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How to Look at Economics Critically: Some Suggestions

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INTRODUCTION: JOE STIGLITZ AND...THE SRAFFIANS

Let us start on a light note. Assume not a set of preferences but a Woody Allen type situation in which there is a character resembling very much an economist like Joe Stiglitz. What would such a person say, qua economist, to the psychoanalyst? We surmise that the confession would go along the following lines: 'I am really obsessed by an upward sloping supply curve crossing a downward sloping demand curve, yielding a unique and stable point of equilibrium. That is my dream world which, however, does nor materialize in practice, not even approximately. Yet the world of the sweet dream is necessary for me to transfer the real world into another dream, this time a nightmare, where those two curves, for all sort of reasons, start zigzagging all over the place, generating unpalatable outcomes. This is my economics of an imperfect world, but I cannot have that nightmare unless I first go through the sweet dream'. This is, in a nutshell, the essence of today's mainstream economics. There is nothing remotely factual, observational, or cognitive in it. And if a Joe Stiglitz denounces the major world financial institution as an instrument of impoverishment this should go mostly to his moral credit rather than to his background as an economist.

What economists say in terms of cognition can be said by the lay person as well. Economists do not verify 'laws' or 'relations'. Edmond Malinvaud, a most distinguished Neoclassical believer, thought, by contrast, that they did just that, arguing his case very strongly, also in emotional terms, at a famous international conference on economic methodology held in Paris towards the end of 1992.[1] Yet, perhaps because of the criticisms aired there, Malinvaud later wrote an article where he tried to explain why economists do not make discoveries, precisely by introducing many doubts about the reliability of verification procedures. These shortcomings were seen as deeply rooted rather than contingent upon the immaturity of the state of the art (Malinvaud, 1996). What the economist can do is only to think up an imaginary–not theoretical or abstract-world and then transfer onto it the perceptions he or she receives from the actual environment. In other words, matter never shapes space, as it were. The movement is always one way from the environment to the model leaving the basic theory intact. This is why our Joe Stiglitz's double must tell the psychoanalyst that he believes in the basic supply and demand story as a soothing sweet dream before moving to the nightmare where everything zigzags.

To be fair to the neoclassicists, the case of the actual world either having to adjust to a predetermined imaginary set of postulates or being totally shut out, applies also to some heterodox streams, particularly those which refuse to integrate their research program with historical analysis. Thus, for instance, a well known contributor to the Sraffian research program, Sergio Parrinello, voiced recently the following critical remarks when discussing Sraffa's legacy as continued by the Sraffians themselves:

> It seems as if they were engaged in a sort of division of labour and as if they say: we have done our critical work and we are still doing it; others, perhaps more expert in the fields of historical studies and of non-economic social sciences, should do the rest of the work in order to explain the level and the structure of economic activity and the evolution of these phenomena relative to historically determined factors. But why does such a second field of enquiry not emerge in a complementary way with the Sraffian theory of prices and the assumed methodology of Sraffa? This is a legitimate question 40 years after the publication of Sraffa's book. (Parrinello 2002: 259).

At this juncture two questions spring up in our minds. The first relates to the reasons why most schools in economics are so impervious to becoming relevant for the analysis of the object of their study, namely the economy which, indeed, may not really exist as a set of phenomena, with their imputed variables, in isolation from the rest of the society.

The second question concerns the issue of pluralism behind which lurks the whole ideological and political dimension of economics as a 'theological' discipline. In the next section we shall try to broach some answers to the first question by arguing that the notion of systemic laws and definite tendencies held by classical economics and by Marx, as well as the immanent principles of maximizing behavior held by the neoclassicists, depend on such special (and similar) conditions that the purported cognitive value of the respective theories vanishes in a more complex world. Hence both streams should be looked at as philosophical and political formulations regarding how to 'imagine' rather than to analyze the economy. It will be suggested that perhaps John Maynard Keynes, in his own far from linear way, attempted to express the most that could be said in economic terms by confining himself to the short period and by constructing a point of view not based on hard tendencies. To quote him from memory, in economics it is always the unexpected never the inevitable that happens.

