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and Low Road Labor Relations: A
Keynes-Marx-Schumpeter Analysis
of Neoliberal Globalization**

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**Slow Growth, Destructive Competition, and Low Road Labor Relations:
A Keynes-Marx-Schumpeter Analysis of Neoliberal Globalization**

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A central lesson drawn from the experience of the decades between the World Wars was that the economic and political fate of the world could not safely be entrusted to unregulated, free market national and global economic systems. History warned that this was a path to economic instability, global depression and political chaos. In the aftermath of World War II, national economies, even those in which markets played a very powerful role, would be placed under the ultimate control of governments, while international economic relations would be consciously managed by the International Monetary Fund (IMF) and World Bank. Trade was expected to rise in importance, but it was thought at the time that the degree of global financial integration would remain modest, with cross border money flows under tight government control. The global prosperity that characterized the quarter century following the war – the “Golden Age” of modern capitalism – reinforced belief in the wisdom of social regulation of economic affairs.

The economic instability that erupted in the 1970s as the structures of the Golden Age unraveled has led us back to the future. The troubles of that decade created a powerful movement, led by business and, especially, financial interests, to roll back the economic regulatory power of the state, replacing conscious societal control with the “invisible hand” of unregulated markets – just as in the period preceding the Great Depression. Though governments still play a large role in most economies, they have ceded an enormous proportion of their economic power to global markets and private interests. The economic theory used to guide and justify this transformation is known as Neoliberalism. Neoliberal enthusiasts promised that this new *laissez-faire* era would dramatically improve economic performance in both developed and developing countries. Unfortunately, these promises have not been kept.

This essay begins with a brief overview of the standard arguments for and against global Neoliberalism and an overview of economic performance in the Neoliberal era. Section II argues that the micro theory appropriate to an analysis of the likely effects of global liberalization is not the neoclassical theory of perfectly competitive markets relied on by Neoliberal supporters, but Joseph Schumpeter’s theory of “natural oligopolies.” Section III presents a theory of the structural contradictions of global Neoliberalism that integrates a Keynesian-Marxian macro perspective with Schumpeterian and Marxian micro theory. The last section considers the political and policy

implications of the analysis.

I. The Great Debate Over Global Neoliberalism

There are two distinct and logically incompatible theoretical perspectives used by Neoliberals in defense of their call for maximum deregulation, liberalization, privatization and global economic integration. Neoclassical or Walrasian general equilibrium theory, which finds its most rigorous formalization in the revered models of Arrow and Debreau, is by far the most influential and widely used theoretical underpinning for the Neoliberal position. It is the only fully specified and widely sanctioned theoretical paradigm offered by economists to justify their support for Neoliberalism. The IMF and World Bank rely on Neoclassical general equilibrium models to support Neoliberal policies, and such models are the stock in trade of the international trade and labor economists who tout globalization's benefits.

There is a second set of arguments, based partly on Schumpeterian ideas about innovation, economies of scale, the positive effects of monopoly power, and the inefficiency of marginal cost pricing, that have been used to defend Neoliberalism. These are examined below.

In the standard Neoliberal view, absent government interference, both national economies and the integrated global economy are believed to operate efficiently, more or less like the models of a perfectly competitive market system found in neoclassical micro economic textbooks. In an unregulated economy with maximum competitive intensity, relative price and profit signals create micro economic efficiency: resources flow to their most productive possible uses. Competitive pressures also keep factor markets at or near market clearing; in equilibrium, there is full employment and optimal capacity utilization. Since interest rates, set in efficient financial markets, assure that investment will equal saving at full capacity output, Say's Law is valid. Aggregate demand always equals full capacity aggregate supply. Given Say's Law, full employment is assured, and inflation control becomes the only legitimate macro policy objective. To contain inflation, Neoliberals support reliance on monetary rather than fiscal policy, and the independence of Central Banks from democratically elected officials.

When fully liberalized, global financial markets will allocate world savings efficiently.

Therefore, as Neoliberalism progresses, real interest rates should decline (once inflation is defeated), investment should rise, and the flow of funds from the capital rich North to the resource rich South should increase. The most productive investment projects will be funded, no matter where in the world they are located.

Since markets allocate resources efficiently, developing country governments are urged to end their reliance on industrial policy. “Getting prices wrong,” as Alice Amsden (1989) put it, in an attempt to construct dynamic comparative advantage is seen as a sure way to destroy development prospects. Replacing state economic guidance with liberalized markets will thus improve output and productivity growth rates in the less developed world.

In sum, defenders of global Neoliberalism argued that it would raise real GDP, productivity, and investment growth rates well above their values in the troubled 1970s, equaling or perhaps exceeding Golden Age performance, while eventually lowering unemployment, inflation and real interest rates. Financial markets would become more stable. Economic performance in developing countries would improve as capital and technology flows their way, creating eventual convergence between North and South.

Section II critically evaluates key Neoliberal micro economic hypotheses. Here I simply observe that even most mainstream economists now acknowledge that, given asymmetric information and principal-agent conflict, markets do not always clear, or generate Pareto optimal prices, even in equilibrium. Keynesian and Marxian critics of macro economic aspects of Neoliberalism argue that Say’s Law has no legitimate defense, even as a crude approximation to empirical reality. Therefore, as the world discovered to its dismay in the Great Depression and its delight in the Golden Age, the state must use macro policy in pursuit of rapid growth and full employment or these objectives will not be consistently achieved. Ceding to monetary policy almost complete responsibility for demand management, while declaring price stability to be the sole legitimate macro policy objective, will retard long-term growth, raise the risk of financial instability, and perhaps even lead at some point to a new depression. Needless to say, a defense of the necessity of government aggregate demand management does not imply either that state economic institutions and policies are always adequate for this crucial task, or that all governments

at all times have had the technical and organizational capacity – or the political will – to do the job effectively. Government regulation of aggregate demand is a necessary, but not a sufficient, condition for healthy, egalitarian growth.

Critics argue that financial markets are inherently unstable because the current value of long lived financial assets depend solely on peoples’ expectations of their future values, and such expectations are bounded only by non-market institutions and social conventions.¹ This is one reason why strong Central Banks were created, why a qualitative increase in US government financial regulation took place after the financial crisis of the early 1930s, why the Bretton Woods system was adopted after World War II, and why tight government regulation of financial markets and control of cross border capital flows were virtually ubiquitous in the Golden Age.

Every development success in the post World War II period, from the high growth Latin American countries in the Golden Age through the economic ‘miracles’ of East Asia, relied on anti-liberal, state guided growth. But IMF, World Bank, and WTO pressures plus widespread financial liberalization are making it impossible to maintain state guided growth, and therefore impossible to achieve economic development. Moreover, financial liberalization creates speculative boom-bust cycles that constrain capital investment and lower average growth rates. In the Neoliberal era, “financial crises seem to occur with almost monotonous regularity,” The Economist recently observed.² It is widely acknowledged that liberalization of domestic financial markets and cross border capital flows was a key cause of the Asian crisis.

In a world of non-clearing markets, key macro variables are determined through the complex interaction of private and public institutions and practices. Section III of this paper argues that in the Golden Age, a *virtuous circle* was formed connecting rapid aggregate demand growth under government Keynesian macro policy management, ‘corespective’ (or partly cooperative) relations among firms in important oligopolistic industries, and worker friendly or high-road enterprise-labor relations. In stark contrast, Neoliberal globalization has created a dynamic interaction among pro-business states (that consider low inflation the only worthwhile macro policy objective), fierce or cutthroat competition in most globally contested markets, and anti-worker, low road labor relations. This triad constitutes an economic *vicious circle* that makes it

impossible to sustain rapid growth, full employment, high investment spending, rapid productivity growth, and distributional equity.

Critics concluded that the extensive liberalization and global integration sought by Neoliberals would lead to the following developments. Inflation obsessed independent Central Banks and instability in global financial markets would keep real interest rates high. With macro policies no longer focused on growth, real GDP and productivity would fail to rise at Golden Age rates. High unemployment, in concert with weaker unions and low road labor relations, would slow real wage growth and raise inequality. Financial markets would become unusually unstable. Developing countries that adopted Neoliberal principles would experience slow long-term growth, greater instability, and sharply rising inequality. These problems were not believed to be the inevitable result of greater global integration. Rather, they would be caused by the uniquely destructive mode of integration associated with Neoliberalism.

Which Side Has the Best Case?: A Brief Look at the Data

Now that the Neoliberal revolution is two decades old, it seems reasonable to ask whether the optimistic predictions of its supporters or the fears of its opponents have been justified by experience.

The evidence to date supports Neoliberalism's critics. The promised benefits of Neoliberalism have yet to materialize, at least not for the majority of the world's people. Global income growth has slowed, as has the rate of growth of capital accumulation, productivity growth has deteriorated, real wage growth has declined, inequality has risen in most countries, real interest rates are higher, financial crises erupt with increasing regularity, the less developed nations outside East Asia have fallen even further behind the advanced, and average unemployment has risen.

The problem is not that the globalization process is too immature to significantly affect economic performance. Liberalization has proceeded at an impressive pace in the past two decades.³ For example, financial capital has become extraordinarily mobile. In 1977, in the midst of petrodollar recycling, about \$18 billion of currency trades took place daily; in 1989, it was \$590 billion. By 1998, \$1.5 trillion moved across borders every day. And foreign direct investment flows, which averaged \$50 billion a year in 1981-85, rose to \$160 billion annually in 1986-91, and were

\$331 billion in 1995.⁴

Not surprisingly, such hyperactive capital flows have been accompanied by increased volatility of exchange rates, and frequent bouts of domestic and international financial instability. The Neoliberal era has been characterized by the near continuous outbreak of financial crises. Martin Wolff of the Financial Times summed up a late 1998 World Bank report on the Asian crisis as follows:

Three crucial lessons can be drawn from the report. It is surprisingly difficult for countries embarking on financial liberalization to avoid disasters. When they succumb, it is no less difficult to escape economic depressions. If short-term capital flows are not tamed, such crises are certain to reoccur.⁵

But freedom of capital flows has not brought lower real interest rates as promised. For the G7 nations, for example, real long term interest rates averaged about 2.6% from 1959-70, and 0.4% from 1971-82, but jumped to 5.6% in the 1982-89 period, and averaged 4% from 1990-97.⁶ High interest rates are one reason why inequality has risen in recent decades; ever larger shares of national income are being transferred from workers and other income claimants to owners of financial assets, who are the richest group in society.

