WEEK 3: PERSPECTIVES ON POLITICAL ECONOMY

Dr. Aidan Regan  
Email: aidan.regan@ucd.ie  
Website: www.capitalistdemocracy.wordpress.com  
Twitter: #CapitalUCD  
Teaching assistant: Daniel.stairs@ucdconnect.ie
Introduction

- From the period of antiquity to the 1700’s there was limited improvement in living standards.
  - This often described as the Malthusian era.

- It was only from the late 18th century that economic growth (capitalist development) began to take off.
  - Revolutions in production, medicine, distribution and exchange

- Classical political economists (and moral philosophers) were interested in explaining this expansion of income and wealth.
  - What interested them was the development of commerce/capitalism

- This week I want to talk about the history of economic ideas.
Key thinkers

- Adam Smith
- David Ricardo
- Thomas Malthus
- Karl Marx
- Karl Polanyi
- Joseph Schumpeter
- Alfred Marshall
- John Maynard Keynes
- Ludwig Von Mises
- Fredrich Hayek
- Hyman Minsky
- Simon Kuznets
- Joan Robinson
- Milton Friedman
- Paul Samuelson
- Robert Lucas
- Elinor Ostrom
- Amartya Sen
- Daniel Kahneman
- Simon Kuznent
- Thomas Piketty
Economic ideas

“ The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air are distilling their frenzy from some academic scribbler of a few years back”

Adam Smith (the labour theory of value)


- In WN, the essential starting point for growth and productivity improvements is the division of labour.
  - The manufacture of a pin or a watch.

- Dividing up the production process into different stages.
  - Skill specialization (dexterity, tacit knowledge, judgment)

- Skill specialization leads to a diversified economy
  - Mutually dependent laborers co-operating freely in a process of exchange. Just look around the room.
Adam Smith (2)

- The division of labour is wealth improving when the market is bigger:
  - *Larger markets increase the incentive to specialize and trade*

- Large markets are made possible by
  - *Trust*
  - *Good government*
  - *Free trade*

- Individual “self-love” gives rise to trade and barter
  - The wealth of a nation comes from commercial expansion (which is dependent on skill specialization and the division of labour).
Adam Smith (division of society)

- The labour theory of value divides society into three classes of persons:
  - Landowners, wage-earners and capitalists
- Those who live by rent, wages and profit.
- The hero in Smith’s tale of wealth accumulation (told in 4 historical stages) is the capitalist entrepreneur.
- Prudence (the desire to save) rather than greed is considered the core virtue.
  - Think Max Weber and the cultural influence of protestant ethic.
Adam Smith (on government)

- Governments should get out of the way of commerce
  - But what he is referring to is **feudalism** and mercantilism

- The role of government is to:
  - Administer justice
  - Provide security
  - Defend property
  - Build infrastructure
  - Provide public education
    - and other essential services that markets insufficiently provide.

- The idea of the *invisible hand* is barely mentioned in WN.
The principal problem of political economy is:
- Distributing national income between rent, profit and wages

This division is the outcome of the workings of commercial market system:
- Landowners, workers and capitalists

Ricardo is deeply concerned about the rise and fall of real wages (purchasing power) as a % of national income.

He is concerned that too much of national income is going to landowners in the form of rent.
Ricardo (on comparative advantage)

- Most famous for his theory on *comparative advantage*:
  
  - A nation should specialize in those industries where it has comparative advantage (exporting steel)
  - It should import those goods that it no longer specializes in at home (importing wine).
  - Open international trade for exchange is crucial (liberalize)

- What does the US specialize in? Germany? Ireland?

- Think about this in terms of contemporary theories of international political economy.
Ricardo (on rising rents)

- In the *Principles* Ricardo is concerned with:
  - the long term evolution of *land prices* and *land rent*

- His **scarcity principle** states:
  - Once population and output grows, land will become more scare. Land prices will then increase. This implies higher rents for landowners. Landowners claim a growing share of national income.

- His scarcity principle is important for understanding why certain prices might rise to very high levels.
  - Think about this in relation to housing in Dublin today.
Discussion

• Adam Smith once wrote:

“in times of necessity the people will break through all laws. In a famine they will break open the granaries and force the owners to sell at what they think is a reasonable price”

Discuss. When do prices become destabilizing?

What is a reasonable ‘price’ for housing? Higher-education?

