Classical Economics, Marx, Marginalism, and Keynes

ALEX M THOMAS

Over the last two decades, several good books have been written on the history of economic thought such as Vaggi and Groenewegen's *A Concise History of Economic Thought* (2003), Roncaglia's *The Wealth of Ideas* (2005), Ernesto and Zamagni's *An Outline of the History of Economic Thought* (2005), and Sandelin, Trautwein, and Wundrak's third edition of *A Short History of Economic Thought* (2015). Heinz D Kurz's *Economic Thought: A Brief History* is a welcome addition to this list.

Economic Thought: A Brief History by Heinz D Kurz translated by Jeremiah Riemer, *New York: Columbia University Press, 2016; pp viii+208, $27.*

Chapter 1 covers early economic thought in brief—economic observations by the ancients, scholastics, and mercantilists. The ancient clay tablets, as Kurz notes, "are perhaps the first national income account in human history" (p 6). Early economic thought was "fairly unsystematic … and oriented towards prescription" (p 5); hence their focus on topics such as "just price" and "just taxation" (p 10). Thomas Mun, one of the prominent mercantilists, advocated running a trade surplus because they equated the nation's wealth with "the stock of precious metals in the treasury of the crown" (p 13).

Classical Economists and Marx

Kurz devotes Chapter 2 to classical economics. The following are some of the key characteristics of classical economic thinking: the tendency towards a uniform rate of profit in a competitive economy; social class as the unit of analysis; "prices reflect the difficulty of producing the various commodities" (p 23); wages are determined by social and historical factors (p 26); and the theoretical interest in "systematic and permanent forces" as opposed to "incidental and temporary factors" (p 25). Kurz rightly points out that Smith's invisible hand metaphor has been "fundamentally misunderstood" (p 28). With respect to income distribution, Smith recognised that employers are more powerful than workers (p 30). Smith also highlights the negative consequences of division of labour: "the devaluation of artisanal skills and the replacement of adult with child labour" and to mitigate such effects, he called for "state-financed elementary school education" (p 33).

Ricardo embarked on his study of economics by reading Smith, and made progress particularly in the theory of income distribution: "the real wage rate and the profit rate had an *inverse* relationship with each other for a given state of technology" (p 35). Smith, Ricardo, and Malthus assumed that planned saving is one and the same as planned investment. However, this did not imply a tendency towards the full employment of labour. Although Mill "saw himself as merely correcting and completing the Ricardian doctrine, he was really a transitional figure, foreshadowing certain elements of the later marginalist doctrine" (p 40). Mill "advocated the so-called wages-fund theory, which was a primitive anticipation of extending Say's law to the labor market. ... Mill later admitted that the wages-fund theory was untenable and retracted it" (p 40).

Chapter 3 presents the economic thought of Marx and the socialists. For Marx, the value of a commodity "is determined by the amount of labour required for its production" (p 47). Through his analysis of the reproduction of the economy, the vulnerability of capitalism to crises was brought to the fore. Marx identifies four reasons for capitalistic crises: (i) "an excess production of commodities in one sector and a deficient production in another sector" (pp 50–51); (ii) inequality of income distribution leading to aggregate demand deficiency; (iii) fall in the general rate of profits; and (iv) leakage of money from the system leading to a fall in sales. Kurz provides very brief and interesting developments within the Marxian framework by Luxemburg, Hilferding, Baran, Goodwin, and Leontief.