With both real interest rates and exchange volatility risk so high, it is not surprising that most studies report a slowdown in capital investment. According to World Bank data, the annual rate of growth of world real gross domestic investment was 7.0% from 1966 to 1973 at the end of the Golden Age. It then fell to 2.2% from 1974 to 1979, rose modestly to 2.8% from 1980 to 1989, then fell slightly to 2.7% from 1990 through 1996, the last year for which data is available.⁷ Investment growth was especially sluggish in the developed world. OECD countries had an average annual growth of real gross capital formation of 6.3% in 1960-73, 1.5% in 1973-79, 2.4% in 1979-89, and 1.5% in 1989-95.⁸

Other crucial performance indicators display the same pattern. For example, the unemployment rate in OECD countries was 3.2% in 1960-73, 5% in 1973-79, 7.2% in 1979-89, and 7.1% in 1989-95.⁹ The growth of labor productivity, a crucial economic indicator, also deteriorated in the Neoliberal era. In the OECD area, it was 4.6% in 1960-73, 1.8% in 1973-79, and 1.6% in 1979-97.¹⁰

Most important, *world economic growth has slowed significantly*. The most authoritative, widely cited data on global growth rates was compiled in 1995 by Angus Maddison for the Organization for Economic Cooperation. He reported that while annual real GDP growth in the world economy averaged 4.9% in the Golden Age years from 1950 to 1973, it slowed to 3.0% in 1973-92. Western European growth rates fell from 4.7% in the early period to 2.2% in the latter one. Latin America's growth averaged 5.3% from 1950-73, but only 2.8% from 1973-92. Africa grew at a 4.4% pace in the first period, but at a 2.8% rate in the second one. Asia, the last bastion of state led development, was also the only major area not to experience a significant post Golden Age slowdown, maintaining growth between 5% and 6% for the entire era.¹¹

The same results follow if we focus on the decade of the 1990s. World GDP growth averaged but 2.5% from 1991-98, after the Neoliberal regime had been firmly established – by far the slowest growth rate of the post war era. The growth rate of world real per capital GDP growth was just as disappointing, averaging only 1.0% per year in the 1990s, less than one third its Golden Age pace. Most of this growth was in Asia.¹² Developed nations had an average GDP growth rate of only 2% from 1990 through 1998. Latin America growth averaged 3.4% from 1990-98, better than in the “lost decade” of the 1980s, but much lower than in the Golden Age. Desperate Africa showed GDP growth of only 2.2% a year from 1990-98. By way of contrast, the state-led economies of East Asia grew by 6.7% from 1990-97, prior to the outbreak of financial crisis in that region.¹³

Ironically, it is only the outstanding performance of the state-guided, anti-Neoliberal East Asian economies that kept developing country growth, inequality, and poverty rates from being even more disappointing. For example, the proportion of the population living on less than \$2 a day in Asia fell by 39% from 1987 to 1998, but no progress in poverty reduction took place in Latin America and sub-Saharan Africa in the same period.¹⁴

Economic performance has deteriorated – on average and for majorities – virtually everywhere but in pre-crisis Asia. And even the majority of people in those East Asian countries most affected by the recent crisis have lived through a significant deterioration in their economic environment. In 1997 the United Nations Conference on Trade and Development evaluated global economic performance in the Neoliberal era. Their report drew the following conclusions.

- Taken as a whole, the world economy is growing too slowly to generate sufficient employment with adequate pay or to alleviate poverty;
- This has accentuated longstanding tendencies for divergence between developed and developing countries;
- Capital has gained in comparison with labour;
- There is almost everywhere increased job and income insecurity.¹⁵

II. Schumpeterian Versus Neoliberal Micro Theory and the Globalization Debate: The Importance of Natural Oligopolies

Does Maximum Competition Really Lead to Maximum Efficiency?

We turn to the most abstract level of the Neoliberal argument, focusing on one critical failure of neoclassical theory as applied to global liberalization that is rarely discussed in the globalization literature. Many of the most important global markets, in goods and services, are significantly mis-characterized by the basic assumptions of neoclassical micro theory. For this reason alone, without regard to the problems of aggregate demand growth and financial instability already noted, the thesis that maximum liberalization in these markets will lead to the best possible outcomes is severely flawed.

Global trade and investment are dominated by key industries – such as autos, electronics, semiconductors, aircraft, consumer durables, shipbuilding, steel, petrochemicals, and banking, for example – which I will call *core industries*. They can be realistically characterized in the following way.

First, they have large economies of scale, both in the production process (at the plant level), and with respect to the firm as a whole, in advertising and distribution efforts that build and maintain brand loyalty (consider, for example, the case of US breakfast cereals or laundry products), in supplier networks, in access to finance, in research and development, and in the organization of the firm itself.

Second, because of scale economies, the capital investment required to enter these industries with best practice or minimum cost capability is very large. For example, General Electric, Ford Motor Company, and IBM have total assets of \$304 billion, \$275 billion, and \$82

billion respectively.¹⁶ Entrance at minimum efficient scale thus creates a non-trivial increase in industry capacity.

Third, the production process is not subject to the 'law' of diminishing returns. The standard neoclassical assumption of perfect substitution among inputs in the short-run production function, which underpins the law of diminishing returns, is not empirically accurate: short-run factor substitutability is in fact quite limited. Thus, marginal cost will either fall, remain constant (a standard heterodox assumption), or will rise but slowly as output increases, at least until capacity is reached.

Fourth, the assets of the firm, both physical and organizational, are significantly immobile, irreversible, or specific. Once in place, they lose substantial value if re-allocated to a different industry or sold on a second hand market. For example, Ramey and Shapiro, in an NBER study of the aerospace industry, estimated that "capital that flowed out of the sector sold for only one-third of its estimated replacement cost" (1998, abstract).

Fifth, agents cannot generate expectations of future economic states that are either objectively correct, or that they subjectively believe to be complete and correct. The future is unknowable in principle: we live in a world of fundamental or Keynesian uncertainty.

Consider first the neoclassical assumption that firms are relatively free to enter and exit all industries. This is the *sine qua none* of the neoclassical thesis that maximum global liberalization will create static allocative efficiency in the global economy. Unrestricted exit assures the quick flow of capital out of industries with below average profit rates, freeing resources to move to above average profit rate industries. Free exit is thus a condition of existence of efficient asset reallocation in response to changes in relative prices.

However, when productive assets are substantially irreversible, the neoclassical defense of allocative efficiency in unregulated markets is dramatically weakened because exit is not free, but entails a major capital loss for the firm. A firm that moves from an industry with below average profits to an industry with above average profits will have less capital in the new industry than it had in the old. Even if the new industry has a significantly higher profit rate, it may well be more profitable for the firm to stay put.

But if there is little freedom of exit, it follows logically that there cannot be substantial freedom of entry, even for newly produced capital. Free entry eventually eliminates the profit rate differential which enticed it; that is what ensures efficiency. A neoclassical firm with perfectly mobile capital can enter an industry to take advantage of even a temporary profit rate differential, then exit without cost when it disappears, to enter some other temporarily profitable industry. This is sometimes referred to as “hit and run” mobility. However, when capital is irreversible, and economies of scale prevail, entrance entails substantial risk of major loss. Any firm considering entry would know that were the profit rate in the new industry to fall below average in the future, it would not be able to exit except at great capital loss. For firms with high debt to equity ratios, entry into an industry whose profit rate were to later decline would lead not just to capital loss, but to possible bankruptcy. Entry into core industries is thus unlikely unless demand growth has been quite rapid and industry profit rates high for an extended period, the entrant has some revolutionary innovation, or incumbents have misused their market power and become extraordinarily inefficient. In normal times, therefore, core industry firms can sustain above average, oligopoly profits.

Since this argument about exit barriers applies both to existing and new capital, asset specificity drastically undermines the claim that unregulated markets have either static or dynamic allocative efficiency. To the extent that core industry firms appear to operate efficiently, and historical evidence suggests that their performance is at times exemplary, it must be the result of dynamic efficiencies that do not exist in neoclassical theory.¹⁷

Asset irreversibility undermines freedom of entry through a second, independent channel. A profit maximizing outside firm will only enter an industry if its post entry revenues are expected to cover the full cost of the capital and organizational assets needed to survive in the industry; expected price must cover total cost per unit. But a firm already in the industry knows that if it were to exit, it would lose a substantial part of the value of its physical and organizational assets. The opportunity cost of the continued use of existing assets is thus measured by the best alternative return on their use multiplied by their post exit value, which might be, say, one-third their within industry value. Thus, an incumbent firm will remain in the industry even if, in this

example, price covers only one-third of its within industry capital costs.

Suppose incumbent firms want to deter entry in order to continue to achieve above average oligopoly profits. To accomplish this, they can threaten potential entrants with a vicious price war upon entry. The fact that incumbents can survive for years even if price drops so low that revenues cover little more than variable cost, whereas a rational outsider would never enter unless price was expected to cover average total cost, makes their price-war threat credible. The greater the degree of asset specificity, then, the greater the power of incumbents to deter entry. As Oster puts it: "Heavy reliance on specific assets encourages firms to stay in an industry even when times are bad, simply because there is nothing else they can do with these assets" (1999, p.37). Above average profits in core industries are protected against erosion via entry by asset specificity.

In the neoclassical model of perfect competition, profit maximizing firms always raise output if price exceeds marginal cost. This increases industry supply, driving output price down. In equilibrium, therefore, price must equal marginal cost; in the absence of this property, competitive markets would not exhibit static efficiency. A necessary condition for the coherence of this model is its assumption of perfect factor substitutability in production. It is this assumption that makes the ratio of capital to labor fall as the number of workers increases, which in turn causes marginal cost to rise rapidly as output is increased. Since fixed costs are assumed to be relatively unimportant, marginal cost will exceed average total cost except at very low output levels. This property is reflected in the standard cubic total cost functions used in neoclassical textbooks, which generate quadratic marginal cost functions. The marginal cost pricing associated with perfect competition is thus consistent with equilibrium in the neoclassical model because in equilibrium the firm receives (just) enough revenue to cover both its variable cost and the cost of using its capital assets.

But since core industry firms have significant scale economies, and short run factor substitution is quite limited, fixed costs will be large, as will fixed costs per unit, and marginal cost will rise slowly, if at all, with output. A simple total cost function, such as $C = k + xQ$, where C is total cost, k is total fixed cost, x is marginal cost (assumed constant and very small relative to k), and Q is output, incorporates these assumptions. Since marginal cost is x , and total cost per unit is

$(k/Q + x)$, *marginal cost is everywhere below average total cost in core industries.* A recent Wall Street Journal article noted that “instead of decreasing returns to scale, which the textbooks argue keep companies from getting too big, the new economy is characterized by increasing returns to scale.” It cites digital telecommunication firms as examples, noting that they are driven “almost inevitably to massive scale.” They can “be difficult and costly to build; but once built, they can be expanded almost at will, since the [marginal] cost of replicating digits is minuscule.”¹⁸

Therefore, if, in a core industry, competition were to keep price equal to marginal cost, as would be the case with maximum or perfect competition, firms could never earn enough money to recoup their investment in fixed capital. In equilibrium, the average firm would be losing money: *under perfect competition, neither the firm nor the industry could reproduce itself over time.* Thus, the assumptions that core industry fixed costs are large, that marginal costs rise slowly, if at all, and that most firms earn, on average, enough to reproduce themselves, are logically incompatible with the assumption of perfect competition. This logic brings us to a conclusion that is central to the globalization debate. *Core industries cannot possibly be organized for long periods of time through perfect competition.* Yet the assumption of perfect competition must be adopted by supporters of global Neoliberalism who wish to enlist the prestige of neoclassical economic theory – such as it is – on their side of the debate.

This argument can be stated differently. Assume that liberalization induces aggressive new firms to enter a profitable core industry, triggering an all out war over market share that threatens the survival of incumbents. Given large scale economies, entry will cause substantial excess capacity to develop, putting every firm under intense pressure to cut price in order to spread fixed costs over greater volume. Even if this price war pushes price well below average total cost, most firms are unlikely to exit because of the large, assured capital loss exit will bring. Even if the war goes on for quite a while, firms may rationally refuse to exit. Every firm knows that at some future period, when enough firms have been forced to exit, the survivors will earn oligopoly enhanced profits once again. But, given fundamental uncertainty, no firm knows for sure that it will not be among the survivors. Facing the certainty of large losses if they exit, and a positive but uncertain chance of above average profits if they survive the struggle, most firms will remain in the fight, prolonging

industry losses. In the case of core industries then, the maximum competitive intensity sought by Neoliberal reforms may lead not to efficient resource allocation, but to the dynamic inefficiency associated with long term excess capacity, low profits or losses, and excessive indebtedness.

