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Globalization checkmated? Political and geopolitical contradictions coming home to roost

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Abstract
The deepening of economic globalization appears to have ground to a halt and the process may even unravel a little. The sudden stop has surprised economists, whose belief in globalization has strong parallels with Fukuyama’s (1989) flawed end of history hypothesis. The paper presents a simple analytic model that shows how economic globalization has triggered political and geopolitical contradictions. For the system to work, politics within countries and geopolitics across blocs must be supportive of the system. That is missing. The model is applied to a global economic core consisting of the US, China, and the European Union. It is revealing of multiple tensions, fracture lines, and contradictions. Within the US, globalization has delivered economic outcomes that have estranged the electoral bases of both major political parties. It has also delivered outcomes that are inconsistent with the US neocon geopolitical inclination. President Trump is a product of those forces, and he will likely prove to be a historically significant figure. That is because he has surfaced geopolitical contradictions that cannot be swept back under the rug. Ironically, his biggest impact may be on the European Union, particularly Germany, which is being compelled to recognize the neocon nature of the US and the vulnerabilities of dependence on US exports and technology. China was already aware of its vulnerabilities in those regards.

Keywords globalization, barge economics, geopolitical contradictions, national political tensions

1. Economic failings and the rise of politics

It has been ten years since the financial crisis. Since then, the global economy has recovered and attention has increasingly shifted to political risks as the trigger for the next economic crisis. That shift of attention has been driven by political events like the UK’s Brexit referendum, the election of President Trump, and the rise of anti-euro populist political parties in Italy. Such events have the potential to cause financial disruptions that trigger broader economic dislocation, which in turn could further aggravate political conditions. In effect, we have moved to a world in which politics has become an important potential economic detonator.

The rise of politics is no accident. Instead, it reflects the popularly perceived failings of the neoliberal economic paradigm which has dominated economic policymaking for the past forty years. Since globalization is the most prominent feature of the neoliberal program and has also had some of the most visible negative effects, it has been placed in the forefront of the backlash. That backlash suggests globalization is unlikely to deepen further, and may even unravel a bit.

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2. Globalization as economists’ version of the “end of history” fallacy

The challenge to globalization has taken economists by surprise. In many ways, there are parallels between economists’ faith in globalization and Francis Fukuyama’s (1989) “end of history” hypothesis. After the demise of the Soviet Union, Fukuyama prophesied that free market liberal democracy had become the “final form of human government, to which all countries would now converge (Fukuyama, 1989, 3”).

Fukuyama’s hypothesis reflected the triumphalism that accompanied the fall of the Soviet Union. Within ten years it was already looking frayed, and within twenty years it was in tatters. At its base, lies a flawed understanding of human psychology regarding the appeal of identity, religion, racism, tribalism, and nationalism. Those profound forces easily lend themselves to majoritarian democracy without minority rights, or even outright authoritarianism. The fallacy of the end of history hypothesis was already visible at its inception in the form of rising Islamic fundamentalism in the Middle East and robust Christian fundamentalism in the USA. The discontent with the neoliberal experiment has further encouraged non-liberal forces, as evidenced by the tilt toward nationalist illiberal democracy in Russia and Central and Eastern Europe. In China, a hybrid state – free market economic system has emerged in which the political system is nationalist and authoritarian and moving in the direction of a high-tech totalitarian surveillance state.

Strong parallels can be drawn between mainstream economists’ belief in neoliberal globalization and Fukuyama’s end of history hypothesis. Economists’ thinking rests on the ideal of competitive general equilibrium which frames modern economic theory. That theory justifies the neoliberal economic paradigm, and trade theory extends the paradigm into the international sphere via application of the principle of comparative advantage which supposedly determines the pattern of specialization and trade.

Given this framework, globalization is presented as inevitable and unstoppable owing to the forces of technology and mutually beneficial gains from trade. The optimal future course of the global economy is to follow the template established by the World Trade Organization (WTO). Any who question that analytical perspective and its policy prescriptions are labelled as protectionists, luddites, or economic nationalists, and they are written off as being on the wrong side of economic history.

Unfortunately, as with Fukuyama’s political version of the end of history, events now threaten economists’ economic version of the end of history. That is because neoliberal globalization has run smack into a host of economic, political, and geopolitical contradictions.

3. Surfacing the economic, political, and geopolitical contradictions of globalization

The nature of those contradictions can be understood with the help of the analytical model shown in Figure 1. At the center is the process and nexus of arrangements that constitute economic globalization. Economic globalization links blocs and reorders economic arrangements, generating changed economic outcomes and possibilities in them. Within each bloc, those changed outcomes and possibilities have political and geopolitical ramifications.²

² Every model constitutes a simplification. Figure 1 shows globalization in terms of three blocs – the USA, China, and the European Union. Those blocs constitute the lion’s share of the global economy.
Mainstream economic analysis of globalization fails on two counts. First, it misconstrues the fundamental economics. Second, it neglects the political and geopolitical feedbacks, which vary by bloc and challenge the future of globalization. Those failings explain economists’ failure to anticipate why globalization now appears to be checkmated.

3.a The economics of globalization

As regards economics, the conventional wisdom interprets globalization through the lens of trade theory, which maintains there are gains for all countries that participate. The narrative is that there have been two globalizations in the modern era. The first began around 1870 and ended in 1914. The second began in 1945 and is still underway. Globalization is identified with the history of trade, and the narrative is constructed around a temporary inter-war interruption that put globalization on hold in the 1920s and 1930s.

In a recent paper (Palley, 2018), I have challenged the conventional view and argued that there have been three globalizations, not two. The first Victorian globalization ran from 1870 to 1914. The second Keynesian era globalization ran from 1945 to 1990. Both were driven by gains from trade that provided aggregate benefits to countries and the world economy.

Since 1990 there has been a third neoliberal globalization which has been driven by industrial reorganization, motivated by redistributing income to capital away from labor. Neoliberal globalization can be described as “barge economics” (Palley, 2007, 2008). The idea draws on the observation by Jack Welch, former CEO of General Electric, that business would ideally like to have “every plant you own on a barge”. Welch envisioned factories floating between countries to take advantage of lowest costs, be they due to under-valued exchange rates, low

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Other OECD, emerging market, and developing countries are excluded for simplicity. However, they too can potentially be analyzed using the same framework.

Proponents of globalization make claims of large gains from trade. Those gains are outlandish in terms of their own theory, which is already based on the optimistic assumption of full employment (Rodrik, 2007). They effectively exclude the possibility of losses contemplated by other theoretical perspectives (Capaldo, 2014).
taxes, subsidies, absence of regulation, or abundant cheap exploitable labor. In such a world, there is an inevitable large increase in trade because goods must cross borders, but trade theory does not explain what is going on.

Barge economics produces winners and losers. In developed economies, capital’s share has increased at the expense of labor’s as workers and the entire economic system are subject to pressures from global labor, regulatory, tax, and social wage arbitrage. Developing countries can gain from arrival of the barge to the extent it brings FDI and technology, and promotes domestic investment and export-led growth. That has been the case in China. But developing countries can also lose to the extent that their indigenous industrial base and income distribution is subjected to barge arbitrage, or to the extent that the barge only brings shallow export-processing zone development. That has been the case with Mexico.

Barge economics is motivated by distributional conflict. Since investments and expenses incurred for redistribution are costly to the economy, it undermines claims of a market economy to be Pareto optimal. Barge economics means there may even be no net gains from trade, and society may be worse off. Profits increase so that capital gains and labor loses, but labor's losses can exceed capital's gains. That is fundamentally different from conventional Stolper – Samuelson (1941) income redistribution effects which are generated in the context of Heckscher-Ohlin trade that increases global productivity.

In addition to misconstruing the economics of the neoliberal third globalization, economists neglect the domestic political and geopolitical ramifications. Those ramifications vary by bloc, and they raise conflicts and contradictions that threaten to check globalization. The domestic political checks operate within blocs, while the geopolitical checks operate between blocs. It is those checks that now challenge globalization.

3.b The US: economics, politics, and geopolitics

In the US, neoliberal globalization has caused massive manufacturing job and wage losses (Bronfenbrenner, 2000; Bronfenbrenner and Luce, 2004; Autor et al., 2013; Scott, 2017), and the economic damage has been significant. The manufacturing jobs which have been lost have historically been “good” jobs, paying higher wages and benefits and having large multiplier effects. They have also tended to be concentrated by community and region, which concentrates the deleterious economic impact.4

The US trade deficit has been a major channel through which manufacturing jobs have been lost, as it has substituted imported foreign production for domestic production. The trade deficit has also mattered because it is a leakage of demand so that it has aggravated recessions caused by demand shortage, and also weakened economic recoveries.5

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4 Some economists try and dismiss globalization job losses as insignificant on grounds that they are small compared to the US economy’s annual job creation and destruction. That reasoning is faulty. Think of an economy with two sectors. Sector 1 jobs are stable and have little turnover. Sector 2 jobs are volatile and open and close each month (e.g. seasonal tourism and retail, or restaurants). Over the year, the cumulative job churn in sector 2 will be huge and will dwarf the total number of jobs in sector 1. But wiping out the stable jobs in sector 1 will do great economic harm and also disadvantage the significant number of workers in sector 1.

5 The trade deficit has been a major channel of deindustrialization. This channel is easily understood by the general public, which has therefore made the deficit a catch-all symbol for the negative effects of globalization. Of course, other macroeconomic factors are also involved in determining the deficit, and economist advocates of neoliberal globalization try to belittle the public for not getting this. The public
Another important channel of manufacturing job loss has been investment diversion. Investment that would previously have taken place within the US has been diverted outside, thereby shortchanging US job growth.

The combination of loss of both existing and new manufacturing jobs has then had static and dynamic negative effects. The static effects reflect the immediate negative effects. The dynamic effects concern the negative impact on growth. Manufacturing is a leading engine of productivity growth (Palley, 1999), and its decline helps explain the failure of US productivity growth to recover the rates of the 1990s.

Lastly, manufacturing job loss has also had severe socio-political impacts. As noted above, manufacturing tends to be concentrated by community and region, which concentrates and amplifies the deleterious social consequences of job loss. Second, union membership was concentrated in manufacturing for historical reasons. Manufacturing job loss has therefore hammered union membership, which has generated serious knock-on labor market and political effects. The reduction of the unionization threat effect in labor markets has diminished wages in non-union jobs. The diminished size and power of unions has meant diminished union political influence, so that workers have had less political representation at a time when corporate political power has increased.6

As regards US politics, the adverse economic effects have triggered a growing popular backlash in the US against globalization. The backlash split the Democratic Party, with the establishment elite siding with globalization and also winning out. The failure of the Democratic party to remedy the issue meant the issue was thrown into open field. That gave the Republican Party, led by Donald Trump, the opportunity to pick it up and fuse it with racist, anti-immigrant, and xenophobic arguments. This has created a toxic populist Republican brew that mixes pro-corporate globalization policy with anti-trade rhetoric, racist anti-immigration policy, and aggressive nationalism. It has also confused the debate. Globalization was made in the USA by US corporations for US corporations, and it has delivered exactly as planned (Palley, 2015). Now, Trump has redefined it as something foreigners have done to the US.7

Trump’s redefinition saved the Republican Party from its globalization impasse with the electorate. However, it means both political parties are now split, with globalization being the fulcrum of their splits. Both parties’ bases are opposed to the existing neoliberal globalization

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6 Some glibly say unions should just organize workers in new expanding sectors and globalization is not the issue. However, the new workplaces are highly dispersed, have fewer workers per worksite, and are difficult and costly to organize. Moreover, the increased political power of corporations has created a legal environment that facilitates worker intimidation by firms and makes union organizing almost impossible. Globalization’s adverse impacts have therefore contributed to creating a doom loop whereby globalization weakens unions and worsens the context, which promotes further union weakness.

7 Such a redefinition was always a possibility, and US progressives have strayed perilously close to encouraging it by framing their opposition to globalization in terms of Chinese “cheating” on exchange rates, intellectual property, subsidies, non-tariff barriers, and export dumping. Unfortunately, that is a pitfall which is difficult to avoid as those issues are serious problems in their own right.
paradigm, while both parties’ elites are supportive of it. The open question is whether the political elites can keep political control, either by explicitly suffocating change or by a subterfuge of promising change that is not delivered on? If they cannot, globalization will be checked by US national politics.

As regards US geopolitics, globalization triggers different fissures. With regard to politics, the establishment political elite is unified and divided from the base. With regard to geopolitics, the country is unified but the political elite is tactically divided.

For the past forty years, the US has become increasingly dominated by the neocon construction of geopolitics. That construction holds never again shall there be a foreign power that can rival the US, as happened with the Soviet Union in the Cold War. It can be labelled the Cheney – Rumsfeld doctrine.8

Originally, the neocon view represented ultra-conservative Republican thinking, but it has substantially become mainstream thinking. Both Republicans and many Democrats now believe the US has the right to intervene unilaterally anywhere in the world, any time it chooses. Those bipartisan forces also believe the U.S. has the right to pepper the globe with military bases and military personnel deployments. Democrats tend to be softer than Republicans on the issue of unrivalled power, but they compensate by supplementing the neocon rationale for global intervention with the claim that the United States has a right to intervene in the name of protecting and advancing democracy. That right derives from “U.S. exceptionalism”, whereby the U.S. has a special mission to transform the world by promoting democracy.

The political bases of both parties are also largely supportive of this neocon construction of geopolitics. The average US citizen is intoxicated by nationalist pride in the military and supportive of the massive military budget even though it means foregoing other publicly provided goods. There has been no meaningful opposition to the state of permanent war, and the tolerance for war is high because the US is significantly insulated from its human cost owing to the absence of a draft, the disengaged nature of aerial and drone warfare, and the Atlantic and Pacific Oceans which prevent the backwash of war reaching US shores. As long as these insulating barriers hide the human costs of war cost and the electorate remains blind to the opportunity cost of resources showered on the military, the US electorate is likely to remain largely supportive of the neocon vision.

Whereas the political elite and the general public are united in their neoconservative geopolitical outlook, there is a fundamental tension between neoconservative geopolitics and globalization. Additionally, there are tensions within the US elite regarding geopolitical tactics. These twin tensions mean globalization also faces checks owing to US geopolitical concerns.

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8 The neocon view does not come out of the blue of US history. The US has always been an expansionist state, and its expansion has been paired with the doctrine of “US exceptionalism” which provides a moral justification. In the 19th century, expansion was directed to colonizing the western frontier, which included conquering a large chunk of Mexico. At the end of the 19th century, the US made the leap to having overseas colonies. The cooked-up 1898 Spanish – American War was decisive, and represented the triumph of imperialism within the US polity (Kinzer, 2017). For fifty years, World War II and the Cold War obscured that imperialist DNA by providing the US with the cover of being a benevolent non-imperialist hegemon. The end of the Cold War and the collapse of the Soviet Union stripped away that cover, revealing neo-conservatism which is the latest evolution of US expansionism.
The fundamental tension between neo-conservatism and globalization is evident in the rise of China, which has benefitted from globalization. Globalization has diminished the US industrial base, hugely strengthened China’s industrial base, and it has also given China a strategic choke-hold over the global supply chain. Those developments have strengthened China’s military and economic power, thereby implicitly diminishing US power since power is relative (Palley, 2013).

As regards the geopolitical tactical tension, the Republican elite is more nationalistic and militaristic. The Democratic elite has a more cosmopolitan view, preferring that foreign country elites be drawn into the US globalization project, albeit as junior partners. Both elites support over-whelming US military superiority, as reflected in bi-partisan support for the military budget and overseas military engagements.

These elite geopolitical tactical differences explain the differences in Democrats’ and Republicans’ political positioning. Democrats’ cosmopolitan neo-conservatism seeks to enlist foreign elites as junior partners, the goal being to permanently handcuff allies and isolate rival powers (especially China). That strategy was epitomized by President Obama’s Trans-Pacific Partnership (TPP), which was supported by the elites of both political parties but was hated by the political bases of both parties. Republicans’ nationalistic neo-conservatism seeks to engage in circus-style globalization renegotiations that actually deepen features corporations want - like expanded global intellectual property rights and protections. Electorally, Republicans’ tactical subterfuge has been more successful, but the risk is their rhetoric deepens public hostility to globalization and further destabilizes the establishment elite’s grip on national politics.

In sum, the US elite wants to push ahead with both its neoliberal globalization and neocon projects, neither of which can be sacrificed. However, consistency between the neocon and globalization projects requires recalibrating neoliberal globalization. That recalibration has been blocked by the public’s resentment against globalization. To square the circle, the establishment elite hopes it can still smuggle through a recalibration of globalization against the public’s will, but that is looking less and less likely.

3.c China: economics, politics, and geopolitics

China is the second component of the framework in Figure 1. China is an authoritarian single party state, which makes it difficult to say much about China’s domestic politics. Instead, globalization can be assessed in terms of China’s economic development project and China’s geopolitical project.

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9 This view of Democrats is different from Faux’s (2006) global class war hypothesis. Faux emphasizes the “Party of Davos” which enables capitalists to escape their national identities and form a global class that wages class war everywhere. Neo-conservatism is a nationalistic philosophy. As such, it inevitably clashes with the Party of Davos. Democrats are better at concealing that, or simply hoped the attraction of Wall Street would be sufficient to finesse the contradiction by seducing foreign elites to come on board as junior partners in the US neocon project. That strategy worked with Mexico’s elite, but not with China and Russia’s state controlled elites. The verdict is still out on Europe.

10 This can be done by fooling the public into thinking recalibrating globalization is necessary for national security, so that popular support for the neocon project is enlisted to trump popular resentment with globalization. Alternatively, the elite can over-ride the public’s will via a bi-partisan Congressional coalition which is protected from the public’s anger by the entrenched monopolistic two party political system.
As regards economic development, China has been a big winner from neoliberal globalization. China has opened itself to FDI, which has resulted in massive inflow of capital and technology that has been used to make China the premier global export production platform for multi-national corporations.

However, unlike Mexico, China’s opening has not been passive. Instead, it has been extremely active. Thus, China has exerted pressure for joint-venture arrangements. It has also fostered development of its own national corporate champions, and Chinese capital has been assisted by provision of subsidized capital and widespread unofficially assisted intellectual property theft. This active industrial policy has been accompanied by a massive infrastructure build and maintenance of robust capital market controls. The goal has been to mimic the development of the Asian tigers (South Korea, Taiwan, Singapore, and Hong Kong) which succeeded in implementing deep development rather than superficial EPZ development. As a big winner and with its development project unfinished, China would like to maintain the existing neoliberal globalization status quo.

As regards geopolitics, China’s goal is to establish itself as the regional super-power. That means no other power, including the US, should be able to rival it in its regional sphere.

Globalization has clearly contributed constructively to China’s geopolitical project. First, it has generated a massive inflow of technology and enormously increased China’s industrial base, both of which have contributed to enhancing China’s military capacity. Second, the China-centric design of globalization has given China a strategically critical place in the global supply chain, giving it a downward choke-hold over regional suppliers and an upward choke-hold over the US (Palley, 2013). Third, the design of neoliberal globalization has also contributed to diminishing the US industrial base. As the US is China’s chief geopolitical rival, that has assisted China’s geopolitical project. Fourth, neoliberal globalization has been structured to produce large trade surpluses for China and trade deficits for the US (Palley, 2015). That pattern has enabled China to accumulate huge foreign exchange reserves which provide it with a defensive shield against US financial power and a “soft power” asset for wooing allies. That too has assisted China’s geopolitical project.

In sum, both China’s development project and its geopolitical project have benefitted from the past thirty years of neoliberal globalization. However, in US eyes, the rules of neoliberal globalization have not been properly enforced against China. If the US view of those rules and their enforcement were to prevail in the future, the benefits of neoliberal globalization to China will change significantly. The economic benefits would be diminished and China will chafe under restrictions it views as being designed by the US for the benefit of US capital and the US geopolitical project.

China will therefore resist both enforcing the existing rules or changing those rules in ways aimed at benefitting US workers. Instead, for China, the challenge is to maintain the status quo which is highly satisfactory.

3.d The European Union: economics, politics, and geopolitics

The European Union (EU) is the third bloc in Figure 1, and the EU’s situation is significantly different from both the US and China. First, the EU’s macroeconomic recovery after the 2008 crisis has been extremely weak. That weakness is significantly due to the consequences of
the euro’s poor design (Palley, 2017), combined with disastrous embrace of fiscal austerity by European politicians (Truger, 2013).

Second, the last twenty years has seen significant EU expansion via incorporation of Central European economies, which has constituted a form of EU own mini-globalization. That process has inflicted economic effects on the EU core similar to those of globalization. The important implication is macroeconomic weakness and deindustrialization in the EU core have been significantly self-inflicted. Those self-inflicted injuries have been folded into resentments about globalization, creating an even more politically confused and fraught situation.

Third, the economic impact of globalization has varied by country and region. Italy and the Mediterranean economies have been losers as their industries competed most closely with those of China and emerging market economies. Germany has been a winner, but it was also a trade winner before globalization. It has benefitted from the globalization success of China and emerging market economies, which has increased demand for German capital goods and automobiles. Additionally, Germany has also benefitted from the euro zone’s macro failings which have devalued the euro, thereby further increasing German export competitiveness.

In sum, the EU is a murky mix of self-inflicted injury, pain from globalization induced deindustrialization, and gains from globalization induced exports. The important point is that economic tensions within the EU, and the induced political tensions, are as least as much due to EU internal policy as to globalization. Both EU expansion and globalization are elite projects, driven by the EU’s Brussels’ bureaucracy and European capital. Together, they have undercut popular political support for further expansion of either project, and the loss of support even threatens the EU itself.

As regards geopolitics, the EU situation is equally fluid and confused. Put bluntly, the EU bloc has lacked a geopolitical project. The UK remains atavistically attached to its imperial past and a misguided belief in a special relationship with the US. France has lost the confidence and capacity to pursue an independent “de Gaulle” style project. And Germany remains shy about stepping up to the plate and playing the role befitting the largest country and strongest economy in Europe. The net result is the EU bloc has largely played the role of follower to the US, significantly assisting the US geopolitical projects in the Middle East and versus Russia.

The EU bloc’s geopolitical rudderlessness reflects a combination of incompetence and continued dominance of old strategic tropes. However, the consequences of the EU bloc’s rudderless geopolitics are proving disastrous. First, the EU has experienced the backwash of US Middle Eastern wars in the form of refugees and increased terrorism risk. The refugee problem in turn interacts with the internal immigration problem created by EU expansion, so that US geopolitics is now feeding EU disintegration.

Second, siding with the US in its aggressive manufactured conflict with Russia risks more collateral backwash damage, as well as possibly damaging the European economy. Third, it is becoming clear that US neocons view Europe as a very junior partner that can be bossed about. The Trump administration has imposed trade sanctions, threatens more trade sanctions in the event that the EU does not toe the US line on Iran, and even more trade sanctions in the event that Germany does not toe the US line on the Nord Stream 2 gas pipeline with Russia.
Those actions and threats have made the EU, and especially Germany, aware of the dangers of dependence on exports to the US and dependence on US technology. Such dependence makes the German economy vulnerable to US neocon disciplines. It speaks to strategically diversifying the German economy by reflating the EU and establishing deeper business connections with Russia, which is a natural economic partner for Germany.

In sum, the neo-conservative nature of the US speaks to the need for the EU bloc to recognize the reality of the US geopolitical agenda and develop an independent EU bloc geopolitical agenda. Meanwhile, the internal political conflicts created by the EU’s expansion project and by neoliberal globalization speak to the political inability of the EU to promote further expansion of globalization. Both challenges are a check on globalization.

4. Globalization checkmated?

Figure 1 shows how globalization is a system of many moving parts. At its center is the process and arrangements constituting economic globalization. Each country or bloc is impacted by globalization, giving rise to economic, political, and geopolitical implications. For the system to work, politics within each bloc and geopolitics across blocs must be supportive of the system.

Mainstream economists present globalization as the inevitable end of economic history. They assume globalization is a positive sum economic development for countries; any adverse country income distribution issues can readily be solved by transfers; and geopolitical issues are a non-issue. Given that, the system’s parts can be smoothly synchronized, both within and across blocs so that globalization becomes irresistible.

The reality is quite different. Barge economics means globalization can be negative sum because production relocation is motivated by search for a higher profit share rather than higher productivity. At the same time, globalization triggers political and geopolitical contradictions within and between blocs, which can derail or even reverse the process.

Globalization is an elite project for the benefit of capital in developed countries. The more that is understood, the deeper will be the popular political opposition in developed countries.

The clearest geopolitical contradiction is between China and the US. China seeks to be a regional super-power that none can challenge in its regional sphere of influence. The US seeks to be a global super-power that none can challenge anywhere. That is a contradiction, and the US elite cannot support globalization in its current form because it helps China.

Attempts by the US elite to refashion globalization, in a way that retains the benefits for capital while reducing China’s economic and geopolitical gains, will face popular opposition from both the Republican and Democratic base – as illustrated by the rejection of President Obama’s TPP proposal.

Conversely, progressive reformers have advocated remaking globalization in a way that includes such measures as enforceable labor and environmental standards, exchange rate safeguards, and capital controls (see Palley 2012, Chapter 10 for a description of such a plan). However, a progressive reform program faces opposition from capital in developed countries. A main purpose of neoliberal globalization has been to escape such restraints on
business which were put in place after the catastrophe of the Great Depression. Consequently, in the US, progressive reform is stymied by both Republican and Democratic Party elites. Furthermore, a progressive reform program will also be opposed by China and other emerging market economies. They will argue it is an attempt to enforce inappropriate standards on developing economies, and China will also see such a program as an infringement of its sovereignty. In sum, globalization appears to be checkmated, making further deepening unlikely.

Just as deepening appears unlikely, so too reversal will be difficult. First, there are significant business forces supporting the existing system. Those forces can threaten to punish governments that seek to change the rules, via such means as moving production facilities or cutting back on investment. Second, globalization is subject to significant policy lock-in (Palley, 2017-18) – “Hotel California” effects whereby you can check in but you cannot check out. Such lock-in has been visible in the euro zone, where countries have been unable to exit. Similar lock-in is present in the system of globalization. Within countries, companies have set up international global supply chains that they depend on, and industries have been shut down on the assumption that companies would be supplied via imports. Changing those new configurations is costly and disruptive, which is a big deterrent to change.

Lastly, never say never. Though popular opinion in the US is strongly against expansion of neoliberal globalization, the political elite may still manage to force through an expansion. The US elite shares a common project. With regard to economics, the entire elite is neoliberal, but Republicans are hardcore neoliberals while Democrats are compassionate neoliberals (Palley, 2012, Chapter 11). With regard to geopolitics, all are neoconservative, but Republicans are more nationalist while Democrats are more cosmopolitan.

The genius of contemporary US politics has been its ability to cast the elite as if it were profoundly divided and as if that division reflected the full spectrum of policy options. In fact, it is a form of “Coke versus Pepsi” politics with lots of fizz, but both are colas. That politics has worked brilliantly for the elite over the last forty years, and it is still possible the elite could pull off another round of globalization against the popular will. For instance, elite “Clinton-Obama” Democrats hope there will be a political reaction against the personality of President Trump which will enable them to smuggle through a version of their cosmopolitan approach to globalization (i.e. a resuscitated version of the TPP). However, that possibility is increasingly challenged by opposition of the political base, which already cost Hillary Clinton the presidency in 2016.

5. Postscript: the historical significance of Donald Trump

Lastly, what is the role and historical significance of Donald Trump? President Trump is an unethical narcissist, but he will likely prove to be a historically significant figure. That is because his actions have surfaced the geopolitical tensions and contradictions in neoliberal globalization that others were either keeping quiet about or in denial about. As a result, those issues can no longer be ignored and nor can they be put back in the bottle.

11 In the past, that approach would have been carried by the combination of the bulk of the Republican Party, an element of the Democratic Party, and an elite Democratic President. However, it is becoming increasingly difficult to accomplish because opposition within the Democratic Party is even larger, while support in the Republican Party is smaller. Opposition to globalization from both parties’ bases suggests packaging globalization in different wrapping paper will no longer sell.
In particular, Trump has surfaced the neocon character of the US polity, with its commitment to US global superiority. China has long been aware of that character, but it suffered it as part of its “long game” approach to development and geopolitics. Trump’s actions will only have made China more aware of its vulnerabilities from export dependence and reliance on imported components and licensed technology.

The really big change concerns the EU, and particularly Germany, which has been forced to recognize the realities of US neo-conservatism and the dangers of dependence on US technology and exports to the US.\(^\text{12}\) Ironically, Trump’s challenge of China (for which there is much legitimate justification) is likely to have a far bigger and lasting impact on the EU which has been subjected to an economic and geopolitical wake-up call about the nature of the US polity.

It is tempting to write Trump off as an ugly idiosyncratic aberration, but that is too easy and wrong. Some of Trump is ugly, idiosyncratic, and aberrant. However, Trump was elected by the US electorate and remains very popular with many, which is revealing of important characteristics of US society. Furthermore, Trump and the Trump administration are Americans, and their actions are revealing of neocon characteristics which are shared across party lines, and which are also held by both the elite and the general public.

Geologists often say they learn most about the earth’s structure from earthquakes which are extreme events. Trump is a political earthquake and he has provided a learning moment about the US polity and its geopolitical aspirations. That learning moment is likely to prove of major historical significance, clearing away lingering delusions of US benevolence which were created in the mid-20th century. That promises to make Trump a historically significant figure.

References


\(^\text{12}\) For example, the EU’s Galileo project aims to provide the EU with its own GPS navigation system that is independent of the US. Projects and policies motivated by desire for independence from the US are likely to increase significantly in the wake of President Trump.


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You may post and read comments on this paper at https://rwer.wordpress.com/comments-on-rwer-issue-no-85/
Capital and class: inequality after the crash
David Ruccio and Jamie Morgan

The premise and promise of capitalism, going back to Adam Smith, have been that global wealth would increase and serve as a benefit to all of humanity. However, the experience of recent decades has challenged those claims: while global wealth has indeed grown, most of the increase has been captured by a small group at the top. This has continued into the “recovery” in the United States and globally. The result is that an obscenely unequal distribution of the world’s wealth has become even more unequal. Those in the small group at the top have long been able to put distance between themselves and everyone else precisely because they’ve been able to capture the surplus and then convert their share of the surplus into ownership of wealth. And the returns on their wealth allow them to capture even more of the surplus produced within global capitalism. This is accompanied by growing income inequality.

However, although people are aware of inequality, they are typically unaware of its real extent, and mainstream economics and the popular press contribute to this situation, which in turn leads to the reproduction of the system that produces ever-more-grotesque levels of inequality.

Both class and ideology underpin this worsening situation. The tiny group at the top, both nationally and globally, have both an interest and the means to maintain the economic and social rules and institutions that allow them to capture the surplus, and thus create more distance between themselves and everyone else. Meantime, mainstream economic and political discourses, inside and outside the academy, tend to ignore the class conditions and consequences of inequality – and to undermine the possibility of a real debate about the kinds of changes that are necessary to give the majority of people a say in how the surplus is utilized.

Global wealth inequality

Since Thomas Piketty published *Capital in the Twenty-First Century*, the World Inequality Lab has become one of the best known and most reliable sources of data on wealth and income
inequality. So far, the Lab has collected reasonably good data for the United States, China, and Europe (which is represented in what follows by France, Spain and the United Kingdom) up to 2015 and provides projections from there. Globally, wealth is substantially more concentrated than income: the top 10 percent owns more than 70 percent of the total wealth. The top 1-percent wealthiest individuals alone own 33 percent of total wealth in 2015. This figure is up from 28 percent in 1980. The bottom 50 percent of the population, on the other hand, owns almost no wealth over the entire period (less than 2 percent). The projection looking forward is similarly dramatic: according to the World Inequality Lab, if present trends continue the share of each of the top groups – the top 1 percent, the top 0.1 percent, and the top 0.01 percent – would grow by one percentage point every five years. What that means is that, by 2050, the share of each group would increase dramatically. In particular, the share owned by the top 0.1 percent would eventually match that of the declining middle group — at a quarter of global wealth.³

Using a different approach a report commissioned by UK MP Liam Byrne (Chair of the All-Party Group on Inclusive Growth) provides an even more extreme projection. Drawing on data compiled by Credit Suisse for 2008-2017, and assuming total wealth grows at the same

³ [https://anticap.files.wordpress.com/2018/05/global-wealth.jpg](https://anticap.files.wordpress.com/2018/05/global-wealth.jpg)
rate as this period, the report estimates that by 2030 the wealthiest 1 percent in the world could hold 64 percent of the wealth.⁴

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<th>Estimated distribution of global wealth under different scenarios, 2017-2030</th>
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<td>Assumimg total wealth grows at 2008-17 annual rate</td>
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Note: the composition of each group will change from year to year. Someone who is in the wealthiest 1% one year may be in the least wealthy 99% in the next.

Projections, of course, are always contestable but the underlying mechanisms that have emerged are not.⁵ What we’ve been seeing in recent decades is that an unequal distribution of wealth leads to even more inequality, since wealth inequality is amplified as wealth is concentrated in the hands of a small group at the top. Past wealth is capitalized at a faster pace, since the rate of return on wealth is faster than the rate of growth of the economy. Moreover, this effect is reinforced by the fact that rates of return tend to increase with the level of wealth: the rates of return available to large financial portfolios are usually much higher than those open to small bank deposits and the other savings vehicles available to everyone else. There is no sign that this is going to change unless more people are made aware and are willing and able to organize. The trend is not just quantities; it is a manifestation of capitalist class dynamics.

Re-estimating wealth inequality in the United States

If we return to the World Inequality Lab, the share for the top 1 percent in the United States is higher than the global figure. It was, for example, an astounding 41.8 percent in 2012 and 35 percent in 2014 (compared to 45.3 percent for the bottom 90 percent of households) However, depending on how it is measured, actual wealth inequality may be even higher. Both the World Inequality Lab and the Federal Reserve (in the Survey of Consumer Finances) include housing and retirement pensions in household wealth – and those two categories comprise most of the so-called wealth of most Americans. The important point is that they don’t own much in the way of financial or business wealth. They live in their houses and they retire based on contributions from their wages and salaries over the course of their work lives.

⁴ https://anticap.files.wordpress.com/2018/06/byrne.jpg
⁵ Note though that: "Danny Dorling, professor of geography at the University of Oxford, said the scenario in which the super-rich accumulated even more wealth by 2030 was a realistic one: ‘Even if the income of the wealthiest people in the world stops rising dramatically in the future, their wealth will still grow for some time,’ he said. ‘The last peak of income inequality was in 1913. We are near that again, but even if we reduce inequality now it will continue to grow for one to two more decades.’” See: M. Savage ‘Richest 1% on target to own two thirds of all wealth by 2030’ The Guardian April 7th 2018
They own little in the way of equities, fixed-income claims and business assets, which we can refer to independently as real wealth (in so far as this wealth is something they can additionally call upon beyond specific retirement products or their home). If we take out housing and pensions and calculate just the shares of financial or business wealth – and, thus, equities, fixed-income claims, and business assets – the degree of inequality is much, much worse. **According to my calculations**, in 2014 the top 1 percent owned almost two thirds of the financial or business wealth, while the bottom 90 percent had only six percent. That represents an enormous change from the already-unequal situation in 1978, when the shares were much closer (28.6 percent for the top 1 percent and 23.2 percent for the bottom 90 percent).⁶

![](https://anticap.files.wordpress.com/2018/02/wealth-inequality.jpg)

What does this mean? The majority do not have the ability to amass any real wealth; put another way, they produce most of the wealth but don’t take home any of the surplus. For the small group at the top, things are quite different. They *do* get a cut of the surplus, which they use, not only to purchase housing and put aside in their pensions, but to accumulate real wealth, for themselves and their families. Moreover, as the labour share declines and the profit share increases, this is exacerbated. This is the background against which wages and incomes stagnate or fall for the majority, a trend that has continued throughout the “recovery” since the global financial crisis.

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Continuing income inequality

The OECD’s Directorate of Employment, Labour and Social Affairs provides the following summary of their Employment Outlook 2018:7

For the first time since the onset of the global financial crisis in 2008, there are more people with a job in the OECD area than before the crisis. Unemployment rates are below, or close to, pre-crisis levels in almost all countries. . . Yet, wage growth is still missing in action. . . Even more worrisome, this unprecedented wage stagnation is not evenly distributed across workers. Real labour incomes of the top 1% of income earners have increased much faster than those of median full-time workers in recent years, reinforcing a long-standing trend. This, in turn, is contributing to a growing dissatisfaction by many about the nature, if not the strength, of the recovery: while jobs are finally back, only some fortunate few at the top are also enjoying improvements in earnings and job quality.

The number of jobs has gone up and unemployment rates have fallen. However, workers are still being left behind because wage growth “is still missing in action.” Workers’ wages have been stagnant for the past decade across the 36 countries that make up the Organisation for Economic Cooperation and Development. The problem has been particularly acute in the United States, where the “low-income rate” is high (only surpassed by two countries, Greece and Spain) and “income inequality” even worse (following only Israel):8

The causes are clear: workers suffer when many of the new jobs they’re forced to have the freedom to take are on the low end of the wage scale, unemployed and at-risk workers are getting very little support from the government, and employed workers are impeded by a weak collective-bargaining system. And it is important to remember that the growth of corporate profits is both a condition and consequence of the stagnation of workers’ wages. Employers have been able to use those profits to undertake share buybacks, in turn, increasing the value of financial assets held by the few (a mechanism exacerbated by corporate tax cuts, since investment has not grown commensurately), but profits have not in the main been used to increase worker pay (except for CEOs and other corporate executives whose pay is actually a distribution of those profits). The investment that does occur uses new technologies to take advantage of national and global patterns of production and trade to keep both unemployed and employed workers in a precarious position. That precarity, even as employment has expanded, serves to keep wages low – and profits growing.

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8 https://anticap.files.wordpress.com/2018/07/left-behind.jpg
Economic growth leaves many Americans behind

**Low-income rate** (share of households earning less than half the median income), 2016

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**Income inequality** (Earnings at the 90th percentile as a multiple of earnings at the 10th percentile), for full-time workers, 2015

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Source: Organization for Economic Cooperation and Development
What we’re seeing then, especially in the United States, is a self-reinforcing cycle of high profits, low wages, and even higher profits. That’s why the labour share of business income has been falling throughout the so-called “recovery”.$^9$

Eric Levitz in a July 2018 article in New York Magazine states that in the end this is political, as “American policymakers have chosen to design an economic system that leaves workers desperate and disempowered, for the sake of directing a higher share of economic growth to bosses and shareholders.”$^{10}$ Productivity, automation, etc. on which economists focus are simply issues within that system. American workers (and workers in general) are being “ripped off”. Nowhere is this seen more clearly than in ratios of CEO-to-average-worker-pay.

**CEO-to-average-worker-pay ratios**

According to a 2017 Economic Policy Institute report, the average CEO-to-average-worker-pay ratio for the largest 350 corporations in the US was 271 to 1.$^{11}$ There are different ways to calculate this ratio and it can be difficult to acquire appropriate data because of the way corporations choose (and are able) to report the relevant numbers and it is only recently that a change in regulations required US corporations to actually provide such a measure. However, what is undisputable is that the ratios indicate extreme inequality and that there has been an upward trend over decades. For example, according to the Economic Policy Institute report.$^{12}$

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$^9$ https://anticap.files.wordpress.com/2018/07/fredgraph.png. The graph maps the precipitous decline in the labor share during the past decade (from 103.3 in the first quarter of 2008 to 97.1 in the first quarter of 2018, with 2009 equal to 100), but the trend is longer: from 114 in 1960 or 112 in 1970 or even 110.2 in 2001.


