

# Economic Power and Economic Governance Political Economy of Contemporary Development Dynamics

Ratan Khasnabis

## Perspective

The contemporary policy of economic development in India is based on the negation of the Nehruvian policy of state-led development. It is argued that the Indian economy was driven to a Pareto inefficient situation, thanks to the interventionist policy of the Government of India during first forty years of its independence. Intervention of the state in the economy, as pointed out by the critics, created agency problems and consequently the rate of welfare augmentation decelerated. According to the critics this was not surprising. The state-centric model of economic development aims at attaining socially desirable equilibrium by suppressing market outcomes. As the market outcomes are suppressed, the economy faces the problem of economic stagnation. This has to be so because the GDP growth rate would remain low in such an economy (as the prices remain suppressed, resource allocation fails to maintain price efficiency. Consequently, the investment and growth rates would decelerate, as the economy would fail to perform well in resource mobilisation). In effect, as the market outcomes were suppressed, the Nehruvian policy of economic development was exploited by the powerful social groups that gained in the distribution of economic benefits. The economic groups privileged by such intervention earned economic rent and gradually the rent seekers established their sway over the economy. The economy failed to serve the interest of the people at large; it only wasted resources and distorted policy outcomes at the peril of the common people.

New policy resets the agenda. Now the basic understanding is that with well-defined property rights, a competitive market which would be Pareto efficient would accelerate growth and the society would be placed in a Pareto superior situation. The emphasis should therefore, be on institutional reforms so that India might move towards a free market economy. Institutions in this context are not only economic institutions. Institution also cover 'law, informal rules and conventions that give a durable structure to social interactions, influencing who meets whom, to do what task, with what possible course of action, and with what consequences of action jointly taken' (*Samuel Bowles, Micro Economics, p.240*). The recent policy changes are based on this theoretical understanding.

## Market and Power

At the very outset, one should point out that there is nothing wrong with market, *per se*, if market is considered to be an institution that mitigates the exchange related issues. As institution, market should be allowed to play its role in ensuring price efficiency, which every economy needs to maintain for its long run sustainability in a resource constrained society. This does not, however, imply that the price efficiency is achievable only in the private property-based capitalist society. Rational economic calculation that needs efficient pricing which market is supposed to provide, does not preclude even a 'collectivist regime'. As Vilfredo Pareto, the 19<sup>th</sup> Century economist who introduced the anti-socialist concept of optimality in social welfare, observed, "... pure economics does not give us a truly decisive criterion for choosing between the organisation of society based on private property and a socialist organisation." (*Pareto: Manual of Political Economy (1971); p.364*) Joseph Schumpeter, the arch opponent of socialism also conceded "... there is nothing wrong with the pure theory of socialism." (*Capitalism, Socialism and Democracy (1942); p.172*) The contemporary wisdom, however, is that the debate over forms of property rights is over. The market should be free to every form of economic organisation, with properly defined property rights. Known as neo-liberal views this apparently is the most democratic strand and the pure theory of market efficiency does endorse this view. In effect, however, the so called free market economy that allows every form of property would ultimately serve the interest of big capital, the corporate capital to be precise, at the cost of other forms of economic organizations on one hand and labour on the other.

Let us explain why this is so. The so-called free market economy works with a set of incomplete contracts. This has to be so because even the most advanced market economy operates with a set of incomplete and asymmetric information. Furthermore, the economic agents have bounded rationality. Consequently, even with defined property rights and a powerful judicial system, there exist 'residual claims' on the economic output which remain uncovered by contracts. In so-called free market economy where no 'non-market arbitrator' like state or any democratic organisation is allowed to operate, the 'residual claims' are settled by economic power. Power is interpersonal, an aspect of relationship among people, not a characteristic of a solitary individual. The crux of the issue is how the power is enforced. Exchange of power involved threat and use of sanction because there is no other mechanism by which this can be exercised. The threat and use of sanction might be impersonal, embedded in a system, but nevertheless, that cannot be otherwise in a power game. The society lives with the power game with the understanding that the concept of power is normatively indeterminate, allowing for Pareto improving outcomes (as students of Hobbs or Marx would stress). One should not however, ignore the fact that it could be otherwise as well. Power is 'susceptible to arbitrary use to the detriment of others in violation of ethical principle.' (*Samuel Bowles: Microeconomics (2004), p.344*). In fact, with unequal distribution of wealth and incomplete contracts, power is usually used arbitrarily in settling claims on residuals (i.e., surplus) in a free market economy with incomplete contracts. In a given social framework, it would attain Nash equilibrium, without much of social tension once the rules of the power game are settled by negotiation or be coercion. The equilibrium is attained by formal or informal rules or by convention. One may add that the institution of legal system hardly needs to intervene in the process once the rules of the power game are settled. Even if such an institution is to serve as arbitrator in case of exigencies, the system works in favour of the

more powerful economic agents.