To make things worse, there is no guarantee that the most efficient producers will be the winners. Those most likely to exit are firms that go bankrupt because they relied heavily on debt to finance asset acquisition. Bankruptcy *may* help reduce industry excess capacity, though it is quite possible that the assets of the bankrupt firms will be resold at bargain prices to firms that remain in production. But, as Keynes argued, reflecting on the situation in the British cotton industry in the 1920s, the correlation between technological or cost inefficiency and indebtedness and vulnerability to bankruptcy may be weak.¹⁹ Inefficient, conservative firms may have the least debt, while the most efficient firms may be most indebted because they invested aggressively in debt financed new technologies. Victory may well go to those with the deepest pockets, not to the most efficient producers, a point to which we return.

Two important conclusions follow from this analysis. First, core industries characterized by large scale economies and limited short run factor substitutability cannot, for long, be organized through the intense competition sought by Neoliberals. They are what John Maurice Clark called “*natural oligopolies*”: their firms *must cooperate* sufficiently to maintain industry price far enough above marginal cost to cover total cost per unit for the average firm. Joseph Schumpeter designated such interfirm relations, that include both competitive and cooperative dimensions, “*corespective competition*.”

Second, since core industries include many of the largest and most important industries in national economies and in world trade and investment, and serious ‘natural’ barriers to entry and exit are inherent in their basic structure, the central Neoliberal thesis that maximum liberalization, creating maximum competitive intensity, will lead to stable and efficient economic outcomes is fundamentally mistaken. These barriers could not be eliminated by the termination of every form of government interference with free market competition. For this reason, *there is no legitimate foundation for the presumption that liberalization will lead, through increased competitive intensity, to the efficient allocation of new or existing resources around the globe*. On the contrary, maximum

liberalization in core industries is likely to trigger a long period of destructive struggle leading to the kinds of inferior outcomes seen in the past two decades.

Indeed, globalization has already initiated what is likely to be a long period of restructuring through mergers, alliances and bankruptcies, that could eventually culminate in re-oligopolization across national lines, where no political jurisdiction either capable of, or willing to, regulate the new oligopolists in the public interest currently exists.

A comment on the new Neoliberal Schumpeterians mentioned earlier is in order. US Treasury Secretary Lawrence Summers, a former winner of the prestigious John Bates Clark Award given bi-annually by the American Economic Association to the most outstanding economist under the age of forty, recently gave a talk on the “new economy” that represents this position well.²⁰ He argued that we were moving inexorably toward an “information-based” world in which the most important industries would “involve large fixed costs and much smaller marginal costs.” This “new economy is Schumpeterian” because:

the only incentive to produce anything is the possession of temporary monopoly power – because without that power the price will be bid down to marginal cost and the high initial fixed cost cannot be recouped. So the constant pursuit of monopoly power becomes the driving force of the new economy. (2000, p.2)

Given virtually limitless economies of scale, governments should do everything possible to maximize the size of markets. The “crucial implication for those of us in government is that policies that help to expand the size of markets in any way become that much more important.” Support for maximum deregulation and global integration follow: deregulation “ensures that government is not preventing or distorting the development of fast growing markets,” and “support for international trade becomes much more important – because it enables us to take better advantage of the new economies of scale” (2000, p. 4).

The reader of Summer’s speech might well be astonished at the lack of *any* empirical evidence presented in support of these policy conclusions. If economies of scale are “huge” and rising rapidly, then it is not at all obvious that mere “temporary” monopoly power will provide an incentive strong enough to induce the investments needed to maintain dynamic efficiency. It would seem logical to assume that market power over an extended time period would be necessary

to assure that “the high initial costs [can] be recouped,” otherwise the destructive aspects of “creative destruction” would dominate its creative aspects – especially in an environment when so much investment is debt financed. But if this is so, would not a world of monopolistic giants require a powerful new domestic and/or international government agency to regulate them in the public interest?

Summers is aware that these Schumpeterian assumptions destroy the standard Neoliberal arguments for global liberalization. They totally alter “what it means to say that a market is efficient,” he argues, and make traditional neoclassical micro theory useless as a guide to policy (2000, p. 1). The “right metaphors for the new economy are more Darwinian, with the fittest surviving, the winner frequently taking all” (2000, p. 2). Summers and others like him thus cavalierly reject neoclassical micro theory, the most influential and widely used defense of Neoliberalism, and replace it with nothing more rigorous or ‘scientific’ than a few interesting assertions about the nature of competition and innovation in the “new economy.”

However flawed neoclassical general equilibrium theory may be, and it is indeed deeply flawed, replacing it with a few ‘stories’ about Schumpeter’s “gale of creative destruction” as the only line of defense for Neoliberal globalization seems like a very risky ideological gambit. There is no widely accepted formal – or, indeed, informal – model of an integrated Schumpeterian market system, no analogue to the Walrasian general equilibrium system taught in every economics department. There is no well specified model that carefully investigates the systemic effects of a rolling sequence of massive, largely debt financed, immobile investments in one industry or technology after another, each of which is quickly devalued by the continuous gale of destruction Summers envisions? Arguments like those presented by Summers are either derived from formal models of a single isolated market, or are merely hunches or guesses about how things might possibly work in a simplistic Schumpeterian system. As such, they have little if any professional standing, or no claim to the pseudo-scientific status neoclassical economics aspires to. They thus provide a totally inadequate foundation on which to build support for a radical new global economic system such as Neoliberalism. The world is being asked to put its economic future at great risk based on nothing more than the guesses and intuitions of a small group of free market

devotees.

A Theory of Natural Oligopolies

A useful theory of globalization requires a theory of the behavior of natural oligopolies. The idea that most important industries do not have the necessary attributes to be efficiently organized through perfect competition is not new; it can be found in the work of many modern theorists (such as, for example, Best 1990, Bowring 1986, Chandler 1990, Lazonick 1991, Oster 1999, Perelman 1999, Porter 1980, and Sylos-Labini 1962). But in the history of economic thought, the theory of natural oligopoly is most closely identified with the work of Joseph Schumpeter 1976 [1943] and John Maurice Clark 1961. They argue that the conditions required for perfect competition exist only in a small number of industries, the great majority of which are not of major importance to national or global economic performance.²¹ As Schumpeter put it:

perfect competition is the exception and ... even if it were the rule there would be much less reason for congratulations than one might think. If we look more closely at the conditions ... that must be fulfilled in order to produce perfect competition, we realize immediately that outside of agricultural mass production there cannot be many instances of it. (1976 [1943], pp. 78-79).

As noted, fixed cost per unit will be dangerously high in core industries unless firms can operate near optimal rates of capacity utilization, where the excess of marginal cost over average total cost is smallest. The reproduction of the industry over time thus requires enough cooperation among incumbents to maintain price above average total cost and keep excess capacity from becoming too large. Fortunately, the economies of scale associated with these industries and the substantial immobility of their assets constitute entry barriers that limit the number of firms who can achieve minimum efficient scale. Thus, they simultaneously create the need for, and the conditions required for, cooperation among leading firms. The smaller the number of firms, the easier it is to establish coordination agreements and prevent defection from them.

“Corespective” rather than perfect or cutthroat competition is required in natural oligopolies for at least four reasons. First, price wars must be avoided. It is imperative that price be held significantly above marginal cost, especially in times of sluggish demand and high excess capacity, when the incentive for firms to cut price and increase production to reduce fixed cost per

unit is at its highest. Consider that the industry price wars that took place in the last decades of the nineteenth century in the US, when rising economies of scale and rapid technical change were causing dramatic declines in total cost per unit at optimal operating rates, led to such widespread losses and bankruptcies that they ushered in a merger and consolidation wave, which culminated in the rise of the Great Trusts of the era.

Second, high trend excess capacity must be avoided. The industry must establish some method of investment coordination that can prevent supply from running too far ahead of demand. Excess capacity lowers the industry profit rate. Moreover, if one firm builds capacity much faster than industry demand is growing, that firm will be in a position to initiate a price war, because it will have the capacity to accommodate large customer defections from the other firms. The restriction of excess capacity to the amount needed to accommodate expected future demand and provide a cushion against uncertainty creates an environment conducive to cooperation because it guarantees that no competitor can significantly profit from severe price cutting. The very act of building disproportionate capacity is therefore likely to destroy interfirm cooperation because it will induce other firms to over-invest in self-defense, in preparation for a price war. Excessive investment or over-investment in a natural oligopoly can result from defensive acts, not just from aggression or firm optimism about future demand and profit growth, a point further explored in section III, where 'coerced' investment is analyzed.

Third, corespective competition may be a necessary, though not a sufficient, condition for the adoption and maintenance of partly cooperative or 'high road' enterprise-labor relations. High road labor relations were adopted by most of the successful global core industry firms in the post World War II era. To be able to initiate and react efficiently to innovations and to environmental change of all types, and to achieve a high degree of production efficiency, firms need a loyal, experienced and flexible labor force, one that has maximum firm specific skills. To attract and maintain such a workforce, firms may have to offer workers benefits such as job security, wages that rise with experience, decent treatment on the job, acceptance of unions, and a fair share of the company's productivity gains. It is especially likely to offer these benefits in economies where unions are strong, unemployment is low, and the government supports the labor movement.

Destructive competition, on the other hand, eliminates firms' ability to maintain the high road because it perpetually undercuts their profits, forcing them, as a condition of short term survival, to minimize cost at each point in time. Short term cost minimization requires wage cuts, replacement of high with low wage workers, work speedup, reneging on implicit contracts, as well as layoffs whenever demand fails to grow as fast as productivity. Maximum competition thus forces firms to adopt low road labor relations; corespective competition does not.

Fourth, and most important, *corespective competition in natural oligopolies is necessary to achieve fast paced capital accumulation and rapid innovation*, the forces that create high long-term productivity growth. It is difficult to induce long lived investment and innovation in the unprofitable and uncertain environment that destructive competition generates. Cooperation is conducive to investment and innovation because it raises the industry profit rate and prevents profits created through investment or innovation from being eroded by excessive competition. It also lowers the uncertainty associated with the expected return on investment.²² Note that in periods with fast paced capital accumulation, rapid innovation, and rising productivity, sustained industry demand growth is a necessary condition for cooperative behavior because without it, the industry cannot avoid rising excess capacity, which leads to price wars.

Natural oligopoly theorists such as Schumpeter and Clark emphasize that the impressive long run historical record of rapid economic growth, rising output per worker, and rising per capita income in the advanced capitalist countries, had little to do with the alleged static efficiency properties of free, competitive markets. Rather, they insist along with Marx that the great accomplishments of capitalism result from the combined effects of capital accumulation (including the buildup of human capital) and innovation, which includes, but is not limited to, technical change. In the twentieth century, private capital accumulation has been concentrated in natural oligopolies, which have also been the site of the implementation, if not always the invention, of the most productive economic innovations. Innovations create new products, improved production technology, more effective organization of the enterprise (for example, the creation of the multi-division firm made it possible to efficiently administer ever larger enterprises), new sources of material supplies, growing product markets that are required to take advantage of economies of

scale, and new sources of finance. It is the dynamic efficiency largely associated with natural oligopolies, not static efficiency, that matters in the long run.²³

There are good reasons why so much capital investment and such a disproportionate share of innovation has taken place in natural oligopolies. Huge capital investments in long lived, immobile assets of the kind needed to compete in natural oligopolies put the owners of the firm at risk of great potential loss. And major innovations often require years of trial and error, large investments in R&D and in engineering talent, numerous false starts, and many mistakes in implementation, even after the right general path has been identified. Yet though the costs of innovation are often great, the possible sources of failure are almost too numerous to list. The potential entrant faces the possibility that the industry will decline, or that a price war with more established incumbents, who may have deeper pockets, will erupt. The inside innovator faces the possibility that the industry will decline, or that the innovation will fail, or that some other innovator will implement the innovation first, or, perhaps worst of all, that the innovation will be quickly and inexpensively copied by competitors should it prove to be successful.