$^{12}$ https://anticap.files.wordpress.com/2018/04/ceo.jpg
We can also look at individual firms and compare the ratio, average worker pay and the poverty line. Amazon has reported an average compensation for its varied, mostly warehouse (and now, with Whole Foods, grocery store), workers at $28,446 a year. The federal government defines its poverty guideline for a family of four to be $25,100. So, Amazon’s average wage falls easily within 150 percent of the poverty line – and stands at about one-half of the median household income in the United States. The only private employer bigger than the e-commerce giant is their retail competitor Walmart, whose workers average only $19,177 per year, putting them far under the federal poverty guidelines. Moreover, the ratio to average-worker pay of Walmart CEO Doug McMillon, who took in $22.8 million last year, was an astounding 1,188 to 1. And the extraordinary numbers continue, across the economy. Royal Caribbean Cruises: 728-1. Regeneron Pharmaceuticals: 215-1. Netflix: 133-1. Live Nation Entertainment: 2,893-1. Honeywell International: 333-1. Fidelity National Information Services: 654-1. UnitedHealth Group: 298-1. And on and on. Each such ratio indicates the obscene level of inequality in the United States, based on the amount of surplus pumped out of workers and distributed to those who run American corporations on behalf of their boards of directors.

https://www.bloomberg.com/graphics/ceo-pay-ratio/
“Ripped off” starts to have real meaning when confronted with these ratios. It is no wonder that Amazon is owned and run by literally the richest man in the world, Jeff Bezos. While he technically “made” only $1.7 million last year, he’s worth $127 billion. The business press makes much of the idea of indispensable innovators, the wealth creators, but it typically neglects the fact that the reality of working for a large corporation involves hard-headed wealth extraction. Jeff Bezos recently received a hostile reception from workers when he arrived in Berlin to pick up an innovation award. As Frank Bsirske, the head of the Verdi trade union, explained: “We have a boss who wants to impose American working conditions on the world and take us back to the 19th century.” Meanwhile, back in the United States, Amazon reported that its profits more than doubled to $1.6 billion in the first quarter of 2018, sending shares of its stock soaring to an all-time high.

While the figures of CEO-to-average-worker-pay are reported in the business press, they are not and have not been widely discussed in the mainstream media or by the nation’s politicians. This is a situation found in many countries; it matters because it creates a situation of systematic ignorance of the real extent of inequality even though ordinary people are both aware that there is (growing) inequality and that it is created by economic arrangements that are fundamentally unfair. Lack of awareness serves to undermine or prevent the expected outrage and reduce the momentum to organize and pressure for change—following Levitz’s comment, to compel policymakers to choose differently or themselves be changed.

The under-estimation of inequality and mainstream economics as ideology

In a 2014 study, Sorapop Kiatongsan and Michael Norton asked about 55,000 people around the globe, including 1,581 participants in the United States, how much money they thought corporate CEOs made compared with unskilled factory workers. They then asked how much more pay they thought CEOs should make. American respondents estimated that executives out-earned factory workers by a factor of roughly 30-to-1. As also indicated by the Economic Policy Institute report, this is exponentially lower than the contemporary figure, and is actually just about what that ratio was in the 1960s.

According to the study, Americans believed the ideal ratio should be about 7-to-1. Furthermore, Americans didn’t answer the survey much differently from participants in other countries. Australians believed that roughly 8-to-1 would be a good ratio; the French settled on about 7-to-1; and the Germans preferred around 6-to-1. In every country, the CEO pay-gap ratio was far greater than people assumed. And although they didn’t agree on precisely what would be fair, both conservatives and liberals around the world also concurred that the pay gap should be smaller. People also found themselves in agreement across income and education levels, as well as across age groups.

Clearly, representations of the economy that minimize the existence of inequality or the problems associated with inequality are bound to reinforce the systematic misperceptions

15 https://www.hbs.edu/faculty/Publication%20Files/kiatponsan%20norton%202014_f02b004a-c2de-4358-9811-ea273d372af7.pdf
16 This follows a 2010 paper in the same journal in which Michael Norton and Dan Ariely also find that Americans have a notion of economic fairness that is strikingly more equal than the current reality, and more equal even than their own underestimate of the degree of inequality. http://www.people.hbs.edu/mnorton/norton%20ariely%20in%20press.pdf
found by Norton and others. As has been widely noted since Piketty's *Capital in the Twenty-First Century*, previously mainstream economics had relatively little to say about inequality. Mainstream economics in general tends to deflect attention from the existence of inequality (e.g., by focusing on growth, output, and the price level versus distribution) and from the economic and social problems created by inequality (by attributing the growing gap between the haves and have-nots to forces like globalization and technological change that are beyond our control, or invoking more education as the only solution).

Mainstream economics continues to form part of what others, such as Vladimir Gimpelson and Daniel Treisman in the NBER working paper “Misperceiving inequality”, refer to as “ideology”, something “which may predispose people to ‘see’ the level of inequality that their beliefs and values convince them must exist.” The dominance of mainstream economics in the United States – in colleges and universities as well as in the media, think tanks, and in government – and around the world is one of the main reasons Americans, like people in other countries, tend not to see the existing degree of inequality. Of course, no ideology can be complete, and this is also the case for mainstream economics. It jars with our experience of the world and our aspirations regarding the world we want to live in. That's why Americans and citizens around the globe do see that the degree of inequality created by existing economic arrangements is fundamentally unfair.

**Conclusion**

Trends in global income and wealth concentration unequivocally suggest that unless radical economic changes are made within nations, the existing inequalities created by contemporary capitalism represent both the premise and promise of an even-more-unequal distribution of income and wealth in the decades to come. And the consequences of growing inequality – for the tiny group at the top as well as the vast majority at the bottom, albeit in different ways – make that case even more compelling. Neither group can escape the existing logic and its effects unless existing rules and practices are fundamentally transformed. At the same time, the widespread sense of fundamental injustice and unfairness, which is only partially masked by mainstream economics and politics, can serve as the clarion call for a ruthless criticism and reimagining of contemporary economic and social institutions.

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17 [https://www.nber.org/papers/w21174](https://www.nber.org/papers/w21174)
Post-crisis perspective: sorting out money and credit and why they matter!
John M. Balder\textsuperscript{1} [Newton, Massachusetts, USA]

Introduction

The Queen of England, on a visit to the London School of Economics in November 2008, asked a poignantly serious question: “Why did no one see it coming?” Fortunately, some economists did (Bezemer 2009), though their views were mostly ignored, given that they operate outside the mainstream (neoclassical) framework. As for neoclassical economists, they missed the crisis by design, given that they view finance (banking, money and credit) as a “veil” that does not impact real economic activity.\textsuperscript{2} In other words, the most important crisis since the Great Depression fell outside the purview of their models; it was a “black swan.”

The failure of mainstream neoclassical economics to integrate crisis speaks to the framework’s ideological fixation with stability and general equilibrium models.\textsuperscript{3} In response to the failure of the (Dynamic Stochastic General Equilibrium) models to predict the crisis, Robert Lucas (2009), the doyen of mainstream economists, founder of micro-foundations for macroeconomics, winner of the 1995 Nobel Prize for economics and a former president of the American Economic Association, wrote the following in the \textit{Economist}:\textsuperscript{4}

“The charge is that the forecasting model failed to predict the events of September 2008. Yet, the simulations were not presented as an assurance that no crisis would occur, but as a forecast of what could be expected conditioned on a crisis not occurring.”

Andrew Haldane (2016), Chief Economist at the Bank of England, responded as follows to the comment from Lucas:

“This is no defense. Economics is important because of the cost of extreme events. Economic policy matters precisely because of these events. If our models are silent about these events, this jeopardizes the very thing that makes economics interesting and economic policy important.”

As Haldane suggests, economics can ill-afford to remain silent about extreme events, especially given their real-world consequences (rising unemployment, bankruptcies, etc.). An

\textsuperscript{1} John M. Balder has an extensive background in public policy, financial stability and economics. He is currently working on a book that discusses connections between neoliberalism, financial markets and income inequality.

\textsuperscript{2} Solow (2010).

\textsuperscript{3} Jamie Galbraith (2009) suggests that neoclassical economics has “formed a kind of Politburo” in which “no one loses face in the club, for having been wrong, and still less is anyone from the outside invited in.” Paul Romer states that “For more than three decades, macroeconomics has gone backwards.”

\textsuperscript{4} Robert Lucas, in his role as president of the American Economic Association, in 2003 stated that macroeconomics “central problem of depression prevention has been solved, for all practical purposes, and has in fact been solved for many decades.” As Steve Keen (2011) writes neoclassical economists “had no idea of what was about to happen….and fundamentally……no one but themselves to blame for their ignorance.”
alternative, more appropriate real-world approach is to integrate finance and economics and to abandon the a priori equilibrium assumption. Taking such a step will help us understand (1) why financial crises occur, and (2) what, if anything, can be done to mitigate the frequency and magnitude of these events.

The proper response to the key question raised by the Queen of England, which had much in common with the children’s book, *The Emperor’s New Clothes*, was that mainstream neoclassical economics failed to see it coming by design – they ignored the role of credit and asset prices. To achieve proper balance in the real world, economics and finance must be reunited.

**History of capitalism: both dynamic and also unstable**

Capitalism is an inherently cyclical system that periodically experiences crises. The endogenous source of this cyclicity can be attributed to risk-taking in an uncertain environment. To its credit, capitalism has generated prolific wealth creation for more than two hundred years that have resulted in improved living standards. Even the most trenchant 19th century critic of capitalism, Karl Marx, celebrated the productive achievements of capitalism. Curiously, his insights into the evolution of capitalism were far more profound (and lyrical) than the more mechanical views of well-known advocates of free markets, such as Milton Friedman and F.A. Hayek. As Marshall Berman (1982) writes in *All That Is Solid Melts into Air*, Marx praises owners of capital (“bourgeoisie”) “more powerfully and profoundly than its members have ever known how to praise themselves.”

Marx (1844) writes in the *Communist Manifesto* that capital:

“…has created more massive and colossal productive forces than have all preceding generations together. Subjection of Nature’s forces to man, machinery, application of chemistry to industry and agriculture, steam-navigation, railways, electric telegraphs, clearing of whole continents for cultivation, canalization of rivers, whole populations conjugured out of the ground – what earlier century had even a presentiment that such productive forces slumbered in the lap of social labor?”

The highly dynamic nature of capitalism differentiates it from previous social systems (e.g., Feudalism). Marx poetically acknowledges that capital:

“cannot exist without constantly revolutionizing the instruments of production, and thereby the relations of production, and with them the whole relations of society. All fixed, fast-frozen relations, with their train of ancient and venerable prejudices and opinions, are swept away, all new-formed ones become antiquated before they can ossify. All that is solid melts into air, all that is holy is profaned, and man is at least compelled to face with sober senses his real conditions of life, and his relations with his kind.”

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5 Although Marx continued to be ignored by mainstream economists, his insights into the workings of the capitalist system have become more relevant in recent years, primarily given the failure of the mainstream neoclassical framework.
Marx’s analysis did not end there. Marx (1844) also wanted to understand capitalism’s “pathology,” namely its endogenous tendency toward crises. In his words, modern capitalist society:

“….is like the sorcerer who is no longer able to control the powers of the nether world whom he has called up by his spells. There is too much civilization, too much means of subsistence, too much industry, too much commerce. The productive forces at the disposal of society no longer tend to further the development of the conditions of property.”

Marx’s comment that “all is solid melts into air, all that is holy is profaned” speaks to the dynamism of an evolving (organic) economic system where nothing is fixed. As the Irish poet, William Butler Yeats writes: “Things fall apart, the center cannot hold.” Schumpeter’s comment about creative-destruction looms large over the process of capitalist development. Wealth creation and instability are closely linked in capitalism, according to Marx, whose approach is entirely at odds with stability and equilibrium.

Capitalism has experienced two major crises over the past one hundred years, the Great Depression of 1929 and the recent global financial crisis (GFC) of 2008.6 The Great Depression spurred innovative government action that generated extraordinary performance during the next quarter century (1945-1970). Policies were introduced that constrained finance, supported organized labor and collective bargaining, and the creation of a strong social safety net (that included Social Security). Remarkably, this framework successfully generated stable robust real economic growth, declining inequality and financial stability, during the “Golden Age” of capitalism.

Eventually, this too faded. As real economic growth slowed, and inflation accelerated during the 1970s, businesses coalesced around changes that gradually pushed the US economic system toward a neoliberal (or free market) approach. The initial steps were taken during the Carter Administration, which cut capital gains taxes and deregulated various industries, including airlines, trucking and finance. However, neoliberal ideas became fully endowed during the Reagan Administration. Reagan adopted free market policies that included deregulation of finance, a frontal assault on organized labor, cutbacks in the social safety net, tax cuts for the wealthy and the creation of a business-friendly, deregulated environment, in short a return to the laissez-faire policies that pre-dated the Great Depression.

A key component to the economic shift was the deregulation and liberalization of financial markets. In part, this transition was driven by globalization and technological changes, but it also was based on the emerging ideological belief in efficient markets. Basically, mainstream economists ignored financial markets, choosing to treat them as another sector in the economy, based on a belief that they could regulate themselves. The unbridling of financial markets led to the buildup of credit and asset prices in a series of financial (boom-bust) cycles that ultimately culminated in the disastrous collapse of 2007-2009. The failure to understand the real-world implications of decision-making have imposed disastrous consequences on most Americans that have become quite clear since the global financial crisis struck in 2007-2009.

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6 Smaller crises have occurred as well, including the stock market crash in October 1987, banking/thrift crisis in 1990-1991, numerous crises in emerging markets, Long-Term Capital Management, the tech bubble in 2001, etc. The focus in this article is on the two major crises.
Finance: need to understand banking, money and credit

To explore the origins of the global financial crisis, the first step is to specify the relationship between banking, money and credit. According to the mainstream view, a bank serves as an intermediary between a borrower and a lender. As a pure intermediary, a bank has no impact on real economic activity. This view – taught in most Economics 101 textbooks – implicitly assumes that money is available in finite quantities that are regulated by the central bank.

Several years ago, Paul Krugman and Steve Keen engaged in an enlightening back-and-forth about banking, money and credit. The discussion examined whether banks lend existing money (implying money is neutral) or newly create the money they lend (money is not neutral).

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<thead>
<tr>
<th>Economist</th>
<th>Category</th>
<th>Result</th>
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<tbody>
<tr>
<td>Krugman (2012)</td>
<td>Money is neutral</td>
<td>Banks lend already existing money</td>
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<tr>
<td>Keen (2011, 2017)</td>
<td>Money is not neutral</td>
<td>Banks newly create the money they lend</td>
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In support of neutral money (mainstream view), Krugman (2012) casually asserts:

“Think of it this way: when debt is rising, it’s not the economy, as a whole borrowing more money. It is rather, a case of less patient people – people who, for whatever reason want to spend sooner rather than later – borrowing from more patient people.”

Krugman notes that banks lend existing money as intermediaries between borrowers and savers. In other words, a bank must have $100 in deposits before it can make a loan for $100. Deposits create credit (or a bank liability is needed for a bank to create an asset). This view asserts that money is neutral and can be ignored, as it has no relevance for real economic activity. This view seems to be intuitive, in fact almost obvious; after all, if I do not have $10, I cannot lend it to you.

Conversely, Keen (2011) argued that banks newly create the money they lend. If true, this suggests that money creation impacts real economic activity and is not neutral. But how does a bank “create” money? **When a bank makes a loan, it simultaneously creates a deposit (which is money) for the borrower in an identical amount.** For example, if I borrow $10,000 from my bank, the bank creates a deposit account in my name with $10,000 in it. In creating credit, a bank necessarily creates a deposit and thus, money. This is how double-entry bookkeeping works. Loans create deposits.

According to Richard Werner (2012), more than 95% of all money created in the US and UK is a direct result of credit creation by banks. When a bank creates credit, it also creates money. Post-Keynesians have been making this argument for more than three decades, though few have listened (e.g., Basil Moore was an early proponent) and this view was recently affirmed by the Bank of England (McLeay 2014a and 2014b): “Whenever a bank

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makes a loan it simultaneously creates a matching deposit in the borrower’s bank account, thereby creating new money.” Yet, despite the factual basis of this claim, it has been ignored by neoclassical economists, given their attachment to equilibrium analysis.

Banks are authorized to create credit, ex nihilo (“out of nothing”) so credit (money) cannot be neutral. In creating credit, a bank creates money that a borrower uses to purchase goods and services that add to aggregate demand and economic growth. Banks are not limited to acting only as intermediaries that move money from savers to borrowers. Importantly, banks also determine how credit and money are allocated. In the real-world, money creation distinguishes banks from other financial intermediaries (e.g., shadow banks) that can extend credit but do not possess the authority to create money. Within the financial sector, only banks are granted this authority. Money is a form of credit, an obligation to pay. In Werner’s (2012) words, “banks are the creators of the money supply” and “this is the missing link that causes credit rationing to have macroeconomic consequences.” In short, finance (banking, money and credit) matter!

Transition from flattened to unbridled finance

The government response to fixing the financial system during the Great Depression was comprehensive. Policymakers adopted a framework that successfully constrained excessive credit growth and protected financial stability. These policies worked remarkably well for more than three decades. For example, the passage of the Glass-Steagall Act (Banking Act of 1933) regulated interest rates that banks and thrifts could pay on deposits (Regulation Q); fragmented permissible activities for various financial institutions; separated investment banking from commercial banking; and created deposit insurance for small bank depositors.

These policies constrained finance and successfully protected the US economy from excessive credit creation, asset price bubbles and boom-bust cycles as banks and other financial market participants focused on supporting the real economy. However, as growth slowed during the 1970s, debate commenced about whether to remove these constraints, given rising volatility. There was little consensus and no action was taken. Then, in 1980 Congress passed legislation that eliminated restrictions on interest rates paid by depository institutions, allowing banks to compete for business. The expectation among policymakers and financial regulators was that the price mechanism would ration credit in place of the quantitative restrictions (Regulation Q) that were then being eliminated.

The chart below illustrates the shift that occurred as financial markets were deregulated and liberalized. During the postwar period (1945-1980), growth in credit was tightly correlated with GDP growth. The two increased in parallel, given that newly created credit generally targeted the production of goods and services (real economic activity). In this early phase, real economic growth drove credit creation and a repressed banking system was held subservient to the needs of productive capital.

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8 Mainstream economics continues to assert that credit and money are neutral and do not impact real economic activity. Neoclassical economists have good reason to be defensive. Given the structure of their models, dropping the neutral money assumption will result in an indeterminate outcome.

9 The lessons from the Great Depression had been long forgotten by 1980 as the “turn toward markets” unfolded, driven mostly by corporate interests and right wing ideologues. In the words of Mark Twain, “history does not repeat itself, but it often rhymes.”
As constraints on credit growth were lifted during the 1980s and 1990s, private sector credit surged relative to GDP. From 1980 to 2007, household debt more than doubled relative to GDP, increasing from 47% to 99%; in nominal terms, it increased from $1.6 trillion to $14.4 trillion.

Productive versus financial uses of credit

In addition to the explosive growth in credit, the manner in which credit was deployed also shifted toward financing transaction in housing and other assets (e.g., equities, bonds, et al). As noted above, up until the early 1980s, credit was used mostly to finance production of goods and services. Growth in credit from 1945 to 1980 was closely linked with growth in incomes. The incomes that were generated were then used to amortize and eventually extinguish the debt. This represented a healthy use of debt; it increased incomes and introduced negligible financial fragility.

However, as constraints were lifted, credit creation shifted toward asset-based transactions (e.g., real estate, equities bonds, etc.). This transition was also fueled by the record-high (double-digit) interest rates in the early 1980s and the relatively low risk-adjusted returns on productive capital. The expansion of credit lifted asset prices, fueling creation of more credit. Over time, financial innovations, including securitization and derivative instruments, also contributed to the explosive growth in trading activities that accompanied asset price appreciation.

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<th>IMPACT OF DEREGULATION AND LIBERALIZATION</th>
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<tr>
<td><strong>CREDIT GROWTH/GDP</strong></td>
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<td><strong>USE OF CREDIT</strong></td>
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<td><strong>IMPACT ON STABILITY</strong></td>
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Unlike credit allocated to the production of goods and services, a decision to allocate credit to finance transactions in already existing assets (e.g., home mortgages) does not increase...
value-added or GDP (wealth-effects aside). As the *International Currency Review* stated in December 1987:

> "Financial markets are quite special. They are subject to particular sources of instability that are not well understood and that have much more to do with the psychology of crowd behavior than with the behavior of goods markets. This kind of latent instability does not affect product markets at all."

Positive feedbacks between credit growth and asset prices during the neoliberal era is illustrated in the stylized boom-bust cycle description below. The full scope of these relationships reflects the role of “crowd psychology” in unconstrained (self-regulating) financial markets. Ultimately, this process is not sustainable, as “trees do not grow to the sky.” When this process unwinds, it can trigger a severe financial crisis.

Financial deregulation and the shift to neoliberal policies spurred financial cycles that previously were dormant throughout the postwar era (1945-1980). Importantly, asset price appreciation does not result in creation of value. If the price of an asset increases, the gains to the seller are offset by the increased cost to the buyer. For example, if Susan makes a $40,000 profit on the sale of her house, the purchaser must pay the higher price. A financial transaction necessarily has both a buyer and a seller. If the price of the house rises, the seller benefits, but the buyer pays the higher price. From a wealth creation perspective, this transaction is necessarily zero-sum (negative-sum, once fees are included). In brief, wealth has been redistributed, not created. This distinction between wealth creation and wealth distribution is at the heart of financial crises, given that credit-induced asset price booms ultimately are not sustainable (though admittedly, the precise timing of the reversal is highly uncertain, given what Keynes properly described as “animal spirits.”).

From 1980 to 2007, rapid credit growth primarily fueled transactions in already existing assets (mostly real estate), not real productive growth.¹⁰ In addition to extensive lending to households during this period, lending by financial firms to other financial firms increased from $0.5 trillion in 1980 to more than $18 trillion in 2008, or from 20% to 123% of GDP. This activity reflected the securitization process and the growth of extensive inter-connections between financial institutions that heightened systemic risk.

¹⁰ The Quantity Theory of Money implicitly assumed that credit is deployed only to support production of goods and services. However, from the early 1980 to 2007, and even more so from 2000 to 2007, most credit targeted the financial circuit, or the Finance, Real Estate and Insurance (FIRE) sector. This distinction explains the reasons for the decline in velocity that began during the 1980s. For more see Werner (2012).
The easing of quantitative restrictions on credit creation powered positive feedbacks between credit growth and asset price appreciation that fueled serial boom-bust cycles between the late-1980s and 2007. Household net worth increased from $9 trillion (1980) to close to $68 trillion in 2007, before falling to $55 trillion during the GFC. In response to the liquidity-induced QE-bubble engineered by the Fed and other central bank since the crisis ended, US household net worth today stands at a record $101 trillion (505% of GDP).

Category error: money and credit are different

The decision to deregulate and liberalize finance effectively treated finance as another sector in the economy. However, this view ignored what differentiates banks from other sectors in the economy. Banks create money with distinct social consequences that differentiate them from other sectors in the economy. A decision by the banking system not to extend credit in uncertain times can have untoward consequences for asset prices and/or economic activity; conversely, a decision to expand credit can fuel inflation in goods and services or in asset prices.

The application of “free market” rules to banks introduced positive feedbacks between credit growth and asset price appreciation that over the past century have twice culminated in major crises. Once unbridled, credit creation feeds asset price appreciation which in turn results in creation of still more credit. Banks and other financial institutions benefit, as profits accelerate with rising asset prices, until the process can no longer be sustained, perhaps because interest rates rise, asset prices peak, expectations shift, et al. As the process reverses, only intervention by the government is capable of restoring stability to the financial system. A failure of the public sector to act can trigger a debt-deflation depression. This underscores events leading up to the depressions in 1929 and again in 2008.

Importantly, the decision by government to enact policies that “flattened” finance during the Great Depression acknowledged this reality. The extraordinary economic performance that followed during subsequent decades included rapid real economic growth, declining income inequality and financial stability. As Adair Turner (2015) notes, even the free market economist, Henry Simons, a co-founder of the conservative Chicago School, stated
that application of “free markets” to money and credit was a “category error.” Given the social nature of money, **finance must be treated differently. In other words, flattening finance and targeting it toward production of goods and services is a prudent policy.**

The powerful ideological aversion to government intervention that has been dominant in the US over the past thirty-five years has resulted in the unfortunate creation of an enormous infrastructure of ideological support for free, deregulated financial markets. (e.g., Efficient Markets, Rational Expectations, Modern Portfolio Theory, CAPM, Black-Scholes, etc.). Much of this has emanated from the free market Chicago School. This highly ideological view asserts that government intervention is unnecessary and often disrupts optimal market outcomes. It hides its ideological roots behind the supposed virtues of “economic science” that appears natural (invisible hand). However, ultimately what has been created is a political framework that largely benefits those that have previously benefited from the economic system (Balder 2018). Some critics of government intervention have improperly (absurdly) blamed the 2008 crisis on government intervention (e.g., the Community Reinvestment Act and/or Government Sponsored Enterprises).

However, when financial markets collapsed in 2008, the government stepped in to stabilize conditions. This intervention was nowhere near as comprehensive and far-reaching as the policies put in place during the Great Depression, which put workers first. The initial decision to stabilize the financial system in 2008 was prudent, though arguably many of the largest US banks should have been nationalized. No one went to jail, other than Bernie Madoff. The failure to place constraints on the activities of these institutions or to address the underwater mortgages held by many middle-class families has left the US financial system susceptible (once again) to the excesses of financialization.

**The global financial crisis**

During the early 2000s, the real estate “wealth-effect” sustained aggregate demand and corporate profits, as the bottom 90% of households borrowed (against their home equity) to supplement declining incomes. These activities fueled the upward movement in asset prices and generated rising profits for financial institutions. The securitization of these loans in turn created additional trading opportunities that generated still more profitability for the financial sector. Profits for the financial sector peaked at 40% of overall corporate profits in 2001-2002, having more than doubled from levels during the 1950s and 1960s. From 2000 to 2006, real estate lending accounted for more than 84% of overall net lending to households, as housing prices nearly doubled.

The Fed adopted an increasingly asymmetric monetary policy during the late-1990s and early 2000s, leaving markets alone as asset prices appreciated (faith in the “free market”). However, when conditions deteriorated, the Fed intervened, lowering rates and injecting liquidity (if needed). As the Fed adapted to unbridled financial markets, investors increased risk-taking. Fed policy was labeled the “Greenspan Put,” which provided investors with an adjustable floor on asset prices. As stock prices rose, so did the floor value of the “put,” which spurred investors to increase risk-taking and leverage.11

11 Curiously, the Fed lowered short-term interest rates to a 45-year low of 1% in June 2003, which fueled the housing bubble despite evidence that the economy was recovering from the tech bubble.
The Fed could have utilized a symmetric policy, either tightening and easing when conditions warranted, or leaving markets to determine the proper valuations. Instead, its framework boosted risk-taking and helped fuel excessive credit growth and over valued asset prices. It was the Fed’s primary responsibility to maintain financial stability; that was the principle reason for the creation of the Fed in 1913. The decision to deregulate and liberalize financial markets made the Fed’s job more difficult. Arguably, the shift toward an asymmetric approach, though regrettable, might have been inevitable, given emergent pressures from policymakers and investors.

In any case the Fed’s approach certainly was not what former Fed Chair William McChesney Martin had in mind when he stated that the Fed’s job is to “remove the punch bowl just as the party gets going.” The Fed learned in March 1997 that raising short-term rates to stem a bubble could have serious political consequences (that might have jeopardized its so-called independence). Although the Fed might have thought itself independent from government, it clearly was not independent of the financial community. In addition, the “Washington Consensus” (efficient markets, etc.) dominated policymakers and regulators, who failed to understand (as Hyman Minsky and others operating outside the mainstream framework did) the impact of deregulation on market structure and behavior.

The Fed also had access to other tools, including margin requirements on stock transactions and loan-to-value (LTV) ratios for real estate. Utilizing these tools would likely have triggered pressures from market participants and policymakers. Selective credit controls, while sensible, were a non-starter as asset prices appreciated. The potential downside to the Fed taking these actions (raising interest rates or deploying credit controls) dwarfed any potential upside, especially given that asset price inflation (unlike inflation in goods and services) were viewed by investors as capital gains (and thus, income).

It seems unlikely that the Fed will take decisive actions to constrain boom-bust cycles, especially given pressures from market participants and its own concerns about protecting its so-called “independence.” The failure to fragment and compartmentalize financial organizations during the debate about Dodd-Frank, as occurred following the Pecora Hearings with the passage of the Banking Act of 1933, et al, was unfortunate, and all but ensures that another crisis will follow. Despite the starring role played by banks and other financial institutions in the GFC, the pressures placed by the financial lobby and the out-of-power party (Republicans) make it remarkable that any legislation was adopted. In any case, the next round of major reforms will need to focus on fixing the structure of financial markets (and not regulation).

Post-crisis recovery: 2010 to today

The global financial crisis had much in common with the Great Depression during the 1930s. As market liquidity dried up in 2008, highly leveraged financial institutions were paralyzed, and asset values and GDP collapsed. Given declining credit quality, opacity (no one knew where the exposures were nor how exposed a counterparty might be) and the erosion of trust, access to the inter-bank market dried up. Massive leverage and inter-connectedness between

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12 The bankruptcy of Lehman Brothers alone did not cause the crisis though it had severe knock-on effects on AIG, money markets, commercial paper, etc. As Kay (2015) notes Lehman was not a consequential institution, though it was “too inter-connected to fail.” It was not important, but it was systemically important.
large financial institutions (banks and shadow banks) created enormous potential counterparty risk that deepened the crisis. Only the colossal intervention by the Fed and US Government were capable of stabilizing the financial system (e.g., AIG, Citicorp, money markets, commercial paper markets, etc.).

The policy response to the GFC by the US Government and Federal Reserve successfully staved off another Great Depression, though losses to middle-class households were significant (including declines of 44% of net worth from 2007-2010). The consequences of the Great Depression (including declines of one-third of GDP and 25% unemployment) were largely attributable to the reticence of President Hoover to utilize fiscal spending to stabilize the economic system. In 1932, the government created the Reconstruction Finance Corporation (RFC), to help stabilize the faltering financial system, though it was “too little, too late.”

Remarkably, Marriner Eccles, a banker from the State of Utah, who would subsequently become the Chair of the Fed, was the only witness in a list of more than 200 who opposed budget balance in a hearing before the Senate Finance Committee in February 1933. Eccles recommended massive public sector spending to address the imbalances between production and spending. The Roosevelt Administration, which assumed office one month after Eccles testimony, though initially reticent not to balance the budget, subsequently created the New Deal that laid the groundwork for robust economic growth after the Second World War.

In contrast with the success of US economic activity during the Golden Age, the actions taken by the US Government and the Federal Reserve in response to the more recent global financial crisis have resulted in weak growth for several reasons.

- First, the decision not to provide debt relief to middle-class homeowners with underwater mortgage debt has slowed growth in aggregate demand and GDP.
- Second, the shift in corporate governance toward shareholder value maximization has pressured and incentivized CEOs to utilize earnings to make payoffs to shareholders (via share buybacks and dividend payments. These have reduced productive growth, wages, R&D, etc.
- Third, implementation of Quantitative Easing (QE) policies have created liquidity that has boosted stock prices, benefiting the wealthiest households (the top 10% who own 90% of all financial assets), while doing very little for real economic growth, wages, investments, etc. Very little of this money has been invested in productive activity that benefits US workers.

The failure to make greater use of fiscal policies to provide debt relief to middle-class households and invest in infrastructure has resulted in slow growth over the past decade at a cost to the bottom 90% of US households. The policy framework that has been in place for much of the past 35-years has mostly benefited the wealthiest US households. This is readily

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14 Senate Committee on Finance (1933). Eccles analysis of the causes of the Great Depression preceded Keynes’ publication of *The General Theory* by three years. Eccles awareness of the impact of the distorted distribution of income on aggregate demand and real economic growth was prescient.
15 Main and Sufi (2014).
16 John Kay (2015) states: “The belief that the profitability of an activity is a measure of its social legitimacy has not only taken root in the financial sector but has spread its poison throughout the business world.” Lazonick (2015) has provided extensive detail about this important topic.
apparent in the redistribution of income and wealth that has been presented by Piketty, et al (2018).

The tax cuts engineered by Reagan, Bush II and Trump also have benefited the wealthiest households. In lieu of tax payments to the government, these households often own the government debt that has been issued to cover the shortfalls. In lieu of a liability to the IRS, these households now possess an income-earning asset, the interest of which is paid by the USG. And the evidence is quite clear that very little of these tax cuts are invested by households in new productive activities – most simply find their way into the financial markets, further boosting asset prices.

Another perspective is to examine the divergence between rising corporate profits and falling investment, wages and salaries throughout the current recovery. *Ironically, profits are at record levels and have been throughout the current recovery, despite weak growth in investment and real economic activity.* This points to the persistence of financialization – the stock market has continued to soar while wages and investment (and real economic growth) are in the doldrums – but for how long can this pattern be sustained?

![Graph showing profits, wages, and investments from 1960 to 2016](image)

**Conclusion**

The adoption of neoliberal policies, including the deregulation and liberalization of finance, has benefited the wealthiest segments of society at the expense of the bottom 90% of households.¹⁷ There is a need to balance market outcomes so that they better impact the bottom 90% of households, who have paid a significant price over the past 35 years as income and wealth have been redistributed to the top 10% of households.¹⁸

**Financial policies should be adopted that simplify, flatten and reconnect finance with real economic needs, including job creation, increased wages, investments, infrastructure, R&D, etc.** Buybacks of shares by non-financial corporations (under SEC Rule 10b-18) should be eliminated. Permissible activities for financial institutions should be fragmented, much as they were during the Great Depression. A Tobin Tax on financial

transactions should be administered with the revenues utilized to support a Marshall Plan to rebuild decaying infrastructure.

Tax policies should be revamped to reverse the excessively generous treatment of the wealthiest segments of US society, including income and estate taxes. Taxes on capital gains (and “carried interest” should be equalized with income taxes. The belief that the wealthy invest the funds from their reduced taxes in productive activity is mythical – mostly, they spur speculation (and rising asset prices), not investment! The fact that the top 0.1% of US households now own as much wealth as the bottom 90% is not a healthy condition for a democracy. The notion that the wealthy engage in philanthropy to offset their advantaged situation may be well-intentioned but undermines the role of government and establishes an unhealthy relationship between donors and recipients.\(^\text{19}\)

These agenda items comprise a wish-list that is clearly not acceptable in the current political environment. Is another major financial crisis required before proper measures to balance the needs of the bottom 90% can be considered? Is the current emergence of populism a “canary in the coal mine”? The current-day reality, the role of lobbyists, Citizen’s United versus FED, Janus versus AFSCME, et al, makes this shift appear inconceivable. So why write now?

A parallel exists with the early 20\(^{th}\) century that provides some grounds for optimism. The formation of the Progressive Party during the early 1900s formulated policies that similarly were not initially acceptable, given opposition from a laissez-faire government and eventually the Supreme Court (sound familiar?). However, the framework continued to evolve and eventually, during the Great Depression, much of it was implemented providing remarkable benefits to workers who had been ignored during the early decades of the 20\(^{th}\) century.

In any case, continuing down the current neoliberal (laissez-faire) path cannot end well. Another major financial crisis (potentially more devastating than in 2008, albeit with different causes) could well energize even more virulent populist forces. The next generation and the generations after that should demand changes that include a more “just” government as a countervailing force to neoliberalism and free markets.

Neoliberal policies have contributed to the polarization of income and wealth. Sadly, the financial industry that has been a chief beneficiary has successfully bamboozled people into thinking that their current activities are essential for economic growth (“God’s work” in the words of Goldman Sachs CEO Lloyd Blankfein). Despite the devastating crisis in 2008, nothing has been done to constrain finance from continuing to operate in its own self-referential world, “trading with itself, talking to itself and judging itself by performance criteria it has generated.”\(^\text{20}\)

Hopefully the next generation, which has already faced a very difficult road, will recognize that people make their own history – FDR’s New Deal provided a turning point in capitalism toward a blend of markets and community that benefited the middle-class, while constraining finance. Lessons from the recent teacher protests against massive cutbacks in educational funding in the states of Oklahoma, West Virginia, Arizona, et al attest to the strength of movements that emanate from the bottom-up with broader societal interests in mind.

\(^{19}\) Anand Giridiharadas (2018) makes a powerful, compelling, contrarian argument about the role of philanthropy.

Alternatively, if the system does not adapt, capitalism may well confirm Marx’s vision and bring about its own demise. Fortunately, alternative approaches are readily available, if only the political will exists.

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With their back to the future: will past earnings trigger the next crisis?
Shimshon Bichler and Jonathan Nitzan

1 Jerusalem and Montreal

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1. Why is the stock market tanking?

As these lines are being written (April 2018), the U.S. stock market is again in turmoil. After a two-year bull run in which share prices soared by nearly 50 per cent, the market is suddenly dropping. Since the beginning of 2018, it lost nearly 10 per cent of its value, threatening investors with an official ‘correction’ or worse.

As always, there is no shortage of explanations. Politically inclined analysts emphasize Trump’s recently announced trade wars, sprawling scandals and threatening investigations, as well as the broader turn toward ‘populism’; interest-rate forecasters point to central-bank tightening and China’s negative credit impulse; quants speak of breached support lines and death crosses; bottom-up analysts highlight the negative implications of the Facebook/Cambridge Analytica debacle for the ‘free-data’ business model; and top-down fundamentalists indicate that, at near-record valuations, the stock market is a giant bubble ready to be punctured.

And on the face of it, these explanations all ring true. They articulate various threats to future profits, interest rates and risk perceptions, and since equity prices discount expected risk-adjusted future earnings, these threats imply lower prices.

But there is one little problem. Unlike their pundits, capitalists nowadays tend to look not forward, but backward: instead of matching asset prices to the distant future, they fit them to the immediate past.

[1) Submitted to RWER on April 6, 2018. Shimshon Bichler and Jonathan Nitzan teach political economy at colleges and universities in Israel and Canada, respectively. All of their publications are available for free on The Bichler & Nitzan Archives (http://bnarchives.net). Research for this paper was partly supported by the SSHRC. The article is licensed under Creative Commons (Attribution-NonCommercial-NoDerts 4.0 International).]
With their back to the future

Judging by Figure 1, the main driver of U.S. stock prices is current earnings per share, or EPS.\(^2\) The chart contrasts Datastream monthly data for U.S. EPS and share prices since 1995. The top panel plots the levels of the two variables, while the bottom panel shows their annual rates of change, and in both cases the temporal pattern leaves little doubt: share prices and current earnings are tightly correlated.

**Figure 1** U.S. Datastream Stock Prices and EPS, 1995-2018

Before we proceed, it is worth noting that ‘current’ earnings are not exactly current: the EPS for a given month are earned not during that month but up two years earlier. The reason is twofold. First, each EPS observation is a 12-month trailing average of previously reported earnings. And second, each of these previously reported earnings represents profits earned in the previous year. All in all, then, each EPS observation covers 12 to 24 months’ worth of earnings.

\(^2\) In this article, we use ‘earnings’ and ‘profits’ interchangeably.
profits, so if stock prices are indeed driven by EPS, they are driven not by current profits, but by past ones.

These considerations have two implications. The first and less important is that, contrary to popular belief, the recent market trajectory – i.e., its increase till December 2017 and its drop since February 2018 – has had little to do with President Trump’s impact on earnings, actual or alleged. As the chart shows, when Trump took office in January 2017, prices were already rising on the back of an EPS recovery that started in November 2015 (marked by the first vertical dotted line). EPS growth accelerated after Trump entered the White House, but since EPS data represent profits earned up to two years earlier, this acceleration could not have been influenced by Trump’s election, let alone his policies. Similarly with the 2018 price drop: as the figure shows, the February market decline came after EPS fell in January 2018 (second vertical dotted line), and since most of the profits represented by January’s EPS were earned before Trump’s policies came into effect, they could not have been significantly influenced by those policies to start with.

