application of machinery to any branch of production, as should have the effect of saving labour, was a *general good*, accompanied only with that portion of inconvenience which in most cases attends the removal of capital and labour from one employment to another" (*Works* I: 386; emphasis added). Previously, he had been convinced (in accordance with John R. McCulloch's theory of automatic compensation) that any displacement of workers due to technical change will swiftly be compensated by a growth in effectual demand either in the same or in some other sectors. Technical progress, Ricardo now insisted, was not an unambiguous and immediate blessing for all members of society. The system may rather experience prolonged periods of what was later called "technological unemployment". He stressed: "I am convinced, that the substitution of machinery for human labour, is often very injurious to the interests of the class of labourers" (*Works* I: 388).

Whereas prior to the third edition, Ricardo had maintained that maximising profits and maximising employment levels went in parallel, he had now convinced himself that this need not be so. He argued:

> My mistake arose from the supposition, that whenever the net income [profits] of a society increases, its gross income [net income plus wages, which equal a year's labour] would also increase; I now, however, see reason to be satisfied that the one fund, from which … capitalists derive their revenue, may increase, while the other, that upon which the labouring class mainly depend, may diminish, and therefore it follows … that the same cause which may increase the net revenue of the country, may at the same time render the population redundant, and deteriorate the condition of the labourer." (*Works* I: 388)

It is interesting to note that Ricardo called machines the "mute agents" of production because, unlike workers, they do not ask for higher wages or better working conditions. He saw machinery and labour "in constant competition" with one another (*Works* I: 395) and insisted that "these mute agents are always the produce of much less labour than that which they displace" (*Works* I: 42). He even contemplated, in 1821, the limiting case of a fully automated system of production and the problems this implied for workers: "If machinery could do all the work that labour now does, there would be no demand for labour. Nobody would be entitled to consume any thing who was not a capitalist, and who could not buy or hire a machine" (*Works* VIII: 399–400).

Ricardo therefore saw clearly that the introduction of improved machinery was not only a device used by firms in the competitive struggle with other firms, it also affected the balance of power between capitalists and workers in favour of the former. In the extreme case, when no labour was needed any longer, workers were deprived of any power whatsoever. This echoes Adam Smith's statement: "In the long run the workman may be as necessary to his master as his master is to him; but the necessity is not so immediate" (WN I.viii.12)[39]. In the case of a fully automated system, Ricardo insisted, this necessity has completely vanished.

Business leaders' quest for power and control impacts their choice of technique and organisation of business. This was especially stressed by Marx and then by Kalecki (see below) and it is also echoed in Stephen Marglin's essay "What do bosses do?" (1974). Marglin insisted (against Adam Smith) that the "social function of hierarchical work organization is not technical efficiency, but accumulation", and that "the origin and success of the factory lay not in technological superiority, but in the substitution of the capitalist's for the worker's control of the work process and the quantity of output." As a consequence, "the workman's choice from one of how much to work and produce, based on his relative preferences for leisure and goods, [changed] to one of whether or not to work at all, which of course is hardly much of a choice." (Marglin 1974: 62)[40]

(d) Criticism of the Bank of England

Ricardo was highly critical of the Bank of England (which remained a private institution until 1946) and the governor's and bank directors' policy, which often consisted in little more than self-enrichment. In February 1816, Ricardo published some *Proposals for an Economical and Secure Currency* (see *Works* IV: 43–141), in which he put forward anew his "Ingot Plan". The plan suggested a return to the Gold Standard by making bank notes convertible not into specie (coins), but into bullion (gold ingots), which implied the demonetisation of gold in domestic circulation. This would have several desirable effects: it would allow Britain to continue to use paper money as the actual means of payment, which Ricardo endorsed; it would reduce the need for gold reserves held by the Bank of England and thus dampen the upward pressure on the value of gold; and, last but not least, it would curb the huge profits pocketed by the governors and directors of the Bank, who benefited from the appreciation of gold. These profits, Ricardo insisted, belonged to the public. The House of Commons decided on a plan for the gradual return to note convertibility in bullion, starting in early 1820 and ending in May 1821 at the pre-1797 parity. During this period, Ricardo's

Ingot Plan was implemented. However, immediately after the old parity had been restored, the Bank of England decided to return to note convertibility in coin. This led to huge profits being reaped by its directors, who in anticipation of the move and reflecting some sort of insider trading *avant la lettre* had amassed large amounts of gold, which they now sold to their bank at very favourable terms—precisely the kind of self-enrichment Ricardo chastised.

In 1823, Ricardo composed a *Plan for the Establishment of a National Bank*, which was published posthumously in February 1824 (see *Works* IV: 271–300). His plan had first taken shape in 1815, while he was composing the pamphlet *Economical and Secure Currency* and was then put forward in the first edition of the *Principles* (*Works* I: 361–3). Of the two operations that the Bank of England performed—issuing paper currency and advancing loans to merchants and other investors—the former should be taken away from it and given to independent commissioners, who acted as bankers to the government, but were "totally independent of the control of ministers". This would not thwart the provision of the economy with money, but "in a free country, with an enlightened legislature" (*Works* I: 362) it would transfer a part of the profits of the Bank to the national Treasury and thus to the public.

7. Karl Marx on the silent compulsion of economic relations

The classical economists' analyses had an important impact on Marx's thinking. The core of Marx's contribution to political economy consists to a considerable extent of a critical discussion of Ricardo and Smith's analyses and his endeavour to improve upon them. Like Smith, Marx was convinced that private property in the means of production and their unequal distribution is the main source of power in capitalism. He also insisted that power is difficult to observe. In a passage in *Capital*, Volume I, that summarises his view of the essence of capitalism, he wrote about the *silent compulsion of economic relations*:

> The organisation of the capitalist process of production, once fully developed, breaks down all resistance. The constant generation of a relative surplus-population keeps the law of supply and demand of labour, and therefore keeps wages, in a rut that corresponds with the wants of capital. The dull compulsion [*stumme Zwang*] of economic relations completes the subjection of the labourer to the capitalist. Direct force, outside economic conditions, is of course still used, but only exceptionally. In the ordinary run of thing, the labourer can be left to the "natural laws of production",

> *i.e.* to his dependence on capital, a dependence springing from, and guaranteed in perpetuity by, the conditions of production themselves (Marx 1954: 689; see also MEGA^2 II/5: 591 and MEGA^2 II/10: 662).[41]

This fact is closely related to the ruling class's domination of the way people think about and perceive the society in which they live. As Marx put it in *The German Ideology*:

> The ideas of the ruling class are in every epoch the ruling ideas, i.e. the class which is the ruling material force of society, is at the same time its ruling intellectual force. The class which has the means of material production at its disposal, has control at the same time over the means of mental production, so that thereby ... the ruling ideas are nothing more than the ideal expression of the dominant material relationships, the dominant material relationships grasped as ideas. (Marx and Engels [1945] 1976: 67)

Marx did not manage to complete his intellectual project: only Volume I of *Das Kapital* was published (Marx 1867) as a text he authorised, whilst Volumes II and III were edited and published only after his death by Friedrich Engels on the basis of the manuscripts and notes he had left. As the MEGA^2 edition shows, Engels did not leave the substance of the material untouched, but changed it in a number of places. Especially when Marx expressed doubts as to the correctness of some of his propositions, such as the falling tendency of the rate of profits, Engels unswervingly kept on course. Marx's vacillations (and not so much health problems and political involvements) are perhaps the main reason why he failed to complete his work.