Given such risk, the question arises as to why any firm is willing to enter industries with large economies of scale, or why any firm seriously contemplates shouldering the large, certain costs of a major innovation when the benefits are so uncertain. What provides the necessary incentives and what keeps perceived risk down to manageable levels?

The theory of perfectly competitive markets is not helpful here, because it cannot deal with significant scale economies and denies the existence of fundamental uncertainty. Indeed, given its assumptions, it would be irrational for any neoclassical firm to ever undertake a costly search for a major innovation. If capital is perfectly mobile, entrance free, and all economic knowledge freely available to everyone, there is no incentive to engage in costly innovation. The knowledge associated with any innovation is assumed to be immediately and freely available to all, so no competitive advantage accrues to the innovator. If the innovation reduces unit costs, perfect competition guarantees that price will quickly fall, eliminating the above average profits innovation brings. Industrial organizational theory acknowledges this fundamental flaw in the theory of perfect competition, and deals with it by recognizing the need for patents, and tax incentives for

R&D spending. Patents, which have seventeen year lives in the US, give firms monopoly rights to the super profits that accrue to innovation, solving the incentive problem nicely, though preventing the benefits of innovation from being shared with consumers for almost two decades. However, many important innovations have not had patent protection, and many firms and industries have managed to maintain above average profits even after the patents that created them ran out. How is this to be explained?

The theory of corespective competition in natural oligopolies stresses the fact that large, risky investments will not be undertaken unless the organization of the industry offers both high rewards and insurance against excessive risk and uncertainty to the successful investor. Corespective behavior provides the key insurance policy; as long as it prevails, destructive competition will not trigger the excess capacity associated with an investment war, or lower price by enough to eliminate above average profits, or generate excessive uncertainty. Barriers to entry make it possible for such industries to maintain above average profit rates for decades, providing the incentive needed to induce costly and risky innovation. Industry competitors will of course try to copy and improve on the initial innovation, but once we acknowledge that information is asymmetric and often tacit, and very costly and time consuming to acquire even where acquisition is possible, the profits created by an innovation are likely to accrue to its initiator for a long time.

Schumpeter also called attention to the fact that significant innovations often come in cumulative bursts, rather than in a single once-and-for-all change. One firm changes a product or process, another finds a way to improve on it, and so on. It often takes experience and learning by doing to establish the innovation's final form. This phenomenon, which "profoundly affects" the efficiency with which firms respond to technical change, is "invariably overlooked." To be dynamically efficient and avoid the premature obsolescence of its capital stock, a core industry must allow firms either to extend the time between the introduction of new techniques, or to skip over some stages of a cumulative innovation process.

This is what might be called *ex ante* conservation of capital in expectation of further improvements. Frequently, if not in most cases, a going concern does not simply face the question whether or not to adopt a definite new method of production that is the best thing out and, in the form immediately available, can be expected to retain that position for some length of time. A new type of machine is in general but a link in a chain of

improvements and may presently become obsolete. In a case like this it would obviously not be rational to follow the chain link by link regardless of the capital loss to be suffered each time. (1976 [1943], p.98)

Destructive or perfect competition makes firms “follow the chain link by link,” creating a coordination failure that is, as Schumpeter stresses, irrational for the industry. Each firm has to invest in every possible phase of the innovation process because if it skips a link that its competitors acquire, it will lose customers and endure rising excess capacity because its products are inferior to, or its variable costs higher than, those of other firms. Under destructive competition, a wave of innovative activity could leave in its wake a mass of obsolete, devalued capital. If these investments are large and entail substantial debt financing, the industry could develop severe financial fragility. In contrast, corespective behavior allows dominant firms to coordinate investment – to manage the pace of implementation of innovation, permitting maximum industry gains from the process. One vintage of capital may be kept in place long enough to generate revenues that cover its cost before the next vintage of capital is adopted, or one stage of a multi-stage process of capital embodied technical change may be skipped altogether. Firms can wait for the next, superior vintage before investing. In this way, the destructive dimension of Schumpeter’s “gale of creative destruction” can be minimized without sacrificing its creative dimension.

Having examined various reasons why cooperation is essential in natural oligopolies, and why natural oligopolies are an essential part of the development process, it is necessary to address the balance between cooperation and competition that must be maintained in these industries if they are to remain viable and be dynamically efficient. When corespective relations are stable, competition that puts industry growth and profitability in jeopardy tends to be avoided. This helps prevent excessive price competition and capacity expanding investment wars. However, the struggle across other dimensions of competition may be quite intense. Firms may fight within broad limits over market share through advertising, and by developing more effective marketing and distribution systems. Product differentiation and the development of brand loyalty is an ongoing process.

By far the most important forms of competition over the long run involve new products,

improved technology, and organizational change. Depending on the industry, large resources may be invested in R&D, either to be able to initiate innovation (offensive competition) or to be able to respond quickly if some other firm introduces an important product or process innovation (defensive competition). *There is a strong incentive to cut costs over time, because it is the low cost firms that have the strongest exit options should coresponsive behavior break down.* Indeed, if one firm develops a large enough cost advantage over its competitors and has created substantial excess capacity, it is in position to initiate a war to reorder relations of domination in the industry. All important firms therefore, if only in self defense, must try to keep pace with the industry's low cost producer. The kind of competition that is crucial for dynamic efficiency, Schumpeter insists, is not the price competition focused on in neoclassical theory.

In capitalist reality as distinguished from its textbook picture, it is not [price] competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization (the largest scale unit of control, for instance) – competition which commands a decisive cost or quality advantage and which strikes not at the margin of the profits and outputs of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door, and so much more important that it becomes a matter of comparative indifference whether competition in the ordinary [static] sense functions more or less promptly; the powerful lever that in the long run expands output and brings down prices is made of other stuff. (1976 [1943], pp. 84-85)

The last point emphasized by Schumpeter, on the source of long term price decline, is extremely important. Dominant firms in natural oligopolies cannot set price as high as they please. Though large barriers to entry give them a good deal of pricing leeway, they cannot let price or profit rates get so high that they entice outsiders to the industry. It is entry prevention pricing combined with competitive pressure to lower cost which induces firms in natural oligopolies to eventually share the benefits of long term productivity improvements with consumers in the form of lower prices.²⁴

It should be noted that coresponsive relations among dominant firms in natural oligopolies do not last forever, though history does provide examples in which they have lasted for a very long time. They are subject, one might say, to the law of uneven development. An initial distribution of

relative power among firms, leading to a particular mode of domination and cooperation, is likely to change over time, possibly triggering an outbreak of war within the industry. If the barriers to entry are initially large enough, cooperation may become too cozy and competition too weak, eventually creating a large gap between the best available technology and current industry practice, and between the potential and actual efficiency of incumbent firms. These gaps are likely to induce a successful invasion of the industry by more technologically and/or more financially powerful domestic or foreign firms. The collapse of the global dominance of “Big Steel” in the US after the 1960s is just one example of this phenomenon.

The policy lesson to be drawn from this discussion is that society cannot depend solely on markets to ensure that powerful groups of corporations will operate in a manner consistent with the interests of the majority of the population – no matter what form of competitive relations prevails in core industries. The argument that “perfect” competition will destroy core industries does not imply that coresponsive competition assures socially efficient performance. It is imperative that the competitive environment be effectively regulated by government bodies that are both competent and politically insulated from the corporations they oversee.

The implications of this analysis of core industries for the debate on globalization are self evident. The acceleration of liberalization across the globe in the past two decades strongly eroded the conditions necessary for the maintenance of coresponsive behavior in many of the world’s most important industries, as state imposed barriers to entry fell almost everywhere, financial capital began to move rapidly back and forth across national borders, and technological change made it easier to shift real capital around the world and locate virtually any corporate function any where without loss of efficiency. This raised the intensity of competition in most of the globe’s core industries. Of course, there were benefits associated with these changes. Important new, technologically advanced industries emerged. Some inefficient firms were forced to improve or die; the creative destruction of intense competition is needed from time to time to eliminate the least efficient producers and destroy outdated capital. Some firms from the developing world were also able to gain greater access to financial capital, and create needed economies of scale by moving into newly opened Northern markets.

But it must be remembered that natural oligopolies cannot reproduce themselves over long periods under excessive competitive intensity. At some point, theory tells us, the competitive wars raging across global industries will begin to create winners and losers, the forces of consolidation will overwhelm the forces of competition, and industries will begin to re-oligopolize. We have already seen this process emerge in many industries in the great merger and acquisition boom of the 1990s.

Karl Marx developed perhaps the most important single insight into the relation between competition and cooperation in the history of economic thought. He believed that neither pole of this relation ever gained permanent domination over the other; rather, their relation changed dialectically across time. In the following quotation, the term monopoly should be broadly interpreted as cooperative interfirm relations.

In practical life we find not only competition, monopoly and the antagonism between them, but also the synthesis of the two, which is not a formula, but a movement. Monopoly produces competition, competition produces monopoly. Monopolists are made from competition; competitors become monopolists. ... and the more the mass of the proletarians grows as against the monopolists of one nation, the more desperate competition becomes between monopolists of different nations. The synthesis is of such a character that monopoly can only maintain itself by continually entering into the struggle of competition. (1963, p. 152, emphasis added)

At the present moment, the drive to re-oligopolize in core industries grows ever more intense even as the winds of destructive competitive continue to howl across the globe.

III. Structural Contradictions of Global Neoliberalism: From the Virtuous Circle of the Golden Age to the Vicious Circle of the Neoliberal Era

Say's Law has no relevance to the real world, and the neoclassical theory of perfectly competitive markets cannot explain, even to a first approximation, the dynamics of important global industries. Integrating insights from Keynesian and Marxian macro theory with Schumpeterian and Marxian perspectives on competition leads to the conclusion that long term, widely shared prosperity cannot be achieved by unregulated markets. Rather, it requires the creation of an effective, historically contingent, complex, interrelated set of government and

private institutions and practices. This section stresses the complexity and inter-connectedness of such arrangements. In the Golden Age, governments could act effectively only because of the healthy condition of the private economy, and the private sector could grow rapidly only because of effective government economic policy. Global Neoliberalism has destroyed the conditions required for a productive, symbiotic relationship between state and market, and between micro and macro economic activity.

To achieve sustained economic good times, governments must regulate industrial and financial markets, see to it that aggregate demand grows fast enough to maintain high employment, keep excess capacity low, and secure the conditions needed for co-respective relations among core industry firms, and to take whatever actions are required to counter the market's natural tendency toward inequality and instability. If the state performs these tasks adequately, markets may function reasonably well for a time. But ongoing market processes eventually undermine the initial conditions that enabled them to function successfully. Any set of government institutions and policies adequate to generate egalitarian growth in one period, will become to some degree obsolete and ineffective as conditions in the market economy evolve over time. The challenge to design institutions capable of exercising adequate social control over markets, though not necessarily the political power needed to do so, is thus presented anew to each generation.

Consider the conditions that generated the Golden Age. First and foremost, class power relations were such that a growth-with-equity policy regime was *politically* feasible. The 'social contracts' of the era committed most interest groups to at least passive support of progressive national economic policy objectives. Elites went along in part because strong capital controls and low levels of trade and investment flows after the war left them without an effective run-away option. In the absence of cross border mobility, industrial firms and rentiers could not credibly threaten to undermine government economic policies they did not like. Their fates were thus tied to the health of their national markets; to grow and remain profitable, industrial and financial capital needed a prosperous domestic economy with high employment and rapidly rising mass consumption. Given these conditions, and the general fear of the political consequences of a return to depression, governments around the developed world accepted responsibility for

regulating aggregate demand growth, and used macro policy to pursue growth and high employment. Under the political conditions of the time, Western governments, with varying degrees of enthusiasm, lent their support to unions, passed worker friendly collective bargaining laws, regulated business, tightly controlled financial markets, and built social welfare systems that gave workers reasonable exit options in their negotiations with employers and held poverty and inequality in check. These laws and regulations, in concert with strong union movements, sustained low unemployment and high road management-labor relations in many core industries, helped maintain a better power balance between capital and labor in both the political and economic spheres than had previously been the case. An important lesson from the Golden Age experience is that state guided growth functions most effectively when: (1) the interests of the majority of the population strongly influence the political process; and (2) the institution and policy structure is such that government has the power needed to effectively regulate business behavior.