The second implication is broader and much more important. According to the data, present-day capitalists seem to view the world much like the Aymara people of Southern Peru and Northern Chile do: with their back to the future. The Aymara language reverses the directional-temporal order of most other languages: it treats the known past as being ‘in front of us’ and the unknown future as lying ‘behind us’. And judging by the Pearson correlation coefficient recorded in the bottom panel, capitalists do the same: since 1995, a full 46 per cent of the (squared) variations in the rate of change of stock prices can be explained by variations in the rate of change of past earnings.

This Aymara-like behaviour borders on sacrilege. In general, equity prices are thought of as determined by two types of factors – ‘fundamental’ (primarily earnings, risk and liquidity) and what we may call ‘deviational’ (including momentum, investors’ hype, technical omens and other occult forces and self-propelling prophecies that cause prices to diverge from their ‘true’ values). At any point in time, prices reflect the weighted average of both sets of factors. But there is broad agreement that, over the longer haul, the ‘fundamentals’ dominate. And the ‘fundamentals’, by definition, are forward looking.

According to finance textbooks, investors should look not backward, but forward. Their standard capitalization ritual, reiterated endlessly by the scientists of finance, conditions and compels them to discount not past profits, but future ones. Moreover, since corporations – and the capitalist system more generally – have no ‘expiry date’, their owners should look far beyond their immediate horizons. To properly price their assets, they must discount the profits they expect to earn not in the next few quarters or even several years, but all the way to eternity (Benjamin Graham, quoted in Zweig 2009: 28).

But if so, why do present-day capitalists defy their most sacred ritual and, instead of peering into deep future, remain fixated on the immediate past?

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3 See Núñez and Sweetser (2006) and Pincock (2006). To test this inverted perception, just look up at the stars: ahead of you you’ll see nothing but the past.
3. The radical inversion

To complicate things further, according to Figure 2 (also based on Datastream) this backward-looking posture is in fact rather new. As the bottom panel shows, until 1995 the cyclical growth rates of stock prices and EPS moved not together, but *inversely*: whereas the Pearson correlation between these rates was +0.46 in the post-1995 period, in the pre-1995 era it was −0.58. In other words, whatever affected the growth rate of stock prices from 1973 to 1995, it was *not* the growth rate of recent profits.

This radical inversion is highly perplexing. Why would capitalists obey their rituals in one period only to ignore it in the next? What happened in the mid-1990s that made them shift from forward- to backward-looking asset pricing? What does this shift mean for the broader logic of capital accumulation? And what does it imply for the near future?

**Figure 2** U.S. Datastream Stock Prices and EPS, 1973-1994

Note: EPS are computed as the ratio of stock prices and the price-earnings ratio. Annual rates of change are calculated relative to the same month in the previous year. The last data points are for December 1994.

Source: Datastream (series codes: TOTMKUS(PI) for price and TOTMKUS(PE) for earnings per share).
4. Systemic fear: the power of denial

In our RWER paper ‘A CasP Model of the Stock Market’ (Bichler and Nitzan 2016), we argued that the extent to which capitalists look backward rather than forward is indicative of their ‘systemic fear’ – namely, their apprehension for the very future of capitalism.\(^4\)

Since capitalization is forward-looking, variations in current profits should have no more than a negligible impact on asset prices, and variations in past profits should have no impact at all. Exclusive reliance on the future attests the capitalists’ systemic confidence. It demonstrates their belief that earnings will continue to flow and that assets will always have buyers – in other words, that their current system is eternal, and that the ritual of capitalization will dominate the world forever.

Now imagine the opposite situation – a setting in which capitalists lose this systemic confidence in the future and are instead struck by systemic fear, the apprehension that the current mode of power might crumble. Interestingly, the capitalists’ immediate reaction to systemic fear is not capitulation, but denial: ‘What? We worry? Fear for our system? No way!’ To sustain this denial and retain a semblance of confidence, though, capitalists need proof; they need evidence that they are still in driver’s seat, and the most readily available evidence of such control is their EPS here and now (read in the most recent past). If EPS remain high – or better still, if they continue to rise – then we, the capitalists, can remain hopeful despite the threatening future. And if our group as a whole stays hopeful, then, as individual investors, we have good reason to hold on to and even augment our equity holdings.

Paradoxically, then, the evidence for systemic fear lies in its very denial. We can know that capitalists have been struck by systemic fear by the fact that they effectively negate and abandon their core ritual of forward-looking capitalization; and we can measure the degree to which they negate this ritual by the extent to which their asset pricing comes to depend on past or current earnings rather than future earnings. This power of denial underpins our systemic fear index.

5. The systemic fear index

The systemic fear index measures the short-term correlation between stock prices and EPS. The higher this correlation, we argue, the greater the reliance of equity pricing on current and past earnings and, by implication, the more fearful capitalists are for their system’s future.

Figure 3 shows the construction of this index.\(^5\) The top panel shows monthly price and EPS data for the S&P 500 group of companies, dating back to 1871. The bottom panel plots short-term correlations. The thin series in the bottom panel measures the 12-month trailing correlation between the price and EPS series shown in the top panel. Each observation shows the correlation over the past year, with a value ranging between −1 (perfect inverse correlation) and +1 (perfect direct co-movement).\(^6\)

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\(^4\) The remainder of this article draws on, updates and extends aspects of our earlier paper.

\(^5\) For a detail explanation and comparison with earlier formulations, see Bichler and Nitzan (2016: Section 6).

\(^6\) The usefulness of a moving correlation here was suggested and shown by Ulf Martin in private communication.
The difficulty with the thin 12-month trailing correlation is that it oscillates widely, so visual inspection alone is not very revealing here. The thick series in the bottom panel addresses this difficulty by smoothing the thin series as a ten-year trailing average. Each observation in the thick series measures the average 12-month trailing correlation between price and EPS over the previous ten years. We call this series the *systemic fear index*.

**Figure 3** The S&P 500 Price and EPS: The Systemic Fear Index

Note: The S&P 500 index splices the following four sub-series: a combination of bank, insurance and railroad stock series weighed by Global Financial Data (1820-1870); the Cowles/Standard and Poor’s Composite (1871-1925); the 90-stock Composite (1926-1956); and the S&P 500 (1957-present). The 12-month trailing correlation in the bottom panel (thin series) measures the correlation between price and earnings per share (EPS). The 10-year trailing average (thick series) is the mean of this trailing correlation over the past 120 months. The last data points are September 2017 for EPS and March 2018 for price.


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7 For example, the systemic fear index for September 2017 (last observation) is +0.50. This result is derived by averaging out the 120 monthly readings of the 12-month trailing correlations between August 2007 and September 2017.
6. The evolution of systemic fear

Figure 4 enlarges our systemic fear index taken from the bottom panel of Figure 3, making it easier to examine. The chart shows two clear patterns: one long term, the other shorter term. The long-term pattern has a V-shape, with the early 1990s as its low point. Until the early 1920s, forward-looking capitalization was still in its infancy, so the correlation between price and EPS was pretty high, hovering around +0.4. But even then, there was already a visible down drift, and by the 1940s this down drift had turned into a sharp decline. Discounting methods were now making their way into introductory textbooks, and by the 1950s, with the capitalization ritual becoming more widely accepted and increasingly internalized by equity investors, the correlation fell to around zero. For the next half century, the index hovered around this value – albeit with some significant oscillations (the lack of correlation during this period is evident in the bottom panel of Figure 2).

And then came a decisive upward reversal. It started in the mid-1990s, and initially the uptick looked like part of yet another short oscillation. But by the early 2000s it became evident (at least in retrospect) that the century-long downtrend had been broken. Instead of reverting back to zero, the systemic fear index continued to soar and, by the early 2010s, reached an all-time high of +0.6 (the tightening correlation during this period is evident in Figure 1).

This V-shape pattern, though, has been anything but smooth. Oscillating around the long-term down- and uptrends are plenty of shorter-term fluctuations, some of which are pretty pronounced. So the question we need to address is what lies behind these patterns: what determines the long-term V-shape of the index and what accounts for its shorter-term fluctuations?

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For a short history of capitalization, see Nitzan and Bichler (2009: Ch. 9).
7. **Short-termism: culture or power?**

At stake here is the connection between the two key quantities of the capitalist nomos – the price of capital and its underlying earnings – so the question is obviously important. Yet, to the best of our knowledge, that question has never been asked, let alone answered. Indeed, as far as we know, the V-shape pattern of the short-term price-EPS correlation shown in Figures 3 and 4 is a new finding.

It is common to argue that, since the 1980s, U.S. capitalism has been marked by a growing emphasis on ‘shareholder value’, heightened ‘short-termism’ and a nearly universal obsession with quarterly increases in profits. This popular view is certainly consistent with the post-1980s surge of the price-EPS correlation shown in Figure 4 – and this consistency should hardly surprise us. With capitalists paying more and more attention to the latest bottom line and analysts glued to the latest bit of news, it is no wonder that equity markets have become increasingly sensitive to the most recent variations in earnings.

But what is the cause of these changes? Why has the capitalist time horizon shrunk? Why have investors – who, for a whole century up until that point, cared less and less about current earnings and often seemed perfectly happy to buy and hold stocks for the long haul – suddenly started to insist on quarterly increases in profits? Is the V-shape reversal of the early 1990s merely the consequence of a changing ‘investment culture’? Is it simply a new fad imprinted by the theoretical winds of just-in-time neoliberalism and emboldened by the ideological flare of Margaret Thatcher, Ronald Reagan and Alan Greenspan – or are these developments themselves the result of a deeper change?

The evidence presented below suggests the latter. Present-day capitalists and analysts, we argue, have come to demand quarterly increases in profits not because they started to ‘feel like it’, because they were taken over by a new financial ‘fashion’ or because they were somehow convinced that short-term increases are more ‘economically efficient’ than long-term growth. In our view, they do so because they are compelled to, and the force that compels them has nothing to do with any of the above. The reason, rather, is that their capitalized power is approaching its asymptotes, and the only way for them to counteract their deepening systemic fear is by pushing for higher current earnings.

8. **Capitalized power and systemic fear**

In ‘A CasP Model of the Stock Market’ (Bichler and Nitzan 2016), we developed a capitalized power index, defined as the ratio of the S&P 500 price index and the average wage rate. The numerator and denominator of our power index represent a conflict: the clash between those who own the capitalized means of power and those who are controlled by them.

Note that we use the average wage rate here not as a measure of productivity or wellbeing, but as a benchmark against which to gauge the differential power of owners. Furthermore,
although strictly speaking the wage rate pertains only to employed workers, its temporal movement approximates, however crudely, the changing conditions of the underlying population at large. Thus, when our power index rises, this means that the power of equity owners relative to the underlying population increases – and vice versa when the index falls. Moreover, and importantly, this relative power is forward looking: it denotes not only the rulers’ relative position here and now, but also how they expect this relative position to change in the future.

**Figure 5** The Dialectic of Power and Fear

Note: The systemic fear index represents annual averages of the monthly series shown in Figure 4. The S&P 500 price splices the following four sub-series: a combination of bank, insurance and railroad stock series weighed by Global Financial Data (1820-1870); the Cowles/Standard and Poor’s Composite (1871-1925); the 90-stock Composite (1926-1956); and the S&P 500 (1957-present). The wage rate splices hourly data for manufacturing production workers till 1946 with hourly data for nonfarm business-sector workers from 1947 onward. The last data points are 2016 for the systemic fear index and 2017 for the power index.

Now, as Figure 5 indicates – and here we come to the crucial point – our power and systemic fear indices seem to move in tandem. The dotted blue series, plotted against the right scale, is our systemic fear index, taken from Figure 4 (to reiterate, this index is the ten-year trailing average of the 12-month trailing correlation between the S&P 500 price and EPS). The solid black series, plotted against the left log scale, is our power index, smoothed as a ten-year trailing average to match the periodicity of the systemic fear index. And as the data show, the correlation between them is very tight: its Pearson coefficient for the past 134 years is +0.84 out of a maximum of +1.

What this correlation tells us is that the greater the capitalized power of equity owners relative to the underlying population, the greater their systemic fear and therefore the greater their reliance on current earnings when pricing their stocks – and conversely, the lesser their capitalized power, the lower their systemic fear and hence the weaker their emphasis on present profits.

9. The dialectic of power and fear

At first sight, this co-movement might seem counterintuitive. Why should capitalists fear more for their system as they grow more powerful? Shouldn’t it be the other way around – i.e., the greater their power, the lesser their systemic fear?

To answer this question, we need to backtrack a bit. Power is a complex and often slippery concept. It has numerous dimensions and layers, it is historically contingent and context-dependent and, most importantly, it is deeply dialectical and self-transformative. In our own research, we extend Johannes Kepler’s scientific notion of force to view capitalized power not as a stand-alone qualitative entity, but as a quantitative relationship between entities (Nitzan and Bichler 2014: 141). Here, we define this power very broadly as the relationship between equity owners and the underlying population, quantified by the ratio of stock prices to the wage rate. But we also argue that the quantity of capitalized power expresses the rulers’ confidence in the obedience of the ruled (Nitzan and Bichler 2009: 17) – which in our case here denotes the confidence of equity owners in the obedience of the underlying population.

Confidence in obedience, though, is not a monolithic sentiment. If we are to generalize, we might say that the buildup of power generates not one, but two movements – one extroverted, the other introverted – and that the trajectories of these two movements are not similar but opposite. On the outside, the relationship appears positive: the greater the rulers’ power, the greater their display of confidence in obedience. But on the inside, the connection is negative: the more powerful the rulers, the greater their fear that their power might crumble.

This double-sided relationship is the linchpin of Hobbes’ Leviathan (1691). The relatively equal abilities of human beings, he says, breed their uncertainty, insecurity and mutual suspicion, and these forces in turn compel them to try to increase their differential power without end. But, then – and this is the crucial qualifier – the more power one possesses, the more he or she dreads losing it all. The result is an ongoing cycle, with fear stoking a hunger for power, and the amassing of power heightening the very fear that begot that hunger in the first place (for example, pp. 75 and 94).

Now consider how this double movement unfolds in our case here. Capitalists, we posit, are driven to increase their capitalized power without end, and this increase, we maintain, boosts
their expressed confidence in obedience. And how do we know that their confidence in obedience is indeed rising? Because the stock prices comprising the numerator of the power index are determined by the capitalists themselves, and because capitalists determine those prices by risking the thing they cherish the most: their own money. Indeed, the only reason for capitalists to buy stocks and in so doing bid up the stock price/wage ratio is that they expect this ratio to rise even further. And the fact that they believe that this ratio will go up attests to their confidence in obedience – the confidence that the underlying population will not expropriate them and that the system as a whole will not fail them. In this sense, our power index offers an objective measure of capitalist confidence – at least on the outside.

But as Figure 5 shows, there is another, inner process at work here: the temporal basis for capitalist confidence in obedience varies with the level of capitalized power. When the power index is low, the projected confidence of capitalists is inherently forward-looking. During such periods – for example, the 1940s or the 1980s – capitalists focus on the future and ignore present profits altogether (as indicated by the low, zero or even negative price-EPS correlation). And why? Because the lower the capitalized power, the greater the scope for increasing it further.

In our earlier work (Bichler and Nitzan 2006; Nitzan and Bichler 2009: Ch. 11), we developed the notion of the ‘elementary particles’ of capitalization – future earnings and investors’ hype in the numerator of the capitalization formula, and risk and the normal rate of return in the denominator:

$$\text{capitalization} = \frac{\text{future earnings} \times \text{hype}}{\text{risk} \times \text{normal rate of return}}$$

When the power index is low – as it was, for instance, during the 1940s and 1950s and, again, during 1980s – the elementary particles of capitalization can be augmented/reduced to boost it further: income can be further redistributed in favour of profits; investors’ hype can be further amplified; profit volatility and therefore risk perceptions can be further decreased; and the normal rate of return can be further lowered. And as long as the potential for further augmentation/reduction in favour of capital remains large, equity owners can safely ignore the dismal present and capitalize the promising future.\(^{12}\)

However, when the power index is high – as it was, for example, during the early twentieth century, and as it is now, at the beginning of the twenty-first – confidence in obedience must rely largely on the present (and it does, as shown by the high price-EPS correlation during these periods). And why? Because capitalized power is not unbounded. The greater the power, the greater the resistance to power. And when power approaches its asymptotes – in this case, when the profit share of income and the level of hype are already high and income volatility and the normal rate of return already low – increasing it further within the existing confines of the ‘symbolic machine’, as Ulf Martin (2010, 2018) calls it, becomes harder and harder (Bichler and Nitzan 2012). Such increases require further threat, sabotage and open force, which in turn make the system ever more complex and increasingly brittle, and hence prone to breakdown (Bichler and Nitzan 2010). Under these circumstances, the only way for capitalists to retain their apparent confidence is to be constantly reassured that the system

\(^{12}\) On the elementary particles of capitalization, see Nitzan and Bichler (Nitzan and Bichler 2009: Ch. 11).
still holds here and now. And since the future is too bleak to rely on, this reassurance can come only from current profits.

10. The omen

Rulers always need an omen, a self-serving looking glass to bolster their confidence and galvanize their resolve. But sometimes the omen refuses to cooperate, and when it disobeys, the façade crumbles and the rulers find themselves facing the void. Literature offers many illustrious examples: the evil queen in the Brothers Grimm’s Little Snow-White, whose obedient magic mirror suddenly defies her, declaring that she is not the fairest of all; Genghis Khan in Aitmatov’s The Day Lasts More than a Hundred Years (1983), whose loyal guiding cloud suddenly disappears, leaving the Khan’s globetrotting conquest in tatters; Belshazzar, the omnipotent king of Babylon, whose hubris is suddenly deflated by a mysterious writing on the wall (Book of Daniel: Ch. 5); the list goes on.

These power mirrors, though, are pretty naïve. They typically generate no more than a binary image, and their warnings almost always come too late. By contrast, the stock price-EPS correlation offers an infinitely nuanced reflection. Instead of a binary image, it draws a continuous scale, ranging from a Pearson coefficient of 0 (or less), which indicates that forward-looking capitalists do not fear for their system, to a Pearson coefficient of +1, which means that capitalists, struck by systemic fear, have completely abandoned their core belief in forward-looking capitalization in favour of a defensive, backward-looking posture.

This analytical range is shown historically in Figure 6. The chart presents the same data series from Figure 5, but instead of displaying them on a time scale, it plots them against one another. Each annual observation projects two readings: the ten-year trailing average of the power index on the horizontal scale, and the systemic fear index on the vertical scale. The observations are tightly clustered around a positive slope, reconfirming what we have already seen in Figure 5 – namely, that capitalized power is closely intertwined with systemic fear. For illustration purposes, we use a dashed red line to trace the evolution of this temporal relationship during the most recent period: from 1983, when the systemic fear index was at a record low, to 2014, when it reached its all-time high.

The gradual temporal ‘stretching’ of this dashed line has been akin to pulling a string: as the United States moved up and to the right on this path, the tension between sabotage and resistance kept rising and rising. However, because the process has been so slow and drawn out, initially this buildup was largely imperceptible. Indeed, until recently the key ‘actors’ themselves – i.e., the capitalists and fund managers, along with policymakers and opinion shapers – remained largely unaware of it and seldom admitted it, not even to themselves (and rarely if ever in the manner described here). But as Thorstein Veblen might have put it, although they are yet to recognize it with their mind, they already know it in their heart. And here their actions speak louder than words: with their power rising, they have gradually but systematically abandoned their sacred ritual of forward-looking capitalization in favour of the still-rosy present. Their current mode of power is becoming increasingly unstable, and their short-term equity pricing indicates that underneath the hubris lies a deepening apprehension that it might not last.
Our own study of redistribution as the key power axis of capitalism started during the early 1980s. At the time, U.S. capitalized power and systemic fear were at all-time lows, investors were totally oblivious to the issue and our work was typically classified as ‘social economics’ (with an aftertaste of moralizing ‘social justice’). But as capitalized power and systemic fear increased, the crucial importance of redistribution slowly percolated to the surface, and in 2014, when power and fear reached record highs, Thomas Piketty’s work on inequality (Piketty 2014) was suddenly made top news and everyone suddenly knew (all along) that the top 1 per cent held the rest of the world under its thumb.

And then the discourse started to change. Although the talking heads still hail capitalism as the best of all possible worlds, by the mid-2010s we started to see more and more expressions of guilt (the IMF admitting that the project of neoliberal globalization has been ‘oversold’; Ostry, Loungani, and Furceri 2016), remorse (McKinsey cautioning that the current generation is poorer than its parents; McKinsey & Company et al. 2016), doubts about the ability of ‘economics’ to remain sheltered from ‘politics’ (hedge-fund billionaire Ray Dalio predicting that from now on ‘populism’ will shape economic conditions more than ‘classic monetary and fiscal policies’; Dalio et al. 2017) and dire warnings about the very future of the capitalism (former bond king Bill Gross alerting his fellow capitalists that, although ‘I’m an investor that ultimately does believe in the system’, I believe that ‘the system itself is at risk’; Gittelsohn 2016). With U.S. redistribuational tensions remaining at an all-time high, many savvy investors sense that sooner or later the spring will snap, and as confidence crumbles and the rulers run for the stock-market doors, a new major bear market (MBM) will get under way.\footnote{For the genesis, earlier versions and prior analyses of the MBM concept, see Bichler and Nitzan (2008), Kliman, Bichler and Nitzan (2011), Bichler and Nitzan (2012) and Bichler and Nitzan (2016).}
11. The cunning of history: will past earnings trigger the next crisis?

If current market jitters develop into an MBM, the consequences are likely to be dramatic. Over the past two centuries, the United States has experienced seven MBMs with an average market drop of 57 per cent in constant dollars (Bichler and Nitzan 2016: Table 1, p. 122). Current U.S. market capitalization is almost $30 trillion, so a 'typical' MBM could end up wiping out $17-trillion worth of capitalist assets. And that is just for starters.

During the past century, every MBM has been followed by a major *creordering* of capitalized power and a significant rewriting of the capitalist nomos.14 Thus, the MBM of 1905-1920 was followed by the rise of *corporate capitalism*; the MBM of 1928-1948 was followed by the rise of the *Keynesian welfare-warfare state*; and the MBM of 1968-1981 was followed by the rise of *global neoliberalism*. The consequences of first MBM of the twenty-first century, from 1999 to 2008, are still hard to pin down, but one them seems to be a gradual shift toward a harsher mode of power – perhaps along the lines of Jack London’s *The Iron Heel* (1907). For this authoritarian shift to gain traction, though, capitalism might have to experience another MBM, hence the crucial important of the current moment.

If our analysis here is correct, it follows that the very future of capitalism is now at stake. Yet, paradoxically, the recent history of the stock market cunningly suggests that this future now hinges on the trajectory of... *past profits*.

As Figure 1 shows, the two down legs of the most recent MBM – in 2000-2003 and then in 2007-2008 – were both triggered by and/or coincided with a significant decline in earnings. Now, since both downturns began when the power and systemic fear indices were extremely high (Figure 5), this co-movement is exactly what our model predicts. And ominously, the present situation is practically the same: just like in the runup to the two previous downturns, the power and systemic fear indices are extremely high; and as before, these high levels mean that investors, standing with their back to the future, remain extremely sensitive to the direction of current earnings.

*So which way will earnings go?*

In our opinion, the more likely direction is down, and, prosaically, the main reason is timing. For corporate earnings to continue to rise, there must be further upward income redistribution – from the underlying population to capitalists. Now, as noted, given that the U.S. capitalist share of income and personal income inequality are already at record levels, this redistribution is likely to require a much more authoritarian mode of power; and as the 2017 U.S. election of Donald Trump and the so-called ‘populist turn’ around the world suggest, the push in that direction might already be underway. However, even if a harsher mode of power were to emerge – and at this point, it is hard to say whether it will – this emergence will take time and its impact on EPS will register only with a considerable lag.

And it is here that timing becomes critical. Standing with their back to the future and their eyes staring at the most recent past, U.S. capitalists remain extremely sensitive to even a small drop in earnings, and the cyclical backdrop they are currently looking at is highly unfavourable. The present U.S. expansion is already the second longest in history, interest

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14 The verb-noun ‘creorder’ fuses the dynamic and static aspects of creating order (Nitzan and Bichler 2009, especially Ch. 14).
rates are already at historic lows and the profit share of GDP is still near record highs. If any one of these magnitudes reverts to its historic mean, EPS are likely to drop; if they all revert in tandem, the drop will surely be steep; and with the fear index at record highs, a significant earnings drop is almost certain to trigger a new MBM.

Either threat – a longer-term Iron Heel-like trajectory or a more immediate MBM – spells social turmoil. And sadly, progressive forces in the U.S. and elsewhere seem prepared for neither.

References


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Radical paradigm shifts
Asad Zaman  [Pakistan Institute of Development Economics, Pakistan]

The methodology and ideology of modern economics are built into the frameworks of educational methods, and absorbed by students without any explicit discussion. In particular, the logical positivist philosophy is a deadly poison which I ingested during my Ph.D. training at the Economics Department in Stanford in the late 1970s. It took me years and years to undo these effects. Positivism uses clever arguments to make you deny what you feel in your bones to be true, and make you believe what your heart says must be false – for example our supposed knowledge of subjective probabilities of unknown events.

The roots of the problem go back to the famous Cartesian argument that “I think therefore I am”. Although it is clever piece of logic, it has a deadly effect. I know that I am alive because I can feel the blood flowing in my veins, the tingling of my skin, and a thousand other bodily sensations. “I feel therefore I am”. Denying this experience as a valid source of knowledge reduces me to a brain floating in a vat, which is exactly what logical positivism entails. In fact, despite Descartes, it is impossible to reason our way to certainty. We can only create an illusion of certainty. Descartes’ argument is deeply flawed, and illustrates the weakness of human reason. When we formulate the concept of “I”, isn’t existence automatically part of this? Did I not exist when I was a baby, and was unable to formulate these thoughts? Do I blink out of existence when I go to sleep? If someone has a hard time grasping philosophical concepts, is his existence thereby of a lesser quality? This and many other difficulties make this argument incoherent.

Modern economics is much like this. It starts by making assumptions which are dramatically in conflict with everything we know about human behavior (and firm behavior) and applies mathematical reasoning to situations where it cannot be applied, quantifying the unquantifiable and coming to completely absurd and ridiculous conclusions. Nonetheless, speaking from personal experience, the brainwashing is powerful and effective. It is a slow and painful process to undo. I have often thought about launching a “Positivists Anonymous” club, to help others attempting the same transition, of unlearning positivism.

Based on my own experiences and difficulties in unlearning, and also the experiences of Keynes and many others who have unsuccessfully battered the gates of the citadel of neoclassical economics, I have come to the conclusion that this is a hopeless task. We do not expect to be able to convert the economists. This revolution will not be televised. Our only hope is to work on an external revolution – take the message to outsiders, not to economists. [Recent surveys show that despite the collapse and rejection of positivism in philosophy, economists continue to think in positivist terms.] Even among non-economists, the collateral damage done by positivism and by neo-liberal thinking, is immense. This article is a preliminary examination of the difficulties in making a paradigm shift; that is, I will not discuss

1 For those who want a little help, I recommend my article on Logical Positivism and Islamic Economics. This provides a detailed analysis of the flaws of positivism, and also why, despite these flaws, it came to be widely accepted.
2 Julie Nelson has correctly characterized the situation as “Poisoning the Well: How Economic Theory Damages Moral Imagination".
the major second step of what an alternative paradigm could be, and how we could create and promote it. Awareness of these difficulties is necessary for those who attempt to launch a revolution, since we need to create converts to a new paradigm. Economists are hopeless as a target audience, but even non-economists will be tough nuts to crack if our message is radical. This is because economic frameworks have become widely accepted – witness the popularity of Freakonomics. Nonetheless, it seems necessary to make the effort to save humankind from impending catastrophe, not just on the environmental front, but on many others as well.

The necessity and difficulty of shifting our economic paradigms:

In the wake of the Global Financial Crisis, the failure of economic theories, and of economists, to provide any warnings, analysis, or remedies, became glaringly obvious to all. The Queen of England went to the London School of Economics to ask “Why did no one see it coming?”. The US Congress constituted a committee to investigate why “economics, a field that aspires to be a science… (but)... generally accepted economic models inclined the Nation’s policy makers to dismiss the notion that a crisis was possible.” General discontent with economics has been captured in books too numerous to list; as a small sample chosen at random, consider Steve Keen’s Debunking Economics: The Naked Emperor of the Social Sciences, Joe Earle, Cahal Moran and Zach Ward-Perkins: The Econocracy: The Perils of Leaving Economics to the Experts, and Phillip Pilkington: The Reformation in Economics: A Deconstruction and Reconstruction of Economic Theory.

Many leading economists have expressed serious dis-satisfaction with the profession as a whole. John Cassidy’s article “After the Blowup…” in The New Yorker describes his interviews with apostates from the Chicago creed. Krugman wrote that the “Profession as a whole went astray because they mistook the beauty of mathematics for truth.” David Romer wrote that economists’ “dismissal of fact goes… (so)... far beyond post-modern irony” that it should be called “post-real”. He wrote that the profession has been moving backwards, losing precious insights gained. Olivier Blanchard, Chief Economist at IMF writes that DSGE models make “assumptions profoundly at odds with what we know about consumers and firms”. This is just a small sampler; we can easily find many other similar statements from leading economists, and practitioners intimately involved with finance and central banks on a global level.3

Despite widespread dis-satisfaction, the vast majority of dissidents argue that no paradigm shift is required. Instead of a complete overhaul, we just need to patch-up the problem areas. All of the dissidents have their own favourite culprits – like the DSGE models, rational expectations, ARCH/GARCH methodology for risk assessments, failure to include the finance sector, etc. etc. etc. In contrast to this reformation, I would like to argue for a revolution. We need to re-think the whole project of economics from scratch.4 Just like modern astronomy was created by rejecting the concept of the heavenly spheres on which the stars rotated around the earth, so creating a viable economics for the 21st century requires rejecting the entire edifice of modern economics. The process by which a paradigm shift can be created differs radically from normal science, which involves looking at problems within existing theory and patchwork modifications. As opponents point out errors and difficulties with the

3 For a selection of choice quotes, see: Quotes Critical of Economics.
4 See my “Questioning ALL of Economics?”
maximization/equilibrium methodology, proponents can find ways to patch up the conventional framework to deal with new challenges. This is how Ptolemaic astronomy evolved. If the original spheres did not suffice, then new spheres were added, and if the second did not suffice to match observational evidence, a third sphere was added. Rethinking the whole framework from scratch cannot be done in a piecemeal way.

In “The Structure of Scientific Revolutions”, historical studies by Kuhn show that there are two distinct phases in the progress of scientific knowledge. In the phase he calls “normal science”, a fixed paradigm is applied to solve problems of explaining phenomena and manipulating the world via experiments. However, sometimes progress in knowledge occurs through a second type of event called “scientific revolution”, when an existing paradigm is overthrown, and replaced by a new and different paradigm. Paradigms represent ways of looking at the world, with frameworks, concepts, axioms, and methods. Different paradigms are incommensurable – terms in one paradigm are meaningless in another. For example, while the term “just price” was meaningful to scholastics, it has no meaning within a neoclassical framework. One cannot achieve paradigm shifts by arguments, since concepts and terms of a new paradigm make no sense in terms of the old paradigm. Instead, what is required is to put aside one way of looking at the world, and attempt to understand another way of looking at the same world. It is this putting aside – unlearning the old ways – which creates the greater part of the difficulty in achieving paradigm shifts. In the familiar picture above, when the person looking at the young woman describes the old lady's eye as an “ear”, those fixated on the old paradigm consider this as crazy. As Keynes put it, “The difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds.” It is only by laying aside one coherent way of looking at the world that it becomes possible to visualize alternatives.

Even though Keynes succeeded in escaping from the old ideas, most of his contemporaries and followers never did. Phenomena which were central to Keynesian analysis in his “General Theory” were never understood by mainstream economists, trapped by the mindset created by conventional economic training. As noted by many, the Samuelson-Hicks interpretation of Keynes in terms of the IS-LM analysis has very little in common with the ideas of Keynes. This mis-interpretation of Keynes which is widely known as Keynesian economics today, rejects at least three of the central insights of Keynes. Briefly, these are the failure of

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5 See my “Understanding Macro”
neutrality of money, genuine uncertainty about the future (as opposed to risk), and the consequent essential role of un-anchored expectations in driving the economy.⁶ That is why Keynes said that “I am not a Keynesian”. He expressed his frustration at the inability of his fellow economists to follow him: “The classical theorists resemble Euclidean geometers in a non-Euclidean world who, discovering that in experience straight lines apparently parallel often meet, rebuke the lines for not keeping straight as the only remedy for the unfortunate collisions which are occurring. Yet, in truth, there is no remedy except to throw over the axiom of parallels and to work out a non-Euclidean geometry.”

In order to progress, it is necessary to pay more attention to WHY it is so difficult to make the transition from a Euclidean world to a non-Euclidean world. To understand this difficulty, we have to first unlearn a widely believed mistaken conception of logical positivists about observations and facts. The Logical positivists, building on a widely accepted Western philosophical tradition, regarded “observations” of what is out there as facts of experience, objective, free of doubt and ambiguity, equally available to all, and verifiable by all. Obviously, this fails if what we observe is due to an interaction between the objective and unique reality out there, and our subjective frameworks which we use for perception of this reality. As the Heisenberg Uncertainty Principle states, and as amazing modern physics establishes beyond doubt, the act of observation affects the behavior of that which is observed. But to take an easy to understand example, whether we see the young lady or the old lady – note that we can only see one of the two at any one time – is clearly determined by our subjective framework, and is not part of the picture.

Even though the point is almost trivial, it is of vital importance for what follows, so let me amplify and explain further. When a baby is born into the world, his eyes and ears are assaulted by a rich range of sensory impressions, which make no sense and have no meaning. Exactly the same sensory impressions become very meaningful and clear as learning takes place, which allows him to parse sounds, and to process visual data in images of three dimensional objects. Obviously, our internal processing equipment is of central importance in the process of assembling observations into a three dimensional image of the world around us. Another way to think about the same thing is to consider the problem of computer vision. All a computer camera sees is a flat bit stream of colored points. This binary matrix of data on visual sensory input, must be resolved into a three-dimensional image. A HUGE amount of programming, which relies on knowledge of the environment, is required to be able to process this data and convert it into an image. The child learns to see objects and hear and parse sounds on the basis of experience, which constantly rewards correct parsings and punishes failure to visually comprehend the environment. A famous Stanford experiment showed cats brought up in a vertically striped world were unable to see horizontal stripes. Similarly, children brought up with languages with unusual sounds learn to discriminate and hear intonations and consonants which can never be heard by others in different linguistic environments, where such sounds are not present. This shows that our experiences can fix the frameworks we use to see the world beyond the possibility of change.

The outcome of all this discussion can be summarized metaphorically by saying that we all use glasses to see the world. The direct world out there is a jumble of sensations – a matrix of points – which makes no sense by itself, and must be interpreted using our own frameworks, represented by the glasses. This means that ALL observations are tinged with subjectivity.

⁶ For an accessible and readable introduction, see Paul Davidson: "The Keynes Solution: The Path to Global Prosperity".
and interpreted within the frameworks created by our past experiences, successes and failures, in viewing the world.

A paradigm shift occurs if we remove the glasses we use to view the world, and instead put on a different pair of glasses. A famous experiment conducted by Professor Theodor Erismann, of the University of Innsbruck put reversing glasses on his student and assistant Ivo Kohler. It caused extreme disorientation and discomfort at first, but after about a week of stumbling around, he adapted to this new way of seeing the world. His subjective interpretative equipment learned to interpret the reversed image by performing an additional reversal within the brain to arrive at a correct image of the world. Now, when the glasses were removed, the world appeared to be upside down to Ivo. On a much larger scale, this is what happened in Europe due to the Great Transformation which transformed traditional society to a market society, where everything is viewed a commodity for sale. Later, these ways of thinking were spread throughout the world by colonization and Western education. We learned to value everything according to its market price, and forgot that the most precious things cannot be purchased. Then it became easy to kill a million children, and destroy entire nations, for corporate profits.

We can now understand the extreme difficulty of creating a paradigm shift. For those who have spent lifetimes learning to see the world with a specific pair of glasses, these glasses become melded into the flesh, and are impossible to remove. After failing to convince his contemporaries about his Quantum theory, Max Planck disappointedly realized that science progresses one funeral at a time. Thomas Kuhn also noted that paradigm shifts do not occur by converting those faithful to the old paradigm, but by inducting the young into the new worldview. Unlike the older generation, for younger and more flexible minds, it is possible to take off glasses manufactured in the Euclidean factory, and put on non-Euclidean glasses. Nonetheless, it is still a disconcerting and uncomfortable experience, which will not be undertaken unless there is some expectation of a great reward for this struggle and sacrifice. The costs of paradigm shift must be paid upfront – one loses the ability to talk to the mainstream when one describes the world using an alien framework. The rewards are in the future, and highly speculative and uncertain. Nonetheless, for reasons explained elsewhere, it seems essential to make the effort – the survival of humanity is at stake.

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7 See my “Summary of The Great Transformation by Polanyi”
8 See Evaluating the Costs of Growth or Ecological Suicide.
How to transform economics and systems of power? Critical lessons from the neoliberal / neoconservative take-over
Deniz Kellecioglu [United Nations Economic Commission for Africa, Ethiopia]

Abstract
This paper examines the transformation in economics during the 1970s in order to distil lessons to transformative efforts today. A historiography is developed around four spheres of change: ideas; corporations; politics; and the economics profession. This history is explained through three inter-connected phenomena of the time: ‘neoliberal economics’ (the intellectual backbone); ‘neoconservativism’ (the resulting power system); and ‘elite appropriations’ (the essential instrument of power). First, neoliberal economics ascended as a result of corporate reactions to deteriorating profits and policy influence, in conjunction with the broader economic and political crises. Secondly, neoconservative political elites ascended mainly through the support of economic elites, neoliberal economists, and effective voter strata that harboured negative norms, especially strict egoism, class elitism, sexism, and racism. Thirdly, the ideological gap between neoliberal economics and neoconservativism were strategically transcended by covert and overt power impositions, but especially through the appropriation of neoliberal ideas to achieve neoconservative results. Altogether, this appraisal stresses the importance of distinguishing between theories, structures and instruments of power, while representing an analytical approach to be utilised in such exercises. It is, after all, imperative to conjure subjugatory powers accurately, practically, and through a multitude of perspectives in order to challenge them effectively. The paper ends with a section on recommendations, organised around three action areas (research; policy; and activism), as well as five criteria that needs to be fulfilled in order to transform economics and systems of power: critical juncture; dissimilarity; sensibility; scholar validation; and external power.

Keywords power, transformation, economics, neoliberal economics, neoconservatism, political economy

Introduction

“We can shape the future if, and only if, we make use of the past” (Zinn, 2005).

The academic field of economics has been under an intensified pressure after the Global Financial Crisis (GFC), which began in September 2007 (cf. Backhouse 2010). This pressure involved demands to refine, reform, or completely overhaul the field. The latter group viewed the GFC as another dismal outcome of a dominant economics that is significantly supportive of financial interests, while being hostile to states, peoples, and the environment; unless they functioned in the interest of the prevailing economic and power structures (cf. Dowd 2004, Chang 2014). More than a decade later, dominant economics has not changed much; whether in its theory, education, methodology, or policy (cf. Aigner et al 2018).