The rest of this chapter will deal with the second question, which we believe is more significant than the first. Economics will continue to exist regardless of its cognitive capacities, since, in today's monetary based world, it performs a central ideological role in shaping power relations. In this way, economics has eliminated the multiple array of moral values in our perceptions of what humanity is and of how to address humankind's existence.

FROM SYSTEMIC TENDENCIES OR IMMANENT BEHAVIOR TO AN UNKNOWN FUTURE

The nineteenth century witnessed the crystallization of two theoretical orientations aiming at discovering fundamental long-term tendencies in the economy. The first is the classical strand whose importance, we believe, is due to the fact that it culminates in Marx, while the second is what today is called neoclassical mainstream economics. Let us take a brief look at both and we shall immediately see that they collapse when they move from a simple to a complex world.

Marx's coherence lies in that he made every variable of his system interact with capital accumulation. He took the Ricardian theory whereby the value of commodities is determined by the amount of labor time bestowed in producing them. Such a value is independent of distribution which, instead, is determined by variations in the rate of surplus value, that is by changes in the proportions in which total labor time is divided between the amount needed for the workers to buy their means of subsistence and the amount fetched by the capitalist firm as profit. Variations in the rate of surplus value are caused by the relative size of the 'reserve army of labor', i.e. by unemployment, and by technological change, with the latter depending upon the former. Look now at the brilliancy of Marx's dynamics.

Initially the capitalist core is small but its productive forces are dynamically stronger than those of the surrounding system of petty commodity producers. The weight of capitalistic interests, therefore, brings about the end of natural rights over land. Its privatization thus throws throngs of landless peasants onto the labor market whose impact is to lower the general real wage rate. Marx believed very strongly in the Classical, especially Ricardian, tenet according to which a lower wage rate is accompanied by a higher rate of profit and, thus, by a higher rate of capital accumulation. Consequently the transformation of hitherto subsistence peasants into proletarians will enable the stronger forces of production of the capitalist core to forge ahead thereby claiming the space held by urban petty commodity producers. Yet a stage will be reached where the hinterland will no longer have enough people to supply cheap labor.

At this point wages will rise and accumulation will subside bringing a decline in the rate of profits. Operating under competitive conditions, capitalists cannot increase prices in the wake of a general rise in wages. They have only one route left open for salvation: labour-saving technical change which causes technological unemployment. Not all firms will succeed in implementing the change, so that their bankruptcies will throw onto the labor market additional throngs, not of peasants but, this time, of redundant workers and of bankrupt proprietors. The restoration of the 'reserve army' via unemployment will reduce the general wage rate and accumulation will pick up again on an expanded technical basis. The rates of profits and of accumulation recover but, in the long run, from cycle to cycle, the process of labor saving technical change will increase the capitalist intensity of production generating a secular decline in the rate of profit from which, now, there is no cyclical escape. The economy is relentlessly prodded by the iron-clad rule of competition which is the primary motive for capitalists to invest as much as they can:

> [T]he development of capitalist production makes it constantly necessary to keep increasing the amount of the capital laid out in a given industrial undertaking, and competition makes the immanent laws of capitalist production to be felt by each individual capitalist, as external coercive laws. It compels him to keep constantly extending his capital, in order to preserve it, but extend it he cannot, except by means of progressive accumulation (Marx 1967 [1868]: 555).

One cannot but admire the terse logic in which the entire evolution of capitalism, from its inception to its demise, is encapsulated in a limited set of variables interacting with each other.

Yet is it convincing? Unless one believes in the automatic investment of the entire surplus, Marx's story need not hold at all. It is indeed possible to believe in such an automatic mechanism only if the economy is made of corn.