There is therefore some uncertainty clouding Marx's analysis. Interpreting him is also difficult because of the richness and complexity of his thinking. It presupposes readers that are versed not only in various traditions of economic thought, but also in philosophy, history, jurisprudence, literature and so on. In view of these difficulties, a full-fledged analysis of Marx's treatment of the role of power in the different modes of production he distinguished, and especially in capitalism, would by far exceed the scope of this essay.[42] Instead only a few aspects of Marx's analysis are dealt with in terms of a few observations on each. The heritage of the classical economists will become clear in this, whereas other influences and especially German and French philosophy, will remain in the background.[43]

(a) History – a history of class struggles

According to Marx's historical materialism, history is essentially a history of class struggles over power and domination in society. In any given epoch, one social class typically exerts power over and dominates some other class (or classes) and uses the capacity to work of the latter's members to its own advantage. Such relationships are exploitative. However, Marx was convinced no such constellation will last forever: each one is subject to self-transformation from within. This and the dominated class' efforts to shake off its yoke will eventually bring about a new socio-economic order characterised by new power asymmetries amongst (partly new) social classes. Marx's vision involves a version of the doctrine of the unintended consequences of human action, as it had been put forward especially at the time of the Scottish Enlightenment, most notably by Adam Smith: it consists of a particular kind of "invisible hand" argument. Adam Ferguson had famously coined the dictum: "History is the result of human action, but not the execution of any human design." In essentially the same vein, Marx stressed that people variously act individually rationally on behalf of what they consider to be their interests, but "behind their backs"—so his recurrent formulation—something emerges that they neither intended nor could possibly foresee, which in the end undermines the social status quo: the "relations of production"; that is, the property and class relations, come into contradiction with the further development of the productive forces of society. Consequently, any mode of production, including capitalism, is transient and will eventually give way to some other mode. There is a single exception to this: socialism is taken not to be ridden with class conflicts and thus to escape the necessary social metamorphosis to which all other modes of production are said to be subjected. In this conception, socialism is characterised by the disappearance of (marked) power asymmetries.

Marx's major concern was with unravelling the "law of motion" of capitalism. He wrote: "Development of the productive forces of social labour is the historical task and justification of capital. This is just the way in which it *unconsciously* creates the material requirements of a higher mode of production" (Marx 1959: 259; emphasis added). As capitalists tirelessly seek to increase their profits, they trigger a process the final result of which is the corrosion of their social power and domination of the working class.[44] The self-defeating forces they set in motion gradually gain momentum. Marx apparently counted upon a ruse of history: precisely by squeezing ever larger surplus value (profits) out of workers via the use of methods of production that exhibit larger and larger "organic compositions of capital", capitalists unintentionally precipitate the birth of a classless society.

In the *Grundrisse*, Marx called the "law" of the tendency of the rate of profits to fall "the most important law from the historical standpoint" (MEGA² II/1: 622), because it captures the impermanence of the capitalist mode of production. The law revolves essentially around that form of technical progress he considered to be congenial to, or rather a natural implication of, capitalism. Close scrutiny shows that, interestingly, it is the special form Ricardo had contemplated in the chapter on machinery as being most detrimental to the interests of workers. In Marx it is taken to be the most detrimental to capitalists as a class, at least in the long run. While in Ricardo it is one form amongst several others, in Marx it became the dominant one and was taken to shape the secular trend of the capitalist economy.[45] This type is characterised by a growing ratio of "constant capital", C, that is, dead labour incorporated in the produced means of production, to freshly performed, living labour, L, that is, a rising organic composition of capital. Its inverse gives (in labour value terms) the maximum rate of profits, $R = L/C$, associated with hypothetically zero wages and thus a zero "variable capital", V. Obviously, if the organic composition tends to infinity, the maximum rate of profits will tend towards zero, and sooner or later the actual rate of profits will also vanish.

Marx felt entitled to accuse Ricardo of having fled "from political economy into organic chemistry" by explaining a fall in the rate of profits in terms of diminishing returns in agriculture and thus in terms of a decreasing productivity of labour. He, Marx, wished on the contrary to show that the rate of profits would fall, "not because the productivity of labour decreases, but because it increases"—it would fall despite technical progress (MEGA² II/4.2: 309; my translation). We now know thanks to Piero Sraffa and Nobuo Okishio that Ricardo was right and Marx wrong: for a given and constant real wage rate (and putting on one side the problem of land), technical change would increase the general rate of profits or leave it constant, but would not diminish it.

(c) Alienation, commodity fetishism and "false consciousness"

Under capitalism, capitalists have power over workers. This is reflected in the fact that workers work for longer hours than would be necessary in order to produce and reproduce the quantities of commodities constituting their real wages.[46] What are the sources of this power? These, Marx was convinced, cannot be understood by just looking at single agents, but require an understanding of the working of the system as a whole.

We mention in passing that Marx agreed with Smith that capitalists are keen not to expose their power openly, except in labour conflicts, when force may be used and the assistance of state power sought. What matters in the present context is that the exposure of power is not necessary, because capitalism is characterised by commodity fetishism, which creates a false consciousness about things and leads people to misread reality: the dominated strata of society do not see that they are dominated. Marx considered the institution of private property to be the source of an encompassing alienation: man is alienated from the product of his work, from his nature as a human being, and from other men as human beings. Alienation characterises social states in which people treat others in an instrumental way, as means to the fulfilment of their own interests. The commodity the worker produces is not for him but for the capitalist, and even the latter is not interested in the commodity itself, but only in the profit its sale yields. Social relations lack mutual recognition and appreciation of the people involved. Under capitalism, Marx maintained, human beings develop a quasi-religious relationship to products and attribute imaginary and supernatural features to commodities, money, and capital, such as the notion that money and capital are themselves capable of generating interest and profit. The commodity form of products involves a network of unequal relations between human beings, but this is hidden by commodity fetishism and the idea that only equivalents exchange for one another. The exploitative character of the system is thus concealed. Finally, the power asymmetry is systemic and continuously reproduced by the working of the system as a whole: it is the kind of technical progress that dominates capitalist development which, by continuously introducing labour saving methods of production, fuels an "industrial reserve army of the unemployed" and thus produces "supernumerary" workers who compete for jobs with those employed. This keeps the aspirations of workers in check and secures real wages that are lower than labour productivity, thereby engendering positive profits (see, for example, Marx 1954: 593-4; MEGA^2 II/5: 510). Capitalism and full employment, Marx was convinced, are incompatible with one another except in short periods of time during booms. And also very much like Smith, he saw the power of capital relative to labour, other things being equal, to be greater the larger is the rate of unemployment.[47]

(d) Hilferding, Gramsci and Kalecki

Marx insisted that capital's power tends to increase with the concentration and centralisation of capital. Rudolf Hilferding elaborated on this in *Finance Capital*, originally published in German in 1910, a book, which at the time was dubbed the fourth volume of *Capital*.[48] Hilferding identified as characteristic trends of modern capitalism, in addition to the formation of cartels and trusts, the ever-tighter dovetailing of banking and industrial capital. The growing importance of finance capital rested on its role as creditor and promoter of new firms ("promoter's profit") and the issuance and acquisition of stocks in light of the growing number of joint-stock companies. Because of their interlocking assets, Marx had already observed that banks were able to use a relatively small share of their own equity capital to control a much larger volume of overall capital, which greatly contributed to the rising importance of "money power".

The shift of power away from industrial and towards finance capital, which put its mark on most recent developments in an alarming manner, had started already in the nineteenth century. There emerged what Marx had called "a new financial aristocracy, a new variety of parasites in the shape of promoters, speculators and simply nominal directors; a whole system of swindling and cheating by means of corporation promotion, stock insurance, and stock speculation. It is private production without the control of private property" (Marx 1959: 438). Given the instability of the financial sector, which is repeatedly shaken by crises resulting from speculation bubbles, finance capital and the industrial capital it controls sought protection under the umbrella of the state: their quest for safeguards resulted in what Hilferding called "organised capitalism".

Marx's ideas resonate in the writings of many other authors. We mention just two of them: Antonio Gramsci, the philosopher and close friend of Sraffa's, and Michal Kalecki. In his *Prison Notebooks* (1971), Gramsci developed the concepts of "hegemony" and the "manufacture of consent". While in the sphere of "political society" the capitalist state is said to rule through force, in "civil society" it rules by consent: views, convictions and beliefs are being shaped and the bourgeois hegemony is reproduced by means of various social institutions—schools and universities, the media, religion and cultural life. The upshot of the bourgeois hegemony is the manufacture of consent that legitimises the given social conditions and acts as its protective belt. Changing these conditions, Gramsci was convinced, could not be achieved by the working class by simply taking control of the means of production in a revolutionary act, but required the formation of a new hegemony, alternative to the existing one, establishing new principles of legitimacy.