1 Disclaimer: the United Nations does not necessarily endorse the contents of this research paper. The United Nations, including its various entities and staff members, is therefore not responsible for the contents of this research paper.
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This economics ascended over the 1970s, achieving complete dominance in the Global West by the early-1980s, and almost anywhere else by the early-1990s. Its dominance is closely related to the emergence of a new kind of capitalism and power system, often referred to as ‘neoliberalism.’ After all, as concluded by Wolff and Resnick (2012: 311): “over the last one hundred and forty years or so, capitalism not only oscillated among its different forms, but economic theory focused on understanding capitalism also oscillated among alternative kinds of reasoning. Moreover, these two different kinds of oscillations are interconnected.” This paper examines such oscillations from the vantage point of economic theories, focusing on the transitional period of the 1970s. The objective with this ‘political economy of economics’ is to distil lessons to utilise in emancipatory efforts to transform economics today.

Although this history has been extensively reviewed, few studies are directly concerned with transformations in economics. This critical literature exhibits one common conclusion, however: external powers have significantly influenced the character of mainstream economics (cf. Chang 2014, Näring and Douglas 2012, Skidelsky 2013, Dowd 2004). However, this conclusion is often observational, suggestive, and part of a presumptive diagnosis - rarely proven in a systematic manner. This is surprising considering the importance of the issue and the weight of the allegations. One major reason for this shortfall ought to be the immense empirical challenge. After all, as the renowned power theorist Steven Lukes (2005:1) puts it, “power is at its most effective when least observable”.

Thus, there is still a lot to understand about powers that construct and obstruct transformations in economics. This appraisal aims to contribute in this regard. The rest of the paper is organised as follows. The next section introduces three terms that are central to the analytical apparatus of the paper. This is followed by a historiography, divided into two sections: the transformation context (section three) and the transformation processes (section four). Section five concludes (backward-looking inferences), followed by a final section with recommendations to the agenda of transforming economics today (forward-looking inferences).

Analytical concepts

The kind of economics under scrutiny here garnered a number of labels over the years: mainstream, neoclassical, new classical, market-liberal, new conservative, employer-friendly, corporate-friendly, supply-side, orthodox, zombieconomics, fakeconomics, old-paradigm, or simply ‘economics’ for those who are unfamiliar with other economic school-of-thoughts. The labels often differ depending on the vantage point or purpose of the label maker. In addition, the teachings of economics may differ considerably from journal articles, or implemented policies. For instance, mainstream education in economics are often labelled neo-classical, but as concluded by Lawson (2013:1): “the term [neo-classical economics] is invariably employed rather loosely and somewhat inconsistently across different contributors.” In this paper, the term ‘neoliberal economics’ is found suitable for the purposes and time period at hand. This is simply because its theories form the same market-oriented hardcore as the liberal neoclassical economics that emerged and dominated economics in the late 19th and early 20th century. Moreover, it is “new” in the sense of providing additional sophistication, empirics, rhetorics, ideas, and aggressive support for “free-market” capitalism (cf. Chang 2014, Brown 2006). These theories are elaborated upon in the historiography below.
However, seemingly paradoxical, the analytical concept ‘neoliberalism’ is found unsuitable for this appraisal. This is because the term has been so extensively analysed that it now means everything and nothing about contemporary power. This concern was recognised by, for instance, the late Stuart Hall: “intellectual critics say the term lumps together too many things to merit a single identity; it is reductive, sacrificing attention to internal complexities and geohistorical specificity. I sympathize with this critique, [but] naming neo-liberalism is politically necessary to give the resistance to its onward march content, focus and a cutting edge” (Hall 2011: 706). Although Hall’s analyses are always valuable, a term with almost infinite content about contemporary power is more likely to serve the opposite purpose: confusion, apathy, and passivity. After all, when power is elucidated, so that its various facets are made concretely visible, the reasons and options to dissent also becomes more clear and manageable (cf. Lukes 2005). This is especially true when we have a narrower time frame and objective at hand.

It is found that ‘neoconservatism’ is a semantically more appropriate term to describe the political and economic power impositions from 1979 onwards. This is a “new” conservatism mainly because it is based on more multi-dimensional governance techniques. This power system is intellectual, covert, strategic, rhetorical, subtle, yet very aggressive and gravely dangerous for humanity and earth. For this appraisal, it will be particularly shown that neoconservative elites tactically exploit neoliberal ideas to carry out their hegemonic project (neoconservatism). They do so, mainly because the neoliberal language is more appealing to a larger spectrum of elites and non-elite citizens than their own language, especially from a global perspective. After all, neoconservatism embeds elitism, racism, sexism, various prejudices (social Darwinism) as well as authoritarian approaches to manage governments, markets, democracies, norms, narratives, specific events, and other institutions of society (cf. Brown 2006, Eisenstein 1987).

This ideological dichotomy between neoliberal economics (theory) and neoconservativism (reality) were transcended by covert and overt power impositions, but mainly through a specific covert power imposition, here termed ‘elite appropriations’. This term refers to the practice of taking someone’s item and adapting it to one’s own purposes, often without the owner’s permission. In our historical context, it refers to the frequently occurring practice of taking neoliberal ideas to exploit them in neoconservative hegemonic projects (neoconservatism). These appropriations took many forms in 1970s: co-optations, disfigurements, re-workings, distortions, hi-jacks, re-calibrations, etc., but also indirect exploitation of various pretexts and vulnerable conditions on the ground, in order to achieve economic and political ends. The objective of gathering these practices under one term is to contribute to the conjuring of the “third dimension of power, [which is] the capacity to secure compliance to domination through the shaping of beliefs and desires, by imposing internal constraints under historically changing circumstances” (Lukes 2005: 109). By making these types of power more observable, we are in a better position to challenge it. Thus, the analytical concept ‘elite appropriation’ intends to subsume scattered and elusive forms of power impositions in order to expose them. The term is also useful as a lens to regard previously known information and knowledge differently; hopefully in a more lucid manner.

The three analytical concepts are brought to the centre here in order to provide specific vantage points to the power exercises that are extremely variant, omnipresent, yet very difficult to observe. They will be further substantiated below, but it is their inter-relation that is of essence to our appraisal. One example of this inter-relation is economics textbooks. They are sold in millions all over the world and transmit a distinct rationality for economic, but also
political and social decision-making. Zuidhof (2014) critically reviews a number of mainstream textbooks and conclude that they are mainly prescribing for ‘classic liberal’ governments, and less for governments according to ‘neo-liberalism.’ This is not a surprising finding when ‘classic liberal’ and ‘neoliberalism’ are, in this paper, approximately corresponding to ‘neoliberal’ and ‘neoconservatism,’ respectively. In between the two, there are various power impositions at play, especially elite appropriations. In other words, neoconservative political elites, with the supportive and coercive power of aligned economic elites, utilise neoliberal economics in rhetorics and as foundations to policy design, but actual policy implementations have neoconservative characteristics and consequences.

The transformation context - critical juncture

Keynesianism dominated economics and economic policy after World War II until the 1970s. Its meta-theory, that of an interventionist government that deploys appropriate economic policies to balance an inherently unstable economy, was rather successful. The indicators supporting such a conclusion includes high economic growth, low unemployment, and the absence of macroeconomic crises, whenever and wherever it was implemented, mainly in the Global West (Chang 2014). However, the so called Golden Age of Capitalism began to deteriorate as a new phenomenon surfaced over the early years of the 1970s: stagflation – the coexistence of high unemployment and high inflation. This was unaccounted for in Keynesianism, why it was interpreted as its fundamental failure. The presence of stagflation was of course in conjunction with the emerging crises in the economy, but also in politics (cf. Duménil and Lévy 2004a, Palley 2004). These crises were burdened on Keynesianism, even in the face of mounting evidence that Keynes’ theories had not been implemented consistently, coherently, or optimally (cf. Palley 2004, Skidelsky 2010, Madrick 2011, White 2012). These issues formed the context to the neoliberal and neoconservative take-overs.

The economic crises

Although the first signs were emerging in the late 1960s, the entire 1970s were marred by recessions and stagflation. All advanced capitalist nations, more or less, experienced the stagnation of economic growth, technological progress, wages, profits rates, as well as higher inflation and unemployment (Duménil and Lévy 2004b). In 1970, the new chair of the Federal Reserve, Arthur Burns, intended to control inflation through a combination of higher interest rates and a tighter monetary policy. Although economic activity was restrained, and unemployment levels rose, inflation rates remained unchanged. At the same time, it became obvious that the war against Vietnam continued to stimulate the economy, through state consumption and investment, resulting in higher prices throughout the economy (cf. Blyth 2002, Chang 2014).

Furthermore, in 1971, the US disowned its commitment at the 1944 Bretton Woods Conference to convert any dollar claims to gold. In response, other countries abandoned their practice to tie their currencies to the dollar. The consequence was currency value fluctuations, additional economic instability, and heightened uncertainty. This also meant a massive transfer of exchange rate risk from the public to the private sector. The Nixon government also shocked a variety of stakeholders when, on 15 August 1971, it announced price controls. The plan was quite detailed, comprehensive, and consisted of three phases. Phase one involved a 90-day freeze on wages and prices along with a 10 per cent surcharge on imports. The intention was to relieve the pressure on the dollar in light of the newly established free
currency fluctuations. A second intention was to halt the cyclical formation of higher wages and prices. The import surcharge, on the other hand, were to function as a back-door devaluation while restraining the part of inflation owed to importation (Blyth 2002). In other words, instead of designing and implementing policies that address such structural challenges, the state opted for desperate and symptomatic measures.

Phase two of the price controls began on November 14, 1971. It involved the establishment of a price commission and a pay board, both of which were to have representation from the tripartite government-labour-employers. It also explicitly mandated that wages could rise by maximum five per cent, but go toward an average target rate of three per cent annually. The employers faced a limitation on profit margins, but in practice this was not monitored. A year later, these two measures seem to have paid off as inflation fell to 1.8 per cent. Nixon declared the policy as successful and arranged for Phase three to be semi-voluntary, but in practice it was entirely voluntary, and mainly involved a specific target to not allow wage hikes (Blyth 2002). Phase four was introduced in June 1973, in the midst of the Watergate Scandal. The intention was to regain a success in restraining inflation. But part of the failure was clearly the expansionary monetary policy which entailed a money (M2) growth of 10.8 per cent as an annual average over 1971-1972, compared to for instance 2.4 per cent annually in 1968-1969. Phase four was also very limited and did not even cover wages. It was more of a decontrolling scheme, rather than price controls. Inflation continued its trajectory and uncertainty rambled on (Blyth 2002).

A few months later, in October 1973, the Arab-Israeli war lead to a quadrupling of petroleum prices; from 3-4 dollars per barrel in 1971 to about 12 dollars by December 1973. As petroleum was one of the most important products of the US, this development led to a supply panic and major inflationary effects. It was difficult to curtail importation volumes, at least in the short run given the lack of alternatives, low domestic production, and uncertainty about supply for the future. The state opted for the Emergency Petroleum Allocation Act, but it had the reverse effect: panic buying and even higher prices. The Federal Reserve and the US state simultaneously responded belatedly to this supply shock by higher interest rates and fiscal spending, respectively. This led to a collapse in output in the face of higher input costs and interest payments, while the investment share of GDP declined substantially from 23.4 per cent in 1973 to 20 per cent in 1974 (Blyth 2002, Chang 2014).

The state could simply not resolve the stagflation that continued to worsen over the mid-1970s. A rising unemployment was supposed to be a sign of lower demand for labour; a scenario which would, restrain wage hikes, and income growth in general, which in turn was supposed to restrain cost-push and demand-driven pressures on prices, resulting in lower inflation rates. US inflation exhibited three distinct trends over the period of our concern. It had been, at most three per cent between 1956 and 1967, averaging 1.9; then varied between 3.3 and 6.2 per cent until 1973, averaging 4.7; and then between 5.7 and 13.5 until 1981, averaging 9.0 per cent. The equivalent averages for the US unemployment levels are 5.1 (1956-1967); 4.7 (1968-1973); 6.9 (1974-1981) (OECD 2015). The second oil price shock in 1979, associated with the production fall and perceived uncertainty in conjunction with the Iranian Revolution worsened the economic crises around the world. The lingering economic crisis were quickly mirrored into crises in the leadership of the State (cf. Dowd 2004, Chang 2014).
The political crises

The economic, human and environmental costs of the US Cold War proxy wars were enormous. They had also major cost implications to the public coffers. In fact, in 1965, the Council of Economic Advisors to President Lyndon B. Johnson discovered that the costs of the Vietnam War were not publicly acknowledged and not being factored into economic analyses and policy statements. It was therefore concluded that this omission created some of the divergence between performance and predictions. The galloping costs were also part of an over-heated economy. The state machinery was, however, both institutionally unable and politically unwilling to tackle the inflation. The political ambitions of winning political support at home and crushing dissent abroad were seen as more important (Blyth 2002, Zinn 2005). This is another testimony to a failure of hegemonic preferences rather than a specific school-of-thought.

The 1950s and the 1960s were, otherwise, characterised by political improvements, both in the Global West and in the Global South. Almost all countries under colonial rule became independent, at least formally, by the mid-1960s. Labour rights, popular social movements and citizen engagement flourished during the 1960s and early 1970s, particularly with the civil rights movement led by Black Americans and women’s movements (Eisenstein 1987, Fairclough 1990, Hohle 2015). As argued by Wainwright (2018: 19), “the movements of the late 1960s and early 1970s challenged the very bases of dominant forms of power. They sought to transform and even eliminate power inequalities altogether.” The women’s liberation movements aimed, by and large, to transform the gender imbalances in the society, while the civil rights movements challenged white supremacy and aimed to transform racial imbalances (Wainwright 2018). After all, USA was built on colour-coded racism (Kellecioglu 2010, Zinn 2005). In 1954, the world got the news of the landmark ‘Brown decision’ in which US judges ruled unanimously that racial segregation of children in public schools was unconstitutional. Almost a decade later, in 1964 the Civil Rights Act made racial discrimination also unconstitutional in the workplace, schools, and all “public accommodations,” including organisations receiving public funds (Fairclough 1990, Hohle 2015). Thereafter, up to 1975, a number of legislative changes were introduced that prohibited discrimination in federally assisted programmes and activities. In 1975, gender was added to the ‘suspect category’ of discrimination that included race, colour, or national origin (Eisenstein 1987).

At the same time, labour organisations in the Global West had ever-increasing bargaining power in terms of wages and working conditions, as well as direct political influence from the mid-1930s through the 1960s. In fact, they were often key actors in the design and implementation of national policies. For instance, in western Europe, unions were associated with the post-war reconstructions (Steiner 2009). In the US, one culmination of this development was the far-reaching Occupational Safety and Health Act of 1970. But these measures had compliance costs to corporations at a time when their credit reserves were being eroded by escalating inflation. At this time, even a Republican government implemented tax reforms disfavouring the wealthy. In response to a mounting pressure over the late 1960s, in which the Democrats argued that millionaires had an effective tax rate of zero, Nixon enacted the Tax Reform Act of 1969. This bill was seen by business as an ultraliberal measure that drained tax benefits from the rich. There were also other regulatory and institutional changes in favour of the masses, but disfavouring the wealthy. Even grassroots organisations, such as Common Cause, and consumer movements gained momentum in this political atmosphere (Blyth 2002).
These developments in favour of workers, citizens, the environment, and the emerging economic and political crises, encouraged the coming-together of the corporate sector. This became particularly acute with the Watergate Scandal, which eventually led to the resignation of Richard Nixon, on August 9, 1974; the only president to do so, thus far. This event added to the already mounting disdain for politicians and the state as an institution.

The transformation processes

This section attempts to describe processes that were put in motion in order to change the discourses and policies employed by the powerful in the society. It is organised according to the four arenas identified, in which the transformations in economics and governing spheres of society took place: ideational; corporate; political; and the economics profession. Although the four domains are organised separately, they are obviously intertwined.

The ideational drifts - the encroachment of neo-liberal theories

How could a line of theories dominate not only economic policies, but also cognitive frameworks? Harvey (2005: 5) rightly argues that “for any thought to becoming dominant, a conceptual apparatus has to be advanced that appeals to our intuitions and instincts, to our values and our desires, as well as to the possibilities inherent in the social world we inhabit”. An idea needs to be firmly embedded in the person’s common sense to be accepted. In the US, political ideals of human dignity and individual freedom had been promoted for a long time, and they were revamped during the economic and political crises (Harvey 2005, Madrick 2011). A number of economists lay the ground for such normative shifts, arguably the most important one was Milton Friedman (1912-2006).

Milton Friedman - economist and super activist

Friedman’s exceptional role in transforming economics has been emphasised by a number of scholars (cf. Dowd 2004, Blyth 2002, Klein 2013, Medema 2013) even when they strongly disagree with his ideas (cf. Galbraith 2013, Mirowski 2013, Madrick 2011). Furthermore, Klein (2013) confirms this picture by drawing the attention to a 2010 survey of economics professors. The survey asked respondents to name their favourite deceased economists of the twentieth century. Friedman was a close second to John Maynard Keynes.

Friedman was very active and highly influential in public discourse; mainly in the United States, but also well beyond. He was invited to publish writings, hold speeches, and conduct formal advisory work to officials and candidates from around the world (Klein 2013). He devoted three decades trying to undermine Keynesian thought. His efforts paid off professionally as time went on, but not considerably until the end of the 1960s. His famous book, Capitalism and Freedom, was written during the 1950s but not published until 1962. More importantly, it received little national attention at the time. The central theme of the book is that free markets are the most efficient way to solve the challenges of not only economic production and distribution, but also social problems, such as poverty. His moral philosophy consisted in calling for individual freedom (Madrick 2011). He had the right ideas at the right time. Medema (2013) supports that statement by asserting that “ideas have power, but it is only in the hands of the right personality and the proper context that those ideas become transformative. Milton Friedman was one such personality, and he was fortunate enough to
live and work during a period in social and professional history in which he could become what he came to be" (pp. 202-203).

Already in the 1940s, he argued against government spending to stimulate growth, as it would spur inflation, which would, in turn, deplete the nominal value of the economy. According to Friedman, inflation is contained if central bank restrains the nominal supply. This reasoning led to his school being called monetarism. Friedman became, over time, known to certain powerful circles and was hired as the chief economic advisor to the US presidential candidate Barry Goldwater for the 1964 election. Friedman's particular talent for eloquent writing and articulate oratory, on top of his appealing theoretical and moral stance, made him attractive to a broader audience. On top of writing Goldwater's economic plans for The New York Times, he started to write regular columns for the popular Newsweek magazine. He also made television appearances at a time when this was reserved for the few. In addition, the editorials and news coverage in The Wall Street Journal, the major daily financial newspaper of the US, promoted his ideas rather frequently, even before the 1970s (Madrick 2011).

However, it was one particular event that turned out to be Friedman's most important theoretical contribution. In December 1967, Friedman gave a presidential address to the American Economic Association, which later came to be interpreted as a novel prediction. He argued that if the New-Keynesian policy of pushing down unemployment were realised at levels below a certain structural threshold (the natural rate of unemployment thesis), then inflation would take-off considerably alongside higher unemployment rates. In his view, when wages rise in the face of low unemployment, employers would try to offset the higher wage costs with higher prices. In the face of lower real wages, some workers would quit their jobs. And if the government tried to stimulate the economy in order to dampen unemployment levels, the cycle would start again. Over the long run, the cycle would result in both higher rates of unemployment and inflation (Madrick 2011).

Therefore, in the years of stagflation, Friedman and his ideas rose to prominence. In addition, at the height of the crisis in 1976, he received the Sveriges Riksbank Prize in economic sciences in memory of Alfred Nobel (popularised as 'the Nobel prize in economics'). This was an additional major boost to his person and his theories. His fame rose over the 1970s and was established further in 1980 when a simplified version of his book Capitalism and Freedom was published, entitled Freedom to Choose. This book was also the basis of a public television series, a unique step for economic theories. Friedman became the intellectual leader of a movement that aimed to downscale governmental influence in the economy and upscale business influence under the umbrella of individual freedom (Madrick 2011).

James K. Galbraith (2013) especially points out Friedman's debating skills as exceptional, playing an important role in supplanting the New-Keynesian school. According to Galbraith, Friedman's genius lay in his line of attack. He did not reject Keynesian theories outright. Instead, he tilted them to a vulnerable character in order to modify them according to his position. Although he promoted logical positivism, hypothesis testing and evidence had nothing to do with his debating methods, which were more experimental. In so doing, New-Keynesians would fall for various rhetorical tricks in debates. Real Keynesians, who avoided such tricks, were ridiculed. Friedman was also appealing to mass audiences, built around simple arguments and optimism. He lived and acted in an optimistic age for optimistic audiences, painting a vision of capitalism in which losers would largely disappear (Galbraith 2013).
Other dissenting economists and meta-theories

Friedman’s monetarist theories were also complemented by other theories in the attacks on the dominant Keynesianism. A central one was the so called ‘micro-foundations critique.’ It argued that the aggregated macroeconomic components of the Keynesian school lacked foundations at the micro level. The aggregations were not based on the sum of individual components; they were taken for granted. Policy success was, therefore, measured arbitrarily and nothing was being said about individual welfare. Keynesianism fooled individuals in believing that there is policy coherence and success. Instead, the individual level was promoted; whether it is the individual consumer, firm, or government (Chang 2014, Blyth 2002).

In addition, ‘rational expectations theory’ argued that economic policy could be more successful if it is accepted that individuals have rational expectations and act strictly selfishly. In this scenario, the role of the state should be to announce and deploy small and credible policy changes that individual economic agents would respond to according to their selfish preferences. Policy targets such as full employment would make agents adjust their expectations to low unemployment and actively modify wage and price levels to the prefigurative scenario in the near future. Policy outcomes of such major targets would lead to zero effects (inflation discounted), if not negative for economic output and investments. Government were not trying to solve problems; they were the problem (Chang 2014, Blyth 2002).

A theory that was re-introduced and adapted from neoclassical economics was ‘supply-side economics’. In this version, labour supply was seen to be extremely sensitive to inflation, albeit under the absurd assumption that unemployment is voluntary. If workers receive higher real wages, they would supply more labour, prompting higher output and investments. This virtuous cycle was suggested to be triggered by tax cuts that would be financed by higher savings in the short run. Arthur Laffer went as far as suggesting that tax cuts would generate higher public revenues and finance any potential deficit. This doctrine became quite influential in this period. It aligned well with monetarism and rational expectations theory, since it advocated for tax cuts, especially for the wealthy who would invest the additional resources and thereby contribute to overall economic activity; the so called ‘trickle-down economics’ (Blyth 2002).

Another theory that surfaced in this period was the ‘public choice theory.’ This was a more direct attack on the foundations of the institution of government and, indirectly, democracy. This theory stated that democratically elected governments had to provide ‘goods’ to their electorate in order to get re-elected. Under the assumption that governments are selfish and aim to maximise votes (in analogy to market agents), they would implement policies that influence business cycles according to election calendars. The results would be inflation, lower economic activity, and inefficient utilisation of state resources (Blyth 2002). This theory was directly compatible with rational choice theory, supply-side economics and micro-foundations critique; all of which were emerging as part of a broader economic discourse and narrative that promised freedom. Markets would deliver freedom, as the superior conveyer of information between buyers and sellers; of goods, services, labour, capital, environmental externalities and so on. In fact, markets would clear at an optimal equilibrium when it was allowed to function smoothly (cf. Chang 2014).
Although economic growth was the main target of these neo-liberal theories, the real battle was on power distribution; political, economic, social, and even cultural. For instance, George Stigler, a member of the prominent and powerful Mont Pelerin Society, wanted to capture the minds of powerful elites by innovating new economic and political doctrines which those elites would recognise as being in their interest once they were introduced to them. Stigler wanted to occupy the state rather than to dismantle it (Mirowski 2013). Friedrich Hayek, another leading Mont Pelerin Society member, pursued a strategy to convince intellectuals, arguing that they would transmit the conviction into decision-making processes (Miller 2010). In retrospect, their collective project was very successful. One sign of this was the recognition given to Hayek, who in 1974 received the “Nobel Prize in Economics” (Mirowski 2013). All in all, the challenge to the mainstream Keynesian economics involved multifaceted and complementary attacks; both theoretical and tactical. Of course, these scholars would not have achieved much success without the corporate support.

The new activism of the corporate sector

At the onset of the 1970s, the US business community was troubled. They were experiencing deteriorating profit rates, higher costs associated with regulations on working conditions and production structures, as well as increased tax burdens, while witnessing policy paralysis. These crises resulted in deteriorating wealth and incomes, especially for the wealthy. Mainstream Keynesians were deeply divided about how to solve income distribution effects, and what role, if any, downward nominal rigidity played in generating unemployment. This disunity and the successful rhetoric of ‘government failure’ helped neoliberal economists (Palley 2004). Corporate executives concluded that they needed new ways to influence policy. This widespread conclusion triggered the reinvigoration and establishment of a large number of initiatives, business associations, think tanks, and other business institutions over the 1970s and well beyond, both at the national and international levels (Blyth 2002, Harvey 2005, Birch and Tickell 2010, Miller 2010, Mirowski 2013, Chang 2014).

For instance, the American Chamber of Commerce (ACC) grew from about 60,000 member firms in 1972 to about 250,000 a decade later. The ACC also grew financially over this time, reaching 80 million dollars per annum. The ACC operated mainly in three areas. First, it embarked on an extensive public relations campaign to improve the general negative image of business. Secondly, it set up the National Chamber Litigation Center to challenge any litigation brought by activist and state representatives with the intention to make corporations abide by regulations such as Occupational Safety and Health Administration and Environment Protection Agency. Thirdly, it changed its lobbying activities from Congress level to mobilisation almost entirely from the grassroots up. This was mainly a tactical response to the Congressional reforms in 1974 that detached power from incumbent committee chairs and senior senators. By 1980, the ACC had set up about 2,700 Congressional Action Committees (CACs) in member districts. This strategy proved to be very successful since the ACC could for instance, in a very short time produce research material, or swiftly carry out campaigns to influence local elections (Blyth 2002, Birch and Tickell 2010, Miller 2010).

Another major business organisation that emerged in this period was the Business Roundtable, becoming by the mid-1970s the premier business lobbying entity. To give an idea of its power, it controlled $1,263 trillion in assets and produced $1,265 trillion in revenues in 1978, while its collective gross revenues were equal to about one half of the US GNP. At this time, if the Business Roundtable were a country, its GNP would be second only to the United States. An individual Roundtable firm’s spending on lobbying (between $850 and $900
In order to be successful influencers, the business community produced and disseminated business-friendly ideas and institutions, while contesting existing ideas and institutions. To be successful, they had to win back the state and larger spectrum of the electorate. In more ways than one, this amounted to a corporate appropriation of democracy. The major route to do this was made possible by the widening of the Political Action Committees (PACs). This measure is rather complex, and became increasingly so over time, but PACs are, in brief, financial funds based on various contributions from corporations or labour organisations to be utilised for political purposes. In practice, the measure became increasingly co-opted and distorted in favour of corporations. For instance, Blyth (2002: 155) concludes that “in 1975 the Federal Election Commission (FEC) upheld [Sun Oil’s] interpretation in the so-called SUNPAC ruling and effectively handed business a license to print political money.” Before this ruling, in 1974, there were 89 PACs with $4.4 million in financial muscle; after the ruling, in 1976 the digits were 433 and $19.2, respectively. Moreover, by the end of the 1970s, two-thirds of the PAC resources were associated with Republican candidates, breaking the trend of roughly equal share with the Democrats (Blyth 2002).

The corporate right was fast becoming a force also in the ‘market of ideas.’ In particular, three foundations aggressively engaged in this field: The Smith Richardson Foundation, the Scaife Funds, and the Olin Foundation. They financed, in whole or in part, a large number of policy institutes and think tanks that were explicitly designed to promote free-market and corporate-friendly ideas. These institutions often divided their work based on either a general support for competitive capitalism, or work that re-built the foundations of that system. They were engaged in dismantling Keynesian ideas, while strengthening the case for their worldview. This involved production of research material, expert consultancy to other business organisations, and by bankrolling resources to scholars, journalists, writers, journals, magazines, newspapers, that were, or became willing to advance their ideas, values and ideology. For instance, it was the Scaife Foundation that financed the television version of Friedman’s Free to Choose. In this environment, National Bureau of Economic Research (NBER) became arguably the most influential business-friendly research entity, which by 1983 was receiving almost half of its budget from Fortune 500 companies. (Blyth 2002, Birch and Tickell 2010, Miller 2010).

These business people perceived neo-liberal theories as sophisticated statements of their worldview. Although differing in character and aggressiveness, they shared the long-term program of altering the society into a more corporate-friendly direction (Phillips-Fein 2009). For instance, Jenkins and Eckert (2000) identifies three ideological groups over the late 1970s: moderate conservatives at the Business Roundtable and American Enterprise Institute (AEI); ultraconservatives at the Chamber of Commerce of the United States (COCUS), the National Association of Manufacturers (NAM), the Heritage Foundation and the Hoover Institution; and liberals at the Brookings Institution and the Committee for Economic Development (CED) that opposed aspects of the policies that were increasingly adopted, first by the Carter and then by the Reagan administration. In the end, “the partisan think tanks functioned almost like a political party” (Phillips-Fein 2009: 282).
The neoconservative take-over of the state

The corporate-led advocacy programmes bore fruit as their ideas, theories and language were converted into policies, especially in 1979 with the entrance of neoconservative Margaret Thatcher as prime minister of the UK, and Paul Volcker as Chair of the US Federal Reserve. Two years later, Ronald Reagan became US president and aggressively implemented neoconservative policies. These figures led a radical deregulation of the economy in general, and financial markets in particular, while diverting the services of the state to corporations and wealthy individuals. They were even able to defend their policies by claiming that “There is no alternative,” as infamously expressed by Thatcher (Chang 2014). Although with great variety, form, and magnitude, political leaders everywhere enacted laws that suppressed the majority, by restricting rights of association, protest rights, and alternative local governance. This global process was also part of an extension of Western imperialism and capitalism at large. The West accrued benefits from the periphery by exploiting natural and human resources; often through the operations of transnational corporations and by draining their financial flows, mainly through the debt accumulation extended to political elites (cf. Duménil and Lévy 2004b). The dismal neoliberal theories had devastating neoconservative consequences. The language was freedom and economic growth for all, but its policy effects was economic and power re-distribution in favour of the already privileged.

Baker (2010) argues that the process was not so much about deregulation and minimising government; it was about regulatory protection and intervention for the benefit of special groups, especially Wall Street finance and associated large corporations.

Thatcher initiated a swift dismantling of the mixed economy, earning the nickname ‘The Iron Lady’ for her stubborn attitude. She lowered taxes for higher income groups, legally teared down the power of labour unions, abolished capital controls, and sparked a wave of privatisations. Public-owned sectors were now open to private investors, including gas, water, electricity, steel, airlines, automobile manufacture and parts of the public housing. In parallel, UK interest rates were raised to mitigate and lower inflation. This led to a dampening of economic activity but attracted foreign currency, which in turn drove up the value of Sterling. These two effects led to a major recession as demand for labour shrank, while British exports were reduced because they had become more expensive. Unemployment reached 3.3 million people, up from one million. Paradoxically, one of the slogans of Thatcher’s election campaign was ‘Labour isn’t working’ - a slogan invented by an advertising company (Chang 2014). The new masses of the UK regarded, of course, the labour union movement as its arch enemy, and therefore had to be brought to its knees. This happened through a number of channels, including outright assaults. For instance, Thatcher granted the Police sweeping powers, and hiked their salaries. Police gratitude was demonstrated during the Miners’ Strike of 1984-5, and in the infamous 1984 Battle of Orgreave, when miners were charged by mounted police (Jones 2014).

In the US, the newly appointed chairman of the Federal Reserve Bank, Paul Volcker, raised interest rates to an unprecedented height, causing unemployment to jump to levels not seen since the Great Depression. On the other hand, inflation was halted and kept at low levels. This represented a victory for capitalists in the face of the classical policy priority battle between inflation and employment. It was a deliberate policy priority to halt losses to financial assets, despite its expected (and later realised) negative effects on economic activity, unemployment, household debt, public revenues, and job security in general. This event was the beginning of the ever-increasing, albeit uneven, financial hegemony, not only in the US, but also around the world (Duménil and Lévy 2004b).
Immediately after his election victory, Reagan established six economic policy task forces, comprising entirely of individuals aligned to the new ideas surrounding monetarism, supply-side effects, rational choice theory and other gap fillers. The Economic Recovery Act of 1982 and other regulatory changes, produced by these task forces, consisted first and foremost of substantial tax cuts for wealthy individuals and large corporations (Blyth 2002). In this economic and political atmosphere, the influence of US labour unions declined; most obviously through legislations that made organising more difficult and collective bargaining rights harder to obtain and defend. For instance, federal aid to the unemployed were limited to only “unfortunate persons who through no fault of their own cannot be reasonably expected to work” (quoted in Blyth 2002: 180). This was probably a way to ‘establish’ their theory that unemployment is voluntary. Indeed, neoliberal ideas had long been prescribing for cutting the power of organised labour, as it was seen as a coercive obstruction to a ‘free economy’ (Steiner 2009). A telling example of neoconservative assaults on labour is Reagan’s sacking of the 11,400 striking members of the air-traffic controllers union who were employed by the state.

These decisions were part of a larger paradigm shift in managing labour, represented best perhaps by Reagan’s re-configuration of the National Labor Relations Board (NLRB). This board, which was traditionally pro-labour, were altered completely and by 1983 triggered a policy path that involved rulings that would have been unthinkable few years earlier. A few telling examples should indicate this policy shift. The NRLB ruled, in March 1984 that a worker who left work to find medical assistance for another worker was voluntarily terminating employment. Three months later, NRLB found that an employer, or the employer's agent, was allowed to take pictures of workers involved in union activities so that they would be remembered. In the same month, June 1984, the NRLB decided that the sacking off union supporters was legal since membership constituted a contractual breach; regardless of whether workers were informed that they were in breach or not. Over this time period, the NRLB also managed to disregard any collective bargaining success reached by labour unions (Blyth 2002). Reagan also allowed the minimum wage to drop in real value, and weakened welfare safety nets, such as unemployment insurance benefits and Aid to Families with Dependent Children (Campbell 2004).

All in all, the ‘New Right’ managed to preserve capitalism and made it even more favourable to whites, males, and elites. They could not have appropriated the state without stirring up effective voter strata, however. Voters harbouring sentiments of nationalism, racism, sexism and authoritarianism were successfully mobilised in elections (Desai 2007). When it was time for policy implementation, a number of pretexts were utilised, as the racial component was silent in neoliberal economics. One pretext in the US was the white-private/black-public binary at the time. White people were associated with the market and business, as well as superiority; while black people were associated with public works and social services for the marginalised, and thus, inferiority. But instead of being explicitly about black and white, the narratives and policies were built and implemented around concepts, such as “hard work,” “individual responsibility,” and “undeserving entitlements to lazy poor people” (Hohle 2015).

In particular, Hohle (2015) substantiates four important economic policy channels in which market-solutions re-enforced racial segregation: austerity, privatisation, deregulation, and tax cuts. Austerity ensured that black employment in the public sector were reduced, social welfare cuts hit the black poor hardest, and public support to businesses that hired blacks were reduced. At the same time, privatisation ensured that the private sector became richer and stronger; especially the already privileged white elites, while well-selected parts of the
public sector became weaker. Deregulations functioned in the same way, benefitting the white-private sector and selectively disfavouring the black-public sector. Tax policies followed the same logic: tax cuts to the private sector and the wealthy, but increased tax burden on the employees in the public sector, the unemployed, and other vulnerable groups. This turn of events emerged over the 1970s, especially under Nixon, but were intensified considerably under Reagan (Hohle 2015, Eisenstein 1987).

The racist Reagan administration operated also along sexist lines. Eisenstein (1987) shows that this was most evident in its budget and discourse on women. Women were also negatively affected from the selective dismantling of the state, in terms of employment, opportunities, and welfare support. The neoconservatives did not argue that women were not equal to men; only that they were different. They supposedly did not mind that women worked but that they had to be free to compete in the race of life, just like everyone else. It was through such narratives that the state dismantled the affirmative action programmes of the previous decades. One concrete and telling policy change based on this worldview is the altered burden of proof when it came to discrimination. It was no longer the employer who had to prove that discrimination did not happen, it was the individual who had to prove the occurrence of discrimination. In parallel, any discrimination established would only have an individual effect, and not ‘identified victims’ and ‘affected classes’ as before. These changes were the response of the new political elites to the ‘excess of democracy’ the liberal society had produced thus far (Eisenstein 1987).

These US and UK policies were soon replicated by governments of all political persuasions in the English-speaking world, and later in the rest of the world. One powerful ideological policy tool was privatisation; to sell public enterprises to the private sector, often at ‘wholesale price levels’. This tool benefitted the corporate sector in general, but the financial sector, in particular; both directly and indirectly. The direct benefits included the massive consultancy fees and bonuses derived from managing and executing the privatisations. The indirect benefits included enhanced economic and political power of financial corporations since all major investment decisions come to be driven by the financial sector. Now, it became routine for politicians to be offered attractive jobs in the financial sector, provided, of course, that they followed the right kind of policies when in office. By the 1990s, the privatisation trend had also reached EU, where such ideas were traditionally dismissed (Quiggin 2010). Privatisation also became part of the standard package of reforms forced upon the Global South by the World Bank, the IMF and the US Treasury (together forming the ‘Washington Consensus’).

The appropriations of the economics profession

The changes in the ideational, economic, and political spheres also affected the economics profession. To begin with, economists who helped to put inflation on top of the policy agenda were rewarded. The policy impact of such economists is perhaps best exemplified by ‘independent’ central banks; an institution established in almost all nations of the world, and it is almost completely free from democratic influence (Blyth 2002). Secondly, economists whose research work adhered to the broader agenda of “free-market” capitalism were increasingly favoured over the 1970s, and certainly so by the 1980s (cf. Fullbrook 2014). In particular, the corporate foundations mentioned above supported this type of economics in a much more direct way now. They were certainly not interested in research that was devoted to the tearing down of their ideologies and interests (Colander 1989).
There were also changes in the public sector that transformed the economics profession, again with the US as the pioneering country. In the early 1980s, US economists had to react to the planned, and later realised, public budget cuts to the National Science Foundation (NSF). The NSF received and directed government funds to research activities according to the demand of academics. The NSF’s commitment to the social sciences grew from 1957 in the wake of Sputnik, and culminated in 1968 with the creation of a Division of Social Sciences. During the 1970s, government support for the social sciences had replaced a large chunk of funding from philanthropists, so that the government had become the dominant patron of social science. However, the NSF’s entitlement to federal patronage, their status within the polity, in Congress and in the White House was waning. The 1981 budget crisis shocked social scientists and propelled them to action, which is evident in the statements and efforts of economists in the period 1981-1983 (Mata and Scheiging 2012). They had to play the game right in order to obtain NSF funding. NSF funding would mean ‘selling out’ to the new mainstream economics (Colander 1989).

Of course, funding was not guaranteed just because the research proposal adhered to the tenets of neo-liberal economics. Researchers had to adapt to what NSF saw as acceptable research at the time. Rumours would diffuse through the network about what research was, and what research was not, being considered for funding, and proposals would be shaped accordingly. Thus, there was a certain degree of faddishness in NSF funding with rational expectations catching on in one period, large-scale models catching on in another, and so on. Young economists who felt that their research lead nowhere had to continue in order to get tenure (Colander 1989). Furthermore, Colander (1989: 231) notes that “one would think that after they do receive tenure, they would be free to direct their own research, but by that time they are so caught up in the profession that to change their research focus is impossible.”

