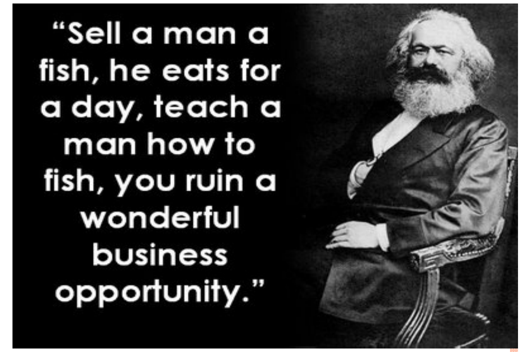
Neoclassical Economics: & the Keynesian Turn

Political Economy in the New Millennium

POL 319

Week 4

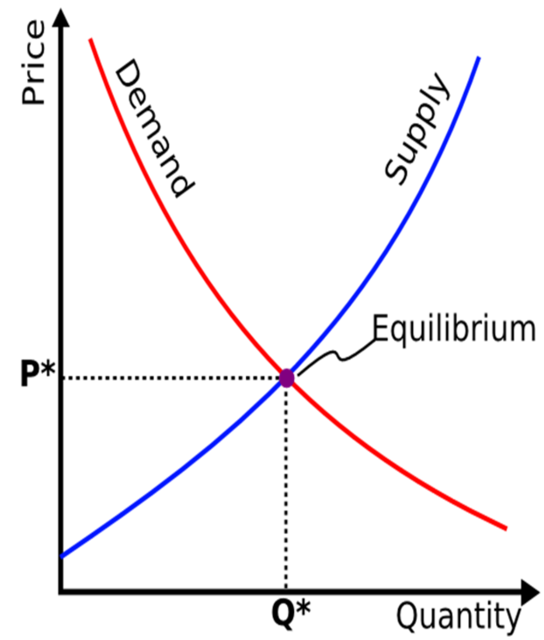
REVIEW



- Marxian Political Economy
  - Capitalism is a social relation between owners and wage-workers who have been dispossessed of any access to the means of production (process of primitive accumulation).
  - But this system presents itself to us as a system of commodity production (there appears to be ever greater productive capacity and surplus!)
  - So this leads Marx to focus on the production process and to ask, like earlier political economists – what is the source of this surplus, what is the source of the owner's profit?
  - Marx uses a labour theory of value – and by this he means that labour and *only labour* in the production process can add surplus value (not capital goods or machines).
  - If the owner paid for the full value of the worker's labour, there would be no profit – Marx argues that profit must be the result of the worker not being paid for all the time he/she has worked adding value throughout the day.

AGENDA

- The Revolutionary Threat
- The Neoclassical or Marginalist Turn
- The Cambridge Controversy
- The Collapse of 19th Century Civilization
- The Keynesian Turn



The revolutionary Threat

- Recall: political economy is born in a period of massive social transformation:
  - Enclosure, expropriation and empire building, urbanization, poverty and pauperism, the struggle for democracy, industrialization, criminalization, capital versus labour and to top it off, revolution!
- American Revolution (1775–1783)
- The French Revolution (1787-99)
- Haitian Revolution (1791-1804)
- The Revolutions of 1848
- The Communist Manifesto (1848)
- The Paris Commune (1871)

‘Is there anything more to history than the call for revolution and the fear of revolution ?’

Michel Foucault
Society Must be Defended

The neoclassical turn

- Everything is in its right place:
  - The evacuation of politics and power from ‘the economy’.
  - The ‘Will to Science’ (mathematical physics)
    - Historical and inductive to mathematical and deductive – explain experience with predetermined axioms.
- The Rise of the Disciplines:
  - Political Science: (power, authority, command, manipulation and dissonance)
  - Economics: (well-being, free choice, exchange and equilibrium).
- We have a <u>fracturing of knowledge</u> into separate little compartments (the disciplines) precisely at a point in time when <u>we have a totalizing system (capitalism)!</u>
- We also get a theory of <u>perfectly competitive markets</u> precisely at a time when capital is centralizing into corporations and government’s role in the economy is increasing!

THE NEOCLASSICAL TURN

- Foley: ‘Where the great themes of classical political economy are dynamic and developmental, bound up with change and evolution, the great themes of marginalism are static and allocational, bound up with the concept of efficiency.’ (155).

- Marginalism is rooted in utilitarian thinking:
  - Long lineage but begins with Bentham (1789)
  - Pain and pleasure govern the human experience.
  - Goal is to seek pleasure – or <u>the happiness principle</u> – the greatest happiness for the greatest number.

The Neoclassical Turn

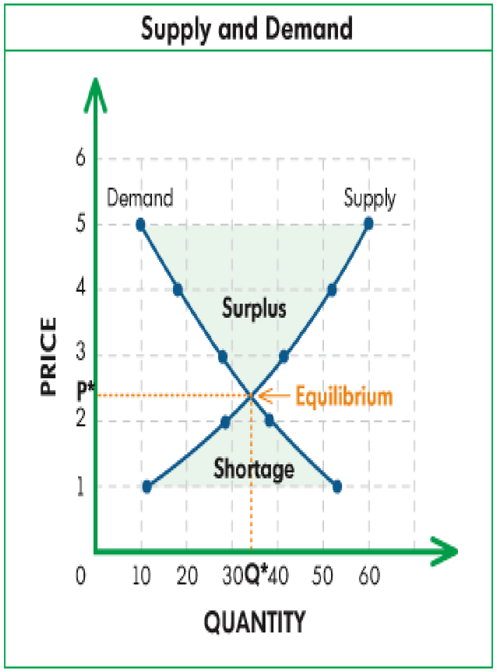
- Marginalism allows no social categories (like class, race, gender) that transcend the individual or the combination of individual actions.
  - The starting point is always an abstract, isolated, self-interested individual.
  - The goal of this agent is to maximize utility!