Michal Kalecki (1939) took the concentration of market power in oligopolies and monopolies to be reflected in a macroeconomic "degree of monopoly" that determines the share of profits in national income. The power capitalists have assumed in modern times is also well expressed in Kalecki's famous dictum, reported by Joan Robinson: "Capitalists receive what they spend, workers spend what they receive." In his later works (see especially Kalecki 1971), he advocated the concept of a "structural" degree of monopoly, designed to provide a general measure of power and not just of the price setting power of oligopolies and monopolies.[49]

Two further aspects of Kalecki's analysis deserve to be mentioned. In an essay on the political element of business cycles, he argued that a successful employment policy tends to undermine the power of business leaders and therefore is "a first class political issue" (Kalecki 1943: 324). He explained:

> The *maintenance* of full employment would cause social and political changes which would give a new impetus to the opposition of the business leaders. Indeed, under a regime of permanent full employment, "the sack" would cease to play its role as a disciplinary measure. (Kalecki 1943: 326; emphasis in the original)

Worse than possibly shrinking profits would be to business leaders the erosion of the "discipline in the factories" and "political stability". He added: "Their class instinct tells them that lasting full employment is unsound from their point of view and that unemployment is an integral part of the 'normal' capitalist system" (1943: 326). Hence, according to Kalecki, as for Marx before him, permanent full employment is incompatible with capitalism since it would subvert the power of capital.[50]

8. Land as power

In much of the early economic analyses dealing with feudal and semi-feudal modes of production, the attention focused especially on concentrated private property in land and other natural resources by the king, nobility and the church. For a considerable time, the possession of land was considered the ultimate source of power. Whoever owned land of a sufficiently high quality and in a sufficient quantity was able to feed himself and his family and was thus in principle independent of others, provided his independence was not thwarted in one way or another by the use of other means of control and domination, from high taxes to the use of military force. Entire schools of thought focused on the role of privately owned and unequally distributed land as the main source of inequality—with the lucky few possessed of wealth and riches and the large majority of the population living in poverty and deprivation. The critics of such situations attacked the institution of private property of land as socially unjust and economically inefficient.

Even in fairly recent times, a number of authors saw huge inequalities in land property to be the ultimate cause of all social problems. Authors like Henry George, Achille Loria, Theodor Hertzka, Franz Oppenheimer and other agrarian reformers and socialists were convinced that land should be turned into common property and made available to all citizens as the basic resource needed in order to make a living.[51] Land and other natural resources, they argued, are available in sufficient amounts to provide the necessary means of sustenance for all human beings. The problem was that they have been appropriated privately and their ownership was concentrated in a few hands. These resources are not economically scarce, as some economists had contended, they are rather legally or artificially rendered scarce. Had the poor strata of society free access to land, they would have no difficulties to look after the upkeep of themselves and their families.[52] These kind of considerations have recently assumed great importance again especially in Africa, Asia and Latin America in view of what is known as "land grabbing" (see, for example, Reinert, Ghosh and Kattel 2017; Nell, 2018).

Henry George in *Progress and Poverty* (1879) argued that land is the common inheritance of all members of society and therefore ought to be collective property. The rent obtained does not belong to a few landlords, but rather to the community as a whole. Rents may then be used by the state to replace taxation. This proposal echoes the Physiocratic doctrine of *impôt unique*, which suggests that public expenditures ought to be financed by a single tax on the rents of land only. George claimed that in this way economic activity would not be paralysed; quite the contrary: the incentive to accumulate capital and to innovate would benefit from it, because all other taxes that negatively affect the dynamism of an economy would be abolished. Therefore, collective ownership of land is advisable both in terms of social justice and economic effectiveness.

Franz Oppenheimer's analysis revolved around a particular concept of the origin and purpose of the state. In his treatise *The State* (1914), he rejected the social contract view of the state advanced by representatives of the Enlightenment in Europe. He maintained instead that the state was the result of a victorious group of conquerors subduing a defeated people (or race) with the purpose of exploiting its members.[53] The main political instrument used by the dominating group to secure its power was the forceful appropriation of all land. Deprived of the possession of land, the dominated people, in order to make a living, had to compete with one another in the labour market and underbid each other. The "original sin" of conquest and submission of people, while having taken place a long time ago, continued to exert its influence in modern times and was the main source of inequality amongst men: the plight and misery of the working class had as its ultimate cause what Oppenheimer called "Bodensperre"—"land monopoly". It prevented a utilisation of land that was both "efficient" and "just". Removing land monopoly would do away with the exploitation of man by man and solve the "Social Question".

It is interesting to note that some early marginalist authors also opposed private property of land. Hermann Heinrich Gossen in his *The Laws of Human Relations*, first published in German ([1854] 1983), insisted that there was a single "obstacle" preventing the realisation of "paradise on earth". This obstacle is said "to consist in the fact that man cannot according to his own discretion choose the most favourable plot on earth's surface to carry out his production" (Gossen 1854: 250). Private property in land and its unequal distribution amongst men imply losses in efficiency and thus have negative effects on wealth. However, Gossen opined, this "evil" (*Übelstand*) can easily be overcome by means of the state raising a credit and buying the land. The state may then lease land to the bidders offering the highest rents and use these rents to pay back the debt. This would be feasible because the better allocation of land would increase the amount of total rents in the economy and because the state would benefit from favourable credit conditions in view of its immortality and the size of the credit taken. Hence the nationalisation of land would pay for itself (1854: 258-60).

Interestingly, Léon Walras, influenced by his father Auguste, advocated a similar view independently of Gossen, and when William Stanley Jevons eventually drew his attention to the German's work, he became a great admirer of this "économiste inconnu" (unknown economist). Walras, who called himself a "scientific socialist", was convinced that the nationalisation of land and the abolition of the tax system would lead to an economically more efficient and a more just society. It would allow workers to save and accumulate wealth, thereby reducing the inequality in the distribution of wealth and income.[54]

9. Böhm-Bawerk: Power or economic law?

The locus classicus of the marginalist discussion on the role of power in the economy and in economics is Eugen von Böhm-Bawerk's 1914 essay "Macht oder ökonomisches Gesetz" (Power or economic law) (Böhm-Bawerk 1914).[55] In it, Böhm-Bawerk took issue with the view that the remuneration of the factors of production—functional income distribution—is not governed by "economic law", but is strongly influenced by social institutions and policies of various kinds. This view had been advocated by several German authors such as Karl Rodbertus, Adolf Wagner, Wilhelm Lexis and especially Rudolf Stolzmann and the Russian economist Mikhail Tugan-Baranovsky (1913), to name but a few. In his book *Die soziale Kategorie in der Volkswirtschaftslehre* (The social category in economics) (1896) and in other writings, Stolzmann, whom Böhm-Bawerk singled out as a main representative of the view under consideration, had insisted that income distribution ought to be seen as a "social category": real wages, for example, reflect "the given position of power, education and covetousness of workers" and not the working of some "iron law" of whichever derivation— classical, Marxian or marginalist. In response, Böhm-Bawerk asked whether "the entire all-important problem of distribution of wealth is regulated and dominated by *natural economic laws*, or by the arbitrary influence of social forces [gesellschaftliche Gewalten]." (1914: 206; emphasis added)

Interestingly, Böhm-Bawerk referred to "natural economic laws" as if these were self-evident facts disclosed by some sort of natural science. Clearly, they were (and are) not. What he meant were the laws postulated by a particular kind of economic theory. In fact, he started from the premise that marginalist theory (and especially its Austrian variant) had unravelled the laws governing the economic world. The reference is explicitly to "the law of supply and demand" (1914: 205) and to marginal productivity theory. The latter seeks to explain the rule according to which the product is shared out amongst the various claimants—capitalists, workers and land owners—and therefore assumes centre stage in his essay.

The thrust of Böhm-Bawerk's argument consists of two propositions. First, he did not deny that at any given moment of time power exerts some influence on income distribution, in some societies more than in others. However, he strongly disputed the view that the influence of power asserts itself in contradiction to the economic laws of price formation, and insisted that it rather asserts itself in conformity with and through these laws: "not even the most imposing dictate of power can accomplish this: it can never operate against, but only within the economic laws of value, price and distribution, it cannot invalidate these, but only confirm and fulfil them." This he called "the most important, and the most certain, result" of his argument (Böhm-Bawerk 1914: 266). He sought to back his view in terms of a discussion of how a monopoly on either the demand or the supply side of the labour market affects the real wage rate and causes deviations from labour's marginal product.