Yet another structural transformation went by way of Reagan’s White House. As he entered office, he staffed his administration with unaccredited economists that adhered to monetarism and other neoliberal economics that guided him. Economists who wanted political recognition and influence had to adapt to the new situation and demands. Over time, the economic language in both the public and private sector became much more common, as well as the broadening of their revolving doors, in which civil servants, lobbyists, business people and economists traded roles (Mata and Scheiging 2012). These developments led to a concentration of like-minded individuals in powerful roles, which in turn, affected the character of economists. Keynesian and other economists were increasingly purged from the profession. The purge rate was close to 100 per cent in economics departments at elite universities. This was particularly alarming, since the media turns firstly to them for expert commentary. Over time, the public heard very little about how economies looks when viewed through non-mainstream lenses (Fullbrook 2014). Economists who wanted a career had to reinvent themselves or disappear elsewhere, while students had to adapt themselves to the new curricula, aspirations, and career paths.

By the early 1990s, similar developments were taking place all around the world, and the position of neoliberal economists had reached very prominent heights. They served power also in demonisation of socialist and Marxist alternatives, given the Cold War atmosphere (Wolff and Resnick 2012). After all, the ascendance of neoliberal economics and neoconservativism were the outcomes of a collective effort by an international community of economists, political scientists, and other scholars wishing to dismantle the welfare state and run society with markets and corporations as central governing institutions (Phillips-Fein 2009). Neoliberal economists were also helped by an image of sophistication, given their
formalistic models and empirical work. These scientific credentials were accumulated over time and became the new normal (Blyth 2002). All around the world, these economists would prevail in central government institutions, inter-governmental bodies, international organisations, corporations, financial institutions, civil society organisations, etc. They provided ‘expert advise’ on, not only ‘the economy,’ but nearly everything else in the society; based on the ‘solution powers’ of strict egoism, competition, market effectiveness, and other tenets of the new dominant economics (cf. Hirschman and Berman 2014, Earle, Moran and Ward-Perkins 2017).

Conclusions

Neoliberal economics did certainly not achieve its dominance through methodologies prescribed by its adherents. It was not through ‘objective’ and ‘intra-scientific’ contestations of superior verisimilitude that ensured its ascendency (cf. Popper 1970). It was through ‘extra-scientific’ circumstances and interventions. The critical juncture in the form of economic and political crises triggered a number of reactionary efforts by various individuals, groups, corporations, politicians, and institutions. They reacted to perceived and potential losses in a number of crucial areas, particularly: corporate profits; class hegemony; white supremacy; and patriarchy. They found channels to combine forces, directly or indirectly, in order to achieve sufficiently overlapping objectives. The most important channel involved financial support and inducements (mainly from the private sector, but also from the public sector) to the production, dissemination and advocacy for neoliberal theories. The second channel was the political parties. Neoliberal theories and ideas were increasingly endorsed, and later on, appropriated by political elites. Thirdly, these theories were also increasingly endorsed and appropriated by prestigious institutions, awards, media, journals, universities, etc. Fourthly, they appealed to a significant share of the population by way of mass media.

Furthermore, the neoliberal take-over of economics and the neoconservative take-over of society were based on successful exploitation of negative norms, such as strict egoism, profit-orientation, (class) elitism, racism, sexism, prejudices, and ignorance in general. There are, however, also positive lessons from this period. The socio-economic conditions under the 1950s and 1960s vis-à-vis the increasingly egalitarian and democratic atmosphere implies that economic theories could play a positive role in society, even when they are deployed in disfigured manners. However, there is also a lesson in the reactionary backlashes against the progressive developments – the importance of building institutional cushions to such forthcoming backlashes. The neoliberal and neoconservative take-over of economics also shows the importance of: exploiting crises; being context-bound; being solution-oriented; inciting hope; using ‘creative’ language; alliance-building (overt and covert, with seemingly disparate stakeholders); operating on multiple arenas; and that activist scholarship could be effective.

In addition, when appraising the multi-faced and complex transformations of the 1970s, a common thread is evident: elite appropriations. These are the strategic and selective exploitation of theories, ideas, sentiments, terminology, institutions, governments, media, scholarship, academia, world-views, narratives, democracy, etc. that were conducted and carried out by economic and political elites. They utilised seemingly ‘neutral’ and ‘objective’ neoliberal language, knowing fully well that the underlying conditions in society are far from neutral or objective. The neoliberal theories, converted into policies, exacerbated the existing imbalances in society, especially when they were tilted and adapted to favour the already
powerful and privileged. For instance, when neoliberal theories prescribed lower taxes for everybody and especially the wealthy, the neoconservatives reduced taxes considerably for the wealthy, somewhat for the middle class, and nothing at all for the ones in low income brackets. When neoliberal theories disapproved organised labour, neoconservatives employed the neoliberal logic to conduct full assaults on this group. When neoliberals prescribed a small government with minimal interventions, neoconservatives dismantled public services to the masses, but expanded services to corporations and the wealthy. In this manner, the neoconservatives exacerbated and entrenched the very same imbalances that neoliberals suggested would wither away when markets rule. For instance, by generating a society that is even more driven by strict egoism, they further normalised this belief. This process, in turn, 're-confirmed' their world-views and the necessity to further implement their policies. This vicious cycle pushed societies further to the ideological right, as well as the broader acceptance to populist and authoritarian rulers (cf. Kellecioglu 2017a).

However, this does not necessarily mean that the appropriations of the 1970s were well orchestrated, optimally sequenced, and coherently executed. They oscillated between random and carefully designed decisions and plans; between set-backs and progress. They were results of a large number of push and pull factors produced by a diverse set of people with similar demands: profits and power, especially over other peoples in society. After all, neoliberal economics, and more so neocorporatism, harbour elitism, racism, sexism, and various prejudices. This is visible in their assumptions and analytical aversions. Although vested interests are important for this group, their ethics shape the distribution of money and power among different peoples in society. To put it differently, there are numerous ways to make money and power, but they choose the neoliberal/neoconservative way. Along this way, any egalitarian progress will be directly attacked or appropriated away.

Appropriations are, by definition, deceiving and elusive. They are normative inceptions that are intended to run deeper into cognitive mindsets and last longer in time, when compared to more direct interventions, such as co-optations. If something or someone is co-opted they could be delinked, but if appropriated they have to be delinked first, (mentally) emancipated next, and thereafter be re-built, for instance to its original configuration. Appropriations are widely exercised but require efforts to detect given their subtle character. Thus, appropriations are more difficult to reverse than more direct power impositions. Neoliberal and neoconservative institutions have been increasingly entrenched in our societies over time, and therefore more difficult to conjure and overturn today. This may partly explain the absence of transformations in the aftermath of the GFC. There was only a brief period, lasting over late 2008 to mid-2009, in which forms of Keynesianism were considered and partly deployed, but only because these policies served the powerful themselves (cf. Farrell and Quiggin 2012, Palley 2008). This is yet another testimony to the importance of recognising and challenging elite appropriations.

Recommendations

This section attempts to convert the backward-looking appraisal above into forward-looking recommendations for the transformative agenda of today, i.e. emancipate economics and our societies from neoliberal economics and neoconservativism. To manage this task, the journal paper “How to transform economics? A philosophical appraisal” (Kellecioglu 2017b) is utilised. It involves philosophical accounts about the attributes of a dominant theory, and requirements to supersede it; analytically organised around intra- and extra-scientific
influences. The complex facets of such transformations are, thereafter, organised into five criteria, or conditions “that appear essential to realise a successful transformation in economics: critical juncture; dissimilarity; scholar validation; sensibility; and external power” (p. 1). These criteria correspond well with the analytical historiography above, and therefore employed below. Although organised individually, they overlap considerably.

The first criterion, critical juncture, should not be regarded as an exogenously given event, or a momentary opportunity. It should be seen as something that can be established. There are a number of serious crises around the world today, which are all, more or less, linked together, forming one massive, overarching crisis – a global critical juncture. There are crises in economic distributions; crises in corporate operations; crises in political leaderships; crises with increasing totalitarianism; crises in humanity, as people are increasingly at variance with each other; crises of conflicts and wars; crises with environmental degradations; crises of hunger and poverty; etc. These crises could also be linked to their regional, national, and local contexts, so as to garner sufficient attention and commitment to combat them.

The second criterion, dissimilarity, is about economic discourses that challenge the neoliberal/neoconservative axis. Although each individual discourse may be valuable to the transformative agenda, collective empowerment strengthens the position of dissent. In this endeavour, it is important to achieve unity of purpose, such as an emancipatory interest with the objectives to improve the economy, the conditions of humanity, as well as the environment through sustainable and constructive theories and ideas. The debates on pluralist economics is useful in this regard (cf. Fullbrook 2008). However, it is essential that dissimilar discourses involve solution-oriented research and policy tools to be deployed for each specific objective and context. In similar fashion, they should be able to describe and prescribe for economies that integrate a variety of seemingly disparate economic activities, similar to a ‘mixed economy,’ but with the particular emancipatory interest. For instance, dissimilar research should develop people-led alternatives to the state-led, or corporate-led economies of the recent past; both of which has also been elite-led (cf. Wolff and Resnick 2012).

The third element, sensibility, is of vital importance in order to amass support for dissimilar discourses and power systems; not only from an effective stratum of the popular classes, but also from the middle classes, including scholars, journalists, managers, activists, etc. It is of particular interest to amass support from an effective stratum of women, black people and other traditionally marginalised groups; given the historiography above. Sensibility involves the art of persuasion and utilisation of communication channels in order to inspire, spark or trigger changes. In doing so, our appraisal above shows that it is essential to transcend interests, values and ideology so as to shift cognitive frameworks toward alternatives that appear feasible and realisable. Thus, rather than being traditional and problem-oriented, innovative and solution-oriented ideas are necessary to transcend dominant mindsets. For instance, explaining ordinary people’s economic issues with dissimilar, yet sensible language would not only catch attention, but garner external support.

The fourth element, scholar validation, involves collegial and institutional backing to dissimilar discourses and their scholars. This is important in order to generate more topical, context-bound, practical and coherent theories, ideas, and perspectives, while minimising duplications and maximising complementary research. Strategic and collective scholar activism is also imperative to contest the dominance in economics. The criterion is also increasingly fulfilled the more dissenting scholars strengthen each other’s work. It may also be worthwhile to reach
out to economists that operate within the realm of neoliberal economics. This is only worthwhile occasionally as success is far from certain given the career risks involved. However, the relatively few that directly or indirectly engage with dissimilar discourses and scholars could be important allies. For instance, researchers in international organisations often exhibit dissatisfaction with neoliberal economics, but rarely have the power to influence this structural dependency. Scholar validation should also be sought from marginalised groups, such as women and people affected by racism and white supremacy. Unfortunately, sexism and racism are still widespread realities in our world. They have, however, taken an even more subtle, yet aggressive turn in recent years through the ‘neutral’ and ‘colour-blind’ forms of elite appropriations by the neoliberal discourse (cf. Saull 2018, Prügl 2015). Race and gender issues should therefore be explicitly taken into account in research, rather than be subsumed into analytical concepts such as ‘class’ (cf. Wright 2015).

The fifth and final criterion, external power, is the most important one. It is not possible to generate transformations in economics and the society without substantially tilting it in favour of the emancipatory interest. This entails disempowerment of institutions that sustain the dominance of neoliberal economics and neoconservatism, while empowering institutions that supports people-oriented economics and power systems. This disempowerment mainly involves revealing, dispossessing and blocking the material and immaterial sources of the neoliberal/neoconservative axis. This entails, for instance, conducting case studies that ‘follow the money’ to neoliberal economics curricula and neoconservative politics. There are surprisingly few studies in this regard, while critical assessments of neoliberal theories are numerous. At the same time, the empowerment process could involve developing innovative finance mechanisms to support dissimilar discourses and policy influences. In this respect, it may be worthwhile to identify and garner the support of economic and political elites that have shown interest in halting and reversing neoconservative trajectories. After all, re-distributions of external power in economics should be valuable to, not only radicals and progressives, but also liberals, and even some conservatives, since neoconservatism, and its prospects for fascism, are not aligned with their world-views.

These recommendations are, of course, only one approach to formulate guidance to more systematically challenge the hegemony in economics, and in our societies. They are, however, not intended to be passed on to political decision makers, but to concerned scholars, researchers, decision-makers, activists, students, or anyone else who are unhappy with the state of our economics and societies. The criteria explicitly highlight the importance of dealing with external powers to neoliberal economics, rather than spending time and efforts on its theoretical weaknesses. In fact, one general recommendation is to conduct more research on external powers that obstruct or construct transformations in economics and systems of power (research-oriented). A second general recommendation is to design solution-oriented policies that intend to tackle such obstructions, while boosting constructive forces (policy-oriented). Thirdly, it is recommended that scholars actively seek to change the environment within which they operate (activist-oriented). By pursuing these three lines of action with the objective of fulfilling the five criteria, we may not only generate knowledge on transformations, but also contribute to the likelihood that transformations occur.
References


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Economics and normativity in four sections
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By way of context: the separation, subordination and sublimation of normativity

In articulating what it is that they do, mainstream economists tend to emphasise that they build models and use these to convey information regarding datasets. The grounds of this are supposed to be clear because economic models are mathematical in expression. Clarity is putatively reinforced because the empirical processing is based on statistical methods and publicly available tests. The combination becomes the available material offered to, or constructed for, policymakers. Policymakers use the constructed models as they see fit, typically to envisage likely consequences of policies. The material also becomes part of public discourse directly or indirectly. At least tacitly the material involves the claim that these models adequately describe the world to its inhabitants, albeit synthesised, simplified or reduced in ways whose seminal expression often includes caveats regarding relevance and realism.

Concomitantly, two highly general understandings form the background to how an economist thinks of herself as a social scientist. Policymakers use the models as they see fit and they are responsible for making policy-decisions. There is heavy emphasis on a concept of the *scientist* in the economists’ self-understanding as a “social scientist”. According to the dominant view, her field of study is particularly suited to measurement and quantification (see Fourcade et al. 2015, but for geographical-cultural difference, Fourcade, 2009). When an economist replies to a critic that they are “objective” it is this that she typically has in mind. From within this mindset, much of the critique of economics to a mainstream economist seems either ill-founded, misplaced or patronising, creating oppositional problems of response. ¹ Few will for instance feel the need to respond to accusations or claims that they are neoliberal ideologues or that they are positivists in some pejorative sense or unreflective technocratic number crunchers.

It remains the case, of course, that one can be a positivist even if one does not know what that is (in the sense of aspire to or unwitting adoption or conformity to its tenets). Although the term “positivism” is often used pejoratively, it can nonetheless be an accurate categorisation of the worldview of the person. And, one can be a positivist with variant characteristics, and being a positivist can be problematic even if one has a received position that accords with or approves of the term under some understanding. ²

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¹ By mindset I do not mean to imply a free-floating set of ideas or beliefs reducible to psychology of the person; the whole occurs within structures of social relations that shape how knowledge is produced and reproduced.

² It is important to stress that not all economists are likely positivists in terms of any given account of that term. Caldwell (1994; 2013) focusses narrowly on logical positivism and logical empiricism – involving the strong requirement that science should only make reference to observables and the central quest for ever more precise predictions – and comes to the conclusion that the rhetoric of positivism has waned. “Economists were not following the strictures of positivism, because no science can” (2013, 757). However, in the broader sense (as used for instance by the critical theorists of the German *Positivismusstreit* and, later, by critical realists) also contemporary practices and rhetoric of economists do emanate from positivism. Characteristically positivism in this broad sense involve belief in the one
To be clear, if, based on philosophy of science or social science, one labels an economist as a positivist they will not necessarily know what is meant. This is because their familiarity with the term is unlikely to derive from philosophy of science or social science. The most likely places an economist will come across the term is in a general textbook on research methods (as part of research training where it reduces to use of quantified methods that presuppose or seek regular law-like states of affairs) or from Friedman’s well known essay (irrelevance of assumption, so long as predictive success) or its many imitators. Positivism in a general research methods textbook is presented as one approach among many that different disciplines might think best “fits” what they do. If selecting from a research methods textbook, especially based on a mainstream economists’ mindset, one is acquiring a language of confirmation rather than engaging with a source that encourages questioning. These kinds of textbooks are not detailed arguments in philosophy of science or social science that place approaches in purposive critical context to address whether each is fundamentally defensible or appropriate (as matters of epistemology and ontology etc; see Lawson, 2015; Mäki, 2001).

This is not to suggest that there is no philosophy or methodology of economics that develops the discourse of philosophy of science or social science (see Blaug, 1992; Caldwell, 1994; Boumans and Davis, 2016). Nor is it to suggest that nothing has been written by philosophers and methodologists of economics about Friedman and the nature of the argument posed (see, for example, Mäki, 2009). Questions raised include: is positive science the same as positivism, and which kind? Is the positive-normative divide necessarily associated with these? For instance, if science should only make reference to observables, it would appear that values cannot be scientific (testable). More generally, if economics is a science but not necessarily a positivist science, what kind of science is it? For example, what do prominent originators later say regarding the consequences of what they have wrought. What I want to emphasise is that little of these philosophical discussions has actually filtered into the discipline at large (see also Colander, 2013).

To reiterate, because of their training and background assumptions, few mainstream economists will feel the need to respond to accusations or claims that they are positivists or unreflective technocratic number crunchers or neoliberal ideologues. Moreover, not all mainstream economists are positivists and well-known economists have also included critics of positivism; and to reduce all of economics to a unidirectional ideology will likely seem to mainstream economists a grotesque parody that impugns the professional basis of a hard earned and valued (in high demand and relatively well compensated) skillset. So, a further problem is that the sociological framing provokes personal affront and “it is” becomes "you
are” (it is difficult to balance a sociological account with a genuine dialogue about both substance and philosophy of science). That critics are actually concerned with fundamental issues of economics as knowledge, its realism, social construction, social significance and normative consequence is readily lost in translation.

In the main, mainstream economists will self-identify if pressed, as scientists offering objective, since mathematically expressed and quantified, technically skilled insight for others to make use of. Within the mindset, the positive-normative divide has become a self-understanding where normative issues are the aspects separated out. The understanding is that the economist is offering something technical and responsibility for what is done with that is left to others, even if the concepts, findings or claims lead to advocacy. The positive-normative divide has come to mean in practice, and upon reflection, an “it’s up to you what you do with this”, and a view that economics is “about how you (best) make choices” not what you choose. To be clear, this is its practical understanding, not its formal statement, and, of course, it tends to fall back on the means-end distinction built into Robbins’ originating definition. Today the means-end distinction is linked to a looser reference to the “objective” status of that which is offered, creating a degree of circularity and a whole host of possible tensions if one questions what objectivity means. For example, if objectivity is understood in terms of rational self-interest, behavioural economics has shown that choices can be manipulated, often in subliminal ways. Public relations, marketers, economists, politicians etc may have an interest in manipulating the choices presented to the decision-makers.

What I am suggesting is that economists have a particular socialised sense of a normative separation, which is also about where responsibly is placed for knowledge produced. Responsibility for knowledge produced is ultimately placed with the recipient (including the subject that is objectified as a modelled entity – the locus of utility, preference or profit). Still, there is a presumption that economists have a privileged right to be heard, and they have a duty to offer themselves to policymakers to be heard. This is unquestioned, and yet, from a sociological point of view, quite odd. Perhaps it is a facet of the status of the skillset, its “objectivity”, which adds to the “it’s up to you” a “but given the data any rational person would…” (the problem of “observational equivalence” notwithstanding).5

This also helps to explain how economists can make sense of the interminable disagreement that also characterises the profession. By this I mean there are many disagreements regarding what models are best, and what is to be done because of what is modelled, amongst those with common commitments to economics as a science. Even this restricted world involves norms and normative concerns. However, normative concerns are rarely discussed as such. Rather dispute regards differences of assumption and technical construction: what to loosen, what to emphasise, what to weight, omit or order, how to test, what to infer, what degree of failure (imprecision, proxy, error or variation) constitutes current progress based on best practice. The responsibility for normative choices is externalized to decision-makers, business-leaders and consumers.

Little, if any, thought is given to the problem of normativity that prefigures the issue of any given norms or normative principles built into economic knowledge, and the normative commitments that flow from how the world is “described” or policy possibilities are reduced and framed. This has been clearest when and where formalism and axiomatization dominate.

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5 Observational equivalence refers to indeterminacy between models in relation to findings based on the data. Any number of models can be made to fit with given set of data.
As economics becomes more axiomatic it loses both the means and the will to deliberate regarding value judgements as value judgements; these become propositions, postulates and predicates. However, the practice of exteriorisation and lack of comfort with values as values is not restricted to the highly formalistic varieties of economics (pure theory) or to the era of its dominance. It has remained relevant through the “empirical turn” of the late 1990s and 2000s and into the contemporary “credibility revolution”. The main reason for this is the gradual elimination of history, philosophy and methodology from an economics education and their replacement by mathematical and statistical methods (this elimination seems to follow logically from positivism, cf. note 2).

The language and concepts of normativity have been lost, and with them the simple sense of ease that this is a legitimate area of concern as economics. Just as responsibility is placed, the problem of normativity is displaced, in so far as it is delegated, either to other social sciences or to sub-disciplines of economics (philosophy, methodology or history) that are no longer part of the majority’s economics education (a point well expressed by Cartwright and Davis, 2016; Lawson, 2017). All of which is to suggest that an economists’ approach to the positive-normative divide is not quite, in its contemporary form, an unambiguous ought-is divide. It is separation, subordination and sublimation of normativity in the actual practices of the economics profession.

Neutralization is not neutrality

Focusing on placing responsibility does not make the knowledge produced by economists neutral. The kind of objectivity that most economists have in mind cannot make it neutral. The construction has consequences, and emphasising who decides does not negate that there are consequences that flow from the forms that can be chosen from. Though economics’ capacity to address normative concerns is in a sense neutralized (externalized) it does not follow that economics is normatively neutral.

If one falls back on the clarity made possible by, first, mathematics as a means to express models and, second, statistical analysis as a means to use datasets (where datasets are supposedly used to test models and models are supposedly used to extract information from datasets), then one has restricted the scope for contestation but has not created neutrality. This is the framing within which failure (imprecision, proxy, error or variation) is expressed as progress. The restricted scope bends criticism inwards. What counts is primarily what can be counted and thus economics burgeons where datasets are available (even if the focus is trivial or distracting – as, for example, many have noted of the effects of experiment on development economics and funding priorities at the World Bank). When models are criticised, innovations take the form of different constructions of similar modelling formats. Models proliferate through technical modifications in various (sub) branches. This is one important reason why change diffuses so slowly through economics and why change rarely involves fundamentals.

Consider how long it took behavioural economics to gain traction within economics and consider how marginal many of the changes in practice are. Contextualizing concepts, shared

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6 It, for example, owes little to Hume’s guillotine, just as subsequent social science discussion of the positive-normative divide owes little to what Hume actually meant.

7 Specifically, the problem of “randomized control trials” (RCTs).
with much of information-theoretic economics, such as disequilibrium, sub-optimality, limited rationality, inefficiency and so forth take as their point of departure concepts and meanings that are otherwise unrealistic or impossible, and this typically hampers the degree of genuine difference in the diversity offered by behavioural and other new branches of economics. Behavioural economics is in the end not about the messiness of human conduct, but the well-behaved variation in modelled agents. The real world is neutralized in what otherwise seems like a more realistic approach to modelling. The agent is never addressed as a moral centre of ultimate concerns within a field of economic problems that she is invited to deliberate in regard of. Instead she becomes a test subject to isolate a trait that can then be expressed and/or manipulated (loss aversion, status quo, disposition and injustice effects). Normativity is neutralized in so far as economics, which otherwise involves intrinsically ethical subject matter, becomes a billiard ball decision-making enterprise (what does an agent do if treated this way or that?). This infantilizes the human in both conceptual and policy terms, whose mirror is a paternalised corporation or state.

Fundamental problems can and are recognized. However, where statistical analysis is involved this typically leads to permanent deferral of the otherwise clear consequence of the criticism. Ed Leamer, for example, has been a consistent critic (and practitioner) of econometrics for twenty five years. Yet if you compare Leamer 1983 and 2010 he is essentially making the same point: economics has not solved its so called “con” problem (the data potential cannot reproduce conditions that allow for practice equivalent to ideal test conditions, and method includes inherent problems of accounting for cause via variation in possible models and findings). Rather it has changed the context in which the con is produced, the new randomization literature of the twenty first century does not genuinely address the problem of randomisation he actually had in mind. It does not make the new methods any more reliable in their findings. Leamer’s substantive critique is just one version of a set of fundamental concerns (see Velupillai, 2007; Freedman, 2010 or Lars Syll).

Model adequacy requires the basic assumption that the model is “well-specified”. That is, all relevant variables are accounted for (completeness), all are measurable, separable and independent, and are properly ordered, consistent and transitive, whilst conditions assumed in the treatment of the error term remain unchanged; and, of course, that the findings are transferable (have external validity). This technical language may not mean much to you, but it is a highly restrictive set of requirements. It immediately invokes two kinds of possible response: seek to solve the problems of technique and use only where appropriate. The former assumes there are in fact technical solutions that are also relevant, and the latter requires one to first ask about the nature of the world to which the techniques are applied. Technical solutions are the overwhelming focus. Most econometrics textbooks or courses begin with an introduction that tries to articulate scope, but this quickly becomes an introverted focus on what is appropriate to statistical analysis (what kind should one do, what do tests indicate, what makes for “well-behaved” data etc.). This is subtly different than is the statistical analysis appropriate for its point of reference (the actual problem under investigation).

You may be thinking the argument I am making is peripheral to problems of normativity. It is not, however, this argument but the actual subject of argument (economics) that has become peripheral to normative concerns; demonstrating or stating this requires deviation. The nature of contestation in economics has important relevant effects. It does not lead to a questioning of appropriateness, but rather to continuity of practice and focus, a “this is what we do” (rather than a “what should we do?”). The skillset dictates what is done. This is important because
mainstream economists are not wrong when they suggest their skillset is valued (in high demand and relatively well compensated). The limitations are often exposed: explanatory and predictive failure; non-transferability of claims; and continual need to justify re-estimations. At the same time, specific studies are usually not replicated or confirmed independently, although that would be required to fulfil the status stated for findings in terms required by the prevailing methods.

The social value in clarity of mathematical and statistical expression is problematic once it becomes clear that they are technically unclear because of differences that cannot be reconciled, fixes that are required, and limits that are unaddressed. Social value speaks as much to social influence and social usage-as-power as it does to success in its own terms, and response to exterior critique of those terms. This is self-reinforcing. Quantification provides authority, and it is this that no other social science can match. But this involves sacrifice. The focus on measurement elides the social significance of quantification. It also represents a huge transfer of resources from problems that cannot be posed, developed or explored without models or datasets. Normative neutralization is thus also non-neutral in terms of what becomes absent by virtue of focus.

Invisibility, deformation and ideational preference: inequality

What mainstream economics has become creates limits on what society can be because mainstream economics is an extremely powerful source of ideational content. This is not just a matter of what cannot be explored without models or datasets, since many things that can be explored in this way are not actually explored and some that are, are deformed. One well-known current example is inequality. This problematic was conceptually invisible within the mainstream prior to the popularity of Piketty’s Capital in the Twenty First Century (2014) despite more than two decades of growing (if variable) wealth and income inequality (within states rather than necessarily between them), and despite longstanding work by James Galbraith and others. As Piketty notes, this was not accidental, it was a consequence of the dominant conceptual constructs, mindsets and lack of empirical curiosity amongst economists.

The idea that marginal productivity in competitive markets equals to its price means, from a normative point of view, that labour is paid what it is worth (naturalising social division). Trickle down assumptions lead economists to anticipate incomes are all growing and wealth diffuses (rather than power allows wealth to be captured, concentrated and protected). Given the prevalence of these kinds of ideas and assumptions, little attempt was actually made to establish or critique the relations that were assumed, and this in turn, was reinforced by a reluctance to go beyond standardised tests of readily available datasets. This highlights how the economist’s skillset can be an impediment to empirical work, since testing data is not the same as seeking out all available evidence, some of which only comes into view if one is prepared to think in terms of a range of methods and sources – for Piketty that was many different types of tax record (see Pressman, 2015). Mainstream economics has subsequently been required by circumstance to address inequality. However, its prior invisibility – and focus

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8 I would note here that there is limited scope in the general argument that all attempts to explore the world are in some way “models”. This does not properly engage with what is specific to the way economics models, and so is either disingenuous, trivial or misleading. The way Mäki argues sometimes seems to beg such issues, partly due to the way metaphysics and ontology are treated (a point made by Dennis Badeen).
on incentives to individuals and firms – meant in effect that the most powerful social science discourse acted to reinforce growing inequality, since it was to economics one would look for argument and evidence regarding it as a possible problem.

And to be clear, despite new focus on it, mainstream economics has still not fully reconciled to inequality as a problem. For example, mainstream theory does not usually differentiate between different social groups in terms of the impacts of distribution, so it provides no theorisation of the real effects of inequality, including the benefits of raising wages for targeted multiplier effects or their retardation through “hysteresis” effects. Mainstream theory still tends to assume that it is education, skills and competition that determine wages, thereby presupposing a particular account of competitive markets and the market mechanism. This is despite that the value of education and skills, and the nature of competition, are dependent on the rules of bargaining domestically, and the rules of trade internationally. Changes in these provide the actual explanatory grounds for the institutional effects that create the scope for inequality to rise (Morgan, 2015).

The same problem holds for the other main facet of theory, which is that the fundamental engine of income growth is productivity growth. This may well be its context, but it is one subject to distribution. In most wealthy countries productivity and wage growth have been divergent for decades, and nowhere is this more evident than in the US:

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**The gap between productivity and a typical worker’s compensation has increased dramatically since 1973**

**Productivity growth and hourly compensation growth, 1948–2016**

<table>
<thead>
<tr>
<th>Year</th>
<th>Productivity</th>
<th>Hourly Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948–1973:</td>
<td>96.7%</td>
<td>91.3%</td>
</tr>
<tr>
<td>1973–2016:</td>
<td>73.7%</td>
<td>12.3%</td>
</tr>
</tbody>
</table>

Note: Data are for compensation (wages and benefits) of production/non-supervisory workers in the private sector and net productivity of the total economy. “Net productivity” is the growth of output of goods and services less depreciation per hour worked.

Source: EPI analysis of Bureau of Labor Statistics and Bureau of Economic Analysis data

Updated from Figure A in *Raising America’s Pay: Why It’s Our Central Economic Policy Challenge*

Economic Policy Institute

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9 Which arguably is why much of the effect is observed – the statistical differences – within states rather than between states. Every country where common policy tenets apply may experience wealth and income concentration even as some benefit more than others from globalized relations – uneven accumulation and its wage effects may also serve to equalize the distribution of income and wealth among states.
So, there is something partial in the blithe statement that if labour wants higher wages in the near future it must first deliver higher productivity in order for this to be affordable. This assumes a fixed relation between wages and productivity and a fixed line of causation for any wage effect (based on a definite relation to, for example, “human capital”). This simply ignores the role of mechanisms that affect distribution. Or perhaps more accurately, this makes it a problem to be modelled in ways restricted by mathematical expression – which has been the case in contemporary “matching” models. The existence of divergence establishes that fixed relations have not applied. Moreover, the way in which it has not been the case has had political consequences. CEO pay is nominally performance based, but has grown in ways that grossly exceed any fixed relation to metrics of corporate activity (which has not prevented attempts to justify top-layer pay, for example, Gabaix and Landier, 2008, which re-specifies Rosen’s 1981 work on “superstars”; and contrast this with Bolchover, 2010).

Populist anger has many sources, but one of them is likely the sense of injustice that is provoked by changes in the world that economics has facilitated and then failed to address. To reiterate, the invisibility of inequality has subsequently become a problem field mainstream economics has not fully reconciled to. Things that can be explored are not and in so far as they are, they are deformed. This, as should be clear from the above, has ideational content and consequence that exceeds the formal statement of theory. It involves implicit principles of what is just (paid what one is worth). Moreover, it involves theory-driven assumptions about foci for research based on what variables are important mechanisms for progress in income and wealth effects, which are manifestly misleading (the dominant picture of relevant mechanisms and processes seems thus inadequate).

Early on I noted that few mainstream economists would feel the need to respond to accusations or claims that they are neoliberal ideologues relying on positivist philosophy of science. In fact, research tends to indicate many economists (in Europe and the US) would identify as politically liberal in the US sense of the term, meaning they consider themselves socially progressive, centrist or left leaning. This is not irrelevant, but this is not the most relevant way to position mainstream economists. They may not be ideologues (some are, but that is true of any field), but economics has form and function, it has ideational content, absence and consequence. The focus and practice of the profession occludes this and decentres it, since economists are not encouraged as economists to be concerned with this normativity. Its lack affects the empirical field.

**Thought closure as normative consequence: money creation and the ideational positioning of finance**

In The Narrative Fixation in Economics (2016) Edward Fullbrook argues that knowledge does not just become ideological by virtue of content and framing, but also by the absence of alternatives. If there is more than one way for a problem, issue or phenomena to be positioned, conceptualised and explored, but only one is conveyed then the capacity for any given position to be constructively critiqued or questioned is reduced, and this is to the detriment of potential progress over and above any given position. This too is a normative issue with normative consequences. It begins with pedagogy. Presenting one position when

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10 Note: this point is not intended to under-emphasize the importance of those who have had the specific intent of transforming the ideational landscape. The point addresses the vast majority of the many 1,000s of economists, not the role of Mont Pelerin, the willed construction of a Washington Consensus etc. The two are, in many ways related, but this does not speak to the self-understanding of the majority.
several exist conveys the impression that the norm is one position. The aim is to achieve one position (unity), and the existence of or seeking for alternatives lacks legitimacy or relevance. This is different than mere disagreement within a broad position on fundamentals. It is a kind of meta-norm of what is the status of knowledge based on the nature of the world to which it is supposedly directed. It is based, arguably, on a misrepresentation of natural science, specifically physics.

As Fullbrook notes, physics has not made progress by closure, but rather by a series of open framework developments, and where physicists have been prepared to maintain an open mind and adopt or consider different frameworks. Shifting between fundamental theoretical perspectives does not cause physicists to collapse in a state of existential angst or confusion, and nor should an equivalent in the social sciences. Though some in physics seek unity they accept that the possibility of this presupposes a prior and for-all-intents-and-purposes permanent openness to alternatives. Economics’ physics envy combined with paradigm policing would thus seem to be a misapprehension of form and practice.

Conversely, a lack of openness, is an invitation to indoctrination, not an encouragement of critical thinking for problem solving. Disciplines, of course, require standards, but this is different than disciplining a discipline to impose a single position. This is the closure of minds. It leads to highly conservative approaches to development within a discipline, and thus to exactly the kind of slow diffusion of change that I have already noted characterises mainstream economics. The vulnerability of economics to this kind of problem is exacerbated by the elimination of philosophy, methodology and history, and by the focus on methods within economics peculiar “objective” framing. If the field heavily emphasises technical skillsets then there is a tendency to teach through didactic demonstration followed by confirmation through practice. The mindset is “accept the basis of this way of doing things and then everything else follows”, “concentrate on mastering the skills”. Arguably it is due to the conformist mindset cultivated in economics that there is often little resistance to the (from any other point of view) weird substance of many core assumptions and concepts in economics.

Consider the problem of money. Money is of central importance to any modern capitalist market economy. Yet it is mainly sociologists, philosophers and dissenters that have maintained an interest in what money “is” with a view to continued critique and development (see Ingham, 2004, 2018; Lawson, 2016; Searle, 2017; Peacock, 2017). One might think this is because economics has already provided an agreed clear concept of money. But this is not the case. Contemporary economics defines money in terms of function (unit of account, store of value, medium of exchange), but puts aside both the actual history of money (after an origin story) and the conceptual problem of money, both of which likely affect the functionality of money in the broader sense of its role and consequence in real systems. Mainstream economics has tended to treat money in a highly problematic way, which, arguably illustrates Fullbrook’s key point.

What appears weird to those outside of the mainstream is that in economic theory in general money is typically absent. It is usually assumed that in a properly functioning market system prices express the value of output such that all prices effectively become representative of ratios between goods and services (and inputs), and this ultimately means a market system operates as though it were barter. Money simply becomes the convenient symbol (in its medium of exchange guise) that expresses these ratios. As such, it has no independent significance, and one ought to look through money to the operation of “real” economic factors, and can in effect ignore money as a contributory, contextualising or significant component in a
system. This is except in so far as monetary policy leads to “monetary disorders” (well-meaning governments and central banks push too much money into an economy, and this has no long term effect on “real” factors but does result in inflation, so the role of monetary authorities is primarily to prevent excess).

The point, however, is that the role of money in real systems has generally been peripheralised because of an arbitrary limitation created by the assumption that money is separate from and then circumspectly significant to “real” factors. This statement may seem odd to a non-economist, since we live in a world where monetary policy is high profile, and a great deal of attention is paid to central bank policy (inflation targeting for price stability), and to the existence and activity of banks. This is different than whether money itself is a well-conceived concept, in economic theory in general, and then in central bank and financial theory in particular.

Within the economics of the finance system little attention is paid to how money is created over and above the role of the state in facilitating the printing/minting of money and central banks in terms of reserve system management. It is simply assumed that money exists and it is used. For decades undergraduate economics textbooks have taught what is termed the money multiplier, where banks can collectively but not individually create money (subject to a mathematical limit expressed as the reciprocal of the reserve ratio). However, this position is not taught to postgraduates and is not generally endorsed by economists who work on banking and finance.

At this level, the general position is referred to as intermediation of loanable funds (ILF). ILF does not actually address how money is created. Instead, it assumes that banks are intermediaries who gather the savings (surplus) of citizens and corporations, pool them, and then lend the pool to borrowers. An interest rate spread exists based on the difference between what they must pay savers to use their savings and what they charge borrowers in order to provide their service (which is essentially a risk management and maturity transformation function). ILF implicitly represents banks as a beneficial social utility providing a vital service that underpins productive investment in the economy; one, moreover, where banks, based on a profit motive and risk assessment, are efficiency enhancing; risk-focused credit management leads to best use of available capital. Any deviation from this is a matter of information asymmetries creating distortions in credit channels, but the norm to which the system tends is credit and capital efficiency, and the positioning of the role and consequences of banks is positive by default.

Clearly, this has significant ideational content in terms of how banks are positioned. One might consider this positioning ideological, since the positive representation of banking conveys an impression, and the essential implication is that there is a “normal” of efficiency that banks can be returned to. It might also be categorised as ideological because alternatives exist that are not taught and are not part of mainstream economics. That is, varieties of credit creation theory (promoted by post-Keynesians, modern money theorists etc). This may partly be because the problem of what money “is” is not reconciled to the basic characteristic that money involves credit-debt relations. Moreover, the dominance of ILF continues despite that empirical evidence tends to suggest that banks create money *ex nihilo* each time they extend a loan (though this has limits and is not equivalent to infinite scope), and despite that central bank researchers increasingly recognise this (even if central bank governors etc often do not; see Kumhof and Zoltan, 2015; Mcleay, et al, 2014).
The difference between ILF and credit creation is important, and the failure to teach or discuss the latter is of equal importance. Consider the difference it makes. If banks create money each time they extend a loan and banks are not dependent on savings in order to do this, then money creation is instantaneous and discontinuous. It is thus difficult to forecast and control for central banks, and banks themselves are more important socio-economic actors than they appear (and they are already manifestly important). If banks are not primarily intermediaries they are instead financiers, and given they are, under this description, the main source of money creation in an economy, what money is created for is highly significant. Money gives banks transformative capacity; that is, power.