Why should the capitalist farmers pile up (save) corn in their silos without plowing it back into the field? Except for a normal precautionary quantity there is no reason for them to refrain from investing all the corn left over and above consumption. But when the economy is slightly more complicated, firms may simply not be able to invest their surplus. It is enough to introduce a separation between consumption goods and machinery, thereby transforming the economy into a monetary one, in order for savings not to imply investment and accumulation. Thus if the appearance of cheap labor does reduce the average wage rate, the rate of profit may actually fall because of the formation of unused capacity in the consumption goods sector following the reduction in the demand for consumption goods induced by that very decline in the wage rate. Unused capacity in the consumption goods sector will generate excess capacity in the machine sector as well. Indeed orders for capital goods coming from the consumption goods sector will decline, with negative effects on the level of production in the machine sector.

If this phenomenon can occur in a very simple model, imagine how much greater this probability would be in a real economy with millions of mostly heterogeneous products. At this point the economy is simply mired in the short period because it has no long term path to hang on to, unless one is forcibly superimposed upon it. Of course it is always possible to build all sorts of adjustment models depending upon the imagination of the individual author. These are just thought experiments. The moment there are no long term paths, the economist must become a historian versed in the politics, institutions, culture and in the social classes and groups of a particular country and/or of a particular period. A *priori* modeling will not do except for sketching out very tentatively some basic accounting framework.

It is interesting to see that similar, almost identical, conclusions can be arrived at by taking a different road to the study of the path to the future: the route of immanent individualistic maximizing behavior. In opposition to Marx who sought objective laws rooted in historical processes, the neoclassicists attempted to derive outcomes from postulates which they believed were immanent in the behavior of every individual. As noted by John Hicks (1969), who was among the founders of modern General Equilibrium Theory, neoclassical theory does not lend itself to historical contextualization, but this does not mean that neoclassical economists do not believe in the concrete validity of the assumptions, otherwise they could not even begin to zigzag their curves.

Cambridge mathematician Frank Ramsey made the most of the utility maximizing assumption and built on it a formal theory which macroeconomic text-books still use to explain why savings happen at all. For Ramsey the model economy is non-monetary, producing only one commodity, say corn. Under these circumstances the problem for the self-sufficient farmers is how much

corn to consume now and how much to save in order to till the land to obtain the next harvest. Given the utility function, the family will decide how much consumption should be forgone in order to have more of it in the future through a larger harvest. The present sacrifice in terms of utility compared to the certain gain in the future should be reflected in the 'real' rate of interest.

As soon as we move out of the corn-based self-sufficient farm, the theory does not hold. In a monetary multi-product economy to save more means, on one hand, to have more money, but, on the other, it entails a reduction in spending and therefore of demand for the other branches of activity. Thus in order to make the whole economy behave as if it were a single self-sufficient farmer, it is necessary to make the absurd assumption that an agent can indeed be conceived as representing the whole society. In modern models, through dynastic transmission, this agent becomes an infinitely long-lived 'thing'; we really dread calling it a human being. In any case there is no relation, let alone identity, between individual and collective behavior, something which has been philosophically ascertained since ancient times but which economists must still labor quite hard to accept (Kirman 1994).

The seemingly conflicting approaches discussed above, equally depend upon the economy being collapsed into one homogeneous sector, thereby enabling the smooth transformation of savings into investment. The smooth transformation defines the path towards the future: via cyclical accumulation in Marx and via intertemporal optimization in Ramsey-type macroeconomics. It is at this point that Keynes's theoretical intuition becomes important because it questions any predetermined tendency. Take for instance the first sentences of chapter 16 of the *General Theory*:

> An act of individual saving means-so to speak-a decision not to have dinner to-day. But it does *not* necessitate a decision to have dinner or to buy a pair of boots a week hence or a year hence or to consume any specified thing at any specified date. Thus it depresses the business of preparing to-day's dinner without stimulating the business of making ready for some future act of consumption. It is not a substitution of future consumption-demand for present consumption-demand, it is a net diminution of such demand. (Keynes 1936: 210).