Then Böhm-Bawerk turned to his second proposition. He asked the question, "which of the rates of remuneration enforced through means of power will be of *long duration?"* An answer to this question, he added, "is all the more interesting, in that it is *by far the more important one"* (1914: 242; second emphasis added). Rates of remuneration of factors of production that deviate from marginal productivities, he surmised, entail effects and motivate actions of self-interested agents that typically diminish and eventually remove the deviation by eroding the monopoly power that caused it. While according to Böhm-Bawerk, there are some not very significant exceptions to the rule, there is, he opined apodictically,

> *no case in which the artificial intervention could be of lasting importance* as against the quietly and slowly, but incessantly and therefore ultimately successfully, working counterinfluences of a "purely economic nature", called forth through that artificial interference and the new situation created thereby. (Böhm-Bawerk 1914: 266; emphasis added)

From this, he inferred boldly that economists are well advised to develop their general long-period reasoning in terms of the assumption of perfect competition, in which no agent is possessed of any power, and deal with deviations from it only if necessary and within a short-period setting. The message was heard and absorbed in large parts of the profession and has led to a situation in which power is typically taken to be a quantité négligeable—something from which one can easily abstract without significantly affecting the correctness of the analysis.[56]

The contrast with the classical economists is obvious. In Smith and Ricardo, a positive and uniform rate of profits is considered to result in conditions of free competition and its magnitude to signal the power capitalists have to force workers "into compliance with their terms", as Smith put it. Free competition does *not* involve a powerless situation. And, as we have seen, such power is expressed in analytical terms with the help of economic theory. In Böhm-Bawerk, on the contrary, in the long run and on average capitalists are taken to be as powerless as workers and a positive rate of interest (profits) to reflect the marginal productivity of capital. Marginal productivity theory presupposes the full employment of labour and of all other productive resources, an assumption not to be found in the classical authors—recall, for example, Ricardo's analysis of labour-saving machinery.

However, when Böhm-Bawerk published his essay, that is, some time after "the advent of the 'marginal' method", "this standpoint … of the classical economists from Adam Smith to Ricardo [had already] been submerged and forgotten", as Sraffa (1960: v) perceptively observed. This fact is well reflected in attempts by economists with a critical orientation towards marginalism to strike a compromise between their critical orientation and marginal productivity theory. Cases in point are Erich Preiser ([1948] 1952) and Kurt Rothschild. The correctness of marginal productivity theory, Preiser, for example, contended, cannot be disputed, but in order to discern the impact of power on wages and profits, one has to turn to the distribution of wealth or endowments of factors of production. These are fundamental and rather stable data of the social order and the ultimate determinants of income distribution. Power is hidden in the supply relations of the factors of production and the corresponding supply elasticities. Power, Preiser insisted, is a factor that is embodied in the relative scarcities of the factors of production and their distribution amongst people and in this way has an impact on income distribution. Since the distribution of wealth does not change all that much in the course of time, actual income distribution does not move in the direction of what is called "natural" distribution, which is the distribution that would result, if there were no inequality in wealth and factor endowments (see also Kalmbach 2008: 93–7).

However, can the "natural economic laws" Böhm-Bawerk invoked and the majority of economists accepted around the turn of the century and thereafter be relied upon? Does marginal productivity theory convincingly decipher the laws governing the distribution of income? We now know that this is not the case except in singularly special conditions, such as a one-good economy (See on this, Sraffa 1960, Garegnani 1970, Harcourt 1972, Kurz and Salvadori 1995: chap. 14 and Opocher and Steedman 2015). Therefore, much of the discussion reported above (and below) does not stand up to close scrutiny of the underlying analytics. Freed from the straightjacket of marginal productivity theory, there appears to be much more scope for a discussion of the role of power in economics than is generally acknowledged.

Before we proceed, it deserves to be mentioned that around the time of the publication of Böhm-Bawerk's essay, if not earlier, attentive observers especially of American capitalism stressed the trend towards oligopolies and monopolies, which fundamentally changed the face of capitalism. The "wretched spirit of monopoly", of which Adam Smith had warned, had successfully transformed the capitalist economy. Vis-à-vis the new situation, Böhm-Bawerk's advocacy of the assumption of perfect competition looked anachronistic. Joint stock companies implied the separation of ownership and control and gave rise to the principal-agent problem, highlighting the phenomenon of asymmetries between agents because of unequally distributed information. Conglomerates influencing governments and the state made an appearance and put the power of big business into sharp relief.

Perhaps the most important representative dealing with these trends was the American institutionalist Thorstein Veblen.[57] In *The Theory of the Leisure Class* (1899), he identified social recognition and prestige as the chief motives of human action. Wealth and high income are a means to the end of "conspicuous consumption": the public display of wealth and power in order to impress others. In Adam Smith's concept of the "parade of riches", we encounter essentially the same idea. But when markets noticeably serve individuals' vanity, how should efficiency be assessed? In *The Theory of Business Enterprise* (1904), Veblen extended his critical view to the business world. Managers and bankers, he insisted, chiefly follow their own interests and not those of owners and clients—and they frequently understand amazingly little about business. Their focus is very often on restricting competition and attaining monopoly rents. Emphasising the efficiency properties of perfect competition, as many economists did at the time and still do nowadays, leads them to worship a system that no longer is (and perhaps never was).

The criticism was directed also at the idea of "consumer sovereignty", according to which only consumers had (limited) power, with producers as their vicarious agents. In contrast to the conventional marginalist doctrine and that of Carl Menger, and in accordance with his teacher Friedrich von Wieser, Joseph Alois Schumpeter stressed:

> Innovations in the economic system do not as a rule take place in such a way that first new wants arise spontaneously in consumers and then the productive apparatus swings round through their pressure. ... It is ... the producer who as a rule initiates economic change, and consumers are educated by him if necessary; they are, as it were, taught to want new things' (Schumpeter 1934: 65).

In the first German edition of *The Theory of Economic Development* published in 1912, Schumpeter had been even more outspoken and had insisted that innovators "force" upon consumers new goods and consumption patterns and prompt the "hedonic majority" of the population to comply with their will. Entrepreneurs, not consumers, and innovators-investors and banks, not savers, are the driving forces of the capitalist system. There is no pure and undiluted consumer sovereignty that rules the roost in a world of ubiquitous economic change. Similarly, John Maurice Clark stressed:

> Economic wants for particular objects are manufactured out of this simple and elemental raw material [primitive instincts] just as truly as rubber heels, tennis balls, fountain pens, and automobile tires are manufactured out of the same crude rubber. The wheels of industry grind out both kinds of products. *In a single business establishment one department furnishes the desires which the other departments are to satisfy.'* (Clark 1918: 8; emphasis added)

In a similar vein, Frank H. Knight deplored the "persuasive influence by sellers upon buyers and a general excessive tendency to produce wants for goods rather than goods for the satisfaction of wants' (Knight [1934] 1982).

But if demand is systematically influenced by suppliers, then supply and demand are no longer independent of each other, and the explanatory value of demand and supply theory (and a fortiori of welfare theory), whose fundamental axiom is the autonomy of agents, is called into question.

10. "Exploitation" in a marginalist framework

Mainstream economists could not permanently shut themselves off from the new reality, and so we see various attempts to come to grips with market forms other than perfect competition. There could be little doubt that power was far from being evanescent, as Böhm-Bawerk had contended. Arthur Cecil Pigou (1920) and Abba Lerner developed the marginalist concept of power and the related marginalist concept of "exploitation".[58] In price theory, Lerner introduced the notion of "degree of monopoly" in product markets i, «_i, which equals the difference between the product price and its marginal cost, divided by the product price:

$$\text{«}_i = (p_i - mc_i)/p_i.$$

Given that in perfect competition the price equals marginal cost, the degree of monopoly is zero and there is no power at work in the system. Reformulating the degree of monopoly in terms of the Amoroso-Robinson formula shows that the degree of monopoly expresses the price elasticity of demand.