Core industries played an influential role in Golden Age developments. Natural oligopolies across the North – in autos, steel, rubber, aluminum, consumer durables, and so forth – had a disproportionate share of physical capital, profit and investment spending, did most private sector research and development, and generated the highest productivity gains. Consistent with John Kenneth Galbraith's theory of counter-veiling power, they also were the industries with the largest and most militant unions; this facilitated a relatively equitable sharing of oligopoly 'rents' through productivity based real wage increases.²⁵ These industries were dominated by a small number of firms – such as the “big three” in US autos and steel, which made interfirm cooperation feasible. An analogous situation prevailed in East Asia and in high growth Latin American countries where large firms in key industries thrived in part because they were protected from the most destructive aspects of competition.

Thus, conditions necessary for corespective interfirm relations were present in the Golden Age. Aggregate demand was rising rapidly, so firms could reasonably expect their industry to achieve sustained growth. This meant that capacity utilization could remain high even in the face of rapid investment and innovation, a necessary condition for cooperative interfirm relations.

Corespective relations in turn kept average profit rates high and contained instability and uncertainty, providing the incentives needed to induce long lived investment and innovation. In this environment of contained uncertainty and assured high profits, firms in core oligopolies could engage in long-term planning, generously fund R&D, offer lifetime employment to most workers (thereby making labor a quasi-fixed firm asset), and manage the introduction of new technologies to ensure that capital equipment did not become obsolete before its pay-back period was over. Long term horizons also permitted the development of efficient supplier networks, and made the provision of 'patient' capital possible. Moreover, profits were high enough to finance most investment internally and, since real interest rates were low, indebtedness was held within safe bounds.

Most important, long term planning horizons made it possible for firms to choose high road labor relations. If firms can credibly offer workers benefits such as long-term job security, reasonable pensions, a fair share of productivity gains, and wages that rise with seniority, workers are likely to offer firms loyalty, flexibility, honest effort, and investment in firm specific skills in return. This is the productivity enhancing "implicit contract" that most industrial relations experts were so enamored with, at least until recently. High road relations are usually associated with the Japanese firms that dominated world trade in the 1980s, but they were also used by successful German firms and core US industrial firms in the Golden Age. Some aspects of high road relations are also found in successful, non-Japanese East Asian firms, though at times accompanied by brutal suppression of labor rights. Casual empirical observation strongly suggests that throughout the post World War II era, the most successful firms in the world relied on high road labor relations. Acceptance of high road labor policies did not prove that top corporate managers were progressive, union loving people. It suggested only that given the conditions of the time, which included low unemployment, strong unions and labor friendly governments, high road labor relations were either understood to be an effective means to achieve key firm goals, or that, at a minimum, serious labor conflict was seen as too costly to provoke. Of course, from time to time, the strength and resolve of unions were tested by management.

However, though high road labor relations are efficient and productive in the long run,

they cannot survive slow demand growth and the cutthroat competition, high excess capacity and low or negative profit rates it brings. Under such conditions, with prices pushed well below average total cost, the survival of the firm is called into question, drastically shortening planning horizons. Long term policies become a luxury which firms cannot afford. They are inefficient in the short run either because, in the case of R&D and capacity expanding capital investment, they require a large commitment of scarce internal or borrowed funds well in advance of expected returns, or because, in the case of high road labor policies, they fail to take advantage of the short term cost reductions associated with layoffs, labor speed-up, and wage and benefit cuts. Chances of short term survival under duress are maximized by aggressive cost cutting of all kinds. And, to state the obvious, interfirm cooperation is impossible when all firms are in a life and death struggle for survival.

High road labor relations thus require corespective competition, which in turn requires adequate demand growth. To close the virtuous circle, we observe that sustained growth is not possible even if governments are committed to it, without corespective competition and high road labor relations in the core of the economy. In the Golden Age, core firms were able to invest at an impressive rate and achieve a remarkable record of technological improvement. This produced the high productivity rates of the era, which raised potential aggregate supply. Fast paced investment spending plus real wage gains in line with productivity growth in the core, which kept upward pressure on wages in more competitive sectors, helped keep private sector aggregate demand growth in line with aggregate supply. *Conditions in the private sector thus made it easier for governments to perform their required tasks.* They could use Keynesian macro policy and the social welfare system to support growth, moderate instability and inequality, augment private sector demand where necessary, regulate business in the public interest, and maintain private sector confidence that the whole process could be sustained over time.

The demise of the Golden Age is an oft told tale – though not everybody has the story right.²⁶ By the tempestuous 1970s, reflecting the law of uneven development, several decades of growth and change had reduced the effectiveness of the Golden Age matrix of public and private institutions and policies. This forced Northern elites and electorates to consider a change of

economic regimes. They could have chosen either to reform the existing system of government managed growth so it could achieve its traditional objectives in the new environment, or, alternatively, they could have changed course, letting lightly regulated global markets determine the broad outlines of the economic future. The process through which this choice was made is examined in Crotty 2000. For current purposes it is sufficient to note that powerful economic elites, especially in the US, in pursuit of their own self interest rather than the public good, chose the market dominated option. Global Neoliberalism was the result. It has by now created a new and destructive dynamic inter-relation among public and private sector institutions and policies, turning the virtuous circle of prosperity into a vicious circle of slow growth, destructive competition and low road labor relations. And it has undermined state led development strategies in the South.

Sources of Slow Growth in the Global Neoliberal Regime

This section briefly discusses six related forces, deeply rooted in Neoliberalism, that have pushed global aggregate demand growth well below its Golden Age level in the past two decades. We argue that the slowdown in demand growth is a crucial component of the complex forces that have caused a deterioration in economic performance in the Neoliberal era.

However, this does not imply that strong global growth rates would be necessary for a healthy global economy under all possible institutional frameworks. For example, there are economic reforms which would make the achievement of full employment in the developed world possible at lower rates of growth than are presently required for this purpose. And environmental problems may force governments in the intermediate future to seriously redesign modes of economic growth. Our argument is that rapid demand growth is required for global prosperity *under existing institutions and policies*.

The most important constraint on global demand is the slow growth of wages and mass consumption brought on by global Neoliberalism. Wages have been restrained by high average unemployment, the decline of unions, weaker government support for collective bargaining, and a worldwide slowdown in productivity growth. More intense international competition has destroyed corespective inter-firm relations in most industries, causing firms to shift from high- to low-road

labor relations. Fear of job loss has risen dramatically due to rising import competition, the increased mobility of physical capital, the 1990s merger and acquisition explosion (brought on in large part by the onset of destructive competition), and chronic job “churning” (associated with labor-saving technical change and new corporate strategies of downsizing and re-engineering).²⁷ By weakening labor’s bargaining power, job insecurity has lowered both real wage and household income growth. One study of 19 developed countries (not including the US) found that after rising rapidly through the early 1970s, real compensation growth fell to 1.2% a year in 1979-89 and again to 0.7% in 1989-96.²⁸ Moreover, increased global openness and improvements in technology have made it easier for multinational corporations to substitute low-wage Southern labor for higher-paid Northern labor – which may contribute to lower global wage inequality, but reduces global labor income nonetheless.²⁹ Finally, growth in workers’ disposable income has been retarded by a shift in the tax burden from mobile capital to immobile labor, rising household debt burdens, and, recently, a shrinking social safety net.³⁰

Second, the evolution of the global financial system has depressed global growth. High real interest rates were imposed after 1980 by independent, conservative, and inflation-obsessed central banks. The natural predilection of independent Central Banks for high real interest rates was reinforced by the spread of financial deregulation in the 1980s and 1990s, which increased the power of global financial interests. Rentiers were increasingly able to use capital flight to punish countries that used macro policy to pursue growth and employment rather than low inflation. Moreover, the heightened instability of global financial markets has significantly increased the incidence of banking and currency crises, which induce serious recessions in the areas in which they occur, and lead financial investors to demand larger risk premiums on loans.

Third, the pace and the character of global investment restrain growth. The growth of investment spending has slowed in the Neoliberal era due not only to high real interest rates, but to sluggish aggregate-demand growth as well. Slow demand growth retards investment, which in turn further slows demand growth in an ongoing multiplier-accelerator process. Investment has also been restrained by low profit rates in most industries most of the time, and by excess capacity. The breakdown of coresponsive relations has also reduced investment by increasing uncertainty.

But beyond this, much investment in recent years has been labor-saving and labor-disempowering, undertaken in response to destructive competition and in support of a shift from high road to anti-worker labor policies. Thus, the increased aggregate demand it created has been counteracted to some degree by the job and wage losses associated with it.

Fourth, fiscal policy has become increasingly restrictive. Large cuts in the social safety net and an abhorrence of fiscal deficits are part of the Neoliberal revolution. The importance given to austere fiscal policy was recognized explicitly in the criteria established under the Maastricht Treaty and carried over to the Euro zone. Government social spending in Europe and North America is still large; it represents a higher share of national income than even a decade ago. But there is no question that after rising significantly in response to slow growth and high unemployment rates in the 1980s, government spending as a share of income has peaked, and in many countries begun to decline, as conservative political forces become ever more powerful. For example, the structural budget deficit as a percent of GDP for the advanced countries exhibited a continuous fall from 3.9% in 1992 to 0.5% in 1999, and it is expected to continue to decline.³¹ A drop in aggregate demand equal to 3.4% of GDP is a huge drag on economic growth.

Fifth, the expanding role of international institutions such as the IMF and World Bank has slowed global growth. As more developing countries experienced national insolvency over the past two decades, the Fund and the Bank have stepped in with ever larger loans – the loan package put together for Korea in 1997-98 was on the order of \$58 billion. But they have invariably mandated austerity macroeconomic policies plus Neoliberal restructuring in return for their money. The growth of Fund-Bank mandated austerity-plus-restructuring programs around the developing world has severely constrained global aggregate demand. It has been estimated that something like 40% of the world's population living in 55 countries is under IMF dictate.

Finally, the 1990s witnessed a severe weakening of East Asian type models of state-guided development. Battered by increased liberalization of trade, investment, and, especially, financial capital flows, by threats from the G7 nations, the IMF, the World Bank, the WTO, and multinational firms and banks, and by ever stronger demands from domestic elites for freedom from government control, the traditional structures of state economic regulation across Asia are

weakening. Korea and Japan are two examples of this dynamic process. Under its indigenous development models, East and Southeast Asia was the only high growth area in the world in the Neoliberal era. Business Week reported that “Of 119 countries studied by the World Bank over these decades [from the mid-1960s through the mid-1990s], seven achieved both high growth and low income inequality. All seven were in Asia.”³² About half of the growth in global GDP from 1989 through 1997 originated in East Asia. If Neoliberalism were to permanently replace state-guided growth in East Asia, lower average global growth rates could be expected to follow.