In the era of globalisation, the most powerful agent in the globalised market economy is the corporate capital. The free market economy that we experience is the economy where there do exist incomplete contracts, asymmetry in information, and bounded rationality for the economic agents as in case of any other market economy. The difference, however, is that the residual claimant under such dispensation is the corporate capital. In such an economy, there might not exist any rent seeker; the gains of economic pursuit might be distributed according to market mitigated fairness. But then, the rules of business would be designed by corporate capital. The legal provisions, the informal arrangements and the conventions would be set in such a way that a Nash equilibrium consistent with the new dispensation would be achieved.

This precisely is the scenario in the present day globalised economy where the entire human society is being exposed to the new rules of power game. The dynamics of this transformation contains several politico-social factors interplay of which is not at all captured in the economics of Nash equilibrium. Will the new economic order benefit every body? In other words, would the new Nash equilibrium be Pareto superior? Whether a Pareto superior situation would be attained under the new dispensation is still not clear because the redistribution of assets is taking place at a very high pace and every redistribution need not necessarily result in a Pareto superior situation. One point, however, is obvious. The corporate capital-led growth is inequality enhancing. The new equilibrium that the economy would strive to attain would not be based on equity and therefore it would therefore enhance social tension. One may therefore argue that the paradigm shift associated with the new rules of business is therefore being associated with a plethora of social issues that cannot be captured in the language of pure theory of economics. However, the root of such problems is the equity based rules of transaction are being violated shamelessly in the name of neo-liberalism.

## **Rules of Business in the Era of Corporate Capital**

Let us see how the principle of equity is being flouted in the new economic order. The market outcomes are not to be suppressed according to the new rules of business. However, the rules of market are being regulated in such a way that the benefit of a free market economy would remain unrealized for the weak, as and when the interest of the corporate capital is undermined. For example, according to the principle of free market economy, market is to open up at global scale; there should be unrestricted factor mobility. However, under the new rules of business, factor called capital would transcend national boundaries but labour will not. In other words, factor price equalisation must not be allowed to work in the labour market.

The implication is that the share of labour in the so-called free market economy would be determined by the power of corporate capital. In free market economy, where factors are supposed to have free mobility, the factor price equalisation would work in favour of the labour of the third world economy. Price (wage) being low there because of the existence of reserve army of labour, the labour from the third world would move to the developed economy where labour is scarce. As a result, there will be a general rise in the

wage rate, which, *inter alia*, will increase the share of labour in the output. Since this goes against the interest of the corporate capital, the rule of the game is set in such a way that the price inelasticity of labour would be maintained by restricting the inter country mobility of labour. Capital therefore is allowed to transcend the national boundaries but labour is denied inter country mobility.

Thus, for Mexico, which is a member of the US-led NAFTA, the free trade zone, every restriction on mobility of labour is maintained, in case its labour intends to cross the border and enter the job market in the USA where the wage rate is higher. Mexico, however is to allow the US capital to enter freely in the Mexican economy so that it can reap the benefit of cheap labour there. In sum, the implication of the free market economy in NAFTA is that US corporate capital would move freely to Mexico, but Mexican labour will never be allowed to enter the US labour market. Even in the commodity market, the sanction would be there either in the form of anti-dumping law, or in the form of non-tariff barrier in case there is price distortion at the disadvantage of the corporate capital.

It appears that the corporate capital is to maximise the surplus that is the 'residual' by newer and newer devices. Reducing transaction cost by utilising the Information Technology is one such device. Abolition of middle tier executives in the name of 'lean management,' eliminating intermediaries between production and retail point and outsourcing at reduced costs are some examples of how the transaction costs are being minimized for enhancing 'residual claims'.

The rules of free market economy were never enough for settling residual claims. The law, the informal rules and the convention always play a role in setting the residual claims. Pure theory of economics can hardly help one understand the process which involves economics, state politics, jurisprudence and culture which plays a role in setting social norms and nuances. Through the interplay of these forces a general approval, tacit though, is achieved which the economists would note as Nash equilibrium. The society attains this equilibrium through a complex interplay of various forces, once the rule of business for settling the residual claims are worked out. There was one such equilibrium in pre-globalisation era. The present era of globalization which is designed to enhance the residual claims for capital of this era, corporate capital to be precise, needs to reset the rules of business. The norms and nuances in production and distribution are being reset. Consequently, the law, the informal rules and the conventions are to undergo changes. The society has to attain a new equilibrium under this new dispensation. In the name of reform or restructuring, the society is admitting the new sets of residual claims that goes for furthering the interest of the corporate capital. The law, the state politics, the jurisprudence, the culture—everything has to undergo a process of reforms so that a new equilibrium is achieved. .