In a more general formulation, deviations from perfect competition in both product and factor markets were taken into account. On the input side, power is now reflected in a deviation of the remuneration of a factor from the value of its marginal product. The price of one unit of factor service j, q_j, can be shown to be determined in the following way:

$$q_j = \pi' p \frac{(1 - \frac{1}{\varepsilon})}{(1 + \frac{1}{\eta})}$$

Here π' is the marginal product of the factor service, p the product price, ε the price elasticity of demand and η the price elasticity of supply of the j-th factor service under consideration (j = 1, 2, ..., m).

If and only if

$$\varepsilon = \eta = \infty,$$

the marginal productivity rule applies in its well-known form. Monopolistic and monopsonistic conditions imply that factors will not be paid the values of their marginal products. This finding prompted some marginalist authors, especially Pigou, to speak of "exploitation", thereby deliberately invoking a concept used by Marx. However, the meaning of the concept is very different: whereas in Marx only workers could be exploited (by capitalists and, perhaps, by an "aristocracy of labour"), in the marginalist conceptualisation each and every proprietor of a factor of production could, in principle, be exploited by getting less than (the value of) the factor service's marginal product.

Hence within the confines just delineated, power is dealt within marginalist theory and it is expressed through "economic laws" at work as they are conceived of by the theory. Power may be discernible both in product and factor markets and its effects are seen in terms of deviations of prices and rates of remuneration of factors from what they would be in conditions of universal perfect competition. As Kurt Rothschild (2002) perceptively remarked, perfect competition has thus been advanced to the status of a *norm* against which reality is assessed. Due to the optimality properties of perfect competition derived within the conventional marginalist framework, this norm also played an important role in economic policy and especially in competition policy and *Ordnungspolitik*.[59]

Yet the importance many economists attribute to the static properties of economic systems characterised by perfect competition is also fundamentally mistaken for another reason. Schumpeter ([1912] 1934) agreed with Marx that capitalism is a restless system, continually transforming itself from within because of innovations and technical and organisational change. Innovations, however, entail necessarily monopoly positions that are more or less long-lived, either of the pioneer or of successful second movers. Since innovations take place all the time, the related kind of market power is permanent and not a transient phenomenon, as Böhm-Bawerk opined.

As has been emphasised above, any "laws" taken to underpin economic phenomena are intellectual constructions. The validity of such laws hinges upon the validity of the economic theory that enunciates them. As regards the validity of marginalist theory, we have already reported some serious reservations in the above. These concern: (i) the set of data from which the theory starts, which cannot be considered to be independent of each other; and (ii) the capital theoretic foundation of the theory. Hence what marginalist economists consider a "law", its critics consider a misconception.

Böhm-Bawerk had famously titled his essay "Power or economic law", deliberately suppressing the question mark one would have expected. His brother in law, Friedrich von Wieser, also a social scientist, did not always agree with him. For example, he (like Schumpeter) strongly opposed the view that a positive rate of time preference—Böhm-Bawerk's "higher estimation of present over future needs and wants"—was a cause of a positive rate of interest (alias rate of profits). Wieser argued instead that it was an effect of it: as soon as there happens to be a positive rate of interest, rational behaviour requires that people discount future payments. He also opposed the idea that power did not matter and in fact eventually published a book whose title could be read as the exact antithesis of Böhm-Bawerk's essay—*Das Gesetz der Macht* (The law of power) (Wieser 1926).

11. Friedrich von Wieser: The law of power

Wieser and Böhm-Bawerk are typically counted as major representatives of the second generation of "Austrian" economists. Both attended lectures by Carl Menger at the University of Vienna and shared many of the ideas of the founding father of what became known as the "Austrian School" (see Kurz 2016c). However, they differed in important respects. Wieser, like Menger and Böhm-Bawerk, originally embraced the "causal-genetic" approach to the theory of value, starting from the needy individual and his or her estimation of goods and eventually leading to "catallactics"—a general theory of exchange. We owe Wieser even the term "Grenznutzen"—marginal utility. In this perspective, and closely following Menger, only consumers have some power. They compel firms to align production with their needs and wants. However, Wieser quickly understood that Menger had failed to solve the infamous "imputation problem", a finding that had far-reaching consequences for the further development of Wieser's thinking and probably was instrumental in pushing him to recognise the all-important role of power in social relationships. In the following, we summarise briefly the route Wieser took and the new sociology of power he elaborated.

The imputation problem consists of splitting up the value of a consumption good—a "good of the first order", in Menger's construction—which was taken to be determined exclusively from the demand side, into the values of the goods and factor services involved in its production—Menger's "goods of second, third etc. order". This causal-genetic perspective on things implies that producers and firms are the obedient servants of consumers and compete in executing the latter's wishes as best as possible. Wieser observed that in the case in which the number of consumption goods is larger than the number of inputs used in their production, the problem is over-determined, whereas in the case in which it is smaller it is under-determined. If the two numbers coincide, there may or may not be a solution, and if there is one, it may or may not make economic sense. Hence Menger's theory had several loose ends and was far from convincing.

Wieser also rejected Menger's concept of production as a one-way-avenue of finite length leading from original factors of production (labour and land services) via a series of stages to final products, and stressed instead that in modern, industrialised economies the "various branches of production are mutually intertwined" (Wieser 1884: 50): there is no stage at which land and labour services alone cooperate without any intermediate products. Yet, if commodities are produced by means of commodities, Menger's idea of a hierarchy of goods collapses—one and the same good may perform both the role of a consumption good and an input or cost good. In this case, the value of goods cannot be determined in a recursive manner, as Menger had thought. All values have rather to be determined simultaneously, which runs counter to Böhm-Bawerk's contention that simultaneous equations contradict all "economic logic".

This led Wieser to study the case of a given number of commodities, *n*, produced and reproduced by means of themselves, in which there is no primary factor of production except homogeneous labour.

Subtracting from gross output levels all amounts of commodities that have been used up in the course of production either as means of production or means of subsistence in the support of workers, a surplus product is obtained and is received by capital owners as interest alias profit (Wieser 1889: 130). In the special case in which the material rates of surplus happen to be the same with regard to all commodities, the general rate of profits can be ascertained at a glance, in terms of a comparison of two quantities of commodities without any need of a theory of value.

Starting from a critical account of Menger's theory, Wieser thus arrived at a view of the problem of value and distribution that bears a close resemblance to that of the classical economists from Adam Smith to David Ricardo (and foreshadows elements of Sraffa's analysis). Objectivist elements assume centre stage and move subjectivist ones to the background. The question is: why is the rate of profits high (low) and why are real wages correspondingly low (high)? Has this anything to do with economic power, and if yes, how? Clearly, marginal productivity theory cannot be applied in the case under consideration.

Wieser was apparently perplexed by his original finding and was not clear how to go about it. It was only later in his life that he (implicitly) distanced himself from marginalist theory, of which he had been a major architect. The theory, he felt, neglected the all-important element of power, which could not be reduced to the power of consumers directing production. As an expression of this, and of his wider interests, he expanded his research area and turned to sociological and historico-philosophical questions. Under the influence *inter alia* of Max Weber and the French social psychologist Gustave Le Bon, author of *The Crowd: A Study of the Popular Mind* ([1884] 2002), he began to investigate the changing tension between power and liberty in the course of the development of society and elaborated a sociological analysis of power, leadership and entrepreneurship. In 1910, he published *Recht und Macht* (Legislation and power), and in 1926, *Das Gesetz der Macht*. His ideas about leadership had a particularly deep influence on his former student Schumpeter.

While in the past, liberty and freedom were hard won against feudal rule, and liberty and power thus stood in strict opposition to one another, in modern times a new determination of the two was needed. According to the individualistic doctrine, reflected in marginalist economics, the individual is in marked contrast, if not opposition, to society. Wieser was convinced that this doctrine involves a fundamental misconception that can only be removed in terms of a "purified concept of Freedom" (Wieser 1910: VII). The allegedly felicific “unlimited freedom” does not exist. In order to realise the liberty that is possible, what is needed is the “support of the historically well-tried and tested powers of liberty”, which, however, do not only protect liberty, but also prune it.