Closing the Vicious Circle: Slow Growth Triggers Destructive Competition, Which Further Lowers Growth

According to the business press, chronic excess capacity in many global industries is a fact of life in the Neoliberal era. Business Week noted that: “supply outpaces demand everywhere, sending prices lower, eroding corporate profits and increasing layoffs.”³³ GE Chairman Jack Welch claimed that “there is excess capacity in almost every industry.”³⁴ The Wall Street Journal observed that “from cashmere to blue jeans, silver jewelry to aluminum cans, the world is in oversupply”.³⁵ The Economist worries about “a malign deflation caused by excess capacity and weak demand,” speculating that the gap between sales and capacity is “at its widest since the 1930s.”³⁶

This widespread growth in excess global capacity raises a puzzling question. Why hasn't global supply growth adapted to the reduced pace of global demand growth in the past two decades, creating sluggish but balanced growth? A theory of natural oligopoly suggests an interesting answer. *By reducing the trend rate of aggregate demand growth, Neoliberal policies created an initial problem of excess supply in most core industries. This destroyed the conditions necessary for co-respective competition. An outbreak of destructive competitive processes then caused over-investment in many global manufacturing and service industries, which continuously reproduced excess capacity.*

In the Neoliberal era, rapid technical change, increasingly open borders, and the end of governments' commitment to high growth and strong unions destroyed the conditions necessary for co-respective behavior. We have witnessed an outbreak of what I have called “coercive competition” (Crotty 1993) in manufacturing and elsewhere, based on cut-throat pricing, the destruction of secure oligopoly rents, over-investment relative to demand, (leading to chronic

excess capacity), and faced-paced technical innovation that often renders recently constructed capital goods prematurely obsolete – and the debt that financed them unpayable.³⁷ Note that this over investment is limited to globally contested core industries. Since there has been a pronounced decline in the rate of increase of all other forms of fixed capital investment, including government investment, and since even in core industries investment undertaken solely to expand capacity has dried up, there is no logical inconsistency between the fact, noted above, that the growth rate of global fixed capital formation has declined, and the argument that coerced investment in key global industries had increased.

With their survival threatened by fierce competition, much of it international in character, large firms in the industrialized North were forced to adopt shorter planning horizons. Semi-cooperative management-labor relations were now considered unviable. Firms believed they had to slash labor costs through downsizing and wage cuts to survive beyond the short-run. Conflict-driven labor relations policies became the order of the day.³⁸ Coercive competition quickly altered the strategies of US and British firms, which had the weakest institutional, legal, and cultural commitment to the high road. They were the first to attack their unions, repudiate existing ‘implicit contracts’ with workers and suppliers, maximize outsourcing and the use of temporary workers, and adopt downsizing as a permanent policy. But coercive competition is inexorably deconstructing the traditional practices of European and even East Asian firms as well. Ironically, the new Anglo-American firm is at its strongest under conditions of instability and adversity, and relatively weakest in stable, prosperous eras, because its emphasis on flexibility shifts the costs of adversity and instability from the firm and its shareholders to workers and governments.

But how does coercive competition lead to chronic excess capacity in globally contested core markets?³⁹ Under corespective competition and adequate demand growth, core industries are highly profitable. Therefore, large multinational corporations from mature industrialized economies, anticipating high future profits and acknowledging the massive cost of exit, want to continue to dominate them. However, as the post-war period evolved, developing countries that desired to move up the technology/productivity/value-added ladder, such as Japan, Korea and Taiwan, entered many of these industries. Each new wave of entrants, like the countries of South

East Asia in recent decades, added to the potential for market overcrowding, making inter-firm cooperative relations increasingly difficult to maintain. Had global aggregate demand growth remained strong, the newcomers would have been easier to accommodate, and the breakdown of corespective relations might have been postponed. In the Golden Age, fast growth and limited international competition allowed Northern oligopolies to maintain some degree of corespective relations even as Japan and, later, Korea and Taiwan began their slow ascent up the export pecking order. But, as we have seen, Neoliberalism severely constrained global demand growth. With sluggish demand, established players must quickly exit from the industry as new firms enter to avoid chronic excess supply, falling prices and low average profits. This obviously did not happen.

This raises another key question. Why do new entrants keep coming and why don't established firms withdraw from these markets as profits deteriorate? *Emerging countries have to pass through most of the rungs on the technology ladder if they are to achieve economic development*; they cannot go directly from labor intensive textile exports to auto and semiconductor exports. That is, they *must* either invest in core industries or give up any hope of becoming a developed nation. But established firms have reason not to exit; they have huge sunk physical, human and organizational costs which will largely be destroyed if they are forced to pull out of the industry. Fundamental or Keynesian uncertainty plays a big role in this process. If it were known in advance which firms would ultimately lose the struggle for survival, the losers would exit early to cut their losses. And those who are demonstrably weaker than their opponents often do leave, or are taken over by financially stronger firms. But given the importance of many of these markets and the huge sunk costs required to enter and thrive in them, most competitors try to 'stay in the game' even as competition mounts, hoping to survive the current struggle so they can reap the secure, above average profits expected to emerge when the eventual winners are in a position to *re-oligopolize* the industry.

The key to understanding the continued reproduction of excess capacity in core global industries is this: *firms that decide to stay in the game must continue to invest in the face of these seemingly disastrous industry conditions* – and largely because of, not in spite of, these problems. In Crotty 1993, an article that focused on the complex role of competition in Marxian investment theory, I labeled

this phenomena “*coerced investment*.” The deliberate creation of excess capacity as a weapon in competitive wars was discussed above. Price cutting cannot generate greater sales volume to lower fixed cost per unit if the company cutting price has no extra production capacity. More important, price-profit pressures *force* firms that have decided to ‘stay in the game’ to invest to raise product quality and lower costs of all kinds, including labor costs, administrative costs, the cost of sales and distribution, intra-firm communication and control costs, transportation costs, and the cost of supplies. And Neoliberalism has invited firms to locate cost cutting investment any place in the world that looks best suited for the job.

Firms must invest to take advantage of the ever larger returns to scale made possible by technical change. And the shift from high to low road labor relations requires a reconstitution of the labor process: investment is thus needed to shed labor through downsizing and re-engineering, and to increase direct monitoring and control of labor, because the implicit contracts and worker loyalty that previously helped elicit energetic labor effort have been destroyed. Firms must invest to acquire best practice technology for both cost reduction and quality reasons; in core markets such as autos, semiconductors and airplanes, the acquisition of best-practice technology often requires huge capital investments of ever increasing size. Finally, they must invest to get inside the borders and on the ground floor of expected high growth developing markets, a designation that now rapidly shifts back and forth across geographical boundaries. Of course, plant closings take place along side coerced investment, but their impact is too weak to eliminate industry excess capacity. With profits and cash flow at low levels, a high percentage of this investment will be debt financed.

Many of these coerced investments appear at first glance to be irrational and, for this reason, they cannot exist in Neoclassical theory. From the perspective of the economy or society as a whole, they *are* irrational. But Neoliberalism has created massive coordination failures that make it individually rational for firms to behave in ways that are collectively destructive. All but the weakest firms hope to survive the competitive wars. As the Wall Street Journal put it, “the survivors of overcapacity downturns often emerge as the big winners.”⁴⁰ Significant investment in the face of excess supply, low profits, and perhaps financial fragility is required by any firm that hopes to be a winner.

The point that must be stressed is that *sluggish aggregate demand growth and chronic excess aggregate supply reinforce one another as part of Neoliberalism's vicious circle*. The more competitive pressures develop, the more they force firms to cut wages, smash unions, substitute low for high wage labor, and pressure governments to cut social and infrastructural spending so that taxes on corporations and the rich can be slashed without creating budget deficits. But these actions constrain global aggregate demand ever more tightly, creating yet stronger competitive intensity, and so on.

This destructive cycle operates in financial as well as manufacturing markets. In the wake of continuing financial deregulation, large commercial banks have entered into competitive wars both with investment and brokerage firms and with one another.⁴¹ Increasingly, high profits can be obtained in the financial sector only by creating new products or new markets – which merely postpones the problem unless the temporary scarcity rents generated are solidified through oligopolization – or by taking on ever more leverage and ever greater risk. We have witnessed both processes unfold in the last two decades.

Keynes, Minsky and Marx, among others, taught us that unregulated financial markets are inherently speculative and volatile, subject to irregular cycles of over-optimism followed by excessive pessimism.⁴² But it is not just excessive optimism or belief in fairy tales about the “new economy” that has led large banks to write incredibly risky loan and derivative contracts or undertake dangerous off balance sheet commitments. Faced with the ongoing loss to other institutions of their corporate loan business – their main source of profit, banks were forced to undertake greater risk, or decline in size and power. It should not come as a shock to find that they chose greater risk.

Global liberalized financial markets are thus *both highly speculative and coercively competitive*. It is therefore not surprising that banking and currency crises generated by risky and reckless lending and financial investment patterns break out with increasing frequency. Only continuous IMF and Central Bank bailouts (at enormous taxpayer expense) have prevented the self-destruction of the global financial system, and sustained the profits of multinational financial enterprises. But both recurrent crises and subsequent ‘rescues’ erode global demand growth by creating deep,

extended recessions in the crisis areas, adding high risk-premiums to interest rates, and forcing more and more countries to submit to the austerity macro policies mandated by the IMF and World Bank.

The recent Asian financial crisis is one example of the way that structural contradictions within the global system create financial instability and real sector crises in the developing world.⁴³ Slow growth and below average profits reduced the rate of growth of gross investment in the developed world in the Neoliberal era, while rising incomes at the top of the income pyramid sustained the flow of funds seeking investment outlets. Financial deregulation, the removal of capital controls across the globe, and technical innovation made it possible for an increasing proportion of these funds to flow across national boundaries in search of high returns in the less developed world. The flow of short term portfolio investment and bank loans to developing nations accelerated sharply in the 1990s, especially to East Asia.

To prevent the sudden withdrawal of these short-term funds, recipient nations must avoid significant deterioration in their trade balance. To eventually repay the loans, they must run substantial export surpluses for extended periods. But, it is increasingly difficult for developing countries to maintain healthy trade balances because slow global growth, especially in developed countries, constrains the total demand for exports, while fierce competition in global manufacturing markets constrains the profit margins and market share any particular country can hope to maintain. Consider South Korea, a major recipient of short-term foreign bank loans. Semiconductors are one of Korea's largest export earners. In 1996 excess supply and fierce competition drove semiconductor prices down by almost 80%, contributing to a sharp increase in the trade deficit (from 2% to 5% of GDP) that helped trigger the Korean financial crisis. Most of the area experienced a similar problem. South and East Asian export growth fell by two-thirds in 1996 from the rates achieved in 1994 and 1995.⁴⁴

Thus, slow growth and low industrial profit rates in the North helped stimulate financial flows to Asia, but the combined impact of slow growth and coercive competition made it almost impossible for the recipient countries to sustain the trade performance needed to service their loans and hold on to their portfolio investments from the North. Having forsaken import

regulation as part of the liberalization process, affected countries felt they had little choice once the crisis hit but to accept IMF intervention and the deep, import slashing, recessionary policies it brought. Paradoxically, the structural contradictions of the Neoliberal Regime ended up destroying, at least temporarily, the high growth and profit rates that attracted the funds to Asia in the first place.