Yet if:

> saving consisted not merely in abstaining from present consumption but in placing simultaneously a specific order for future consumption, the effect might indeed be different. (*ibid.*)

However there is no reason to believe that to be a normal occurrence, hence:

> an individual decision to save does not, in actual fact, involve the placing of any specific forward order for consumption, but merely the cancellation of a present order. (211)

It follows therefore that the cancellation of a present order will contribute to a fall in investment and in employment, exactly the opposite of what an increase in savings was supposed to do. This is Keynes's critique of the neoclassical view of savings. However, the general decline in real wages brought about by the expansion of the 'industrial reserve army' in the Marxian framework is equivalent to a general increase in the capacity to save. Will this phenomenon expand accumulation thanks to the shift in the distribution of income from wages to profits? No, because, if we are to follow Keynes' arguments, such a decline in wages is also a cancellation of orders for a large class of consumption goods.[2] Thus, just as there is no tendency towards a neoclassical intertemporal equilibrium, there is no continuous movement on the postulated cyclical path of Marx's accumulation theory. Both systemic processes are predicated upon investment being predetermined by savings.

The methodological implications concerning the very definition of economic processes are quite drastic. Long-term investment cannot be determined in an acceptably meaningful manner because the system is subjected neither to the iron-clad rules of competition outlined by Marx in the passage quoted hitherto, nor to the optimizing behavior of Ramsey's self-sufficient farmers. In Keynes the impossibility of sketching an acceptable long- term theory of investment related to (unknown) future tendencies in the rate of profits and of accumulation, confines the economist to the short period.[3] To analyze what the next period may look like she would have to get her hands dirty and study how conflicting interests, alliances, or other socio-cultural-political factors that the researcher might find relevant, impact on the day to day evolution of the society under scrutiny.

NO MORALITY, BUT ECONOMICS AS THOUGHT CONTROL

The limitations of the major constructions which aimed at formulating a global, causality-driven theory of economic human behavior, or of growth and accumulation, do not stem from the undeveloped state of macroeconomics as a sub-branch of the discipline. Rather they arise from the failure of micro-relations to come up with a consistent general framework. In other words, the moment a macro-system is broken up into subsectors it no longer holds together, but it cannot be built from the bottom up either.

Here again we find a stark convergence in the inadequacies of the two main opposing bodies of economic thought. In the case of neoclassical General Equilibrium Theory, changes in prices in relation to differences in supply and

demand conditions do not necessarily happen according to the principle of substitution since variations in prices change incomes, thereby affecting demand and prices again (Guerrien 1989).[4] Similar problems beset modern day classicists – like the Sraffians – in their search for a long-term position whereby production prices are consistent with uniform rates of profits. The gravitation process may require an immediate response of prices to imbalances in supply and demand – that is, the response must occur at once for the process to unfold towards the long run. Gravitation may also entail wild oscillations between inflation and deflation requiring the adoption of a super-powerful Central Bank, planning credit exactly to avoid those fluctuations (Kubin 1991; Bellino 1999).

All these complications happen in models which do not extend beyond two commodities. How can any of these be taken seriously as devices to understand the economy and its evolutionary transformations? The interesting aspect of the vicissitudes bringing economists working along classical lines onto the same plane as their neoclassical counterparts, is that the former were successful during the construction of the critique but fell into the maze of special cases and of *ad hoc* formulations when they wanted to prove that their approach – gravitation towards production prices-was stronger than the neoclassical one (Cartelier 1993).

Can it be said that there has been no progress in economic theorizing? There has been but in a negative way, as well described in a clear-headed paper by Carlo Benetti and Jean Cartelier (1998) whose observations, we believe, are shared deep-down by many economists of different persuasions. The authors argue that to reach the objective of creating a science, economic theorists sought–since the seventeenth century–to represent society by means of formal theories, based on value and prices without politics and monetary relations in them. Yet, they point out, most analytical developments of the twentieth century did not confirm the conclusions of the founders of the discipline. As a consequence the central questions of economics have yet to receive a satisfactory answer.