What then is power? Wieser rejected all views that focus attention exclusively on easily visible manifestations of power: the power of industry, of money, of the military, etc. In addition to these “external (*äußere*) powers”, he insisted, there are the much more important “internal (*innere*) powers”—the general consciousness, the state of the mind, the level of education, the reliance on and trust in political and economic leaders and so on (Wieser 1910: 6). The relationship between social elites and the masses is based first and foremost on these internal powers. Wieser then put forward a number of “laws” that characterise this relationship. The most important one is the “law of small numbers”, according to which power is typically possessed by a small group of people, the “elite”, and not by large crowds. This law is said to be universally valid. The power of the elite derives from its control of the minds of people, their thinking and feeling and the trust the followers have in their leaders. This constitutes the elite’s social dominance (Wieser 1910: 12). At all times and everywhere, Wieser stressed, “leadership and obedience are the basis of societal action” (1910: 31).

The “law of the small number of great [i.e. powerful] men” therefore stands in marked contrast to the “law of the large number of small [i.e. powerless] men”, cherished by marginalist economists. Wieser variously expressed doubts as to the validity and usefulness of basic premises of marginalism. He rejected, for example, the idea that the preferences of agents are given and immutable, and insisted instead that they are endogenous and at least partly shaped by political and economic leaders. He also questioned the idea that economic leaders are necessarily profit-maximising: similar to political leaders they are often concerned with maximising the number of their followers, that is, their clients and customers, and with establishing a business empire or dynasty. (Both views resonate in the writings of his former student Schumpeter.)

Against this background, Wieser insisted that the theory of the social contract is pure fiction. What matters is the accordance between “what the people understand and what the selected minds are replete with.” The desire of the latter “to be respected by the masses … is the most sincere urge of the healthiest of human sentiments” (1910: 33). A personal right to leadership is legitimised in terms of the “overall advantage” brought about by leaders. These activate and shape the morality and need for achievement of a people and lead it to prevail in conflicts with other people. However, Wieser warned, "it would be a misconception to see in struggles only violence, in heroism only brigandism, as famous sociologists do! The values of the struggle are values that in history could not have been replaced by other things" (Wieser 1910: 46). Although Wieser mentioned neither Ludwig Gumplowicz nor Franz Oppenheimer, who had conceptualised the state as a creation of conquest and submission, his criticism appears to have been directed also at them. The values, Wieser added, are themselves subject to change, "consequent upon changes in the technical and other social dispositions" (1910: 75). Wieser advocated an evolutionary view of the process of social maturation, in which mass psychological elements play an important role.

In *Das Gesetz der Macht*, Wieser deepened his sociology of power. The book is no easy read, not only because of its long-windedness and poor organisation, but also because of its occasionally grim rhetoric. Wieser reiterated his conviction that internal power constitutes the "core of the phenomenon of power". Contrary to external power it does not rely on force, violence and coercion, but on persuasion, conviction and trust. Internal power can show a high degree of permanence, whereas external power is frequently short-lived. The relationship between followers and leaders can be stable and survive even substantial drawbacks in economic and political life, because the followers' belief in the ideas and values advocated by the leaders are deep-rooted. While in some cases the masses follow their leaders slavishly, in other cases things are more complex: the leader is able to give orientation to the thinking and behaviour of the followers, but he cannot fully control and determine them. Wieser insisted that this power relationship between leader and followers is the essence of the social process. He rejected Friedrich Nietzsche's view of the aspiring master man (*Herrenmensch*) as the bearer of the will to power, and argued instead: "The bearer of the law of power … is society with its tension between leader and mass" (1926: III).

As regards the ethical quality of the power so conceived, Wieser stressed that it may be a good thing, but that it can also be a bad thing. People will always be led in one way or another, but they can be misled, with potentially disastrous effects. The judgement passed on the leadership of a king, a politician or a businessman depends on the things he achieved with the support of his followers. Interestingly, Wieser boldly contended that as society develops, external powers can be expected to lose in importance compared to internal powers. This is reflected in another "law" Wieser advocated: the law of the gradual retreat of violence and coercion—and this not long after the end of World War I and with World War II already casting its shadows.

12. Concluding remarks

The short recollection of the views of major social scientists should have made clear the following. First, power is ubiquitous in socio-economic relationships; the assumption that none of the agents has any power whatsoever cannot be sustained. Second, power cannot be neglected in economics and elsewhere: ignoring power will typically not lead to results of the analysis that can be expected to be sufficiently close to the "true" properties of the object under consideration. While these properties cannot be known with certainty, allowing for the impact of power will show significant deviations from the results obtained by an analysis that neglects power. Third, there are many sources of power, and authors from Hobbes to Russell have attempted to classify them and identify the way they make themselves felt. In all cases, power implies an asymmetry between single agents or groups of agents or entire classes of people. What is to be understood is the power structure or network in a given socio-economic system. Fourth, power has many faces: from open violence and coercion to quiet rule, control and domination. Fifth, authors from Smith via Marx and Gramsci to Wieser stressed that in modern societies power typically walks on silent paws: it often tries to avoid the light and prefers to work in secrecy. The fact that it is difficult to discern must not, however, be mistaken for its non-existence. Sixth, in order to unravel its presence, a partial analysis is typically not good enough, but a systemic one is required. This has to try to understand the working of the system as a whole and how it produces and reproduces power relationships. Seventh, and closely related, a purely static analysis will also not do, because the production and reproduction of power relationships is a part and parcel of the dynamic properties of the socio-economic system. An important aspect of this are different forms of technical progress that change the balance of power within and between social groups and classes, that improve the devices to monitor, control and manipulate people, that displace workers and replenish an army of the unemployed, that keeps the aspirations of workers in check, and so on. Eighth, power is embodied in social institutions, the law and political order, norms, both known and tacit, "rules of the game" and the like, and it is supported by beliefs, interpretations, ideologies and theories that reinforce it. In order to understand power, its abodes and intellectual superstructure have to be investigated. Ninth, from an early time on, the powerful were keen to camouflage or make unseen their power and depict social conditions that could have been perceived as unjust as being natural and immutable. This was done in terms of all kinds of devices and resulted in a protective belt justifying the given conditions. In this regard, it was of great help to those who had power, and typically were better informed, that the dominated strata of society lacked the information, knowledge and understanding of the situation and could easily be (mis) led. The phenomenon of intellectual capture has been described from early times onwards and recurs in the writings of major economists, including Adam Smith and Karl Marx. Tenth, understanding the mechanisms by means of which given power relationships are produced and reproduced also allows one to see, in a dynamic setting, how they might erode and give way to a redistribution of power and the establishment of new power relationships amongst partly newly emerging social groups and classes. Interestingly, both Smith and Marx, amongst others, insisted on the importance of the unintended consequences of self-seeking behaviour, not least with regard to the problem of power.

We may conclude by saying that power is a pervasive phenomenon in the economy and society, associated with inequality of income, wealth, race, gender, information etc. If wealth is power, as Adam Smith had insisted, and if wealth is getting more and more concentrated, as has been the case in many countries recently, an irreconcilable contradiction obtains between the democratic logic of "one voter, one vote" and the market logic of "one Dollar, one vote". Democracy is in danger of becoming an empty shell. Economic policies have amplified if not precipitated this trend. It is high time for economic policies to reverse it.

Notes

* This is a substantially revised version of the XXV[th] Krishna Bharadwaj Memorial Lecture I gave at Jawaharlal Nehru University (JNU), New Delhi, on March 3, 2017. An earlier version was given as the keynote lecture at the 14[th] conference of the Italian Association for the History of Economic Thought (AISPE) at the University of Salento, Lecce, 28–30 April 2016. A slightly revised version of the former was then given as the Kunda Datar Lecture at the Gokhale Institute of Politics and Economics (GIPE), Pune, on March 8, 2017. I am grateful to the participants in the three events for very useful discussions. I would like to express my gratitude to Professor C.P. Chandrasekhar who kindly chaired the Krishna Bharadwaj Memorial Lecture and to Jayati Ghosh and her friends who hosted my wife and me so well. Tony Aspromourgos, Amit Bhaduri, Christian Fleck, Christian Gehrke, Geoff Harcourt, Peter Kalmbach, John King, Ulrich Krause, Fabio Petri and Richard Sturn kindly sent me valuable comments and suggestions on earlier drafts of the paper. Any misconceptions in it are, of course, entirely my responsibility. Smitha Francis edited the paper and greatly improved its readability.