Can labour, land and money be treated as commodities?
Main takeaway

• Classical economics coincided with a growing interest in the political theory of economic liberalism
  • This is why it is called political economy

• It is usually associated with “the hidden hand” of the market and a defence of free trade, and opposition to government.

• But what really united these classical scholars was the labour theory of value (which Marx borrowed in total).

• Contemporary “neo-classical” economics replaced this theory of value with the utility (price) theory of value.

• This is premised on a set of rational choice assumptions.
The legacy

- The legacy of classical and *neoclassical* economic ideas can be identified in the Mont Pelerin society (neoliberal) view of the world.

- Ludwig Von Mises
  - Most famous for his rationalist critique of planned economies, and the defense of the de-centralized price mechanism in markets.

- Fredrich Hayek
  - Most famous for his idea that private investment, not government spending is what leads to sustainable growth. Focus on individuals + firms in micro economics.
  - He is also credited with *quantifying* the economics professions.

- Milton Friedman
  - Most famous for his critique of Keynes, and the promotion of the monetarist theory of money supply, and how it relates to inflation.

- Generally, thinkers in this Chicago School tradition promote less government, supply side economics, and rationalist assumptions.
  - They also tend to share a libertarian normative political philosophy of human action.
Critical turn…

• The critique of neoclassical approaches:
  • Power (whose interests are served by a given set of policies?)
  • Institutions (what are the rules of the game that shape and constrain behavioral choices?)
  • Distribution (who gets what, when and how?)

• Classical political economy began with Adam Smith but took a critical turn in 1867
  • Karl Marx and the publication of *Das Kapital*

• Think about 1867 – what was happening across Europe?
Historical context

- 1848 The European revolutions
  - Same year Marx wrote the Communist manifesto

- Think about wages, rent, profit in national income (Smith)
  - There was an emerging and conflictual industrial class structure

- Charles Dickens published his famous novel, Oliver Twist, in the same period
  - Rising poverty
  - Stagnant wages
  - Rising profit

- Marx set out to scientifically study capitalism
Das Kapital

- He sets out to systematically analyze the internal logical contradictions of the market system using:
  - The Hegelian dialectic method

- He accepts the Smithian argument on markets and proceeds to deconstruct it entirely.

- For Marx, competitive markets lead to
  - The centralization of capital (big firms eat little firms)
  - The concentration of capital (class power)
  - Rising inequality between classes
The theory (M-C-M)

• In his story, the capitalist starts out with money (M).

• He then purchases two commodities: labour power (L) and the means of production (P).

• He puts these to work using a given set of technologies to produce a commodity (C).

• This commodity is then sold in the market place with a surplus to make a profit (P).
The theory (M-C-M)

- But the capitalist does not consume everything. He must reinvest and expand the M-C-M production cycle.

- Why? For Marx the *coercive laws of competition* compels the process of infinite accumulation.

- If the market system is crisis free (in a permanent equilibrium) then there would be no problem.
  - But for Marx the system inevitably leads to crises.

- The system breaks down due to its internal contradictions.
5 crises tendencies

- Money - where does it come from
  - Capitalists need to secure the legal apparatus of state
- Labour - how to source supply and demand
  - Capitalists need to weaken the collective organisation of workers.
- Environment - how to deal with scarcity
  - Capitalists need to exhaust raw materials from the earth.
- Technology - the falling rate of profit
  - Capitalists need to constantly invest in new technologies
- Debt – how to keep the system liquid
  - Capitalist need to ensure sufficient aggregate demand

For Marx, each of these gives crises rise to conflict. In the end, he assumed capitalism would morph into communism.

This can be traced to his Hegelian teleology of history.
Discussion

• What did Marx get right? (capitalism is deeply unstable)

• What did he get wrong? (workers will not rise up and build a dictatorship of the proletariat).

• There is not one form of capitalism.

• The post-world war social state suggested the possibility of a marriage between capitalism/democracy.
Karl Polanyi

• The Great Transformation - first published in 1944 - can be read as a critique of both:
  • Marxian economics (particularly the 1st/2nd International)
  • Neoclassical economics (particularly the Austrian School)

• It sought to explain the conditions that gave rise to fascism.

• He starts out by arguing theoretically, empirically and conceptually that it is factually incorrect to separate markets from the state.

• For Polanyi, the assumption of an autonomous competitive market economy gives rise to all sorts of policy delusions and crises.