In a recent book we maintained that the failure of economics to get a handle on the object of its study is not due to still insufficient research (Di Ruzza and Halevi 2003). It results from the refusal to see what Karl Polanyi emphasized long ago. We wrote that the 'activities and gestures defined as economic ones are 'embedded' (in Karl Polanyi's sense), that is rooted, locked into, inserted, contextualized, in a whole system of references...of an extra-economic nature often dominating and determining those very economic activities. Thus multidisciplinarity must be the very principle underlying their study' (Di Ruzza and Halevi 2003: 126, our translation from French). Our view implies that it is virtually impossible to treat economic variables in isolation and in the abstract. Those constructed variables are not like minerals that can be taken

out of the rocks and cut, analyzed, and used industrially. They, instead, are inseparable from the social 'rocks'. But to build a theory of a particular phenomenon, whether real or perceived, it is necessary to isolate a few basic elements precisely in order to ensure the coherence of theory. The problem is that the economy cannot be treated in isolation from politics and other societal elements. The room to construct meaningful economic theories is therefore very limited. No wonder the attempts to construct, rather than find, those laws and behavioral rules have failed.

If we take a hard look at the three major approaches in economics, the Marxian, the Walrasian and that of Keynes, we see that the first appears to be connected to history but its results are fragile, the second is a brilliant metaphysics but its logical outcomes are not robust. The third strand, John Maynard Keynes's own writings, constitutes the most open statement to date that we do not really know, that we must play it by ear, and that we ought not to believe in automatic and symmetric responses. Hence, for Keynes, the whole art of dealing with economic questions is a mixture of politics, journalism, and some 'back of the envelope' quasi-calculations, being always wary of falling into the trap of postulating *a priori* causal relations. But all this also means that Keynes' results, in terms of economics, are very limited and definitely bounded by the conditions of his time.

We can now move one more step away from economics as a structured discipline and advance the proposition that we made, from the floor, in 1992 at the Paris conference on whether economics was becoming a hard science. We stated that anyone can talk about the economy with the same authority as trained economists. When it comes to talking to the public, the discourse of economists is not more informed than that of the lay person who bothers to read quality newspapers, say *Le Monde* or *The Wall Street Journal*. By contrast, not anyone can be a driver of a TGV, or a veterinarian, and not even a lawyer or a chartered accountant. The only element that can give the economist an advantage is the possible role of a priest in the corridors of power, whether private or governmental. The advantage comes from having insider's information. The person's professional profile qua economist is irrelevant. Upon becoming the *conseiller du prince*, or just by positioning himself/herself to be co-opted in that role, our character will start talking in terms of the acceptable jargon involving, in a loose manner, all the causalities belonging to theories which are, to say the least, far from solid. It is unlikely that young, soon to be co-opted, economists will climb the stairs of the Banque de France or of the Bank of New Zealand by waving the major book of the Sorbonne mathematician Bernard Guerrien in which he destroys the concept of flexibility. They will rather enter those buildings thinking of representative agents, of bad rigidities impeding competition, and of bad public sector deficits even when there is a surplus.[5]

More importantly, the role of economics as a thought control process shows up at the crucial junction between what is being said in private-that is: in learned journals, and academic debates-and what is being uttered to the public. The link is represented by university appointments and careers. At the academic level faculty members who are completely aware of the crucial failings of mainstream theorizing, having published papers on the subject, act as gate keepers against heterodoxy, preferring instead the constant reproduction of textbooks' vulgar doctrine. This behavior has had a negative impact on the heterodoxy as well, which, in order to break out of the ghetto, attempted to further professionalize itself by closing its eyes to the imperative of making multidisciplinarity the very principle guiding the study of the economy *in* society. Among the social sciences and the humanities, the lack of pluralism in economics is unique, and so is the system of reproduction of the established view. The message is simple: zigzag your curves as much as you like but do not question the basic postulates, do not get involved in the social views of Marxism, do not raise any queries about the ideological role of the discipline, look at Keynes as just a set of rigidities, etc., and, especially, do not attempt to look at economic processes as social constructions determined by specific historical and political contexts. Thus, while the conceptual criticism of economics as a failed cognitive discipline encompasses virtually all the theories-because of their inability to connect with the historical context-the political and democratic critique must be exclusively focused on the mainstream component.

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