1 The situation is quite different in the other social sciences, sociology and political science in particular, in which power is an important analytical category. The *Sonderweg* economics has taken in this respect is quite remarkable and warrants a special study, only elements of which can be provided here. An account of the history of economics, in which the abandonment of the classical economists' analyses, with power assuming centre stage, and the rise

to dominance of marginalism, with power being marginalised, play an important role, is provided by Bharadwaj (1976, 1989, 1990) and more recently by Kurz (2016d).

2 In oligopolistic competition, strategic behaviour plays a central role, and game theory provides the tools to deal with it.

3 See also the contributions by Bartlett (1989), Lukes ([1974] 2005), who summarises some of the debates on power in economics, Bowles and Gintis (2008), and Bhaduri (2016). In the German literature, several works have been devoted to the theme under consideration. These include, in economics, Schneider and Watrin (1973), Berger and Nutzinger (2008), Held, Kubon-Gilke and Sturn (2008), and, in sociology, Popitz (1986).

4 The problems of basically all varieties of power, their use and abuse, played an important role in philosophy and literature since their beginnings. Here it suffices to mention, in Europe, the writings of Plato and Aristotle and the tragedies of Aeschylus, Sophocles and Euripides.

5 She summarised the history of economics in the following way: "The classical theory we refer to had its beginnings in the works of William Petty in England and the Physiocrats in France. It advanced significantly through the contribution of Adam Smith and David Ricardo and found its comprehensive developments through radical reconstructions in Karl Marx. The DSE [demand and supply economics] theories emerged in the third quarter of the nineteenth century, around the 1870s, spearheaded by the writings of Jevons, Menger and Walras. They rose to dominance eclipsing the classical approach not only for reasons of the logical and analytical hurdles the latter theory met with, but also because of the unacceptability of its sharp theoretical positions stressing the *conflict-ridden dynamics of capitalist distribution and accumulation*. The approach was prematurely abandoned and was superseded even while the logical problems remained insufficiently explored and hence solved." (Bharadwaj 1989: 1; emphasis added)

6 The cartoon by Will Dyson is reprinted in John Maynard Keynes' *A Tract on Monetary Reform* (Keynes 1971: 21).

7 Bartlett (1989: 4) writes: "Neoclassical economics, the dominant school in contemporary Western academia, has had the very least to say about power." This is so because markets are conceptualised in terms of voluntary, bilateral trades, which would not be undertaken unless both parties benefited from them—reflecting the so-called "double coincidence of wants". While markets are seen to be the realm of liberty and (formal) equality, government activities, which typically do not use the instrument of voluntary contracts, are seen as the realm of the exertion of power. On this view, see Milton Friedman (1962: chap. 1) and Alchian and Demsetz (1972).

8 There are notable exceptions to this. Frank Hahn, for example, advocated a kind of negative methodology by insisting that only within the confines of general equilibrium theory defined by the axioms upon which it rests that something precise can be said, whereas outside these confines things are not so clear. He also said that by setting out precisely the conditions under which Adam Smith's conjecture that a competitive economy would bring about a sort of social optimum, the main achievement of general equilibrium theory was the negative one of showing how unlikely this would happen in practice. For a discussion of the epistemological status of a powerless economy, or what he calls *oeconomia pura*, see Weise (2008). Weise stresses the fact that, ironically, in economics the powerless economy exerts a remarkable and actually quite disproportionate (compared to its realism) amount of power as a point of reference.

9 For the following, see Kurz and Salvadori (2004).

10 We shall see this below in greater detail.

11 In Weber's writings, especially in *Wirtschaft und Gesellschaft* ([1922] 1972), the concepts of power and domination play a significant role in numerous contexts. He discussed, for example, the distribution of power amongst the different ranks of people in Italian towns in the middle ages, the power of guilds in that age, the power assumed by bureaucracies in modern times, the power of the Roman Catholic Church, and the "power of capital".

12 Jessop (2012: 3) speaks of power relations "as manifestations of a specific mode or configuration of class domination rather than as a purely interpersonal phenomenon lacking deeper foundations in the social structure."

[13] Some interpreters claim that general equilibrium theory simply formalised Adam Smith's view. However, as we shall see, this can hardly be sustained vis-à-vis, for example, Smith's view of the social embeddedness of agents and the shaping of their needs and wants by the social strata to which they belong. In the tradition of Aristotle's *zoon politicon* (*æþïí ðïëéôéêüí*), individuals are seen as social beings whose motivations, aspirations, capabilities and so on are largely shaped by society or the milieu from which they come. In short, society exists prior to and independently of single individuals.

[14] Francis Bacon had famously stated "scientia potestas est" and had advocated the use of knowledge in the interest of improving mankind's lot.

[15] In this context, see also Krause (2008), who discusses collective dynamics with distributed information and insists on the importance of networks.

[16] With multi-product firms, which are the normal case, the power or influence of a business leader could be conceptualised as some weighted average of these product-specific powers.

[17] For example, in the past, the horse was an indispensable means of transport in many countries and its services were used directly or indirectly in the production of many, if not all, commodities. Today this is no longer so: horses are no longer basic products, but non-basic ones. The invention of cars, trucks and railways has relegated horses to the status of a non-basic good.

[18] Another influential and much earlier author was Niccolò Machiavelli (1469-1527), whose book *Il Principe* (The Prince) was published posthumously in 1534. It was read and commented upon by many economists, including Adam Smith.

[19] As we shall see below, this concept finds an echo in Smith's concept of "labour commanded".

[20] For the following, see also Kurz and Sturn (2013) and Kurz (2016a).

[21] We only mention in passing that Smith, the moral philosopher, was convinced that the acquisition of power and riches does not keep the promises man associates with them. He insisted: "Power and riches … keep off the summer shower, not the winter storm, but leave [man] always as much, and sometimes more, exposed than before to anxiety, to fear, and to sorrow; to diseases, to danger, and to death." (TMS: 302) He added: "And it is well that nature imposes upon us in this manner. It is this deception which arouses and keeps in continual motion the industry of mankind." (TMS: 303)

[22] A due regard for the role of economic power and the institutional constraints on the use of it would necessitate also a thorough investigation of the hierarchical organisation of the division of labour in the factory along the lines presented in Section 3. Smith was aware of the power structure relating master and workmen. See in this context also Marglin (1974). Smith's master-workman dialectic recurs prominently in Georg Wilhelm Friedrich Hegel's P*hänomenologie des Geistes*, originally published in 1807. In the chapter on self-consciousness (Hegel [1807] 1979: chap. IV.B), Hegel provides a dialectic analysis of the relationship between master and slave (*Herr und Knecht*), focusing on the involved "one-sided and unequal recognition" (*einseitiges und ungleiches Anerkennen*). Hegel's argument was an important starting point of Marx's treatment of class relations in bourgeois society. Axel Honneth (1992) elaborated on the concept of recognition.

[23] See also the related concepts of the integrated wage-commodity sector and the profit function in Garegnani (1984).

[24] Sraffa normalises the system by taking total employment as equal to unity.

[25] Smith's view is in marked contrast to Milton Friedman's, according to which the absence of overt coercion implies the absence of power; see Friedman (1962).

[26] While general equilibrium theorists often prided themselves with having accomplished what Adam Smith had intended, but failed to do because of a lack of the necessary mathematical tools at his possession (see, for example, Arrow and Hahn 1971: 1–2), they typically put to one side the aspects of Smith's analysis mentioned above. The recent financial crisis led the late Kenneth Arrow to some self-criticism. In a flyer announcing a talk he gave at the Austrian Central Bank on 22 October 2013, he stated: "A key factor in the organization of the economy is the set

of beliefs that people have about each other. They change those beliefs by searching, by computing, by analyzing, and when looked at properly, this gives rise to some considerable anomalies when compared with the standard theories that I and many others have developed. So in some sense, I'm finding some difficulty with work I've done in the past." Interestingly, while Arrow admitted the importance of the formation of beliefs, he refrained from explicitly mentioning the role of power, informational advantage, intentional mal- or misinformation etc. in this context.

[27] For a more general formulation that includes also the use of scarce natural resources, see Sraffa (1960: chap. XI) and Kurz and Salvadori (1995: chap. 10).