Marginal Economics

The marginal revolution begins with the contributions by Jevons, Menger, and Walras. Economic problems, for the marginalists, are "constrained optimisation problems" (p 62). With the advent of marginalism, economic questions moved away from growth and development to the allocation of resources. The classical principle of intensively diminishing returns (to land) was generalised "indiscriminately to *all* factors of production as well as to the sphere of consumption" (p 61). "They also treated reproducible goods (especially capital goods) in terms of scarcity ... unlike in classical economics, where this was only the case with respect to scarce natural resources" (p 62). They consider the principle of substitution as "one of the most important principles in economics" (p 64). In the same chapter, Kurz briefly discusses the work of Thünen, Cournot, Gossen, Böhm-Bawerk, Wicksell, and Pareto. Austrian economists like Menger and Mises advanced the thesis that all value is ultimately subjective. However, this thesis did not find unanimous support among the marginalists. "Rather, it was Alfred Marshall's interpretation that prevailed, which contended that a complete theory of prices and income distribution must take into account both objective and subjective factors or "forces"—that of supply and that of demand" (p 58). Walras's work in general equilibrium motivated further developments, most notably by Pareto, Cassel, Lindahl, Hicks, Hayek, Arrow, and Debreu. Lindahl and Hicks developed the concept of "temporary equilibrium" and Lindahl and Hayek that of "intertemporal equilibrium" (p 80).

Marshall's economics forms the subject matter of Chapter 5. His method of partial equilibrium "is omnipresent even today and shapes the idea of economics as the science of supply and demand" (p 81). One reason for its omnipresence, Kurz notes, is its "easy teachability." Marshall's "concept of the long-run normal price bears a strong resemblance to the classical concept of the production price, and like the classicists he postulated a uniform rate of return on capital in competitive conditions" (p 83). He presented his theory as a continuation of the classical tradition "although scrutiny shows that it involved a fundamental break with the classical approach" (pp 81–82). In two essays published in 1925 and 1926, Marshall's partial equilibrium analysis was subjected to a "thoroughgoing critique" by Sraffa (pp 86–87); "[b]ecause of the interdependencies between industries, it is simply not possible in general to change the price of just one input or output at a time and analyse the effect of such a change in a single market as if in a vacuum" (p 87).

Chapter 6 discusses utilitarianism and welfare theory. Kurz tracks the origin of the law of diminishing marginal utility of income to the finding of the German psychologist Gustav Fechner that the "perception of a sensual stimulation increases less than proportionally as its intensity grows to the connection between marginal utility and the income an individual receives" (p 90). Kurz also informs us that the popular Edgeworth box was actually invented by Pareto (p 93). Unlike other utilitarians, "Pareto was aware of the limited range covered by the fictional character of homo economicus and of the theory of equilibrium based on that artificial construct" (p 98) and therefore later in life he turned to sociology. The works of Schumpeter, Mises, Lange, Lerner, Pigou, and Hayek are also briefly discussed in the chapter. In the same chapter, Kurz presents the research findings of Atkinson and Piketty which "undermine the foundations upon which Western societies are erected—the belief that what matters for an individual's economic and social success is hard work and high productivity" (p 97).

Internal Critics

The idea that perfect competition will yield socially optimal outcomes is still very much prevalent. This view has been criticised, and rightly so, for "entertaining a sometimes naive gullibility about the efficiency of markets and for ignoring the highly restrictive conditions under which this purported optimality applies" (p 105). The latter has led to work on imperfect competition, the subject matter of Chapter 7. Under this subject, Kurz includes old institutional economics (Veblen and Clark), monopolistic competition (Hotelling, Chamberlin, and Joan Robinson), oligopolistic competition (Bertrand and Stackelberg) and further developments to this line of enquiry by Coase (on firms and transactions cost), Simon (his concept of bounded rationality yielding a huge literature of managerial and behavioural economics), and Nash (who "developed noncooperative game theory to deal with the strategic interaction of several agents or firms" (p 112)).

Chapter 8 is devoted to the economics of Schumpeter and the strands of economic thinking it motivated. For Schumpeter, the most important feature of capitalism is its "dynamism," a consequence of the role of the "entrepreneur" (p 114).