Destructive Competition in Action: The Global Auto Industry

Consider the global auto industry. It is one of the most important industries in global trade and investment, and it has massive scale economies – Ford and General Motors had total assets of \$ 275 billion and \$229 billion respectively in 1997. It is also among the most transnational of all businesses – six of the world’s twelve top transnational firms ranked by the size of foreign assets are auto companies.⁴⁵ Slow trend global growth, new entry, and modest exit has created a huge global capacity overhang in autos. Business Week reported that at least three quarters of the globe’s forty auto makers are “drowning in debt and glutted with factory capacity: the industry can make 20 million more cars and trucks a year than it can sell.”⁴⁶ Pricewaterhouse Coopers, a consulting company, concludes that global capacity utilization, currently below 70%, is growing; their estimate for 1990 was 80%.⁴⁷ But economies of scale and fixed costs, including development costs, are huge and growing rapidly; estimates of current minimum efficient production scale range from 2 million to an astounding 4 million cars per year.⁴⁸ With such large fixed costs, high excess capacity has killed profits in almost all auto markets other than the US in the late 1990s, triggering “cutthroat pricing on top of the overcapacity problems.”⁴⁹ Even in periods when sales rise, intense competition to gain the lower fixed costs per unit that higher volume brings, holds down prices and profit margins. According to the Wall Street Journal, “Economics 101 doesn’t explain this market where robust demand isn’t necessarily a license to raise prices. The huge fixed costs involved in developing new vehicles and running big auto factories means auto makers feel compelled to maintain – or expand market share.”⁵⁰ Pricewaterhouse Coopers observed that “overcapacity represents a huge cost burden in an industry whose costs and profitability are particularly sensitive to levels of capacity utilization.” In their view:

Competitive pressures in the vehicle industry have been intense. Overcapacity, cost reduction, the proliferation of niche models, development of full range brand strategies by

the [vehicle manufacturers] and shortening product cycles have reduced the protection offered by traditional market strengths.⁵¹

This constant pressure on prices and profits has induced fierce cost cutting. Production is shifted to low wage sites, technology is used to sharply reduce employment and labor cost per car, governments are pressured to extend generous subsidies and tax abatements, and companies wage war on their workers to weaken or destroy unions and cut wages and benefits.

Meanwhile, faced with excess capacity and minuscule profit margins, companies pour investment capital into the industry, a phenomenon you won't find in Economics 101 either. For example, Ford, GM and Daimler Chrysler are again investing heavily in Asia, even though sales are not expected to return to 1996 levels until 2004. "With the US and European markets maturing, the Big Three are counting on Asia for growth." But since Japanese firms will not cede this market to them, Asia "has turned into a war of attrition, with the Big Three aiming to be among the winners."⁵² BMW "in five years had poured nearly \$3 billion of investment into Rover" in a desperate attempt to keep it in the game.⁵³ GM recently invested \$1.5 billion in Saturn to try to maintain its competitiveness, and thereby avoid losing the \$5 billion it had previously invested.⁵⁴ Daimler-Chrysler, Volkswagen, and Renault plan to collectively invest \$5 billion in production facilities in Mexico over the intermediate future.⁵⁵ The Wall Street Journal reports that GM is building new plants with huge capacity in Brazil in order to cut costs in a bad market, introduce new models, and produce inside the potentially large Brazilian market: "by containing losses now and pushing ahead with plans for investment in new products, GM hopes to be ready to cash in when the market recovers".⁵⁶ It observed that "many experts warn of vast overcapacity in Asia and South America if auto makers complete even a fraction of already announced plans for new plants," yet adds that these experts "acknowledge the [competitive] advantage of being the first producer" in local markets.⁵⁷ The Economist sees the cost cutting pressures associated with "globalization" as a key culprit behind the burst of new capacity; the "rush to build plants all over the place has merely added to the capacity mountain."⁵⁸ All the large auto makers are investing heavily in the development of new models, a hugely expensive undertaking thought to be required for expansion, or even maintenance, of market share.

This is mostly coerced investment, required to remain in the ongoing zero sum game that will eventually determine which firms survive. Its main effect is to continuously recreate industry excess capacity and debt burdens, maintain downward pressure on wages and employment (not just in the auto firms, but in the industries that supply them), and restrain the growth rate of aggregate demand.

In Prospect: Re-Oligopolization On a Global Scale

The most powerful firms in the most fiercely contested global core industries have not been content to let this process follow its destructive course to the bitter end. Excessive competition that continues long enough in the kinds of industries I have designated as core, will eventually begin to identify winners, who, when they are few enough in number, will seek to restore the cooperative relations necessary to raise the industry profit rate. In Marx's words, "competition produces monopoly." *Since the mid 1990s, core global industries have experienced a ongoing merger and alliance wave of historic proportions.* Since 1994, M&A activity has skyrocketed; in 1999 global merger deals were worth \$3.4 trillion (with \$1.7 trillion in the US), about six times their 1994 value. There was \$850 billion of cross border mergers in 1999, ten times the 1991 amount. According to the Financial Times, globalization is the most important cause of the merger wave.⁵⁹

Coerced investment spending increased rapidly just when profits were weakest, creating or exacerbating problems of excessive indebtedness for many firms. The rapid pace of investment is dividing the competitors into those who are in decline and those who remain relatively strong. Though technological superiority influences this sorting process, it is mainly those with deep pockets, not efficiency in design and production, that are winning this life and death struggle. It is cash rich GM, Ford, and Daimler-Chrysler who are winning the global auto wars. Business Week reported recently that GM and Ford have \$11 billion and \$21 billion, respectively, in cash holdings.⁶⁰ Flush with the profits made in SUVs and light trucks in the US in recent years, and with earnings generated by their financial operations, GM and Ford have been roaming the world in search of desperate, debt ridden auto firms to buy on the cheap. They have done well in this pursuit.

The global auto industry has entered a phase of hectic consolidation – through mergers,

and through alliances of every form imaginable. In 1998, the year that saw the \$40 billion merger of Chrysler with Daimler-Benz, a total of \$80 billion was involved in global auto mergers. This was over twice the value of 1997 mergers.⁶¹ In 1999, total global auto deals totaled \$71 billion, led by Ford's investment of \$6.5 billion in Volvo, and Renault's expenditure of \$5.4 to essentially take control of debt burdened Nissan (though only 37% of the shares were purchased).⁶² "Merger mania in the auto industry continues at a fever pitch," notes Business Week, but adds that there aren't many firms left to grab: "the field of remaining candidates is down to a handful."⁶³

Companies are merging and allying to "cut costs by shedding labor," and to "trim capacity, reduce competition, and hike prices."⁶⁴ In January 1999 Business Week argued that in a decade or so, there would only be six surviving super-firms in the global auto industry.⁶⁵ One year later, the Wall Street Journal could already identify six global super groups in autos that among them accounted for 74% of global auto production.⁶⁶ Formal mergers are only one form taken by this consolidation process. Auto companies have created a vast array of alliances and joint ventures among producers and suppliers. These alliances create inter-firm cooperation or, to use a currently popular phrase, "coopetition," across a wide range of operations - R&D, new product development, marketing, production, platform sharing, and parts supply.

We are thus at a disorderly, intermediate stage in the consolidation process. Coerced investment continues to reproduce excess capacity, and competition continues to severely constrain prices and profit margins. Yet the industry is, at the same time, building cooperative relations across numerous firms and many aspects of business. The financially strong are eating the weak, and the consolidation process has gathered enormous momentum. At some point, if consolidation continues, more universal co-competitive arrangements may be put in place. The winners will eliminate global excess capacity (by shutting down the losers's factories), and be back in position to regulate investment, control price, and restore good profit margins.

Two key questions need to be answered. Will the current momentum toward consolidation overcome the forces of global stagnation that destructive competition is itself helping reproduce? That is, can the ongoing efforts to re-oligopolize core industries be generally successful if aggregate demand continues to be constrained by the same forces that are creating the consolidation

movement? And, if the re-oligopolization of global core industries is successful, *what government institutions - if any - will force these global super groups to act in the interest of the majority of the world's people?*

IV. Conclusions

This essay has focused on theory, but its analysis has obvious policy implications. Neoliberal economic theory is deeply flawed in all its forms – macro and micro theory, the theory of financial markets, and development theory. It is, therefore, a misleading and dangerous guide for institution building and government economic policy making. Sensible alternative economic theories suggest that global Neoliberalism is moving the world towards a disappointing and perhaps disastrous economic future, a forecast that is not inconsistent with the economic experience of the past two decades. They also imply that markets must be socially embedded and the broad outlines of economic development socially determined if the economic interests of working people and the majority of citizens are to be served and protected. All post war economic success stories, whether in the advanced or in the developing worlds, relied on extensive state guidance of market processes. Of course, social regulation of market activity, while necessary, does not guarantee economic progress.

The logic of this essay implies that the state must play an important role at both macro and micro levels of economic activity. Thus, the first issue to be addressed concerns political power and the determination of economic policy priorities. In the current environment, capitalist class forces dominate the political process, and their world view, Neoliberalism, determines which economic ideas are 'respectable' and sets the parameters within which political economic discourse takes place. *Progressive economic change will therefore not be possible unless and until the political and ideological balance of power shifts significantly.*

Progressive, labor oriented political movements are needed to reduce the influence of large corporations and wealthy individuals on the setting of political priorities, increase the political influence of workers and the majority of citizens, and thoroughly democratize the political process - in substance as well in form. Without a dramatic change in the balance of class political power, it

will not be possible to hammer out new “social contracts” that reject Neoliberalism and create socially regulated economic systems. Government control over cross border capital flows and direct foreign investment must be crucial parts of this *political* power re-alignment. As Keynes taught us, it is the credible threat that money, physical capital, technology, and jobs will flee the country if government policies are not pro-business that has given capital the power to determine political priorities in the Neoliberal era. Capital controls can help reverse this perverse political power relation between capital and the majority of citizens.⁶⁷

Turning to policy specifics, governments must reassert their responsibility to regulate aggregate demand, and shift their policy priorities so that full employment growth once again is the dominant goal.⁶⁸ Growth is needed not just for its direct benefits, but to create important preconditions for dynamic efficiency in core industries. Reasonable growth is also necessary to make high road labor relations and a more progressive income division between capital and labor possible, but growth alone cannot assure this outcome. In most national corporate ‘cultures,’ management instinctively leans toward low road options. Therefore, society must provide a set of incentives strong enough to force firms to adopt the high road. Labor needs an institutional foundation powerful enough to make large corporations understand that it is better to have workers as allies than as enemies. Empowering labor in pursuit of the high road requires not only a strong union movement, but sustained full employment, a labor oriented government with effective collective bargaining laws, and a social safety net that gives workers an attractive exit option in their negotiations with business and raises the minimum living standard for the weakest in society. None of these requirements can be met without appropriate government action. Such policies require the implementation of effective national and/or international regulation of cross-border capital flows, so that neither industrial or financial capital can undermine them by threatening to run away. These conditions were present, at least in modest form, in many of the countries that participated in the prosperity of the Golden Age. National governments still have the power to accomplish these tasks; what they lack is the will to do so.

Assuming we avoid a global financial collapse and/or depression, many core industries are likely to re-oligopolize and restore cooperative relations. *But who will make sure that the necessary*

balance between cooperation and competition is maintained, and that global oligopolies do not abuse their great market power? In the Golden Age, dominant firms in core industries had deep roots in one country and were at least potentially subject to that country's political will. For example, political influence on the behavior of giant firms was one of the foundations of the East Asian "miracles." Area governments were involved in the coordination of large firm investment spending. This facilitated the rationalization of excess capacity, the prevention of cutthroat pricing in deep recessions, the forced exit of poorly performing firms, limits on entrance (so key firms could take advantage of economies of scale), efforts to prevent over-investment in buoyant growth phases, and protection against profit margins that were too large to be justified by dynamic efficiency considerations. The point is obviously not that all government efforts to regulate and coordinate the behavior of large firms in countries such as Japan, Taiwan and Korea were successful, but that, on average, they were effective enough to generate development records that were the envy of the rest of the less developed world. Prior to the Neoliberal era, even advanced country governments often used anti-trust and other policies to intervene when core industries acted against the public interest.