[28] Because of incessant attempts of firms to restrict competition, Smith would have in all probability received with disbelief Böhm-Bawerk's view (see Section 9 below) that it is legitimate to start from the assumption of perfect competition.

[29] A modification of the equation giving natural prices allowing for different profit rates in different industries is close at hand.

[30] The Indian scholar Dadabhai Naoroji (1901) titled one of his books aptly Poverty and *Un-British Rule in India*: he accused the British of teaching free trade, the rule of law and the separation of political power and wealth, but practising the opposite.

[31] Alas, like other authors, Smith too suffered greatly from misrepresentation by both friend and foe, frequently turning his messages upside down. Contrary to a widespread view, he was decidedly not of the opinion that selfishness was all that was needed to bring about a good and prosperous society. This was the doctrine of Bernard Mandeville, which Smith found erroneous on each and every count.

[32] A measure of power alternative to Smith's is, of course, Karl Marx's concept of the rate of surplus value or "exploitation". See Garegnani (1984).

[33] On Ricardo's economic doctrines, their geneses and content, see Sraffa (1951), Kurz (2006) and King (2013a).

[34] For a more detailed discussion, the reader might wish to consult Kurz (2015, 2016b) and Kurz and Salvadori (2015).

[35] Ricardo was clear that real wages may (and in the course of the development of the economy will) exceed what is absolutely necessary for workers and their families to sustain life: workers may participate in the sharing out of the social surplus. Here we set aside for simplicity of this aspect and assume that real wages in their entirety are a part of necessary physical costs of production. On the surplus approach of the classical economists, see also Garegnani (1987).

[36] For a brief discussion of Ricardo's pamphlet on *Protection to Agriculture* published in 1822, which deals with the problem under consideration, see King (2013a: 91–3), who also draws the attention to a few letters that have been discovered since the publication of Sraffa's edition of Ricardo's *Works* and that are pertinent in the present context.

[37] *Vis-à-vis* statements like this, it comes as no surprise that the landed gentry was hostile towards Ricardo; see expressions of Ricardo's anticipation in this regard and his expectation to be exposed to "all the charges and vituperation of the landed gentlemen against me" (*Works* IX: 262; see also X: 349). Landlords, he also argued, had a permanent interest in restricting trade in corn and other agricultural products, whereas the manufacturers' interest in protecting their business was only temporary.

[38] It deserves to be mentioned that Nicholas Kaldor, inspired by Ricardo, took the repeal of the Corn Laws in 1846 to exemplify the compensation criterion he suggested as a solution to the problem in welfare theory that policy measures typically have gainers and losers. According to Ricardo's above argument, landlords benefiting from the Corn Laws could not compensate workers and capitalists, because their gains in physical terms were smaller than the losses incurred by the other classes of society.

[39] Smith's above idea was developed by Anonymous (1821) and recurs in Piero Sraffa's papers and notes drafted in the late 1920s and early 1930s, which eventually led to his 1960 book (see Kurz 2012). In the perspective assumed,

the claims of the different parties to the product resided in their power to threaten society by "withdrawing" their productive resources. Workers have to be paid, Smith stressed, at least a real wage that allows their "race" to reproduce itself. In case of a lack of alternatives to the use of their land, landowners, Sraffa surmised, have to be paid a zero rent if their land is not scarce. To capitalists interest (profits) has to be paid, Sraffa argued at the time—again in accordance with Smith, in order to prevent capitalists from withdrawing their circulating capital (including the wear and tear of fixed capital), thus thwarting the "self-replacement" of the economy.

40 Marglin also emphasised that under the Soviet variant of socialism, "no less than under feudalism and capitalism, the primary determinant of basic choices with respect to the organization of production has not been technology – exogenous and inexorable – but the exercise of power – endogenous and resistible." (1974: 112)

41 Isaac (1987: 96) expressed a similar view: "Rather than A getting B to do something B would not otherwise do, social relationships of power typically involve both A and B doing what they *ordinarily* do." What matters are reciprocal attitudes and practices rather than singular impositions of one person's will upon some other person. It therefore comes as a surprise that Jessop (2012: 4) would write: "Marxists are interested in the first instance in power as capabilities rather than as the actualization of such capabilities."

42 See therefore, among others, Isaac (1987), Lukes (2005) and Jessop (2007, 2012).

43 For a summary account of Marx's contributions and the sources he tapped, see Faccarello, Gehrke and Kurz (2016).

44 Compare this, for example, with Adam Smith's discussion of the gradual demise of the feudal and the rise of the capitalist class—'a revolution of the greatest importance … brought about by two different orders of people [landlords on the one hand and merchants and artificers on the other], who had not the least intention to serve the publick' (WN III.iv.17); or his explanation of the decline of the clergy in the course of economic development.

45 Marx studied also other forms, including, for example, what later became known as "Harrod-neutral technical progress", but he appears to have been convinced that the mechanisation of production involves an increase in labour productivity, but is accompanied by a growing capital-to-output ratio, viz. a falling maximum rate of profits. See Kurz (2013: 103).

46 This is another expression of Smith's measure of power in terms of the difference between labour commanded and labour embodied.

47 Richard Goodwin (1967) elaborated a mathematical model of Marx's view of the endogenous reproduction of unemployment and of the cyclical character of capitalist development. He did so in terms of a variant of the predator-prey model, known in biology, with capitalists analogous to predators and workers to prey.

48 For a critical account of Hilferding's treatise, see Kurz (2011).

49 The German economist Erich Preiser (1970) adopted Kalecki's concept in a paper on economic growth and income distribution, but it remains somewhat unclear what determines what Preiser also called a "quasi monopoly"; see on this Kalmbach (2008).

50 Interestingly, Kalecki and Kowalik (1971) were of the opinion that a "crucial reform" of capitalism after World War II caused by a strengthening of workers and their trade unions and political parties stabilised the system and led to a more equal and fair distribution of income. Ironically, they advocated this view at the beginning of the decade in which the Golden Age in Europe after the war was coming to an end and Margaret Thatcher and Ronald Reagan were about to rise to political power in the UK and the USA. King (2013b: 2) commented on the untimely account: "'The owl of Minerva spreads its wings at dusk'. Or so Hegel believed. In plain English: you only find out what's going on when it's about to stop."

51 The kibbutzim movement was strongly influenced by Oppenheimer's ideas (see Barkai 1996).

52 The institutional arrangements under which this would work out smoothly and avoid the "tragedy of the commons" are touched upon in some of the writings, but frequently they are sidestepped.

53 Prior to Oppenheimer, Ludwig Gumplowicz, one of the founders of sociology in Europe, had advocated a similar view of the origin of the state.

[54] As we have seen above, the land-centred view of power resonates also in Bertrand Russell's work.

[55] The American edition published by the Ludwig von Mises Institute translates the title somewhat misleadingly as "Control or Economic Law" (Böhm-Bawerk 2010); in fact the translation of the essay is not always reliable. Here, the translations of passages from it are mine.

[56] Prior to Böhm-Bawerk, Maffeo Pantaleoni (1898: 185) had posited: "monopoly prices are prices which it is known cannot be kept up, ... and they soon bring on a period of overcrowded competition." He also stressed (p. 191): "Economics appears substantially as a science of *voluntary* and therefore of *peaceful settlements*." The axiom of "egoistic hedonism", he inferred (p. 195), "precludes the possibility of speaking of strong and weak" or, in the terminology used here, of powerful and powerless.

[57] On the treatment of power by institutionalist authors, see Samuels (1979) and Dugger (1980). See also the writings of John Kenneth Galbraith (in particular, 1952 and 1983).

[58] For the following, see also Kalmbach (2008: 88-91). For a discussion of how Joan Robinson's *The Economics of Imperfect Competition* (1933) relates to Pigou's concept of exploitation, see Flatau (2001).

[59] It deserves to be mentioned, however, that the representatives of the *ordoliberal* or "Freiburg school" (named after the German university town), and especially Walter Eucken, were very much concerned with the role of power in the economy and society. This is hardly surprising, given their experience with Hitler's dictatorship and learning about Stalinism. Their goal after World War II was the establishment of a durable and well-functioning socio-economic order that combined individual freedom with social justice and sought to reconcile conflicting interests. Competition and social welfare politics were the supporting pillars of the sought order—a "mixed system" or "social market economy".

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