> Although he cherished the achievements of Walrasian theory, he objected that it knows only 'static,' 'hedonic,' and 'rationalistic' types who conform to prevailing circumstances. … They are 'boring equilibrium men' as far as Schumpeter is concerned. (p 114)

Schumpeter draws on Juglar's work on business cycles and Kondratieff's and Spiethoff's statistical analysis of prices, wages, and interest rates. Schumpeter is "considered one of the founding fathers of 'evolutionary economics,' in which economic development is understood as a process of selection whose creative side increases variety, whereas its destructive side decreases it" (p 119); the seminal work in evolutionary economics is by Nelson and Winter. Two other legacies of Schumpeter are in new growth theory (Aghion and Howitt's work within a neoclassical framework) and in the theory of the instability of financial markets (developed by his student, Minsky, in the 1970s) (p 119).

Keynes and After

Chapters 9 and 10 are devoted to the economics of Keynes and the reactions to it respectively. It is important, as Kurz writes, to highlight that Kalecki had independently arrived at the principle of effective demand (p 122), the central message of the principle being that investment determines saving in a two-sector economy via changes in aggregate income. Besides triggering conceptual developments in economic theory, Keynes's economics motivated developments in national income accounting (via Stone) and public finance (via Musgrave). While Keynes's analysis assumed productive capacity as given, Harrod extended the principle of effective demand to the long run—where investment adds to both productive capacity and aggregate demand. Keynes's economics was also interpreted in general equilibrium terms, the chief responsibility of which lies with Hicks. Such interpretations trace unemployment to rigidities in the system (p 138). The marginalist interpretations of Keynes are refuted by the post-Keynesians (Joan Robinson, Kaldor, Pasinetti, Shackle, Minsky, and Davidson) who reject the Say's law, neutrality of money, that saving determines investment, and the marginal productivity theory of income distribution (p 141).

Another marginalist interpretation draws upon the intertemporal equilibrium theory of Fisher to develop what is known as "new classical macroeconomics" (p 146), of which Lucas and Sargent are the pioneers. Yet another Keynesian line of enquiry was initiated by Akerlof and Stiglitz who "analysed the behavior of rational actors in light of price rigidities and asymmetrically distributed information, especially in the context of labor and credit markets with imperfect competition" (p 148). Kurz also discusses monetarism—championed by Friedman—as a reaction to Keynes.

Chapter 11 discusses general equilibrium and welfare theory. Walrasian economics moved in favour for short-period equilibria away from long-period equilibria, although, as Kurz notes, paradoxically, "the time horizon of actors in some new models was posited as infinite" (p 153). Notable contributions to this research programme were made by Hicks, Samuelson, Arrow, Allais, Debreu, and Malinvaud. Basically, short-period equilibria were conceived of as a "sequence of temporary equilibria" which lacked persistence, "typically the hallmark of equilibrium" (p 154). General equilibrium was termed a "failed research program" by Hellwig because the system is stable only under very restrictive assumptions (p 160). Sen's contributions to welfare economics find a mention in this chapter.

The final chapter presents a broad overview of developments in selected fields: game theory, capital theory, growth theory (including demand-led growth theory), spatial and urban economics, development economics and new economic geography, public choice, behavioural economics and experimental economics, new institutional economics, and financial market theory.

I end with some observations on the book in its entirety. Kurz's *Economic Thought* is written in an accessible manner for the interested reader and indeed, "no prior knowledge [is] needed" (p vii). Additionally, owing to the breadth of the book and its focus on classical economics, Marx, marginalism, and Keynes, it can also be used as a supplementary text in undergraduate classes. In the final paragraph of the book, Kurz warns the reader "against the naïve idea that it is the privilege of living economists to articulate only correct ideas" (p 185). Hence, readers of this book will come across contemporary research (especially in capital theory (pp 168–70) and demand-led growth theory (pp 175–76) which has its origins in the ideas of classical economists and Marx. One minor quibble is that this reviewer hoped to see a longer reflection on the method, practice, and usefulness of history of economic thought in the book given the author's substantial scholarship in this area. That said, overall, the book is remarkably successful in its objective of providing a brief history of economic thought.

Alex M Thomas (*alex.thomas@apu.edu.in*) teaches economics at Azim Premji University, Bengaluru.