- It will reject the labour theory of value and mathematize exploitation out of ‘Economics’.

- Project: ‘to endow the social relations of capitalism with an aura of ‘natural law’ that guaranteed the stability and rationality of economic life’ (Foley, 157).

Cast of Characters

- William Stanley Jevons (1835-1882)
  - British Economist and Professor
  - *The Theory of Political Economy* (1871) – first mathematical account of economics.
- Carl Menger (1840-1921)
  - Austrian economist and founder of the Austria School of Economics
  - *Principles of Economics* (1871) – price is determined at the margins!
- Vilfredo Pareto (1848-1923)
  - Italian economist and helped mathematize economics
  - New concept: Pareto efficiency
- John Bates Clark (1847-1938)
  - American marginalist and professor at Columbia
  - *The Distribution of Wealth* (1899)
- Irving Fisher (1867-1947)
  - American economist
  - *The Nature of Capital and Income* (1906)
- Leon Walras (1834-1910)
  - French political economist and professor of PE at the University of Lausanne.
  - Pioneered general equilibrium theory
- Alfred Marshall (1842-1924)
  - English economist
  - *Principles of Economics* (1890) becomes a leading textbook on economics



Jevons' 'Breakthrough'

- Approach the determination of market price from the demand side.
  - But first let's consider that the concept of relative prices, which says that all goods and services bearing a price can be expressed in terms of one another or their ratio.
  - For example: a chocolate bar costs $3, a box of chocolates $15, and a chocolate factory $300,000
  - Divide all numbers by the smallest number
  - So the ratio is: 1:5:100,000.
  - This suggests that a box of chocolates is five times more valuable than a chocolate bar and a factory is 20,000 more times valuable than a box of chocolates.

- Marginal (small change) utility: the usefulness of one increment of a commodity is different from the overall or total utility an individual may gain from consumption of that commodity.
  - Example, the chocolate bar.

Clark's Production Function

- Aim is to explain, but <u>more importantly to justify</u> the distribution of income into: wages, profit and rent.

- Each factor receives returns in proportion to its contribution to the production of output/commodities.
  - But…we must know the value of all the inputs and those inputs can only have one value.

- Marginal Productivity Theory
  - Let's look at the production function

The Cambridge Controversy (1960s)

- Cambridge UK heterodox economists vs. neoclassical economists in Cambridge, Mass.

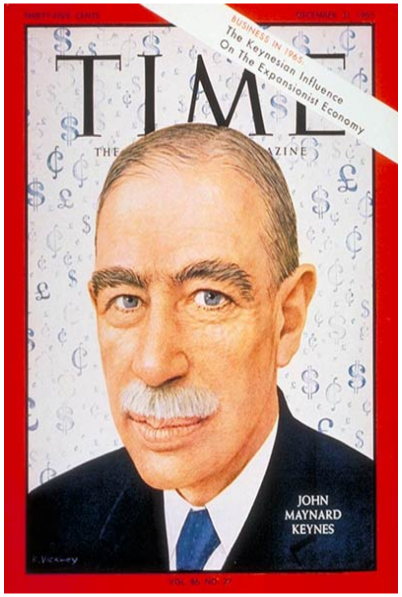
- In order for the production function to work, and therefore justify profit, we have to know the value of capital.
  - But that depends on knowing profit!

- The value of capital goods is the expected future profit divided by the rate of interest.

- But if the expected future profit changes, that means the capital goods can actually have two or more values!
  - Economists admitted this, but they go on believing their theory as a 'matter of faith'.

THE COLLAPSE OF 19TH CENTURY CIVILIZATION

THE KEYNESIAN TURN



- Major work: *General Theory of Employment, Interest and Money* (1936).

- Begins with a critique of Say's Law:
  - Named after Jean-Bapitiste Say (1767–1832).
  - So what did Say, say?
  - Businessmen never hoard money, markets clear and gluts are the result of too many people focused on producing the same thing.

- Investment, Time and Expectations

- Involuntary Unemployment

- Government Intervention
  - Spend when in recession
  - Pay down debt while in the boom times
  - Automatic stabilizers
  - Implement capital controls for 'national' development

CONCLUSION

- ‘Economics’ is far from a ‘science’ and more akin to a church.
  - Very little of neoclassical economics has any bearing whatsoever on the real world – it is an abstraction from the real world and a justification for capitalism and (increasingly obscene) inequality.
  - It does more to obscure reality than to illuminate the real world of power and accumulation.

- Keynes saves capitalism from itself.
  - But the Keynesian compromise will come under attack in the 1970s, during another period of crisis.