• There is no rational market operating separately from the state. The very idea of a “free self-regulating market” is a myth.

• Throughout the book, he refers to market society. Markets are deeply embedded and inseparable from society.
Core ideas

• **Embeddedness**

  • The market is not autonomous but subordinate to politics, regulation, religion, social norms, and social relations. Actually existing markets.

  • The market economy is a socio-legal construction, created to benefit society, and cannot exist independently from the nation-state.

  • Liberal theories of atomised, rational, and self-regulating markets (disembedding the economy) push society into disintegration (rise of fascism).

• **Fictitious commodities**

  • Treating *land, labour and money* as a commodities to be bought and sold in a market has fatal consequences.

  • Nature and people are not commodities. Money and credit cannot be allocated by market mechanisms alone.

  • Just think about the labour movement, climate action today, and the origins of the great financial crash in 2008 (financialization).
Double movement

• The attempt to dis-embed the market, will lead to counter-movements to protect and re-embed market society.

• This does not mean they will be progressive counter-movements.

• The period of globalisation prior to WW1 – and the international monetary regime of the gold standard - gave rise to the conditions that led to fascism, communism and social democracy.

• Post WWII, the general ideational climate was critical of economic liberalism, and the ideas of a self-regulating free markets.

• The macroeconomic ideas of Keynes prevailed, whilst those influenced by the Austrian School were side lined for a generation.
John Maynard Keynes

- The *General Theory of Employment, Interest and Money* was published in 1936, and heavily influenced by the Wall Street crash, the great depression, and the inter war period.

- The book is a defence of government using activist economic and fiscal policies to stabilise income growth.

- Unlike the neoclassical paradigm, Keynes argued that the objective of economic policy should be full employment.

- He argued that wages are not flexible, and supply-side economic reforms are unlikely to work, leading to sticky prices.

- This means that government should actively intervene in the economy to ensure aggregate demand and full employment.

- Keynes was strong defender of markets, and private investment. His argument was that government must play an an activist role.
Keynesian economics

• From the 1950’s-1970’s, most Western governments adopted a mixture of Keynesian economic policies.
  • Mixed market economies. Keynesian welfare states.
  • Global liberal trade embedded in national capital regulations.

• But from the late 1970’s, Keynes fell out of favour. This can be traced to the period of stagflation = high unemployment and high inflation.

• Critics such as Friedman blamed stagflation on Keynesian-oriented economic policies.
  • Government commitment to full employment + strong collective bargaining + welfare state was undermining market competition.

• The election of Thatcher/Reagan ushered in a new generation of economic policies heavily influenced by the ideas of Hayek/Friedman.
  • This shifted the focus to inflation targeting over full employment.
• In the 20th century, the narrative of capitalist development went from apocalyptic endings to happy endings, why?
Simon Kuznets

- Simon Kuznets published an important paper in 1955 titled “economic growth and income inequality”.
  - A rising tide lifts all boats.

- Capitalist development initially creates inequalities but market competition equalizes.

- Balanced growth path.

- This was the period of Keynesian macroeconomic demand management:
  - Commitment to full employment
  - Commitment to social protection
Theory

- Kuznets observed a sharp decline in income inequality in the USA between 1913-1948.

- In 1913 - the top decile claimed 45-50 percent of national income.

- By 1948 - this had declined to between 30-35 percent.

- The Kuznets curve - economic growth initially creates inequalities but then acts as a force of equalization.
Context

• Policymakers jumped at the findings and it subsequently shaped the debate on US distribution. Why?

• The debate was influenced by the Cold War. Capitalism was benefitting everyone, communism was not.

• The West needed to legitimate a new macroeconomic policy regime – Social/Christian Democracy + Keynesianism

• Piketty has developed Kuznets data (and scientific method) to expand the data to 20 countries over 200 years.

• He argues that Kuznets was wrong, and that the golden age of social democratic capitalism was short-lived.
Conclusion

• For Piketty, wealth inequality is growing because capital income is accumulating faster than economic growth (R>G).

• This means he certainly sides with Marx on the question as to whether markets left to their own devices produce inequality.

• But he differs in terms of proposing a fiscal solution. He is perhaps closer to ideas of Karl Polanyi.

• Next week we are going to look at the structural transformation of capitalism from 1870-201, and the underlying politics.
  • Britain, France, Germany and the USA

• Please read chapters 3, 4, 5. P 113-164