In the current era, however, decision making power in consolidating core industries is likely to be distributed across truly transnational giant firms or multi-firm super groups. Yet there are no democratically constituted transnational government agencies capable of ensuring that these new oligopolies act in the public interest.⁶⁹ In many global industries, barriers to entry are becoming virtually insurmountable. For example, no new firm could possibly compete with the big six auto super groups. What is to prevent these super groups from forcing workers and governments across the globe into a desperate competition for the good jobs, advanced technology, and high productivity which only they possess? It is difficult enough for governments to create and effectively implement a structure of incentives and punishments to guide industry development when the firms involved are clearly subject to their political jurisdiction. The creation of effective forms of social regulation of the emerging global corporate super groups, whether at the national or transnational level, is one of the great policy challenges of our times.⁷⁰ At a minimum, all governments should restore their ability to regulate the conditions under which firms and money

can enter and exit their borders, which will enhance their ability to regulate all businesses that operate domestically. Collectively, the US and European governments certainly could subject all important global businesses to effective regulation, if they had the political will to do so.

Successful development by poor and middle income countries cannot take place under the Neoliberal rules of the game. No one has developed successfully without extensive state interference in market processes. Developing country governments must rely on industrial policy, and therefore on capital controls and tightly regulated financial markets, to have a chance at equitable growth. A collective effort to restore the right to utilize these policy tools is most likely to be successful, but as Malaysia recently demonstrated, even a small, isolated country can impose a regime of capital controls effectively on its own if necessary. The restoration of capital controls in both advanced and developing countries will also reduce exchange rate instability and make global financial crises, and the deep recessions which follow in their wake, much less likely.

The arguments in favor of fully liberalized domestic and global financial markets are so weak they border on the absurd. Liberalization in the US and, to a lesser extent in Europe, has led to rampant financial speculation. For example, the US stock market has recently experienced price to earnings ratios more than twice their historic average. The reversion of stock prices to their normal relation to profits will induce a serious American recession and possibly a global financial crisis. Advanced country governments should tighten their regulation of domestic financial markets dramatically. The liberalization of even short term capital flows in East Asia, where many countries have savings rates in excess of 30 percent of national income, was inexcusable. It helped create the conditions that made the Asian financial crisis possible. Liberalization of short term capital flows benefits Northern financial institutions and the world's wealthy elites and injures everyone else. Former World Bank Vice President Joseph Stiglitz recently asked a question that almost no one in authority has had the courage to answer publicly, though everyone knows the correct answer.

Did America and the IMF push [financial liberalization] policies because we, or they, believed these policies would help East Asia or because we believed they would benefit financial interests in the United States and the advanced industrial world? And, if we believed our policies would help East Asia, where was the evidence? ... There was none.⁷¹

The international institutions that currently manage global integration – the IMF, the World Bank, and the WTO – are saturated with Neoliberal ideology and dedicated to the pursuit of the interests of global finance and multinational corporations. They must be replaced with new institutions that support egalitarian growth and encourage state-guided development models. They also must guarantee the right of nations to control capital flows. And, mimicking the medical maxim that the first obligation of a doctor is to do no harm, they must stop imposing austerity macroeconomic policy on countries who need their help in times of crisis.

In sum, the evaluation of the current global economic trajectory presented here is quite pessimistic. If the world continues down the path of Neoliberalism, economic prospects for the majority of people, in both developed and developing nations, are dismal. More of the same disappointing performance that we have experienced in recent decades may be the most likely scenario, but it is also quite possible that serious political and economic instability will erupt – just as it did in 1930s, in the last market dominated era. There is thus an urgent need to reverse course. It is essential that the Neoliberal path be rejected, and replaced with domestic and international public and private institutions and policies dedicated to the pursuit of the security and prosperity of the majority of the population, rather than the maximization of the wealth and power of national economic elites.

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World Bank, Global Economic Prospects and the Developing Countries (Washington: World Bank, April 2000)

ENDNOTES

1. See Crotty 1994 for a detailed discussion of the conflicting views in Post Keynesian and neoclassical theory with respect to expectations formation and financial instability.
2. The Economist, June 12, 1999, p. 65.
3. See Eatwell 1997 for an excellent analysis of the theoretical and empirical dimensions of international financial liberalization in the Neoliberal era.
4. United Nations 1994, p. 12, and 1998, pp. 2 and 385.
5. Financial Times, December 9, 1998.
6. Reported in Felix 1998, p. 184 and International Monetary Fund 2000, p. 188.
7. Data on world investment is for 210 countries for which a complete investment time series is available, and is taken from the World Bank's "1999 World Development Indicators CD- Rom", as is the data for high income OECD countries. Calculations are by the author.
8. OECD, Historical Statistics 1960-1995, 1997 edition, p. 59.
9. OECD, Historical Statistics 1960-1995, 1997 edition, p. 45.
10. OECD, Economic Outlook, June 1998, p. 284.
11. Maddison 1995, p. 60.
12. World Bank 2000, pp. 152-53.
13. Data from United Nations, Trade and Development Report , 1995, p. 4, 1997, p. 4, and 199, p.4.
14. World Bank, Global Economic Prospects and the Developing World, April 2000, p.29.
15. United Nations, Trade and Development Report 1997, pp. 65-66.
16. United Nations, World Investment Report 1999, chapter III, p. 2.

17. Entry would be constrained by the potential for capital loss even if the firm knew the precise expected value if entry. Under neoclassical assumptions, the risk parameters associated with investment are known with certainty, and could, in principle, be insured against, although the cost of insurance would itself be a significant barrier to entry. However, if the joint assumption of imperfect asset mobility and fundamental or Keynesian uncertainty is adopted, reallocating capital from one industry to another or buying new long-lived, industry specific capital goods involves a dangerous gamble whose precise parameters can never be known. Rather, these parameters must be conjured up through expectations or guesses or hunches about the future, and these will depend on numerous contingent and subjective factors. Entry in such conditions is a gamble in which the firm understands that it has no hard data on the likelihood of gain or loss. Since it would take an exceptionally large profit rate differential confidently expected to last for a very long time to induce a rational firm to enter an industry, significant industry profit rate differentials will persist over long periods of time.

Under fundamental uncertainty, expectations are subject to potential instability, and exhibit herd behavior, contagion, boom euphoria and panic. When expectations are euphoric, there may be more investment from both insiders and outsiders than industry profits can justify. Over-investment and excessive entry in heated booms therefore may take place from time to time.

18. Wall Street Journal, January 17, 2000, p. A1.

19. See Crotty 1999 for a presentation of Keynes's views on the destructive aspects of competition.

20. See Summers 2000.

21. The great bulk of economic activity takes place either in small enterprises whose environment is best described by the theory of monopolistic competition, or industries where scale economies are so large relative to the size of the market that they must be organized as natural oligopolies to operate efficiently over the long run.

22. See Crotty 1992 on the properties of investment spending under fundamental uncertainty.

23. Dynamic efficiency is, strictly speaking, incompatible with static efficiency because it requires the withholding of resources from current production, to invest in capital goods, R&D, organizational improvement, and so forth, that provide no current benefits, and it destroys the value of existing assets of all kinds, public and private, sometimes on a massive scale. This is one insight from Schumpeter's concept of "creative destruction."

24. Clark stresses the important role played by smaller firms in core industries in maintaining downward pressure on price. Because they have limited production capacity, small firms can raise output and shave price without triggering an aggressive response from the larger, dominant firms.

25. In the theoretical perspective adopted in this paper, corespective relations are necessary to

achieve rapid technical change, a strong rate of capital accumulation, and high rates of productivity growth in core industries. Thus, the high value added flows created in these industries cannot properly be labeled “rents.”

26. See, for example, the explanations offered in Bowles et. al. 1990, Brenner 1999, and Crotty 1999a.

27. Business Week reports that “Constant restructuring and consolidation by large corporations is driving layoffs to record highs” (December 27, 1999, p.55).

28. Mishel, Bernstein and Schmitt 1999, p.362.

29. Another factor depressing global wages was the entry of workers from China, the former Soviet Union, and India into the available global labor pool.

30. Because it accepts Say’s Law, Neoliberal theory views wages primarily as a cost that must be restrained if profit incentives are to remain effective; there is no basis for concern within Neoliberal theory that low wages might constrain aggregate demand growth.

31. International Monetary Fund 2000, p. 132.

32. Business Week, December 13, 1999, p.120.

33. Business Week, January 25, 1999.

34. New York Times November 16, 1997, p. 3.

35. Wall Street Journal, November 30, 1998, p. A17.

36. The Economist, February 20, 1999, p. 15.

37. See Crotty 1993 for an analysis of the relation between “coercive competition” and over-investment in Marxian theory.

38. An excellent discussion of the effect of changes in the competitive environment on the labor policies of US firms, and of rising wage inequality in general, can be found in Howell, Duncan and Harrison (1998).

39. Much of Robert Brenner’s 1999 book is devoted to a development and defense of the argument that destructive international competition, especially among US, German and Japanese multinational firms, was the main cause of the end of the Golden Age, and of the longevity of the ongoing global economic crisis.

40. Wall Street Journal, November 30, 1998, p. A17.

41. See Dymski 1998 on this point.

42. See Crotty 1985 for a detailed explanation of Marx's theory of financial markets and the role played by finance in the accumulation process.

43. Crotty and Dymski 1998 explain in more detail how sluggish global demand growth and coercive competition helped bring on the Asian crisis.

44. United Nations Trade and Development Report 1997, p.5.

45. United Nations, World Investment Report 1999, chapter III, p.2.

46. Business Week, January 25, 1999, p. 69.

47. In The Economist, January 8, 2000, p. 58.

48. The 4 million estimate is in the Wall Street Journal, March 15, 2000, p. A1.

49. Business Week, January 25, 1999, p. 69. The big US auto companies have been profitable recently, but this is primarily due to the huge profit margins they receive on their popular suburban utility vehicles, and secondarily to profits made on their financial operations. SUVs represented 18% of US auto sales in 1999, up from 10% in 1994. "Profits from SUVs are huge," the Wall Street Journal reported, "while small car sales remain loss leaders" (December 8, 1999, p.A2). It seems inevitable that these abnormally high SUV profit margins will eventually evaporate as a result of more serious import competition, a decline in auto demand due to market saturation or recession, or both. As of late 2000, the corrosive effect of heightened competition in the SUV market from auto companies headquartered outside the US has already begun to erode SUV profit margins.

50. Wall Street Journal, January 16, 2000, p. B1.

51. Pricewaterhouse Coopers, "Global Automotive Deal Survey 1998," p.3, www.pwcglobal.com.

52. Wall Street Journal December 8, 1999, p. B1.

53. Wall Street Journal, March 17, 2000, p. A1.

54. Wall Street Journal, April 20, 2000, p. A4.

55. The Financial Times, May 24, 2000, p. 10.

56. Wall Street Journal, February 25, 1999, p. A 1.

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57. Wall Street Journal, August 4, 1999, p.A1.
58. The Economist, May 10, 1997, p. 21.
59. Financial Times, January 1, 2000, p. 9 and Business Week, March 6, 2000, p. 32.
60. Business Week, November 20, 2000, p. 160.
61. Pricewaterhouse Coopers website, April 14, 1999, www.pwcglobal.com.
62. Pricewaterhouse Coopers, "Automotive Sector Insights 1999," pp. 3 and 24, www.pwcglobal.com .
63. Business Week, March 27, 2000, p. 43.
64. Business Week October 18, 1999, p.234.
65. Business Week, January 25, 1999, p.68.
66. Wall Street Journal, January 14, 2000, p.A2.
67. This argument is presented and defended in Crotty and Epstein 1996.
68. This may require experimentation with standby incomes policies or price controls to develop policy options other than recession to deal with inflation shocks.
69. The European Union has developed a commission responsible for the creation and enforcement of a Union wide competition and anti-trust policy. However, it is not democratically constituted and is quite likely to be captured by corporate interests.
70. Modes of regulation should include important roles for unions and consumer groups, as well as governmental bodies.
71. Joseph Stiglitz, "What I Learned at the Asian Crisis," The New Republic, April 17, 2000.