There is no reason to assume that money is created and lent for productive purposes (since banks are interested in profit, not social welfare, and an evolving finance system creates scope for profit to be made from lending for and against financial assets). Given also that banks are able to influence the environment in which they operate, there is no reason to assume that their consequences will be efficiency enhancing, even as an emergent unintended consequence, since expanding lending may mean following bubbles in financial assets, and banks can operate on the basis of shifting risk through a system of ever greater complexity that banks are helping to evolve (for example, via originate and distribute lending strategies, securitisation and shadow banking). These are significant concerns for regulators, even with a dominant ILF position, but the whole looks quite different if there is no “normal” to return banks to. The alternative opens up very different ways of exploring banking and finance, such as financialization, something which sits awkwardly with ILF, where the term financial deepening is more common.

So, what have I suggested? Norms inhere in knowledge, and normativity in debate is promoted or suppressed by the plurality or lack in what is and is not taught.

**Conclusion: non-conformity and disagreement**

Mainstream economics has been the subject of widespread criticism in recent years. The focus of that criticism is relatively new (failure to forecast and respond adequately to the global financial crisis etc.), but the themes are longstanding. Economics has become less concerned with realism and with real world problems. As a stand-alone statement this seems absurd, and yet if one considers how economics develops, it has become oddly introverted, and this has affected the way economics engages with the world. Economics has normative content and consequence, but in a misplaced and misunderstood manner.

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11 According to Rethinking Economics recent ‘33 Theses’: “24. The majority of new money circulating in the economy is created by commercial banks, every time they make a new loan. 25. The way in which money is created affects the distribution of wealth within society. Consequently, the method of money creation should be understood to be a political issue, not merely a technical one. 26. Since banks create money and debt, they are important actors in the economy, and should be included within macroeconomic models. Economic models that do not include banks will not be able to predict banking crises. 27. Economics needs a better understanding of how instability and crises can be created internally within markets, rather than treating them as ‘shocks’ that affect markets from the outside. 28. Financialisation has two dimensions: short-termist and speculative finance, and a financialised real economy. The two problems must be studied together” (2017: p. 4).

12 In some discourses in order to avoid conflation it can also be important to distinguish realism (the ontological approach within philosophy) from “realistiness” as a facet of specific theory and claims (a point that Mäki is concerned by and Dennis Badeen explores).
The claims I have made here are not ones that many mainstream economists are likely to accept. But as I have noted, there are entirely understandable reasons for this. At the same time, there are good reasons not to be bound by this. Economics is too important to be left in its current state. It is in need of genuine plurality, rather than conformist (sub) diversity. It is in need of philosophy, methodology and history as much as mathematics and statistics. It is in need of frameworks that discuss normativity, rather than stratagems that suppress, repress, deform, condone or circumvent norms. It is in need of deliberative engagement with the world rather than an objectification of that world.

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You may post and read comments on this paper at https://rwer.wordpress.com/comments-on-rwer-issue-no-85/
From Pareto economics, to Pareto politics, to fascism: a Rochambeau model of elite circulation
Jorge Buzaglo  [Independent economist, Stockholm]

Introduction: the reemergence of elite theory

The World Development Report (WDR) is the World Bank’s annual report on the state of the world economy and crucial economic development topics. However, the 2017 version was atypical because the WDR (World Bank 2017) focused on politics, not the economy. The report, “Governance and the Law,” is symptomatic, not only because of its defection from economics but also for the type of political theory it utilizes.

The WDR straying from economics is not too regrettable because the economic theory that characterized this document was mainstream neoclassicism, and the type of economic policy advice was the associated neoliberal set of recipes labelled the “Washington Consensus.” This change in topic could be interpreted as the result of the growing recognition that mainstream economic theory and neoliberal economic policies have not delivered what they promised; in contrast, they induced increased income stagnation and growing inequality.

The realization of the failure of neoliberalism may even have reached the IMF, that is, the central stronghold of global economic orthodoxy. However, it does not seem as if the increasing doubts about and abandonment of the neoclassical–neoliberal paradigm will find a prospective resolution and replacement any time soon. The present uncertainty about the ruling economic model and policy paradigm reflects an uncertainty about the current global geopolitical evolution, a process of hegemonic transition that may take years or decades to settle. Meanwhile, and characteristically, massive state interventionism (particularly in monetary policy) coexists with orthodox laissez-faire and radical “market reforms” (particularly in labor and social affairs).

From Paretoian economics to Paretoian politics

The type of political theory found in the WDR 2017 is regrettable and symptomatic of the deeply disturbing changes in the overall ideological and political climate. The sociopolitical theory that is the basis for the report’s analyses and conclusions was “elite theory,” that is, not abstract political theory or democratic theory, but “elite theory.”

The WDR refers to the three, great canonical “elite theorists”: Vilfredo Pareto (1848–1923), Gaetano Mosca (1858–1941), and Robert Michels (1876–1936). Common to these authors, and for elite theorists in general, is the belief – which they take as an objective and unchangeable sociopolitical and historical fact – that a small minority of elites rules all societies and social organizations.

In the advanced lingo of the WDR, “the distribution of elites maps onto the national structure of bargaining power and the formulation and implementation of laws governing the exercise of power” (World Bank 2017, p. 22). The study “reveals that the identity of the influential actors
within a ruling elite coalition that decides policy at the national level differs greatly over space, time, and issue area” (Ibid.).

The idea that all societies are governed by elites and can only be governed by elites (i.e., that democracy is simply impossible) is one the central tenets of fascist ideology. At the basis of elite theory is a profound pessimism about the capacity of ordinary people (“the masses”) to understand their own interests and to collectively act in consequence. As we will show, it is not a too bold hypothesis to propound that elite theory emerged as a counterideology at a time and place of intense social struggle by the masses for democratic and social reforms; that is, Italy at the turn of the 20th century. Pareto accepted a senatorship offered to him by Mussolini in 1922, after declining the same appointment from Italy’s postwar government. Michels was awarded a chair at Perugia by Mussolini in 1928. Mosca did not support fascism, but still considered a proletariat dictatorship to be a far greater danger and remained a fervent critic of democracy. We will explore their ideas in the following sections.

To get an introductory idea of social pessimism, consider this quote from Thomas Malthus (1766–1834). Similar to Pareto, Malthus was an economist of aristocratic gloom and a clear contributor to the reputation of our science as a distressing, “dismal science.”

“I would by no means suppose that the mass of mankind has reached its term of improvement, but the principal argument of this essay [On the Principle of Population] tends to place in a strong point of view the improbability that the lower classes of people in any country should ever be sufficiently free from want and labour to obtain any high degree of intellectual improvement” (Malthus 1798, p. 68).

Along with social pessimism, biological pessimism became a dominating ideological and theoretical force at the turn of the 20th century. After the introduction by Charles Darwin (1809–1882) and others of the (in the present, largely secularized world) rather obvious notion of biological evolution over the ages, the evolutionary idea became a scientifically consecrated belief that, in its variants and interpretations, tainted the overall intellectual landscape of the time and profoundly influenced social and political ideologies and theories. A particular variant of Darwinian evolution is Social Darwinism.

Darwin explained the evolution of the species through changes in individual characteristics and natural selection of the types that best adapted to a changing environment. Social Darwinism applied these ideas to the evolution of human societies and groups. Human societies and groups evolved, according to this theory, as the result of competition: a “struggle for existence” in which “the fittest” survive. Social Darwinism becomes rather lethal as a theory when the groups in the struggle are interpreted as distinctly ethnic or national groups. In the struggle for existence of nations and “races,” the “fittest,” (i.e., the higher-evolved nations and “races”) outcompete (displace/subjugate/exterminate) the less-evolved nations and “races.”

In the hierarchy of races and nations, normally, the group of the (usually

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1 The quotation marks for “race” are because, as Wikipedia tells us, “… since the second half of the 20th century, the association of race with the ideologies and theories of scientific racism has led to the use of the word race itself becoming problematic.” Throughout the rest of this document, we will use the word without quotation marks, as it is presented in the literature we refer to.
In his autobiography, Darwin reveals that Malthus’s views on population inspired his idea of biological evolution:

“In October 1838, that is, fifteen months after I had begun my systematic inquiry, I happened to read for amusement Malthus on Population, and being well prepared to appreciate the struggle for existence which everywhere goes on from long-continued observation of the habits of animals and plants, it at once struck me that under these circumstances favourable variations would tend to be preserved, and unfavourable ones to be destroyed. The results of this would be the formation of a new species. Here, then I had at last got a theory by which to work” (Darwin 2007 [1876], p. 68).

Thus, it was from economics – from Malthus – that the idea of competition for scarce resources, the “struggle for existence,” came to inspire Darwin’s evolutionary theory. When this idea was later re-exported by Social Darwinism from the natural world back to the social world, it was with the added reputation and undisputable validity of a Law of Nature.

As Friedrich Engels insightfully wrote,

“The whole Darwinists teaching of the struggle for existence is simply a transference from society to living nature of Hobbes’s doctrine of bellum omnium contra omnes [‘the war of all against all’] and of the bourgeois-economic doctrine of competition together with Malthus’s theory of population. When this conjurer’s trick has been performed … the same theories are transferred back again from organic nature into history and it is now claimed that their validity as eternal laws of human society has been proved. The puerility of this procedure is so obvious that not a word need be said about it. But if I wanted to go into the matter more thoroughly I should do so by depicting them in the first place as bad economists and only in the second place as bad naturalists and philosophers” (Engels 1875 [2000]).

It is difficult to conceive today the virulence with which these “scientific” ideas on evolution spread like an epidemic across nations and social classes in the Western world – even parts of the Left and some Marxists were infected, as we will show below. Presented as definitive scientific truth, Social Darwinism became the dominant ideology of the turn of the 20th century. It is probably not a coincidence that the decades around the turn of the century were at the same time an epoch of explosive colonial and imperial expansion by Western powers. As a theory of biological and racial determinism, Social Darwinism provided a “scientific” seal of approval to colonialism and the subjugation of “inferior races.”

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2 This hierarchy largely reflects the order of economic and military power of the time. Darwinian fitness or reproductive success does not seem to be positively correlated with economic or military power. If the strictly biological survival fitness of nations or races were considered (i.e., according to the demographic data on population), the list’s order would radically change. The statistical frequency distribution of the human species according to (darkness or paleness of) color most probably follows a Gaussian normal distribution. (Regarding reproductive success, notably, the global biomass of humans (350 million tons) is lower than that of cattle (520) or earthworms (>3800), according to Wikipedia.)

3 "If it was necessary to illustrate the commonplace normality of these racist theories, we can note how in 1919 the Allied Powers rejected the proposal of the Japanese delegation at the Paris Peace
“Elites” decay not in numbers only. They decay also in quality, in the sense that they lose their vigour, […] which enabled them to win their power and hold it. The governing class is restored not only in numbers, but—and that is the more important thing—in quality, by families rising from the lower classes and bringing with them the vigour […] necessary for keeping themselves in power. It is also restored by the loss of its more degenerate members. If one of those movements comes to an end, or worse still, if they both come to an end, the governing class crashes to ruin and often sweeps the whole of a nation along with it. Potent cause of disturbance in the equilibrium is the accumulation of superior elements in the lower classes and, conversely, of inferior elements in the higher classes. If human aristocracies were like thoroughbreds among animals, which reproduce themselves over long periods of time with approximately the same traits, the history of the human

Conference that sought to include in the League of Nations charter a declaration proclaiming racial equality” (Pichot 2009, p. 302).

The Berlin Conference of 1884–85 was called to bring some order to the “Scramble for Africa.” In 1870, only 10 percent of Africa was under European control; by 1914, it was almost 90 percent of the continent (Wikipedia). The intellectual ascendancy and influence of Social Darwinism shows a similar time pattern. The period is also witness to the irresistible rise of neoclassical, “perfect competition,” economics.
race would be something altogether different from the history we know. In
virtue of class-circulation, the governing elite is always in a state of slow and
continuous transformation. It flows on like a river, never being today what it
was yesterday. From time to time sudden and violent disturbances occur.
There is a flood—the river overflows its banks. Afterwards, the new governing
elite again resumes its slow transformation. The flood has subsided, the river
is again flowing normally in its wonted bed. Revolutions come about through
accumulations in the higher strata of society—either because of a slowing-
down in class-circulation, or from other causes—of decadent elements […]
shrinking from the use of force; while meantime in the lower strata of society
elements of superior quality are coming to the fore, […] suitable for exercising
the functions of government and willing enough to use force. In general, in
revolutions the members of the lower strata are captained by leaders from the
higher strata, because the latter possess the intellectual qualities required for
outlining a tactic, while lacking the combative[ness …] supplied by the

As said, this is a rather simplistic theory. In spite of its cynic “realism,” and lateral use of
biological explanation, this theory does not qualify as science. However, one can see the
appeal that such ideas might have had among antidemocratic conservatives and liberals,
alarmed by the increasingly successful militancy of the working-class movement and the
extension of democratic rights reflected in the constant enlargement of the franchise.

Pareto’s simplistic theory is less sophisticated and has less explanatory power (if any) than
the political theories embedded in classical political economy. The value and distribution
theories of the classical economists were, at the same time, political theories explaining the
distribution of power among the social classes: capitalists, rentiers, landowners, and workers.
The general determination of values in the economy was, at the same time, the determination
of the rates of profit, interest, land rent, and wages (i.e., the incomes of the main classes in a
capitalist society). Many aspects of the political confrontations of the time (e.g., the conflict
around free trade and the Corn Laws in the United Kingdom) were explained by the
interaction and conflict among these classes and their respective interests. Pareto’s
reluctance to use these types of theories may be explained by their Marxian leanings.
Additionally, Pareto being basically a microeconomist, these theories were beyond the
permissible for the atomistic “methodological individualism” of microeconomics.

Elite theory has not progressed considerably since Pareto. Theorists have not been bold
enough in their elitist conviction to risk their academic privileges and become one of “the
masses” for holding (after World War II and until recently) untenable and unacceptable
opinions.

In effect, elite theory has stagnated. According to one political scientist and scholar of elite
theory,

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5 Robert Michels, another intellectual patron of the WDR 2017, also saw a clear biological difference
between the elites and the “lower classes.” “[Michels] pointed to the ‘tragic biological condition which
[the proletariat] finds itself in,’ and that any comparison between the ‘lower’ and ‘upper’ classes of
society would reveal the biological superiority of the later. The lower classes suffered from many
‘physical anomalies’ and, without doubt, were to be considered ‘anthropologically inferior’” (Michels 1966
[1911], pp. 45-46; as quoted in Gasman 1998, p. 219).
“... [E]fforts to produce [a general theory of elites] have not been conspicuously successful. Linking elites causally to major regularities in politics remains elusive; there is no accepted typology of elites and no accepted specification of the circumstances and ways in which one elite replaces another; political interactions between elites and nonelite populations are captured only piecemeal” (Higley 2009, p. 162).

Hence, it seems that, until today, elite theory has lacked a typology of elites, something that was already present in the classical political economists’ economic theories. An explanation of why and how elite groups confront each other, which was one of the central points of classical political economy, is also lacking.

The main purpose of this paper is to provide such a theory of elite circulation. However, the author, not being a social pessimist or a Social Darwinist, the elite circulation model proposed cannot be anything other than ironic. Instead, it is a model that a social pessimist or Darwinist could have thought about. The model depicts a society in long-term stagnation, in which three different types of elites (or castes, or classes) confront and replace one another. It could depict the three-caste system of the “Hindu equilibrium,” the feudal “three-estate” system, or the situation of modern class societies, which are locked in “secular stagnation” and unable to successfully promote a progressive transformation through the incorporation of nonelites excluded from effective political representation and power.

In our model, elite circulation is constructed as a simple Rochambeau game, which provides the rules of elite replacement. Simplistic and ironic as it is, such a model may have some heuristic value and illuminate some of the grievous problems of present-day societies. Castigat ridendo mores, as it were.

In the text that follows, we will first present additional details about the most influential elite theory, that of Pareto – a well-known name for economists. Pareto's economics and Pareto's politics jointly form a coherent body of theory: both are antidemocratic – they show that the existing, undemocratic state of the economy and society is the only, and best, possible option. To prepare the terrain for the elite circulation model, we introduce three historical cases of three-caste systems: the Indian caste system, which lasted for many centuries; the also long-lived European feudal three-estate organization of class rule; and the ruling class system of capitalism, which has shown an admirable degree of “Darwinian fitness.”

The paper then describes the three elite-class model and its Rochambeau succession rules and discusses some possible interpretations and applications. The last section before the Concluding remarks speculates about the possibilities of democratization and pathways out of the elite system.

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6 The present author's anti-pessimistic value orientation may be described by what potentially is the motto of a political party (the Loser Party): “When everything seems to be lost, there is still something to lose.” A kind of Groucho-Marxist approach.

7 "One corrects customs by laughing at them," that is, the best way to change things is to point out their absurdity and laugh at them.
Pareto and social pessimism

Social pessimism, Social Darwinism and elite theory, formed a complex of ideas that acquired immense influence and popularity at the turn of the 20th century. Thanks to the theories of Social Darwinism, the universal economic competition of individuals in the market – the economic Hobbesian “war of all against all” that was pronounced as the optimal state of the economy by Pareto and other economists – received the dignified status of a Law of Nature. For Social Darwinism, the assumed biological laws of evolution and natural selection – “survival of the fittest” – could be applied to human society without modifications. For the (at the time) enormously popular Social Darwinian author Herbert Spencer (1820-1903), this assumption would mean that the State should not in any way interfere with market competition and the workings of the capitalist economy. Protecting the poor and disadvantaged, for instance, would interfere with natural selection and promote the proliferation of “unfit” individuals.

Like Spencerian Social Darwinism, Pareto’s economic theory of the optimum has the same laissez faire message of “no interference with the workings of the market” – Pareto-sanctioned changes in welfare distribution are changes by unanimity; that means that redistribution is barred. For obvious reasons, these ideas became extremely functional and influential elements of the general ideology of the elites and continue to be central pieces of mainstream economic ideology today.

The Haeckelian type of Social Darwinism, by contrast, emphasizes the natural selection of nations and races, not the selection of individuals within species, in particular. For Haeckel (1834-1919) and other racial evolutionists, races and nations, with their distinct particularities and abilities, were factually different species expressing a hierarchical evolutionary process. These adherents of “polygenism” maintained that there is an evolutionary hierarchy of races and nations, which formed through the ages as a result of the natural laws of the struggle for existence. For them, the inequality among races was the result of an objective Law of Nature. At the summit of the evolutionary ladder were the Germans – although this was sometimes modified by non-German Social Darwinists, replacing the “German” with their own ethnicity. As a matter of some urgency, Social Darwinists contended, “… racially white Europe could preserve its biological prowess and maintain its privileged position in the world by embracing the same scientifically enlightened eugenic programs that were being proposed by the Germans, given especially the exponential growth in population of the Oriental world, a

8 “He was the apostle of laissez-faire individualism, determined to argue that social progress would follow inevitably once archaic restrictions upon individual freedom were abolished.” (Bowler 1990, p. 169).
9 On Pareto economics, see the recent RWER article by Gary Flomenhoft (2017).
10 “While Darwin accepted the possibility of superior and inferior intelligence between the human races, he did not believed, as Haeckel did, that each distinctive human race also represented a separate species” (Gasman 1998, p. 15, note 38, referring to Bowler 1990, p. 189). The following quote shows Darwin’s views about racial differences: “The races differ also in constitution, in acclimatisation, and in liability to certain diseases. Their mental characteristics are likewise very distinct: chiefly as it would appear in their emotional, but partly in their intellectual faculties” (from Charles Darwin, The Descent of Man (1871), quoted in Gould 1996, p. 416-417). Darwin might also have believed in the existence of natural selection among races, as indicated by the following quotation: “At some future period, not very distant as measured by centuries, the civilized races of man will almost certainly exterminate and replace throughout the world the savage races” (Ibid., p. 417). According to Gould (ibid.), “[t]he common (and false) impression of Darwin’s egalitarianism arises largely from selective quotation.”
11 It is not difficult to see the potentially lethal effects of such ideas. If the Other is not a human being like us but belongs to a distinct, inferior species, we might have the “right” to kill and exterminate them, as we do with other inferior species. And in that we should even have the support of standard morals.
geometrically escalating threat that posed a mortal danger to the ultimate survival of European civilization” (Gasman 1998, pp. 30-31).

This biological and hierarchical conception of the human world, derived from what was thought to be a scientific view of nature – the struggle for existence – led to an antidemocratic and elitist view of human political organization. The leading political role of social elites was a natural consequence of biologically determined human inequality, in which better-fitted elements tend to prevail. The view of nature as essentially “aristocratic” (i.e., unequal and hierarchical) implied the same necessary, inevitable inequality and elitism when applied to the social and political world. The origin of the elitist social thought of Pareto and other proto-fascist authors can be traced to the biological–determinist theories of the racially oriented Social Darwinists.  

A famous sentence of Pareto’s reflects this cynic, “dog-eat-dog” view of the natural and social world:

“The cat catches the mouse and eats it; but it does not pretend to be doing for the good of the mouse. It does not proclaim that all animals are equal, nor lift its eyes hypocritically to heaven in worship of the Father of us all” (Pareto 1935 [1916], §1050).

Among Pareto’s main sources of inspiration were two – at the time – highly reputed, radical Social Darwinists and theoreticians of the struggle for existence of nations and races, namely, Ludwig Gumplowicz (1838-1909) and Gustav Ratzenhofer (1842-1904). Pareto saw human history as an uninterrupted struggle among nations and races, a permanent battle in which the powerful subjugate the weaker:

“There is not perhaps on this globe a single foot of ground which has not been conquered by the sword at some time or other, and where the people occupying it have not maintained themselves on it by force. If the Negroes were stronger than the European, Europe would be partitioned by the Negroes and not Africa by the Europeans ... [A]s long as the Europeans are stronger than the Chinese, they will impose their will on them; but if the Chinese should become stronger than the Europeans, then the role would be

12 According to a reputed student of the history of fascism, the idea of biological determinism, as it was formulated at the end of the 19th century, was the actual starting point for the development of racist ideology (see Sternhell 1986, pp. 34-38). For Stephen Jay Gould, “the need for analysis [of biological determinism] is timeless because the errors of biological determinism are so deep and insidious, and because the argument appeals to the worst manifestations of our common nature.” (Gould 1996, p. 26) According to biologist R. Lewontin (1991, pp. 36-37) “[t]he nonsense propagated by ideologues of biological determinism that the lower classes are biologically inferior to the upper classes, that all the good things in European culture come from the Nordic groups, is precisely nonsense. It is meant to legitimate the structures of inequality in our society...” Tragically, it seems to still be a generally accepted kind of nonsense among scientists: “Except for a brief interruption around the time of the Second World War, when the crimes of Nazism made claims of innate inferiority extremely unpopular, biological determinism has been the mainstream commitment of biologists” (Ibid., p. 26). The parallel mainstream commitment of economists has been orthodox economics.

13 It may be interesting to mention the telling title of one of Gumplowicz major works, Der Rassenkampf [The race struggle] (Gumplowicz 1893 [1883]). For Robert Michels, “only the strongest societies survive, and ‘every people strives to dominate foreign groups.’ In history, he argued, the ‘need for national expansion underlies all logic and ethics,’ it was only ‘weak and unfree peoples’ who felt a need to proclaim the ideals of ‘justice,’ and ‘fantasize’ about the benefits of ‘international brotherly love’” (Michels 1914, p. 77, quoted in Gasman 1998, pp. 216-217). As George Steiner points out in the Preface to Lyttelton (1973), referring to the world vision of fascist ideology: “Although this vision is often lunatic and nakedly barbaric, it can provide acute, tragic insights into the myths and taboos that underlie democracy.”

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reversed, and it is highly probable that humanitarian sentiments could never be opposed with any effectiveness to an army” (Pareto 1926 [1902], p. 136; in Lyttelton 1973, p. 80).

War, according to Pareto, is the way that natural selection may manifest among humans; attempts to avoid it might be pernicious from an evolutionary point of view:

“There are some people at the present time who think that from now on the human race can dispense with war as a form of selection. They could be right, but equally they could be wrong. What is certain is that they provide no solid proof of their belief — we cannot consider as proofs declarations against the evil entailed by war and the sufferings it inflicts on human beings” (Pareto 1926 [1902], p. 159; quoted in Gasman 1998, p. 210).

In a radically Social Darwinist tone that clearly resonates with the current, increasingly popular discourse of crypto-fascist and racist groups in Europe, Pareto wrote in 1902:

“[F]or contemporary European societies, conquest by foreign eugenic [racial] groups has been of no significance since the last great barbarian invasions, and it no longer exists as a factor in the European social organism. But there is nothing to indicate that it cannot appear again in the future. If European societies were to model themselves on the ideal dear to the humanitarians, if they should go so far as to inhibit selection, to favor systematically the weak, the vicious, the idle, the ill adapted — the ‘small and humble’ as they are termed by our philanthropists — at the expense of the strong, the energetic who constitute the elite, then a new conquest by new ‘barbarians’ would by no means be impossible” (Pareto 1926 [1902], p. 132; quoted in Gasman 1998, p. 209).

An ideology of disillusion and despair

For a candid mind to first make contact with the history of fascism and fascist ideology is a tormenting experience. It is disgusting to realize, at least for a person with firm human values, that several of the main inspirers and theoreticians of fascism were liberals, socialists, and Marxists turned into cynical antihumanists. Mussolini had been a prominent member of the Marxist left wing of Italy’s Socialist Party, and one of the first victims of the devastating, collective war hysteria that infected Europe on the eve of World War I. Mussolini, like many socialists and socialist parties at the time, ardently supported participation in the war, thus abandoning the most important tenet of socialism: internationalism.14

This mass conversion to nationalism and militarism had been preceded, since the final decades of the nineteenth century, by the ascendancy of racist Social Darwinism, and its “scientific” consecration of the struggle for existence and survival of the fittest among nations and races. Successful nations and races are those which can subjugate, colonize, and exploit other nations and races. Unsuccessful ones become colonized, exploited, and may even

14 With time, Mussolini became an almost lyrical apologist of war: “War alone brings up to their highest tension all human energies and puts the stamp of nobility upon the peoples who have the courage to meet it. All other trials are substitutes, which never really put a man in front of himself in the alternative of life and death” (Mussolini 1973 [1932], p. 47).
disappear. Such a theory is obviously a recipe for war – among the conquerors, the conquered, and the competing conquerors.

In the case of the Marxists and many other left-wing socialists, the defection from Marxism and the conversion to proto-fascist ideology originated from several types of disenchanting realizations. First, the disappointment caused by the frustration of the hopes of a general capitalist breakdown and social revolution implicit in the economic–deterministic interpretations of Marx’s theories. Second, the growing ascendancy of Social Darwinism, which was believed to be a new scientific paradigm: a modern theory based in the discoveries of evolutionary science and armed with the instruments of biological determinism should replace, or at least complete, Marxism. Marxian Scientific Socialism should not reject the advances of modern science; on the contrary. Finally, the frustration with the proletariat. The unexpected resilience of capitalism was also because of a lack of proletarian anticapitalist enthusiasm and militancy. There must be something “wrong” with the masses who willingly accept capitalist oppression and exploitation. Former Marxists turned fascists like Robert Michels increasingly found the explanation in evolutionary biology, and in the “anthropological inferiority” of the working class (see note 5).

Georges Sorel (1847-1922) is, perhaps, the most well-known of the Marxist authors who became early fascist-like ideologues. His trajectory is characteristic of the whole generation of converts to proto-fascism and fascism tout court. Initially an admirer of Marx’s historical materialism, Sorel progressively abandoned traditional Marxism, which he thought should incorporate the latest scientific developments, in particular the great discoveries in the biological evolutionary sciences. For Sorel, it was proven necessary to “prune” socialism of its outdated ideas, that is, to rid it of its “utopian socialist” attachment to the assumptions of “equality” and to its old-fashioned “idealist view of the world,” and incorporate the vital implications of the teachings of evolutionary science. Sorel came to approve of “scientific racism” (Vacher de Lapouge 1896), but thought (prophetically, in fact) that the eugenic programs proposed by “scientific racism” were ahead of their time. On the collective psychology of the masses, he came to think that “[t]he man of the crowd thinks in the manner of savages and children; he cannot abide subtle distinctions of language and differentiating verbs; the abstract notion of time is [also] little developed.”

With all these hard “facts” unearthed by science, including the vastly differing national and racial psychologies, and the innate limitations of the proletariat revealed, a new, “realistic” view of socialism was imposed. The new socialism should discount Marxism as obsolete, reject cosmopolitanism, and celebrate inequality and hierarchy. Biological elites emerging from selection within the working class should form revolutionary syndicates, which would be elite groups that would constitute – as a result of the evolutionary social struggle – the nucleus of a new professional elite and ruling class. Many of these theses and ideas were incorporated in the ideology and the reality of fascism and national socialism.

16 Ibid., pp. 316-317. This kind of contemptuous conception of the supposed qualities of common people is, according to Ofstad (1989), a central characteristic trait of fascist and Nazi thought.
17 Tellingly, the name of the unofficial organ of the fascist regime was Gerarchia, founded by Mussolini in 1922.
From Marxism and Social Darwinism, Sorel concocted a type of revolutionary pessimism. Continuing to argue within the context of Marxism, he quoted from The Communist Manifesto (Chapter I) as an alleged approval of his circulation-of-elites view of the world: “All previous historical movements were movements of minorities, or in the interest of minorities.”

In this idea, Marx and Engels had preceded Pareto and the other elite theorists. However, what Marx and Engels saw as the reality of class societies since prehistory, Sorel and the protofascists – infected with the intellectual epidemic of Social Darwinism – projected into the future, as the necessary corollary of an inexorable Law of Nature. According to this Law, it was not possible to count on the mass of ordinary people, described by Pareto as “…the incompetent, those lacking energy, character and intelligence: in short, that section of society which remains when the elites are subtracted.”

Quoting out of context the Manifesto’s sentence on history as the story of class domination, what Sorel and other disillusioned elite theorists had done was to obliterate the message of the next sentence of the Manifesto, the one following the aforementioned quote. That latter sentence contained a message that would inspire democratic and proletarian majorities for many decades: “The proletarian movement is the self-conscious, independent movement of the immense majority, in the interest of the immense majority.”

The pessimistic mood of the time affected not only the socialists who converted to elitism but also people to the right of the political spectrum, like Pareto himself. Pareto’s elite theory also seems to be the result of disillusionment: “Near the end of the century … Pareto’s writings began to manifest signs of the characteristic aura of disillusionment that seems to envelop the foundations of elite theory” (Nye 1977, p. 21). Before 1900, Pareto had been a political liberal who mostly wrote about economics, an opponent to the anti-Semitic trial of Dreyfus in France, and a defender of the left-wing exiles from the worker’s revolts in the Milan “May-days” of 1898.

Pareto’s frustration appears to have originated in what he saw as the incapacity of the bourgeois elites to impose a clear, rigorous class rule, and to forcefully resist the advancement of democracy (exemplified by the progressing enlargement of the franchise) and the working-class movement. For Pareto, the elite’s reluctance to use force and its appeals to rational and humanistic arguments played directly into the hands of its antagonists. The elite, he thought, should apply violence against the primordial violence of the masses.

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18 Curzio Malaparte (1898-1957), considered to be the fascist intellectual par excellence, wrote: “All revolutions spring from an heroic and pessimistic conception of life; they are the political fruit of a natural tendency towards desperation…the political result of a natural desperation” (Malaparte 1961, quoted in Lyttelton 1973, p. 228).


20 There may have been other reasons for Pareto’s disillusionment: “As in the case of other contributors to elite theory Pareto’s growing disenchantment may have been encouraged by failures in his personal life. He returned from teaching a course at the Ecole pratique in Paris in 1901 to find that his Russian-born wife had unexpectedly absconded to her native country with her lover, who was a household servant, and with many of the portable valuables of his beloved villa Angora” (Nye 1977, p. 49).

21 Nye 1977, p. 25. Pareto even used an admittedly contorted, “altruistic” argument: “Indeed, through engaging them in battle the elite helps to eliminate from the masses the ‘impulsives’ and the ‘degenerates’ that centuries of social selection had thus far failed to eradicate” (Ibid.). As a historian of Italian fascism wrote: “We must recognize that there was a powerful strain in Italian fascism which originated in an exasperated and disillusioned liberalism” (Lyttelton 1977, p.18).
Pareto’s perception of the elite’s incapacity to stop the advancement of the masses – and the humiliating sense of having embarked on a (for the elites) path of decadence – may have also been influenced by the social and cultural changes correlated with the declining (relative) income and wealth of the elites. At the turn of the century, the income and wealth of the elites started to diminish in Europe – a downward trend that would continue almost without interruption until the 1970s.  

Historical elite systems

Pareto’s elite circulation theory assumes a homogeneous, undifferentiated elite composed of atoms/individuals. This assumption, among other things, makes his theory particularly ahistorical and unrealistic. Historical, real-world elite systems of class rule comprise different classes or castes. These elite classes are nonmonolithic and in permanent competition and conflict among themselves and against the mass of working people – their main contender.

The Indian caste system and Hindu equilibrium

Perhaps the most resilient elite system in world history is India’s caste system, which has resisted the passage of several millennia, as it is speculated to have originated in the second millennium BC. According to the Bhagavad Gita, a canon text of Hinduism probably composed in fourth or fifth century BC, God created the caste system. Lord Krishna [God] says, “But I am He | Made the Four Castes, and portioned them a place | After their qualities and gifts” (Ch. IV).

The Indian caste system may be conceived of as a petrified class system. The elites are comprised of three castes: Brahmans (the priestly class), Kshatriyas (the warrior class), and Vaisyas (the merchant class). The nonelite crowd of workers and laborers are the Sudras. These castes represent the different stages of evolutionary advancement, reflected in different ranks of moral and spiritual advancement: “The work of Brahmans, Kshatriyas, Vaisyas, | And Sudras, O thou Slayer of thy Foes! | Is fixed by reason of the Qualities | Planted in each” (Ibid., Ch. XVIII)

A Brahman has qualities such as serenity, purity, and knowledge. A Kshatriya is by nature firm, heroic, generous. A Vaisya is thrifty and frugal. The fate reserved for the multitude of Sudra workers consists of service to Brahmans, Kshatriyas, and Vaisyas. However, in what seems to be a faithful interpretation of the spirit of the original text, the populace is qualified in greater detail, in terms which approach the descriptions of Pareto and Michels quoted above:

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22 According to estimations in Piketty (2014, Figure 9.8), the share of the top income decile in total income declined in Europe from over 45 percent in 1900 to under 40 percent in 1920 – in 1980, at its bottom, it was less than 30 percent. The wealth of the top 1 and 10 percent also declined from the beginning of the century until the 1970s – they diminished about 40 and 30 percentage points, respectively (ibid., Figure 10.6). To add insult to injury, these changes in distribution disproved what Pareto thought was a law of nature, viz., the constancy of distribution: “The curve of the distribution of wealth in western societies varies very little from one period to another” (Pareto 1926 [1902], pp. 5-6; quoted in Lyttelton 1973, p. 71). Constancy of distribution came from Pareto’s belief in biologically determined distribution: “The form of the curve is not due to chance … It probably relates to the distribution of the physiological and psychological characteristics of human beings” (Ibid.).

23 The Bhagavad Gita contains, in my view, profound philosophical and ethical insights, but as most so-called sacred books, it also contains superstitious and inhuman prejudice. As in the case of biological Social Darwinism, the Bhagavad Gita may have, in part, simply sanctified already existing ideas, prejudices, and social institutions.
a Sudra is one “who is servile, a sycophant, submissive and labours hard” (Iyengar 2002 [1966], p. 284). And, belonging as they do to the lowest stratum of society, Sudras may also be described as largely dominated by rajas, that is, the lowest category of psychological characteristics (gunas): “… loose of heart, low-minded, stubborn, fraudulent, remiss, dull, slow, despondent…” (Ibid, Ch. XVIII).

“Hindu equilibrium,” the term coined by Deepak Lal (1988), describes the millenary stagnation of the Indian economy. According to this idea, the Hindu stationary equilibrium was caused by the institutions of the caste system that, while giving the social structure a kind of very resilient cultural stability, hindered economic growth and the full introduction of capitalism. However, by the 1980s and particularly since 2000, the Indian economy has experienced accelerated growth and abandoned the “Hindu equilibrium,” typically achieving growth rates greater than twice the world average. It remains to be seen if the caste system, disproving the “Hindu equilibrium” theories, will survive the acceleration of growth or if it has been (or will be) replaced by the standard capitalist class system.

**The medieval class society**

The three estates model of medieval society was also a religiously inspired class system, consecrated by European Christendom – in this case. This model was composed of the clergy (the first estate), the nobility (second estate), and the workers and peasants (third estate). A graphic description of the three estates in Latin is Oratores (those who pray), Bellatores (those who fight), and Laboratores (those who work).

With the development of towns and an economy that was becoming increasingly differentiated, a separate class of burghers (merchants, craftsmen) emerged. The workers and peasants became the fourth class. This four-estate system was formalized in some regions and somewhat less rigid in its membership rules than India’s system. However, the formal identity with the remote Indian caste system is curious and begs the question: What might be the possible determinism at work?

**Social classes in capitalism**

The feudal caste system of the estates of the realm was transformed from the inside by the burgher capitalist class’s successful accumulation of capital – and, progressively, power. The bourgeoisie, embodying the (until then unknown) dynamism of economic growth, eventually became the dominant class of the capitalist elite system. The system did not, however, become a binary bourgeoisie–proletariat system. The repressive and war-making functions of the nobility were taken over by the State, comprised of a nonhereditary professional category of public servants. The ideological, symbolic, and ritualistic roles of the clergy were largely transferred to a set of public and private institutions: 1) the schools, universities, and research centers; 2) the media; and 3) marketing, public relations, lobbying, and other opinion- and preference-forming organizations. There was also a group of relatively autonomous

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24 The Hindu caste ideology was a main source of inspiration for Julius Evola (1898-1974), a prominent fascist ideologue, and a “spiritual racist” and “Nordicist.” According to Gillette (2002, p. 155), for Evola “[t]he ideal state was an empire, resting on a hierarchical, caste-based social structure … Myth, ritual, law, and caste were the ordering principles used by the warrior-priest elite to keep their pristine society free from the corrupting and degenerate forces emanating from the lower merchant and servile castes. Lower castes brought in their wake secularism, egalitarianism, individualism, and transience.” Woman and Jews were additional threats (ibid., p. 167).
intellectuals, the so-called intelligentsia, whose number and influence varied depending on the historical juncture.

As the classical political economists have noted, the dominant class in capitalism is divided into subclasses according to their specific sources of income/surplus. Capitalists earn profits generated in production. Rentiers earn interest and other incomes obtained from ownership of financial assets. Landlords earn land rents. The latter two types of income are sometimes (e.g., in classical political economy or in taxation-related texts) called unearned incomes, because they imply no work effort.

In present-day capitalism, the management of production and exchange is largely controlled by employed professionals, and ownership is mostly a passive function, also giving rise to unearned incomes. In principle, all three types of income could be largely taxed away, or their source could become the property of collectively owned funds — what Keynes called drastically “the euthanasia of the rentier.” In practice, the problem is complicated because a (sometimes large) part of the working population is (directly or indirectly) small-scale shareholders, psychologically bound by this fact to the ideology of capitalism.

To recapitulate on the class system of capitalism, we are still living within a society that has the same structural and functional components as the Hindu, medieval, and other caste systems: a priestly class, with the role of ideological production and conservation; a warrior class comprising the members of the military and security apparatus of the State in charge of war-making, policing, and surveillance; and the merchant and capitalist class, occupied with command and ownership in production and exchange. These three classes constituting the elites will be called, respectively, the intellectual class, the military class, and the capitalist class. The large nonelite majority of the population will be called the working class.

An ironic model of elite circulation

Putting aside all value considerations — a difficult task when considering a clearly ideologically biased model — the Pareto model of elite circulation is a rather schematic and mechanical one, as aforementioned. The elites conform a homogeneous, undifferentiated, atomistic mass, floating in a minimal, kind of mechanico-hydraulic exchange of elements with the non-

25 The ownership of corporations is today increasingly in the hands of collective entities such as e.g. pension or sovereign funds, themselves managed by (over)paid professionals. Collective fund ownership represents one more level in what Marx called “the abolition of capital as private property within the framework of capitalist production itself” Marx (n.d. [1894] Ch. 27, III). “The capitalist stock companies [and, I should add, ownership by collective funds to an even higher degree, J.B.], as much as the co-operative factories, should be considered as transitional forms from the capitalist mode of production to the associated one, with the only distinction that the antagonism is resolved negatively in the one and positively in the other” (Ibid.). The problem with this kind of “negative socialization” within the context of the relatively undeveloped “financialized capitalism” of Marx’s time was, in Marx words, that “…it reproduces 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 issuance, and stock speculation. It is private production without the control of private property” (Ibid.). More than a century after Marx, the problem, much magnified, still waits for a solution.

26 “I see...the rentier aspect of capitalism as a transitional phase which will disappear when it has done its work. ... It will be, moreover, a great advantage of the order of events which I am advocating, that the euthanasia of the rentier, of the functionless investor, will be nothing sudden ... and will need not revolution” (Keynes 1953 [1936], p. 376).

27 If not because of the ideological veil of ignorance, this would be a case of self-inflicted surplus exploitation or social masochism.
elite majority. The model lacks the richness required to represent the dynamics of the permanent state of conflict among the classes for supremacy within the elites and their cooperation in the central conflict against the working majority. This deficit also means that the model has no explanatory power when confronted with real historical and present-day economic and social transformation processes. Its only raison d’être seems to make it clear, and proven in “scientific” terms, that there is no way to move forward from the elite-mass dichotomy. The elite-mass duality – Pareto believes to have proven – is grounded in a biological law of distribution of human proficiencies and, therefore, common to all human societies – past or future. Based on this supposed knowledge, Pareto recommends the elites substitute cunning for humanism and not shy away from the use of force. To rule, Pareto thinks, elites must be prepared to use scheming and violence without inhibitions or scruples.

**A Rochambeau game of elite circulation**

In view of the explanatory poverty and moral misery of standard Paretian elite circulation theory, we will apply – in a mood of dark, ironic humor – a game theory approach to the problem. Having already presented an approximation to the typology of elites in modern capitalism – which reproduces the basic traits of previous caste-ordered societies – an apparent, metaphorical solution will be presented to provide the needed (Higley 2009) set of clear conditions and rules of class succession in which one type of elite replaces another. An apparent solution will also be given to the absence of a theory of the interaction existent between the elites and the masses, and the role of the latter in class replacement.

The solution proposed is based on the Rochambeau game, also known as Rock–Paper–Scissors (RPS). RPS is a simple zero-sum game typically played between two people. The players simultaneously show an outstretched hand with one of three signs: a fist (Rock), a flat hand (Paper), or a fist with two fingers forming a V (Scissors). Rock beats Scissors (blunts it); Scissors beats Paper (cuts it); and Paper beats Rock (wraps it up). One of the two players wins, whereas the other – obviously – loses (if the game is a tie it is replayed). RPS can be played among more than two players: players with the losing throw are eliminated, and the game continues until only one player remains.

There is no winning strategy or favored play in RPS; the best strategy is to flash a randomly chosen sign – which translates into any one of them (Rock, Paper, Scissors) one-third of the time. (This is a *mixed strategy* in evolutionary game theory, because it includes not only one but three different plays.) When the game is interpreted in terms of the strategies of different types of organisms (or social characteristics), every type of actor has a particular, unique play – a *pure strategy*.

A particular organism has a specific strategy: for instance, Rock. Rock can dominate a population of Scissors, but Rock can also be taken over by Paper. After Paper becomes the dominant population, Scissors can displace them. We can now imagine Rock returning and retaking the dominant position, and so on: the cycle repeats indefinitely. In the evolutionary RPS game, there is so-called *cyclic dominance*.

A canonic case of cyclic RPS dominance among animals is the side-blotched lizard’s male mating behavior (Sinervo and Lively 1996), in which three color-types of males successively

28 For details, see, e.g., Walker and Walker (2004). There is a World Rock, Paper, Scissors Society, and a World RPS Championship. There are also programming contests for RPS algorithms.
overcome each other in their competition for females (orange beats blue, blue beats yellow, and yellow beats orange). Selection leads to the stable coexistence of all three types. In general, this type of competition results in the stable coexistence of species – it is not possible for one type of organism to attain permanent dominance.

According to a wide survey of the subject (Szolnoki et al. 2014), cyclic dominance is also at the heart of predator–prey interactions, the overgrowth of marine sessile organisms, and competition in microbial populations. Cyclic interactions also spontaneously emerge in evolutionary games entailing volunteering, reward, and punishment, and are common when there are three or more competing strategies – regardless of the particularities of the game. As the authors say: “It is worth noting that cyclic dominance could be crucial not just to understand biodiversity, but also social diversity” (Ibid. §6).

**Rock, paper and scissors elites**

The RPS type of cyclical dominance leads to a stable coexistence of the three types, which can be sustained for many millennia in biology. We have observed that the caste and class systems in human society have also been very stable and resilient. This stability has led theoreticians such as Pareto to conclude that these systems are unavoidable and permanent, and even – making a virtue of necessity – optimal.

The characteristics of RPS and its rules of succession have been introduced; here, we will apply this model to elite circulation. The historical Hindu, medieval, and capitalist elite systems are three-class systems with similar structural and functional characteristics. In the case of capitalism, the three elite classes are: intellectuals, military, and capitalists – similar to the roles of priests, warriors, and merchants in previous class societies.

Which of the three roles – Rock, Paper, Scissors – should the elite classes of capitalism be assigned to?

Almost intuitively, Rock, Paper, Scissors partitions elites into castes or classes: the priestly class of intellectuals would naturally be allocated to Paper, as paper is – and probably for many decades will still be – the main material vehicle for the creation, transmission, and exertion of symbolic, intellectual power. (“Bible,” for instance, derives from the Greek word for “book.”) The warrior caste and its contemporary equivalent, the military–security establishment, would naturally be associated with the metallic, weapon-like characteristics of the double-knife formed Scissors. Associating the bourgeoisie or capitalist class with Rock could seem farfetched; however, Rock transmits the idea of numbness or callousness: the kind of “rationality” deprived of human feeling and characteristic of the one-dimensional, money-driven, archetypal capitalist.

In summary, the RPS cyclical dominance is as follows: Rock beats Scissors; Scissors beats Paper; and Paper beats Rock. Hence, these are the general succession rules of elite circulation: Intellectuals beat Capitalists; Capitalists beat Military; and Military beats Intellectuals (Figure 1).

29 A skeptical remark may be that the proliferation of ad-hoc models of extremely limited portions of nature or society, and of very specific types of situations/behaviors, might add very little to our understanding. As said by biologist R. C. Lewontin (1991, p. 100) about the risk of evolutionary scientism: "... a story can be invented that will explain the natural selective advantage of any trait imaginable ... They are just stories. Science has been turned into a game."
Now, we will explore if this elite dominance circulation model has explanatory value for real-world societies.

**RPS cyclical dominance in history**

Myths and legends infuse the ancient history of India; perhaps these stories are only myth and legend, interpreted differently in different times. With the increasing ascendancy of racist Social Darwinism, the myth of a Nordic, superior, Aryan race that conquered India several millennia ago came to occupy a central place in fascist and, particularly, National Socialist ideology. This superior race would have introduced the caste system in India, according to the historical legend. A plausible argument for this story is there was a primeval, pristine society governed by a learned aristocracy of priests in which the dominant priestly caste (Brahmans) was in the highest position (phase P in Figure 2). In phase S, the harmony of this perfect society was broken by the rise to dominance of the conquering spirit of the warrior caste (Kshatriyas), who invaded and took over the Indian continent. In phase R, the conquest was completed; peace and a business-as-usual normality was gradually established over the conquered population. The money-making caste (Vaisyas) attained the dominant position. Thus, the triangle of cyclic caste dominance rotates clockwise.

A similar pattern of elite circulation possibly occurred in later conquests of the Indian continent by the Greeks, Mongols, Arabs, British, and others. The cycles may also have appeared any time an armed conflict, or the threat of armed conflict, occurred among the Indian kingdoms.

According to the model, the present dominance of India’s capitalist class would have been preceded by the dominance of the military, and the intellectuals before them. Mahatma Gandhi, Jawaharlal Nehru, and other leaders in the struggle against British rule were intellectuals. However, soon after independence and for several decades, India was in a state of war or serious tension with its powerful neighbors – so acute was this state of affairs that
the rulers decided to develop nuclear weapons. In this second phase, the military must have had a dominant role.

There is a RPS pattern of dominance in the evolution of colonized countries that gained independence after World War II. In the first phase, a group of intellectuals inspired by Marxist theory formed a political party or movement. These are “the years of high theory” (to use the title of a book by G. L. S. Shackle) and intense ideological debate about the future and character of the revolution. The struggle for independence was frequently an armed struggle; in the second phase, the military rose to dominance and tended to maintain this status as long as there was (internal or external) conflict. While the military was in power, theoretical discussion and ideological debate were barred or radically curtailed, and economic growth became the sole objective. The capitalist class then became increasingly dominant.

The three estates systems of the Middle Ages had elite circulation dynamics similar to the Hindu-equilibrium caste system. In times of normalcy, the system tended to be dominated by the priestly class and its Christian religious norms and values. However, Europe’s multifarious medieval states (kingdoms, principalities, duchies, etc.) were engaged in intermittent wars with each other. The nobles and warriors who fought these wars became the dominant caste. The need to reconstruct damaged postwar societies and economies put the caste of merchants in a dominant position.

The great European revolutions of the modern era – the English, French, and Russian revolutions – may also be accommodated by the RPS elite circulation model. The English Revolution (1640-1660) was preceded (and accompanied) by an impressive outburst of ideological creativity. This outburst was expressed, by priests and other intellectuals, in the language of Christian religion and theology, but it communicated in different forms, and by the conduct of different sects, timeless human aspirations to freedom and equality.30

In France, the role of Enlightenment philosophers, such as Rousseau, Diderot, and Voltaire, was crucial for the awakening of the critical spirit of the Revolution. The weight of the intellectuals (primarily lawyers) was also dominant within the Third Estate of the Estates-General convened by the king, in which separate assemblies were constituted for each of the realm’s three estates. This Third Estate became the National Assembly that represented the sovereignty of the French people.

In Russia, the intellectual class had a lively debate about how to transform a reactionary European feudal power, still existing in the early 20th century. Social democratic and Marxist intellectuals devised the theoretical instruments that opened the door to conceiving revolutionary transformation of a backward society. Subsequently, they were also the leaders during the first decade or so of the Revolution.31

This “phase P” of dominance by the intellectual elites was followed, in all three cases, by a “phase S” of dominance by the military caste. The English Revolution engendered a civil war, the growing ascendance of the New Model Army, and the dictatorship of Oliver Cromwell. In France, a few years after the Revolution began, the rising dominance of the military was established by defensive wars against monarchic coalitions, wars of conquest of other

30 Christopher Hill wrote several books and articles on the subject; see for instance Hill (1984, 1997).
31 It is interesting to note that in accord with the RPS model, previously to intellectual ascendancy and revolution, there were attempts to redress (France) and modernize (Russia) the economy – attempts, i.e., that implied merchant/capitalist dominance.
countries, and the dictatorship of emperor Napoleon Bonaparte. In Russia, foreign invasion and civil war increased the power of the military, followed by the gangrenous growth of the repressive apparatuses of the State, on which Stalin presided until his death.\footnote{In 1925 Stalin arranged the removal of Trotsky from the leadership of the Red Army. Some of Trotsky’s supporters pleaded with him to organize a military coup. Trotsky rejected the idea and instead resigned his post. “If [Trotsky] had chosen to stage a military coup d’etat he might perhaps have defeated the triumvirs. But he left office without the slightest attempt at rallying in his defence the army he had created and led for seven years” (Deutscher 1949, p. 297). Trotsky was probably more an intellectual than of a warrior.}

In “phase R” the capitalists take over the dominant position. In the case of England, hegemony by the military started to wane with the restoration of the monarchy. Trade, manufacturing, and empire, following the successful model of Holland, established the growing influence of the merchant–capitalist class. In France, with the defeat of Napoleon and the collapse of the vast European conquests of the Empire, the more pragmatic and economically oriented spirit of the bourgeoisie took over: establishing the dominance of the capitalist class. In Russia, Stalin’s “socialism in one country” implied industrialization led by a managerial–bureaucratic caste that was functionally, although not formally, capitalistic. With the collapse of the Soviet system, this caste became both formally and functionally the capitalist class.

**The role of the underclass**

The aforementioned descriptions make no specific reference to the role of the nonelite underclass in the elite circulation model. The elites seem to circulate and replace each other with no intervention of the masses. The masses are passive witnesses of the cyclical domination of successive elites. Now we will explain how a working majority can participate in the circulation.

One possible means is to expand the RPS game and include the masses as a new strategy, for example, Workers. Then there might be the following cyclic sequence: Intellectuals – Military – Capitalists – Workers – Intellectuals – etc.

For better or worse, this form does not seem to have been, or to be, viable in the real world. However, this scenario has been important in the mythology of millennial human evolution, according to fascist ideology. For the influential fascist ideologue Julius Evola, the millennial evolution of civilization is by nature cyclical:

“Each age is dominated by an elite that emerges from one of the basic hierarchical orders in descending order. The first, god-like Golden Age is represented by holy priest-kings of prehistory. The next phase, identified with warrior-kings, existed in Europe from the ancient Greek Heroic Age until the downfall of the Ancien Régime in France. The liberal-democratic revolutions of the late eighteenth century and early nineteenth century brought in the rule of the merchant caste, the haute bourgeoisie that formed a plutocratic oligarchy. Finally, socialist and communist revolutions had initiated the ‘Modern Age’, a dark time of democracy, the masses, and the “spirit of the herd.” This decrepit state would only be relieved through a cleansing apocalypse, which would set the cycle in motion once again and inaugurate a new Golden Age. A new aristocracy, nourished on the ancient Aryan myths,
would take its rightful place in society” (Gillette, 2002, p. 155-156; based on Tarchi (1974, p. 195) and Shehan (1981)).

In Evola’s grand (and delirious) fresco of millennial evolution, the primeval priestly caste is replaced by the warrior caste, which is replaced by the merchant caste: our familiar P—S—R elite dominance cycle. However, a catastrophic incursion of the plebs (denoted W) follows, and we get P—S—R—W. Evola’s hope is to move forward as soon as possible and start again the cycle, that is, P—S—R—W—P—… Some present-day influential ideologues share similar hopes of apocalyptic cleansing, even if the plebs are not dominant.

In the context of the RPS elite circulation model, a less fantastic and deranged account of the possible role of the masses may be inspired by evolutionary game theory. In this approach, each member of the underclass adheres to one of the three elite castes: R, P or S. The adherents of the hegemonic caste, for instance, R, confront in random pairwise encounters, or as whole groups, the adherents of the other castes. In the confrontation, P beats R and progressively becomes dominant. In a pairwise confrontation with P, S wins and becomes dominant, and so on. If not totally passive, the masses are – in this model – totally subservient to the interests of the elites.

Even so, another possible way of describing the role of the masses is to model their behavior somewhat more closely to the RPS game as people play it. We can conceive of the nonelites as arbitrarily divided into two parties that play the RPS game against each other. The two groups play now mixed strategies, rationally choosing randomly among R, P, and S. On a sufficiently long sequence of plays, we should observe that R, P, and S have each been dominant one-third of the time. But we should not see the sequence R—P—S repeating indefinitely, as we have seen until now. In a conceivable libretto of this social drama, the two groups are the lower and upper halves of the income distribution. The higher income Workers and elites benefit when the Capitalists win. The lower and higher income Workers may both benefit – and the elites loose – when the Capitalists loose. Interest for the masses – or at least for the lower-income workers – in forming coalitions with, and gaining the support of, the Intellectuals and/or Military.33

A type of dominant elite coalition that seems to be at work in some principal world powers is the alliance between the Capitalists – in particular, financial capitalists – and the Military. Dominance is, in this case, shared between two classes, who are both on the top of the inverted triangle in Figure 3.

Figure 3

![Figure 3](image)

33 This should give rise to a rather chaotic kind of predator-prey, Goodwin-like type of dynamics (see e.g. Flaschel and Landesman 2008).
The Intellectual class is subordinate and alone at the bottom – and the working population are under them. This is a seemingly unstable, transient situation that will be followed by, according to the clockwise RPS logic, a dismantling of the coalition, an ascension to sole dominance by the Capitalists, and a dislodgment of the Military. With time, the Intellectual class should start its ascension. The character of the Intellectuals’ regime might benefit the Workers, if a Workers-Intellectuals alliance encourages policies that reduce the Elites’-to-Workers’ income distribution ratio (overall surplus ratio), without reducing the Intellectuals’ incomes and privileges.

**What is to be done?**

Albeit ironically, we have maintained a pessimistic tone characteristic of elite theory—until now. In the RPS model, as in Pareto’s theory, elite rule is universal and permanent. Now, we will explore if, within the structural constraints of the RPS model, there exist some means, however utopian, for the masses to shed their claustrophobic, eternal subordination and inferiority. Speculatively, on the possibility of a “… self-conscious, independent movement of the immense majority, in the interest of the immense majority.”

The elites that struggle and replace each other in the RPS elite circulation model constitute a small minority of the population. Even if the elite classes are not completely closed and hereditary, the rule of the elites can be compared to an aristocracy, a form of government that places power in the hands of a small, privileged ruling class.

Democracy, by contrast, is the rule of the people, for the people, and by the people. According to Radical Enlightenment philosopher and political theorist Spinoza (1632-1677), democracy is the political regime *par excellence*:

…”[T]he democratic republic … seems to be the most natural and to be that which approaches most closely to the freedom nature bestows on every person. In a democracy no one transfers their natural right to another in such a way that they are not thereafter consulted but rather to the majority of the whole society of which they are a part. In this way all remain equal as they had been previously, in the state of nature” (Theological-Political Treatise, Ch. 16, § [11]).

For nonelite majorities living under elite rule to gain real influence on the government of their societies, becoming effective citizens of their states, the task would then be to find a means to transform political regimes from the present aristocratic form of government to the democratic form.

As Spinoza notes in his unachieved last work, in the Political Treatise (Ch. 8, § 4), the rule of aristocracies is always constrained by the fear of the multitude – a fear that is projected back as contempt. A stable aristocracy, not threatened by mass revolt, is an aristocracy that approaches, not in form but in essence, democracy (what Spinoza calls the “absolute sovereignty” of the people): “… it is manifest that this kind of dominion [aristocracy] will be in the best possible condition, if its institutions are such that it most nearly approaches the absolute [i.e., democracy]…” (Ibid., Ch. 8, §5).
From the perspective of the *Political Treatise*, the condition of existent, *externally democratic* elite regimes are increasingly threatened by instability and the loss of legitimacy. The achievable objective for the non-elite populations in these increasingly elitist and undemocratic systems would be to preserve the peace and to re-establish the lost democratic substance of the state.

The further objective should be to persistently enlarge that recovered democratic sphere, thus continuously decreasing the aristocratic character of the elite system. The larger objective for the working non-elites should be to transform the already acquired, formal political franchise into an effective political, social, and economic franchise. This process of reducing the aristocratic character of the State through the progressive enlargement of the economic and social franchise of the working non-elites is illustrated by our RPS triangles.

![Figure 4](image-url)

In Figure 4, the circle represents the total population; the triangles inside the circle represent the elites. In the initial stage, the elites constitute a very small portion of the population, for example, the innermost triangle. In later stages, the triangle successively expands, illustrating the process by which the general population progressively acquires the capabilities, emoluments, and privileges formerly reserved for the elites. In Figure 4, only the three original castes and vocations have been represented, but it is possible to think of an increasing number of vocations and capabilities. That is, a succession of expanding figures with a simultaneously increasing number of sides. At its limit, a polygon with as many sides as there are capabilities includes the whole population within a figure that represents the elites and the masses – or more exactly, neither the elites nor the masses. This process of effective democratization of society is another equivalent and complementary manner of describing the process of human development and dealienation (see Buzaglo 2014).

*Externally non-democratic* systems may also benefit from Spinoza's exhausting intellectual efforts to find a pathway out of the violent, oppressive, and stagnant political regimes of his time. The plan should be to give, if not a form, as democratic a substance as possible to the factually aristocratic regime. First, the ruling elite should be sufficiently large and representative – Spinoza (Ibid., Ch. 8, § 22) estimates that the ruling elite should be, at a minimum, 2 percent of the total population. This ruling elite should compose a Supreme Council that meets periodically. The Supreme Council would elect a council of Syndics whose main duty is to ensure that the constitution and laws of the dominion are unbroken and the...
people in power commit no transgressions. The number of Syndics should be approximately 2 percent of the Supreme Council. A second council, the Senate, is elected by the Supreme Council and in direct charge of public affairs; Spinoza estimates the appropriate proportion of its members should be 1/12 (about 8 percent) of the Supreme Council.

The contrast between Spinoza’s theoretical scheme and the existing externally aristocratic regime of China, and checking for the tenor and potential of the democratic substance of this real case is interesting. The total adult population of China is approximately 1 billion. The membership of the Communist Party of China (CPC) is approximately 90 million, which means that the governing elite represents about 9 percent of the total population, that is, four-and-a-half times Spinoza’s theoretical requisite. CPC members elect 2,300 delegates to the National Congress: this represents less than one in 10,000 members of the CPC, compared with 2 and 8 percent in Spinoza’s second level organs.

The National Congress, which takes place every five years, elects the members of the Central Committee (200 members). The National Congress also elects the Central Commission for Discipline Inspection. This crucial commission (130 members) is comparable in its function to Spinoza’s council of Syndics, although with much fewer members and – apparently – much less power. The Central Committee, which is the highest organ of China’s government when the Congress is not in session, elects the General Secretary, the Politburo (25 members), and the members of the other highest-level organs.

A tentative summary diagnostic would be, from the perspective of the degree of development of substantive democracy, and given the schematic background presented, that the elite group in power is relatively large (9 percent of the population), for example, compared with the current unbridled, substantially “1 percent” systems. Power is also relatively widespread when compared with historical elite systems; although, the long-period rate of increase of the Chinese elite has been low. A second observation is that second level institutions such as the National Congress are not particularly representative and deliberative, because the members represent a negligible share of the elite and general population, and the intervals between meetings are long. The final observation is that formal control of power and legality is very limited.

From the perspective of increasing the effective political, social, and economic franchise – and thereby augmenting the degree of substantial democracy – the present degree, taken as the initial level, would seem appreciable in comparison. From this perspective, the objective should be, in the future, to increase this degree with a zeal similar to that devoted to economic growth. Important objectives also are, in this respect, to augment the degree of  

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34 Information about China’s demography, etc., is from Wikipedia.
35 In the particularly relevant case of the U.S., for instance, a wide empirical study by Gilens and Page (2014, p. 564) shows “… that economic elites and organized groups representing business interests have substantial independent impacts on government policy, while average citizens and mass-based interest groups have little or no independent influence.” A former wide study by Gilens concludes that rather than a democracy, the U.S. political system is closer to a plutocracy (rule by the wealthy): “The patterns of responsiveness [of the U.S. political system] … often corresponds more closely to a plutocracy than to a democracy” (Gilens 2012, p. 234).
36 As a share of the adult population, CPC membership has increased (almost linearly) from 2.3 percent in 1958 (first census data) to 8.9 percent in 2017: an average annual increase of 0.1 percentage points.
37 At the trend rate of increase, CPC membership share should be just 1.3 percentage points more in 2030, for instance. If membership would increase at the rate GDP used to grow, say 10 percent, it would double every seven years – in 2030 CPC membership share would be 31 percent (assuming constant population).
effective intermediate representation and to increase the scope of the democratic control of power.

The international context has been disregarded, until now. After reviewing the above discussion, it would appear as if any society could, solitarily, embark on the journey from aristocracy to democracy and succeed – as if “democracy in one country” was possible. The experience of the “socialism in one country” that became a long and tortuous path to (wild) capitalism would suggest that a simultaneous, organic development should be necessary. As long as countries are involved in Hobbesian competition with each other and states strive to achieve “competitiveness” through all types of mercantilist policies – in particular and most evident, through keeping down the wages of the working population – the elites will appear to be indispensable. Capitalists will continue to appear as indispensable to accumulate and grow, the Military needed to control the masses and wage war against other countries, and the Intellectual clergy – in particular, the economics clergy – necessary to convince the masses that all this is Pareto-optimal and in their best interest.

Therefore it would seem that, if at all possible, democratization should be vertical (at all levels) and horizontal (at all locations) at the same time. Democratization should encompass a small village and workshop in Africa as well as the Security Council of the United Nations and the board of directors of the largest corporations. With good fortune, a multilevel, multidimensional positive feedback process could start somewhere, by which democratic advances at one level and location induce advances at other levels and locations.

The message of this paper could be summarized by the classic appeal: non-elites of all countries, please unite! Or else…

Concluding remarks

Confronted with the hard reality of a global economy and society composed of elite-ruled states in permanent Hobbesian competition among themselves, our paper ends in a rather gloomy, ironic mode. Perhaps, a brighter ironic alternative would be more appropriate for the conclusion.

Today’s international economy and society may be conceived of as a unitary global economy and society. Governance is administered by a global elite system composed of the triad: capitalists, military, and intellectuals. The present globally dominant elite group is clearly the capitalist class, to judge for instance from the historic highs of inequality, capital [nonwage] income share, and extraterritorial or hidden capital. The Rochambeau cyclical dominance model and its Rock–Paper–Scissors succession rule suggest that the dominance of the capitalist class will be followed by the dominance of the intellectual elite. An enlightened intellectual elite, conscious of the risks of existing trends – and of the prospect of the subsequent military dominance implied by the model – may search for modes of democratization of the elite system. Democratization of the global elite system comprises progressively enlarging the effective economic, social, and political franchise of the non-elite populations.

As commented in the Introduction, World Bank intellectuals have lately been occupied with the dismal theories of Pareto and other elite theorists discussed in the previous sections. RPS analysis in our paper would suggest that intellectual elites at The World Bank and elsewhere
should best consecrate their powers to the search of the badly needed theories for a flourishing world economy and society.

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Trump politics towards Mexico. Renegotiating NAFTA while invoking the Monroe Doctrine

Alicia Puyana [FLACSO, Mexico]

Abstract
This paper considers the election of Donald Trump to the presidency of the United States of America, along with political events in Europe and other countries in the world, as the political expression of the economic crisis of 2008. It analyzes the proposals of the new US government, to find out that Mexico has been, since the campaign, a main objective in Trump’s nationalistic offensive to gain the election. Mexico is the lowest political cost target, compared with China or any other country Trump has identified as a threat to United States national security. Under such context, the document enlists responses from Mexico stemming from the political and economic establishment towards national unity and the defense of sovereignty, in response to Trump’s threats. The official responses have no legitimacy after their having aligned themselves for three decades with US politics and interests, partaking economic neoliberalism, NAFTA and globalization. President Trump has not changed his negotiating strategy. As recently as late August 2018 while announcing that both countries have found a win-win accord, President Trump reiterated his intention to bury NAFTA, since it: “has a bad connotation because the United States was hurt very badly by Nafta for many years” (Fortune, 2018).

Introduction
Two and a half decades after the adoption of the North American Free Trade Agreement (NAFTA), the US government demands its renegotiation, under the Damocles threat of pulling out of the agreement if its requirements are not fully satisfied. After seven rounds of negotiations, it seems clear that the United States is going to break the deal. In Mexico, calls abound for an economic shift away from depending heavily on direct foreign investment and towards new markets for Mexican exports and the supply of its imports, especially in agriculture. At the same time, some political and academic circles reiterate that, like in the love song Encadenados, Mexico and United States are, “fatally condemned to trade” (Solano, P. 2018), and “so chained to each other to never part”. That fate was sealed when the Secretary of State, on the eve of his tour of Latin America, emphasized the relevance and importance of the Monroe Doctrine, in managing the relationship between the United States and Latin America (Tillerson, 2018). The demand for a Plan B, the design of a non-NAFTA strategy, is gaining support among diverse sectors of Mexican society, in the midst of growing uncertainty about the possible end of an era that promised modernity and prosperous

1 “In the war between those new Governments and Spain we declared our neutrality at the time of their recognition, and to this we have adhered, and shall continue to adhere, provided no change shall occur which, in the judgement of the competent authorities of this Government, shall make a corresponding change on the part of the United States indispensable to their security” President Monroe’s seventh annual message to Congress, December 2, 1823.

2 Institutionalized on December 2, 1823, the Monroe Doctrine established that the “Western Hemisphere would by dominated exclusively by the United States and Europe would abstain from interfering in its business. Along with the principle of the Manifest Destiny, “that set the precedent and supported the expansion of the United States on the American continent” (USA State Department, 2018). The main founding principal of the Monroe Doctrine: “America for the Americans” (read North Americans) was rejected by Secretary of State Kerry in a speech to the OAS when he declared relations between the United States and Latin America to be based on respect among equals (Kerry, 2013).

3 The Secretary of State said about the Monroe Doctrine: “So I think it clearly was an important commitment at the time, and I think over the years, that has continued to frame the relationship… So I think it’s as relevant today as it was the day it was written” (Tillerson, 2018).
stability, Mexico’s entrance into the club of industrialized and developed countries. The modernizing framework employed by the original NAFTA negotiators of the 1990s, the same group negotiating today, assured that by tying its economy to the United States, Mexico would inevitably advance along the path of progress and become a modern nation.

A second year into the Trump administration and after seven rounds of negotiations, there is now (March 2018) no doubt, if there ever was any, about the principles that have led the U.S. leader to attack Mexico; and the abandonment of NAFTA seems ever more feasible and linked to political events in the USA (Muller’s investigation, midterm elections and the potential Trump’s second mandate). Analysis of the effects of NAFTA, as well as the statements from a wide swath of business leaders in the United States, reveal that the motivations for abandoning NAFTA are political. This conclusion holds even after the bilateral pre-agreement between Mexico and the USA was signed in late August. Trump announced both countries found a win-win accord, reiterating his intention to bury NAFTA, since: “has a bad connotation because the United States was hurt very badly by Nafta for many years.” (Fortune, 2018). Later on August 28, D. Trump reiterated his will to build the wall, making Mexico to pay the bill, forcing Mexican authorities to strongly deny their willingness to do so. Both the Mexican government, the acting president Peña Nieto and the Andrés Manuel López Obrador (who was elected president in the First of July elections) wanted any agreement signed before the first of December – the day when Lopez Obrador would take office. This was in order for Peña Nieto to be able to say that under his mandate NAFTA was saved, and so that López Obrador would avoid having to negotiate with Trump (in Mexico the time between an election and the newly elected present taking up office is five months). So, as in 1994 the agreement was signed at high speed, leaving many questions pending.

Measures passed almost immediately after Trump took office and his most recent statements, have shed light on the contents of Make America Great Again, ranging from white supremacy to nativism and isolationism, the health and tax reforms, the proposals to deregulate the financial system, to relax environmental regulations, and open up protected land to oil exploration, reveal that poor people will have no place in this Great America, that big money and corporations are the biggest winners. That is why the president felt so at home in Davos and received an almost affectionate welcome.

While U.S. negotiators reprimand the Canadians and Mexicans for not presenting counterproposals that satisfy the needs of the United States, Canada and Mexico reproach the United States for avoiding final agreement on issues like trade and agriculture. The seventh round of negotiations ended with chapters on corruption and best trade practices, issues that should be legislated nationally and not within trade deals. The rules that govern the automotive sector and the conflict resolution process in that sector were left unresolved because of the inflexible stance of the United States. Meanwhile, uncertainty and instability threaten the exchange rate, risk inflation and reduced growth in Peña Nieto’s administration. The economic crisis and political uncertainty in Mexico is an echo of the more general crisis and uncertainty that Europe, the United States and the world has been experiencing since the 2008 economic crisis.

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The Brexit referendum, the election of Donald Trump, the electoral gains of Le Pen in France, the extreme right in Germany, Austria and Italy, as well as the establishment of right-leaning governments in Poland, Hungary, Austria and Bulgaria – all these events, even if different in many ways, express the crisis of major political parties abandoned by their voters, a rejection of the economic, political and intellectual status quo and the hegemonic economic doctrines of the last thirty years (globalization and economic neoliberalism), and the rejection of immigrants blamed for poverty, violence and a loss of identity.

This essay considers the context of the election of President Trump and the development of his policy towards Mexico and foreign trade, created in his first year of office, as an expression of a different geopolitical version of US imperialism. To such an end, this paper is divided into the following parts: the first section outlines the political and economic context of the renegotiation of NAFTA; the second section presents the proposals of the new US government in terms of trade, taxes, immigration, national security and drug trafficking, within which Mexico is seen as the main enemy to US security. The third analyzes the how the United States, not Mexico, has been the greatest beneficiary of NAFTA, and the fourth discusses the evolution of the Mexican economy, pointing out various aspects that have reinforced its relative stagnation. The fifth section presents positions within Mexican society in regard to the negotiation and impact of NAFTA, using a review of over 600 declarations and statements made by actors in diverse areas of public opinion. It also outlines possible policy alternatives in view of the preferences expressed and the options for changing the economic course made possible by Trump’s anti-Mexico and position.

I. Economic and political context

The 2008 crisis called into question the fundamentals of economic theory over which the model of global growth had been sustained for the last three and a half decades. Today we witness the crisis of liberal democracy and neo-liberal economics and the liberal internationalism, as well of the Social Democracy doctrine, the New Labor and waning The Third Way, and the fading out of the unrestricted support of globalization (Rodrik, 2017). Some foresee it as the end of the Pax Americana, or US hegemony established since the end of World War II and the world order that emerged thereafter (Roubini, 2017). For Trump, the costs of maintaining US imperialism are unacceptable; qualifying NATO as obsolete and its members as free riders and suggesting nuclear proliferation of Japan and Korea while keeping the USA “at the top the (…nude) pack” (Trump, 2017) would be a sensible strategy, as it would reduce for the US the cost of defending these countries. In reality he is not an isolationist. He aims at controlling word order in his own terms: reinforcing the military power elements of the international security policy and discharging the elements of world peace that inspired the WWII peace agreements and described in F.D. Roosevelt 1944 State of the Union Speech (Roosevelt, 1944), for whom security was not only preventing foreign aggressions but avoiding any threats to economic, social and moral security, because a basic element of world peace is “a decent standard of living for all individual men and women and children in all Nations” (Roosevelt, 1944). Furthermore, for Roosevelt, peace depends on “…freedom from fear which is eternally linked with freedom from want” (Roosevelt, op cit.).

Exacerbated globalization has made clear the contradiction between liberal democracy, which proclaims equality among all human beings and a capitalism that sanctions inequality. Neoliberal economics and the Third Way political programmes, with its supply side model and its trickle down myths, intensifies the innate tendency of capitalism toward concentration of
wealth and, by eliminating the mechanisms of distribution and countervailing measures, widened the universe of losers, mainly workers, and reduced that of winners, and rewarded the latter with ever growing profits. This mismatch is one of the effects of the synthesis of Regan-Thatcher market liberalism and social individualism with social democracy distributive policies. The market was the approach to tackle inequality and avoid social disintegration. The motto of European Social Democratic parties and left of the centre parties elsewhere was, “equal opportunities for all”, while pushing market oriented reforms in education and health. The crisis of 2008 evidenced the extent to which labor had been degraded, wages stalled and social mobility slowed, while services deteriorated and household debt prevented the deterioration of wages getting even worse. Fiscal discipline, or fiscal consolidation, evolved into a permanent austerity, enhancing the effects of the economic contraction, exacerbating inequality and deepening social discontent.

The neoliberal economy has aggravated the conflict between democracy and capitalism and, according to Rodrik, has given the green light to the trifecta of issues still unresolved by the global economy: “the incompatibility between democracy, national sovereignty and integration into the global economy; we can combine two of the three, but never have all three at the same time” (Rodrik, 2017), see Figure 1.

Figure 1

THE POLITICAL TRILEmma OF THE WORLD ECONOMY


Whether or not the trilemma portrays reality, it does highlight the conflicts revealed by Brexit and the election of Donald Trump and his trade and international relations agenda. It rejects the subjugation of national policies to the dictates of trade and transnational capital codified in multilateral or bilateral trade agreements and pacts like the TTP that go beyond simple trade and, according to the ex-secretary treasurer of the United Kingdom, A. Darling, to replace the “classic Keynesian model, in which government assistance to the economy has been substituted for austerity” (Darling, 2017), a change that the author considers demanded by the advancement of financial capital’s globalization. The result of this straightjacket is the almost three decades of lowered living standards, wages and economic security that led to Brexit and to Trump (previously cited), in the countries were neoliberalism was the most advanced. In the European Union it was the subjugation of decisions both private and public to the
dictates of an unelected technocracy, far from citizens and very close to the interests of large banks and corporations, as the Greek crisis illustrated.

II. The world according to Trump: Mexico the first enemy of the American Dream

There is not much difference in the content of recent speeches in Davos, the State of the Nation speech and the inaugural address in which Trump sketched out a United States society that, besieged and weakened by the harassment of internal and external enemies, has lost its dreams, its military hegemony, and the wealth of its middle class. In Davos and in the State of the Nation, Trump, although moderated to a degree, painted the picture of a dynamic country with a thriving economy, but surrounded by enemies that could and were trying to destroy it: immigrants, nuclear weapons, and unjust trade deals – that in defense of national interest it was important to protest against them unless they could be reformed appropriately and trade deficits could be eliminated. To achieve this he announces manipulating the exchange rate and imposing import duties on various products, and with the tax reform attracting capital and increasing the profitability of investments, even at the risk of worsening the concentration of wealth and reducing the middle class's income purchasing power (Galbraith, 2018).

As suggested by the growing debate over the kind of government that Trump will lead, it would seem that the nightmarish Plot against America might be close to reality. For some, this is all about the rise to the White House of a determinist leader, willing to affect all institutions, to "deconstruct the administrative state" (Bannon, 2017); for others, Trump is a right wing populist actor in form and language, devoid of ideology. There seems to be no doubt of his authoritarian character and his determination shake the system creating conflicts with world leaders, both close and distant allies; with the judiciary power, the intelligence institutions, the media, members of his party, with women, ethnic minorities. He also fuels conflicts in the Legislative power between the two parties, given the Republican's willingness to accept all presidential initiatives and to excuse all his outbursts and the conflicts of interest that he decides to defiantly ignore. To this date, everything announces that he is willing make his proposals a reality without abandoning his rhetoric in which truth is not a requirement. How far he will reach is not clear, but the latest changes in his inner circle of secretaries and advisors confirms that he is determine to fulfill all his promises except to improve the wellbeing of the poorest segments of the USA population. It looks clear that the conservative party has closed ranks to defend him as the president since his is advancing the very ultra conservative agenda point by point and looking toward the November 2018 and 2020 elections.

Trump has not abandoned the belligerent tone of his inaugural speech where he sketched an American society that, besieged and weakened by the harassment of internal and external enemies, has lost its dreams, military hegemony and middle class wealth. Migration, made up of criminals and terrorists, bleeds the nation and globalization destroys the social fabric by ruining the productive sector through the export of jobs. Since protection leads to great prosperity, the recipe to “make America Great Again” boils down to: buying made in America, by American workers. In Trump’s alternative realism, there is no room to talk about the crisis of 2008, nor about the ravages of financial deregulation and huge mergers, all of which lead to the dominance of large corporations and financial capital in the global economy and the consequent intensification of inequality.

Today, the US economy is growing at a faster rate than any other similarly developed ones; the number of people receiving unemployment insurance is lower than in 1996, and
unemployment nears 4.1% of total labour force and real medium wages have recently increased and approached the 2007 level. All that suggests that the economy is close to full employment – if the low participation rate is not accounted for. This reality calls into question what Trump’s means when he promises “to bring jobs back home”: more employment? Or higher productivity, with superior technology and robotization? We think that he aims to eliminate and replace jobs in Mexico and for robots in Detroit. Certainly, the Labor Secretary candidate is neither a champion of the workers nor the defender of labor income, minimum wages or labor unions. Trump structures his economic cabinet with officials from Wall Street corporations and has gone in the direction of undoing previous reforms to the financial system, approved after the crisis of 2008. Indeed, it is not an agenda in favor of workers and the middle classes. Neither has he changed his view of Mexico since the campaign. In fact, on January 18, 2018, he said, citing national security, and as a condition of letting dreamers remain in the country, the financing of the wall, “We need the Wall for the safety and security of our country. We need the Wall to help stop the massive inflow of drugs from Mexico, now rated the number one most dangerous country in the world. If there is no Wall, there is no Deal! (https://twitter.com/realDonaldTrump). The rhetoric of the first State of the Union brought together immigration, terrorism; drug trafficking, crime, and trade, adding that he would renegotiate the agreements until they were just and reciprocal, once the borders were secure, and immigration under control.

III. Mexico: the greatest enemy of the United States

Regardless of whether or not Trump can fully enforce his economic nationalism agenda, it is clear that he intends to carry out the vision outlined in his inaugural speech: “Decisions in trade, immigration taxes, and foreign affairs will be taken only for the benefit of American workers and American families” (Trump, inaugural speech). The issues chosen by Trump consist of various things that create internal and external conflict.

Trade

Trump proposes reducing the trade deficit, punishing exchange manipulation and retaliating against unfair trade practices, exercised against the North American interests by non-market economy countries and countries with non-transparent and corrupt trade practices. The main points of the new government agenda were outlined in a draft of the “annual trade policy agenda” of the United States Trade Representative (Council of Foreign Relations, 2017). To protect national interests, Trump decided to bilaterally renegotiate multilateral or bilateral trade agreements, especially NAFTA, for him “the worst agreement ever signed”. He protested against the TPP, signaling the end to the strategy to promote economic integration as the way to prevent the resurgence of nationalist sentiments and violent conflicts of interest. That was the idea behind the construction of the European Union and of the mega trade projects: the TPP and the TTIP, which were the instruments to consolidate USA geopolitical supremacy and to restore the political balance disrupted by the emergence of China as a main political and economic player. Furthermore, Trumps intends to circumvent the WTO, considered a medieval institution in which the tyranny of the majority made it impossible to imposed USA hegemony (Lamy, 2003). Trump is looking to rearticulate trade rules to “defend national sovereignty over trade rules and to strictly enforce USA trade laws” (Council of Foreign Relations, 2017). The National Security Strategy for the New Era published in December 2017 (White House, 2017) reiterates, without the language of the campaign and the inaugural address, the same rhetoric: that trades need to be fair and reciprocal, and that the United States is a victim of the disloyal practices of its partners, the sole cause of the
country’s trade deficits that threaten its prosperity. In terms of trade the president hasn’t budged an inch, as was reiterated by the USA trade representative R. Lighthizer, “I don’t think the president’s views have changed at all. His view has been that if we can get a good agreement we should have one” (Donnan, 2018). The strategy is to eliminate the trade deficits through bilateral negotiations in which the entire weight is placed on the concessions of partners.

**Taxes** are part of the new trade policy. Trump has proposed a border adjustment tax, to compensate for the value-added tax some countries implement. The VAT tax has been incorrectly described as an unfair tax on imports. Secondly, he has proposed revision of corporate tax, to roll back the Dodd Frank Act and to amend the Volcker Rule. These measures would favour big capital and endanger economic stability as they recreate the conditions which lead to the 2008 crisis. The recently approved tax reform might be the only achievement of the Trump administration and is the object of multiple criticisms by analysts of various disciplines (Galbraith, 2018; Skidelsky, 2018). The reform highlights the distribution of income from low and middle income levels to higher ones, and there are no assurances that tax breaks to corporations will transform into investments and job creation. The bonanza to high income brackets and the repatriation of capital may revalue the dollar with the well-known effects of slashing import prices, raising export prices and punishing employment. If, by this mechanism, the trade deficit widens, it is possible that Trump will react by accusing partner countries, imposing tariffs and demanding greater concessions in the NAFTA negotiations.

**Migration** is at the same time an economic issue due to its impact on US wages and, more importantly, a matter of national security, due to Trump’s belief that those who emigrate to the United States are terrorists, violent people, rapists or drug dealers. All this reverberates in the urgency to build the wall on the southern border and in the controversial executive order forbidding migration from seven Muslim countries. Such criminalization of immigrants echoes the stance towards Afro-American and Latino communities, has historical roots and illuminates the political and ideological motivations of D. Trump when he proposes the wall and the renegotiation of NAFTA. In order to change his position and no longer protest the agreement, he will demand of Mexico the maximum concessions. This will be the price to pay in order to maintain integration with a country and a nation that in his mind doesn’t deserve it. The racist roots of the attitude towards Mexico are visible in the War on Drugs and the immigration policy and form a part of the United States citizens’ ideas about Mexicans, in which Mexicans are associated with negative characteristics. Highlighted among them is violence due to marijuana use. These elements are also visible in the history of immigration policy, as suggested by FitzGerald and Cook-Martín (2014) and other recent studies carried out in response to the proposed measures of D. Trump.

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5 It’s well known how drug use was and is associated with certain ethnic groups that are considered inferior: opium with the Chinese, cocaine with African Americans, and marijuana with Mexicans. See Block 2013.

6 In 1911, a Captain in a Texas police department said "...A Texas police captain claimed that under marijuana's baneful influence, Mexicans became "very violent, especially when they become angry and will attack an officer even if a gun is drawn on him. They seem to have no fear, I have also noted that when under the influence of this weed they have enormous strength and that it will take several men to handle one man while under ordinary circumstances one man could handle him with ease." (Abel, 1980). The police officer went on to say that under the influence of this weed, men lose their sense of fear and become exceptionally strong, requiring the police to restrain them (Abel, E. no date). Even with the legalization of marijuana for recreational use, the violence, death, and lives destroyed in the centers of consumption remain regrettable. It’s important to remember that this plant was brought to the Americas, where it is not native like corn, chocolate or potatoes.
Effectively, since 1790 immigrants were discriminated based on ethnicity, and the National Origins Act of 1924 imposed norms to limit immigration in order to preserve: “...the ethnic and racial composition of the United States” (FitzGerald, 2014). This law, enforced until 1965, discriminated against non-Anglo-Saxon whites, and of those, non-protestants (the Irish and Italians as Catholics and Jews) and the Chinese. Up until 1950 it denied them all paths to citizenship (ibidem). The Cold War lead the United States in 1965 to reduce restrictions and provide visas to people from countries recently de-colonized and Latin America, relaxing norms that were then quickly re-restricted towards Latin Americans under various pretexts, principally drug trafficking (Kramer, 2017). Since the attack on the twin towers, the restrictions have increased and combine the control of drug trafficking with that of terrorism, with the discriminatory criteria towards countries and religions, the starting point for Trump’s further restrictions on immigration, accentuating further a latent xenophobia. By linking migration to terror and crime, Trump makes every migrant an enemy to be put on jail or expelled from the USA, with Mexico the main source of refugees and law offenders.

In international relations there are conflicts with China, an emerging power with the ability to challenge US supremacy in the Pacific. There are also the USA’s conflicts in the Middle East and North Korea, but these are not named as frequently as drug trafficking and the flow of immigrants perceived as potential terrorists under the motto “... to get gang members, drug lords and criminals out” (Trump, 2017). President Trump’s national security team resounds the militaristic stance of the government which is confirmed by the high increases for the military in the projected budget and the institutionalization of the National Security Strategy, presented in December of 2017. An expression of this position in relation to Latin America was presented by the Secretary of State at the end of his visit to the region, in which he at the same time praised the Monroe Doctrine, and praised the Latin American militants that fostered peaceful regime changes (Tillerson, 2018). In the National Security Strategy, Venezuela is a focal point of conflict and deep changes have to be stimulated in the name of USA national security. Trump, in a telephone conversation (February 2/2017) with President Peña, offered to dispatch US soldiers in order to contain Mexican “Bad hombres”, as in Trump’s perspective, in the Mexican failed Estate, civil and military authorities are unable or unwilling to do their job. Mexico is thus identified as a unique threat to the security of the United States in most of the issues raised in president Trump speeches and summarized in Table 1.

Table 1 Major threats to United States national security, wellbeing and prosperity, according to President Trump

| Source: Own elaboration |
|---|---|---|---|---|---|---|---|---|
| NAFTA | Central America | European Union | North Korea | ISLAMIC STATE | CHINA | JAPAN | NATO | Germany |
| ASUNTOS EXTERIORES | | | | | | | | |
| SEGURIDAD | X | | | | | X | X | X |
| TERRORISM | X | | | | | X | X | |
| MIGRATION | X | X | | | | X | X | X |
| Home Security | | | | | | | | |
| DRUGS | X | | | | | | | |
| VIOLENCE | X | | | | | X | X | X |
| EMPLOYMENT | X | | | | | X | X | X |
| CURRENCY MANIPULATION | X* | | | | | X | X | X |
| VALUE ADDED TAX | X | X | | | | X | X | X |
| TRADE deficit | X | | | | | X | X | X |

*Subsidies that affect the effective rate of exchange
** Subsidies on wood and diary products
NAFTA, a trade deal not good for the USA. Really?

For Trump, NAFTA is the most damaging trade agreement to US interests ever signed and Mexico is the greatest threat to national security and U.S. employment, which is why in his first State of the Union address he said: “The era of economic surrender is over. From now on, we expect trading relationships to be fair and to be reciprocal (Trump, 2018). NAFTA is the triumph of astute Mexican negotiators full of commitments prejudicial to the American national interest. He repeatedly highlights Mexico as the exclusive culprit (with no mention of Canada) of having deceived the US during the negotiations. Nothing could be farther from the truth. He reiterated his menaces to abandon NAFTA if the deal he wishes just after the bilateral Mexico-USA negotiations reach a partial agreement: “There is no political necessity to keep Canada in the new Nafta deal. If we don’t make a fair deal for the US after decades of abuse, Canada will be out. Congress should not interfere w/ these negotiations or I will simply terminate Nafta entirely & we will be far better off” (Cited in Polity, 2018).

Such an untruthful picture of the agreement calls for an objective depiction of the negotiating process and a brief illustration of the trajectory of Mexican economy since NAFTA, to demonstrate that Trump’s criticisms are ill intended and a pretext to impose a new round of negotiations under conditions of extreme power. At the press conference in Davos he said: “NAFTA’s a horrible deal, we’re renegotiating it. I may terminate NAFTA, I may not – we’ll see what happens. But NAFTA was a – and I went around and I tell stadiums full of people, I’ll terminate or renegotiate” (NBC, 2018). He adds negotiations are hard and risky because Mexico and Canada harvest all the gains. As late as March 5, 2018, D Trump reiterated (in tweets) his assertion on the menace to American security from NAFTA and Mexico drug trafficking.

The statement that US negotiators accepted under NAFTA concessions detrimental to US national interests is untrue. To get NAFTA, Mexico engaged in a negotiating game marked by deep asymmetries emerging from: a) the different level of economic development of the two countries and diverging weight in the regional market; b) the dissimilarities in each country’s economic model and the gap with the implicit model of the agreement; c) the different subjective utility assigned to the non-agreement alternative; and d) the differences in the institutional building process and traditions. By way of Alessina’s (2006) war of attrition, the debt crisis (1982) was an opportunity to enforce the macroeconomic reforms, liberalizing the economy, privatizing sector public enterprises, and joining GATT, even if these were not at the roots of the crisis. President Salinas (1988-1994) and the political and technocratic elite in power, considered the signing of a free trade agreement with the US as the instrument to make irreversible the reforms and the modernization both of the Mexican economy and Mexican society. Blocking up reforms would increase stability and investors’ confidence, reassuring the inflows of capital needed to maintain the economic growth (Ros, 1994). Therefore, for the Mexican government any other alternative to NAFTA had little value, and

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7 Trump said on January 8, 2018, in a meeting with farmers, “When Mexico is making all of that money, when Canada is making all of that money, it’s not the easiest negotiation. But we’re going to make it fair for you people again”, (Trump 2018A). Adding that otherwise he will abandon NAFTA. Similar remarks were sustained in Trump, 2018 B, and earlier in Trump, 2017. He reiterated these menaces in after the bilateral pre-agreement recently signed with Mexico.

8 Bhagwati expressed an abrasive opinion about the reasons and the urgency of the Mexican negotiators to reach the agreement: Mexican architects of NAFTA have a point of view that encouraged them to look at problems from the prism north of Rio Bravo. They were impressed by the US and wanted to emulate it. They said, “The US has done well. If we join with North America, all our problems will be over” (authors translation), Bhagwati, Jagdish N., El Financiero, November 22, 1999, p. 24.
US negotiators were well aware of this. Consequently, Mexico, the smaller economy and the weaker state, took the initiative to begin negotiations; it was the demander, looking for a safe haven for its exports, and willing to negotiate reciprocity by opening its economy even further, after implementing a far-reaching unilateral liberalization to join GATT.

What were the objectives and interests of the USA behind NAFTA? The USA considered that there were no important changes in prices, nor gains from specialization due to marginal changes in tariffs, because practically all Mexican exports entered the USA almost free, with a 4% average tariff. USA exports to Mexico faced several times higher border and non-border trade barriers. So, the US was interested in extracting from Mexico, on top of a drastic cut of all tariff and non-tariff trade barriers, all the concessions Mexico was willing to give. And the country was prepared to pay all the costs just to reach the agreement (Heillener, 1991). These included trade and non-trade and even non-economic incentives that could legitimize the United States signing free trade agreement with Mexico. And it was agreed, as early as 1990, that “Mexico would not be treated as a developing country in the negotiations, meaning that it would not receive preferential treatment in matters such as transition periods for the elimination of tariffs” (Puyana 2003). Mexico granted the USA larger tariff preferences than the ones it received. And in the first year of NAFTA, 50% of the tariff advantages in the US market were lost due to trade agreements the USA signed with countries with an export offer similar to Mexico’s. Since the Mexican economy was more protected and regulated, Mexico had to make larger adjustments in the form of “side payments” as entry fees in the “new issues,” which were eventually included in the agreement, namely trade in services, regulations and protection of intellectual property rights and in foreign investment, considered the jewel in the crown won by the United States. NAFTA was also a pioneer in the Investor-state dispute settlement, later incorporated into the Uruguay Round within GATT, which allows private companies to sue states for policies purportedly damaging to their interests. Furthermore, Mexico wholly and hastily liberalized agriculture and accepted that the US maintained its Farm Bill stimulus, which would later create a dumping effect and losses to Mexican farmers of up to $ 13 billion dollars in constant 2005 prices (Wide, 2009). It is also calculated that no less than 5 million rural laborers abandoned this sector, while the imported content (completely from US origin) of the apparent consumption of Mexican staples (maize, beans, barley, rice, soy, among others) grew up to 50%, sometimes even close to 80%, which constitute a serious corrosion of food security. Moreover, Mexico absorbed all the costs of the institutional changes demanded by NAFTA and adopted the USA ones. Therefore, NAFTA did not entail any cost to the United States (Clinton, 1997). In this context, the increase in Mexican exports under NAFTA is more of a consequence of – on the one hand, the revaluation of the dollar rather than the tariff reductions in favor of Mexico – and on the other, to the increasing imported content of Mexican manufactured exports (USITC, 2003).

The Mexican economy under NAFTA

Certainly, global economic liberalization went too far and Mexico did liberalize at higher speed and intensity than Latin America and the world average, especially regarding financial deregulation, large corporate mergers that nullify the market as well as ever growing transfer of national decision-making centers to supranational non-elected entities, of the policies that affect society, creating a sense of denationalization in everybody’s daily life. However, liberalization and the structural reforms eliminated or reduced state interventions on commodity, labor, and financial markets, but did not act to reduce the large concentration of capital or take measures to control its effects. From then until now, the trend of the Mexican
economy has been less favorable since the end of the 1940s, with the smallest GDP growth rates (close to 1.2% per year), with low labor and total factorial productivity, wage repression, declining tradable sectors in GDP and employment and the explosion of informal labor, which is today about 60% of the total labor force employed. If inflation has been controlled, it has been through internal devaluation and permanent fiscal austerity, amidst very low direct taxation (effective tax revenues represent 14% of GDP, excluding oil income. All this has led the economy to a low-growth equilibrium with low-income, limited aggregate demand, limited investments. This trajectory has implied a redistribution from labor towards capital, in which Mexican labor appears as a big looser when compared to American labor (Figure 2). This change in the functional distribution of income occurred in most countries of the world, but only few present a scale of change similar to Mexico’s. Between 1980 and 2016, the share of wages fell by 11.7 percentage points, a decrease 2.3 and 3.8 times higher than the one in the United States and Canada, respectively, and the highest among OECD countries (OECD, 2016).

Figure 2 Labor share of GDP in the United States, Canada and Mexico, 1970-2016

Source: Own calculations based on OECD.Stat2016, accessed 10 February 2017 at: https://stats.oecd.org

Mexican GDP expanded near 4 times more than national wages, compared to 1.9 in the US. Before the reforms, between 1970 and 1980, the disparity between Mexico and the US was in the opposite direction. In the Mexican manufacturing sector labor productivity grew twice as much as real wages per worker. The high presence of investments implies that Mexican workers handed over income in favor of external foreign capital, basically from American origin, the largest foreign investor in the country. This transfer of labor income to capital is a result of having converted the wage bill into the main element of international competitiveness, therefore a production cost to be abridged and not a constituent of the domestic aggregate demand. Average real wages for 2015 represent 75% of those for 1980 and real minimum wages, only 35%. This fall in labor income has meant that average real wages in Mexican manufactures are lower than those in China and is ironically presented as

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9 Mexico was, amongst the 36 countries listed in the OCDE data base, the country with the biggest labour losses in primary distribution of income, after Ireland and Portugal and closely followed by the United Kingdom, which occupied fourth place.
an achievement in productive efficiency unleashed by liberalization and NAFTA, as explained by former Mexican Secretary of Economy and main NAFTA negotiator, Jaime Serra (Serra, 2014).

**Who depends on whom?**

Another fictitious and permanent argument is that disadvantageous trade with Mexico, China and other countries made the US economy dependent on such partners. This assertion does not fit the reality, for reasons we attempt to explain based on Mexican experiences with the liberalization of national economy and NAFTA: the degree of openness of the economies, the broad geographical diversification of US trade and the morphology of Mexico’s trade deficit.

The US economy is considerably less open than that of Mexico, Canada and China, and practically all OECD countries. The external index of an economy (the total trade of a country as percent of its GDP) shows the degree of openness of an economy to global competition, that is, how much of its product is imported and exported. The United States appears as a relatively self-contained economy with relatively limited penetration of its domestic market by imports and comparatively limited exports. Mexico and Canada are the most open and China is relatively closed. With an external coefficient of 728% of GDP (37.5% imports and 35.4% of exports), the Mexican economy is 2.6 times more open to competition in domestic and external markets, than the American one. Even Canada appears less open than Mexico. So it is hard to understand how the US could be dependent on the Mexican or the Chinese ones. While Mexico depends much more on trade, for the US domestic demand is more relevant.

**Figure 3** Dependency of the economies of Mexico, Canada, China and the United States as % of GDP. 1996-2015

**Panel A. USA dependency regarding Mexico, China and Canada**
In the context of the aforementioned trade openness, we define dependence as the weight of reciprocal trade in the GDP of each participating country. As shown in Figure 3, about 3.3% of the GDP in the US is linked to trade with China and about 3% to trade with Canada and Mexico (Panel A). The dependence from the opposite side (Panel B), surprising, if not alarming: 46.5% of Mexican GDP depends on trade with the US, a dependency 15.7 times more than the one US has from Mexico. In contrast, China's dependence with respect to US trade is almost three times lower than that of Mexico, while the Canadian is 10 points below. With these parameters in mind it is hard to accept that the US depends on Mexico. On the contrary, what stands out is the asymmetrical dependence of Mexico on USA economy.\(^\text{10}\)

Second, the diversification of markets of origin and destination of exchange moderates US commercial dependence. Only three countries each account for more than 10% of total imports (China 22%, Canada 13% and Mexico 13%) and of exports (Canada 18, 3%, Mexico 16% and China 8.3%). Contrasting these proportions with Mexico’s, the United States is the primary destination of 85% of its external sales and the origin of 40% of imports. Worthy of attention is that China accounts for 21% of USA imports and only 7.3% of US exports. This asymmetry is most noticeable considering that the Chinese economy is 7.4 times larger than the Mexican and could capture a larger proportion of US exports. In 2016, the trade deficit of the US with China was 18 times greater than the Mexican one, reaching up to 319.3 billion dollars. In this context, the Mexican trade surplus with the United States must be weighed. The surplus grew from 18 to 58 billion dollars between 1996 and 2016, a trend explained by the automotive sector, which concentrated 79.3% of the imbalance, followed by electronics. Mexican total sales of automobiles and auto parts account for 26% of total US automotive imports, but only 2.3% of its total ones.

Like no other sector, automobile manufacturing reflects the problems of global value chains: approximately 40% of the exported value are inputs, components and parts, imported from the US companies or from Japanese, Korean and European USA subsidiaries. Mexican manufacturing exports are intensive in imported value added, which varies in the different

\(^{10}\) The Mexican dependence on trade with USA is higher than we reported in our 2017 article on Trump policies on Mexico. See Puyana, 2017.
branches. Exports with highest imported content are precisely those activities with greater technological content and greater presence of foreign investors. Those are precisely the activities in which the Mexican trade surplus with the US is higher: electrical, electronic and optical equipment, transportation, machinery. In contrast, Chinese external sales contain less imported content, except for some commodity-intensive products.

The highly imported content of Mexican manufacturing exports intensifies the propensity to import and aggravates the external restrictions facing Mexican economic growth: for each point of increase in GDP, the imports increased by almost 5%. The final effect is a weakening of the link between growth in manufacturing exports, sectoral and total GDP, and employment (Puyana, 2015; 2017).

The decline in GDP manufacturing is associated to a smaller but significant decrease in employment starting in the year 2000, the reason why sector productivity has not grown as would be expected by the progress of the sectors’ openness, similar to that of GDP Total. The deindustrialization of the Mexican economy is real, despite its volume of exports.

The trade of manufactured goods between Mexico and the US is vertical intra-industry exchange, in the sense that the two countries exchange goods classified in the same tariff category, which are differentiated by quality and intensity of factors: Mexico exports to the US goods with lower economies of scale and low technological content for lower income markets, and imports the same goods of more technological sophistication and with higher prices. The effects would be similar to those of inter-industry trade (Puyana, 2003). With these considerations, taxes on companies that produce in Mexico and export to the US, either in the form of a Border Adjustment Tax or import taxes, as stipulated in Trump's Tax reform, would raise consumer prices in a differentiated manner, punishing mostly consumers in the lower income group. Mexican manufacturing production is found in the most labor-intensive fragments of production process of the global value chains and represents a tiny share of the value of each product. Therefore, its return to the US will not represent a huge increase in jobs creation but could imply some inflation, especially when considering it parallel to a large plan of public investment.

What to do?

Two facts looks certain: first, Trump and his team will to follow campaign promises; second, the US presidency is advocating economic nationalism aiming to increase both total production and the profits of major corporations without necessarily moving home the American global value chains11 (“National Trade Policy Agenda for 2017, presented to the Congress the March 1 207). This change of focus has left a void for the Mexican leadership, be it in the public or the business sector. The American president pretends to legitimize chauvinist nationalism, presenting it as economic protectionism in defense of employment and asserting that previous governments forgot to defend the national interest. As if the USA were a developing, commodity-dependent country, Trump says that the US suffers from the effects of an “impoverishing trade” which de-industrialized the country, turning it into a low-value manufactures assembling economy. De-industrialization is not a phenomena resulting from trade, but from a higher degree of development, higher per capita income and the consequent change in the structure of demand. Trump’s ideological positions which guide the

11 National Trade Policy Agenda for 2017, presented to Congress March 1, 2017
formulation of the trade strategy (USTR, 2017) emerge from the false premise “... that if other Nations are encouraged to raise their standards of living, our own American standard of living must of necessity be depressed” (Roosevelt, op. cit.).

Today in Mexico economic debate revolves around whether or not to renegotiate NAFTA or whether to take Trumps policies towards Mexico as the opportunity to revise the development model. In any case, the desirability of diversifying external markets is emphasized as well as reintegrating productive chains and strengthening the internal market, which are at odds with NAFTA. Past economic trends, employment wages, inequality and poverty reinforce the need for changes in economic policies, with or without NAFTA. Table 2 summarizes and groups the 604 views\textsuperscript{12} of several representative sectors of the society with the number of declarations 67% larger than in Puyana (2017).

**Table 2** Views of Mexican society in the face of changes in US policy towards Mexico and NAFTA

<table>
<thead>
<tr>
<th>Sectors Reactions or proposals</th>
<th>To Negotiate NAFTA</th>
<th>Defending free trade</th>
<th>Rejecting border tax</th>
<th>Not renegotiate NAFTA without mutual benefits</th>
<th>Abandon NAFTA and opt. WTO</th>
<th>Diversity markets</th>
<th>Strengthen internal market</th>
<th>Decrease taxes</th>
<th>Protect Agriculture</th>
<th>Industrial policy, infrastructure</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government</td>
<td>44</td>
<td>26</td>
<td>19</td>
<td>27</td>
<td>13</td>
<td>28</td>
<td>18</td>
<td>7</td>
<td>13</td>
<td>13</td>
<td>230</td>
</tr>
<tr>
<td>Political actors</td>
<td>17</td>
<td>13</td>
<td>19</td>
<td>12</td>
<td>11</td>
<td>11</td>
<td>6</td>
<td>2</td>
<td>1</td>
<td>6</td>
<td>83</td>
</tr>
<tr>
<td>Private sector</td>
<td>47</td>
<td>16</td>
<td>27</td>
<td>21</td>
<td>21</td>
<td>24</td>
<td>3</td>
<td>2</td>
<td>6</td>
<td>6</td>
<td>230</td>
</tr>
<tr>
<td>Labor unions, socialmovements</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>0</td>
<td>6</td>
<td>3</td>
<td>29</td>
<td></td>
</tr>
<tr>
<td>Academia</td>
<td>11</td>
<td>5</td>
<td>3</td>
<td>5</td>
<td>2</td>
<td>17</td>
<td>12</td>
<td>2</td>
<td>5</td>
<td>5</td>
<td>71</td>
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<tr>
<td>TOTAL</td>
<td>122</td>
<td>62</td>
<td>79</td>
<td>70</td>
<td>47</td>
<td>96</td>
<td>63</td>
<td>19</td>
<td>46</td>
<td>51</td>
<td>604</td>
</tr>
</tbody>
</table>

Source: Author's elaboration

Mexican society seems divided in terms of how to respond to the situation posed by President Trump. This division is evident even within the government, as is visible in the first line of the three first columns of Table 2. Effectively, if 89 of the 210 government spokespersons prefer to renegotiate, a group of 121 or 58% ask that there be no renegotiation and that the country take the issue to the WTO, while 39% consider it convenient or necessary to transform the current model, look for new markets and revisit the design of sectorial and productive political policies, defending manufacturing and the agricultural sector. In total, more than half, (58%) of government actors prefer no NAFTA and to modify the model, diversifying markets and stimulating internal demand. Some 117 of a total of 604 actors vote to “modernize” NAFTA and preserve the free trade ideology that sustains the economic model of supply. They also reject taxes on imports and exports, national and foreign.

In total, the defenders of free trade make up 36.5% of the responses, a proportion 22 percentile points less than those that prefer a change in the economic direction. This free trade standpoint stems from the premise that Mexico is an important part of the NAFTA region, a fully integrated production area that exports to the world. In that context, any protectionist measure would weaken the region’s competitiveness in the world. Therefore, they propose to seize the opportunity to deepen liberalization and expand NAFTA to areas not initially included, such as communications, the energy sector, as well as to extend agreements on the electronic sector, intellectual property, including anti-corruption rules.

\textsuperscript{12} Opinions expressed in 604 articles in daily and weekly papers as well as specialized publications with high levels of circulation, published between August 1, 2016 and February 2018, that covers the period between the start of the negotiations and the end of the seventh round of negotiations. The table includes 604 opinions from government representatives, political leaders, union leaders, NGOs, academics and businesspeople.
To strengthen its preferences, the government integrated a group of experts to define the negotiating strategy and lead the negotiations, with the same economists who negotiated NAFTA in the first place. The group has already stated the main tenets. First, to educate society as to the benefits of NAFTA, which have already been fulfilled to a greater extent than expected. Second, to reiterate that the greatest beneficiaries of the agreement are the consumers, hiding the fact that the economy has not grown and without mentioning that consumers are first and foremost also producers and workers whose real incomes have severely deteriorated. Third, to extend NAFTA including themes agreed for the TPP and also discussed in the TTIP, eliminating all restriction to trade and to capital, which aim to agree on regulatory convergence on such dissimilar subjects as rules of origin, corruption, intellectual property. It is still in doubt whether these proposals to “modernize” NAFTA would not intensify the wage repression experienced by the Mexican labor sector since the reforms and NAFTA, and as some critics of TTP and TTIP suggested would happen (Bivens, 2015; Felbermayr et al., 2013).

The business sector, with its 210 responses appears divided. While some 33% of them proposes to negotiate NAFTA, around 16% take a moderate stance, either rejecting the negotiations in the face of uncertainty and fear that the results will be negative in comparison, and 50 % want to expand markets, strengthen the domestic market and to redefine sectoral policies, industrial, agricultural, energy and technology policies.

A diverse group of 25 out of 101 – academics, politicians, and unionists – advocates renegotiating the agreement on condition that it is beneficial to the country and that the wall is not built and the border adjustment taxes or any other taxes are not imposed. If it proves impossible to reach an agreement positive for Mexico or if the US decides to abandon NAFTA, the preferred alternative is to go the WTO. Finally, there is a relevant group of political, intellectual and academia actors, proposing not to negotiate, to abandon NAFTA and to go straight to the WTO and to reformulate the economic model.

The positions that favor modifying the macro-economic policies are strengthened by 64% of respondents calling to reform them, with or without the renegotiation of the NAFTA, in the event that a beneficial agreement for the country is not feasible, with industrial policies that reestablish productive chains, generate added value and national employment, as well as provide protection to agriculture, all with a view to strengthening the market. Finally, the movement for the diversification of the destination of export markets is gaining strength.

Some of these proposals would clash with government preferences, but echo Trump’s policy. Almost all of these priorities contradict the liberal NAFTA economic policy model.

Conclusions

It is our opinion that Mexico must seize the current opportunity, redefine the policies institutionalized because of NAFTA, and undo the mistakes made in the initial NAFTA negotiations and the structural reforms since the mid-1980s up to now. The answer to this external shock, induced by the stubborn will to change the norms that have governed bilateral relations for the last 24 years, could be the opportunity of a serious reform to the model of national development. There will be losers and winners, it is true. Depending on the players who would lead the changes, it would be expected that balance will not be adverse to labour as it was for the last 30 years.
With oil running out and the US restricting investments and imports of goods made in Mexico and repressing remittances, the country would not have the resources to invest, accumulate capital and expand production. As in world crises and wars, it is necessary to change course, reindustrialize Mexico and strengthen agriculture, through a new social pact that will integrate groups excluded since the mid-1980s.

Following are some premises for change, emerging from our own recollection and lecture on public opinion in Table 2:

i) To figure first the direction of the country and its economy and, in this context, structure our relations with the US and the rest of the world;

ii) The trajectory of the national economy must rest on sustained and sustainable growth, the generation of more and better jobs to reverse the decline of labor in the functional distribution of income, and reduce inequality;

iii) Protect agriculture so as to ensure food security, as the US, EU, Japan and China already do, reversing the imported content of apparent consumption of maize, beans, rice, soybeans and other primary food products;

iv) An agricultural policy with increases in yields and productivity, not oriented exclusively to exports, but to ensure food security and supply inputs to manufactures;

v) To launch an active industrial policy that incorporates labor and added value, promotes research and, in reaction to the border tax and the import tax, a tariff policy that eliminates negative effective protection and protects national value added;

vi) To structure an energy policy for development, in which the oil that still remains becomes a development factor in integrating clean and alternative energies;

vii) To reject in the economic restructuring process elements accepted in the TPP, either as a negotiating strategy with the US or as a policy to expand Mexico's export markets. They aggravated the structural problems generated by the way NAFTA was negotiated, and they will deepen the now questioned denationalization of the economy;

viii) In this context, the academy, unleashed from political and economic power centers, must study and explain reality and propose objective interpretations and lines of action.

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A brief critical note regarding recent “crowding out” claims

Leon Podkaminer  [Vienna Institute for International Economic Studies, Austria]

The concept of “crowding out” has a long history in economic analysis. It presupposes some variety of competition for limited capital and resources that directly affects interest rates and also the efficiency of investment, and hence the long-term trajectory of economic growth. This in turn is positioned in terms of dispute regarding fiscal and monetary policy and the size and scope of the state. The underlying theme of much of the material that sets out crowding out effects is that “more” state is harmful to the economy. Not only is this often reductive in terms of its analysis of the state and of policy, it can also be problematic in terms of the construction of empirical evidence. A recent CEPR discussion paper illustrates this (see Huang et al, 2018).

The paper sets out to regress private investment in a large number of countries on public debt levels (both items as GDP shares). The regression coefficients reported turn out to be negative and statistically significant. These findings, supported by the results of industry- and firm-level regressions, lead to the claim: “that the relationship between public debt and investment is likely to be causal and that public debt crowds out corporate investment” (ibid). The CEPR paper suffers from two major deficiencies:

1. The GDP shares of private investment have followed a secular downward trend while the public debt shares have been increasing secularly for quite some time almost everywhere. As such the time series of both items are non-stationary in most cases. Regressing one non-stationary time series (the GDP investment share) on another nonstationary series (the GDP share of public debt) may well result in spurious estimates – with necessarily negative regression coefficients.

A spurious model can be indicative of problems of various kinds. This includes a problem of statistical analysis that arises because over time the real processes of one and many economies may be changing.

2. The regression estimates reported at best reflect simple correlations between the contemporaneous values of the two shares considered. These correlations cannot say anything about causation. Correlation is not causation, as every schoolboy knows.

Equally, one could have regressed public debt shares on the investment shares. Such reverse regressions would also yield negative and statistically highly significant regression coefficients which, by analogy, could have indicated that lower investment causes higher public debt. In actual fact, this makes more sense. According to the fundamental national accounting identity the private sector’s excess savings (private savings minus private investment) equal the public sector deficit plus the foreign balance. Falling private investment shares (observed secularly) means rising public sector deficit/GDP shares, ceteris paribus. There are good grounds to believe that falling investment shares may indeed cause higher public deficits (which give rise to accumulating public debts).
It is not my purpose here to dwell on the simultaneous co-determination of private investment and public debt. In any single year (or quarter) both items must mutually adjust so that the fundamental macro identities eventually hold. How that adjustment is achieved remains open to debate. My purpose here is simply to highlight that the empirical evidence for crowding out is suspect. This can be achieved using classical Granger causality tests involving the two items in question. As most economists are aware, Granger causality is a statistical measure and not a full or adequate concept of causation. It is fundamentally a test of a relation between past values of x and future values of y, which tells one no more than that there is an ordering in time rather than what it is about these that orders it, how they relate, and what else may be relevant in a complex sequence of pattern of relations. Whilst this may be problematic in many ways, a Granger test is arguably sufficient to bring into question the directional link claimed in the CEPR paper. In order to expedite the test, I make use of auxiliary unrestricted Vector Autoregression (VAR) models. Again these have their problems but can be used to capture the dynamic links between the two items in question. I apply this to 25 countries for which longer-term data (1995-2017) are available (from AMECO). The eventual endogeneity of the variables considered does not create identification problems here because in the models considered the variables are not contemporaneously related. In effect the ordinary least squares estimates for such VAR models are adequate and the resulting Granger causality tests are informative.

Table 1 shows the P values for pairwise Granger causality tests (based on chi-sq. stat.) for 25 countries, based on auxiliary VARs for years 1995-2017.

As can be seen (column 1), in only three countries the hypothesis that an increase in the public debt/GDP share does not Granger-cause an increase in the private investment share may be rejected (at 0.05 level). In these three countries (Belgium, Denmark and the UK) a change in public debt can be claimed to have been followed by a change in private investment. The latter change can be negative or positive. In the context of a crowding concept this represents either crowding out or crowding in. In the remaining 22 countries, a change in public debt has not had a statistically significant effect on the private investment share. Observe (column 2) that in six countries (including Germany, the US and Japan) the Granger causality runs in the opposite direction: from a change in the investment share to a change in the public debt share. Here too one does not know whether a fall in the investment share Granger-causes a rising, or falling, public sector debt share.

The key point, however, is that in the vast majority of cases there is no reliable evidence of Granger causality running in either direction. The same conclusion applies to the levels (columns 3-4). Again, in the vast majority of cases there is no evidence of Granger causality running in either direction. Granger causality running from the debt share to the investment share can be claimed in only one major country (the UK) and the opposite Granger causality also in only one major country (Japan). Accordingly, it is an open question whether causations involve ‘crowding out’ or ‘crowding in’. The statistical basis of empirical evidence is highly questionable and this still leaves the broader issue of whether “crowding” is an adequate way to position the creation and uses of capital and debt.
### Table 1

P values for pairwise Granger causality tests for the changes in the investment and debt shares (columns 1-2) and for the levels of the investment and debt shares (columns 3-4)

<table>
<thead>
<tr>
<th>Country</th>
<th>Δ(debt) does not Granger cause Δ(investment)</th>
<th>Δ(investment) does not Granger cause Δ(debt)</th>
<th>Debt does not Granger cause investment</th>
<th>Investment does not Granger cause debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>0.0003</td>
<td>0.3454</td>
<td>0.0032</td>
<td>0.4267</td>
</tr>
<tr>
<td>Czech R.</td>
<td>0.2271</td>
<td>0.4210</td>
<td>0.0177</td>
<td>0.9139</td>
</tr>
<tr>
<td>Denmark</td>
<td><strong>0.0008</strong></td>
<td>0.5626</td>
<td><strong>0.0000</strong></td>
<td>0.9632</td>
</tr>
<tr>
<td>Germany</td>
<td>0.0945</td>
<td>0.0417</td>
<td>0.7694</td>
<td>0.0850</td>
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<tr>
<td>Estonia</td>
<td>0.5838</td>
<td>0.1409</td>
<td>0.5952</td>
<td>0.8036</td>
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<tr>
<td>Greece</td>
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<td>0.0780</td>
<td><strong>0.0000</strong></td>
<td>0.6516</td>
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<tr>
<td>Spain</td>
<td>0.6711</td>
<td>0.0780</td>
<td>0.4316</td>
<td>0.8655</td>
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<td>0.1820</td>
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<td>0.9008</td>
<td><strong>0.0142</strong></td>
<td>0.7245</td>
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<td><strong>0.0482</strong></td>
<td>0.4019</td>
<td><strong>0.0414</strong></td>
</tr>
</tbody>
</table>

Source: Own calculations based on AMECO data for 1995-2017. The P values for Granger noncausality tests for the levels (columns 3-4) are derived from the auxiliary VARs using the Toda-Yamamoto procedure. The auxiliary VARs (for both the increments and the levels) are unstable for Ireland: no reliable P values can be inferred for that country.

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