Theories of Global Economic System

- Mercantilism deals with the economic policy of the time between the Middle Ages and the age of laissez faire or as some scholars put it, 16th to 18th century (Viner, 1968; Kuhn 1963).
- The period under which mercantilism held sway was not uniform in Europe.
- It began and ended at quite different dates in the various countries and regions of Europe (Heckscher, 1955).
- Mercantilism promoted governmental regulations of a nation’s economy for the purpose of augmenting state power at the expense of rival national powers.
- It was the economic counterpart of political absolutism.
- The 17th century publicists, most notably - Thomas Mun in England, Jean-Baptiste Colbert in France, and Antonio Serra in Italy – never, however, used the term themselves; it was given currency by the Scottish economist, Adam Smith in his *Wealth of Nations*(1776)

- Eli Heckscher (1955) identified the environment out of which mercantilism evolved as:
  - The ruin or disintegration of the universal Roman Empire
  - the rise and consolidation of states, limited in territory and influence though sovereign within their own borders, which grew up on the ruins of the universal Roman Empire.
  - Henceforth, the state stood at the centre of mercantilist endeavours as they developed historically: the state was both the subject and object of mercantilist economic policy.
  - The state had to assert itself in two opposing directions. On the one hand, the demands of the social institutions of the confined territories had to be defended against the universalism characteristic of the Middle Ages. On the other hand , the state had to assert its economic independence.
  - Nation-states split up and took to themselves the authority previously exercised over the Christian world by the unified Medieval Church

- **The main economic forces of mercantilism** included:
  - Mercantilism is anchored on the contention that economic forces strengthen state power.
  - Bringing about and maintaining an excess of exports over imports;
  - Accumulation of wealth as a basis for state power;
  - Erection of protectionist system anchored on high tariffs and restriction of imports;
  - The desire for a "favourable" balance of trade was never based by mercantilist writers on a desire to see their countries engage in capital export, to make investment abroad.
  - This fact lends support to the widespread charge that many mercantilists, even if they did not mean to attribute value to the precious metals alone, were at least confused as to the difference between money and wealth (Kuhn, 1963)

- The mercantile theory held that colonies existed for the economic benefits of the mother country and are useless unless they help to achieve profit.
- The mother nation should draw raw materials from its possessions and sell the finished goods, with the balance favouring the European country.
- This trade should be monopolistic, with foreign intruders barred.

- Mercantilism contained many interlocking principles, namely:
  - Precious metals, such as gold and silver, were deemed indispensable to a nation's wealth
  - If a nation did not possess mines or have access to them, precious metals should be obtained by trade;
  - It was believed that trade balances must be "favourable", meaning an excess of exports over imports.
  - Colonial possessions should serve as markets for exports and as suppliers of raw materials to the mother country.

- Manufacturing was forbidden in colonies, and all commerce between colony and mother country was held to be a monopoly of the mother country.
- A strong nation, according to the theory, was to have a large population, for a large population would provide a supply of labour, a market, and soldiers;
- Human wants were to be minimized, especially for imported luxury goods, for they drained off precious foreign exchange.
- Sumptuary laws (laws regulating expenditure affecting food and drugs) were to be passed to make sure that wants were held low.
- Thrift, savings and even parsimony were regarded as virtues, for only by these means could capital be created.
- In effect, mercantilism provided the favourable climate for the early development of capitalism, with its promises of profit.

- **Criticisms of Mercantilism**
- Mercantilism was severely criticised. These criticisms included:
- Advocates of laissez-faire argued that there was really no difference between domestic and foreign trade and that all trade was beneficial both to the trader and to the public.
- They also maintained that the amount of money or treasure that a state needed would be automatically adjusted and that money, like any other commodity, could exist in excess.
- They denied the idea that a nation could grow only at the expense of another and argued that trade was in reality a two-way street. Laissez faire, like mercantilism was challenged by other economic ideas.

- **Leading Protagonists of Mercantilism**
- **Thomas Mun (1571-1641)**
- Thomas Mun was one of the first to deal extensively with the balance of international trade.
- Writing in the 17th century, he described in detail the ways and means by which to maximise commodity exports and to minimize the domestic consumption of commodities produced abroad, listing for example, the need to moderate or abolish duties on the export of native commodities and to impose or increase duties on imported manufactures other than those for re-export.
- Mun was one of the few early writers who, in dealing with trade matters extensively, made use of the employment argument.
- To foster the re-export or entrepot (warehouse) trade and to win the carrying trade away from the Dutch, he advocated specially favourable customs treatment of goods imported for re-export.
- Mun wrote a book titled, *A Discourse of Trade from England into the East Indies* (1621) and *England's Treasure by Forraign Trade or, the Balance of Our Forraign Trade is the Rule of our Treasure* (written about 1630 and published posthumously in 1664)

- **Sir William Petty (1623-1687)**
- He was the first to reformulate and expand a still tenuous set of principles inherited from the Middle Ages.
- In his book, *Treatise of Taxes and Contributions* (1662), he set forth interesting elements of a theory of interest and a theory of rent.
- As to the former, he distinguished two principal cases:
  - The one in which the lender may call in his loan at any time he wishes;
  - The case in which the borrower can choose when (and where) to repay.
- In the first of these contractual arrangements, interest is not justified as the borrower is under the imminent necessity of having to tap an alternate source of finance in order to satisfy his creditor, who presumably is suffering no disadvantage as long as he can re-attain at a moment's notice the full control over the funds lent.
- In the second, the cards are turned around, with all the potential advantages accruing to the borrower, who consequently should pay something (interest) for their enjoyment.

- **Richard Cantillon (1680-1734)**
- Irish merchant and economist who made significant contributions to the study of political economy.
- Cantillon is best known for his *Essai sur la nature du commerce en général* (1755; *Essay on the Nature of Trade in General*, 1755), published after his death.
- His work was popularized around 1880 by the British economist William Stanley Jevons, who called it the "cradle of political economy" due to its systematic treatment of almost the whole field of political economy.
- Cantillon was the first to note that the quantity and quality of natural resources, along with the quantity and quality of human labour, are components of the intrinsic price (value) of finished goods.

- Cantillon’s ideas are contained in his book.
- The first part of Cantillon’s book defines wealth, narrowing it into the elements of land and labour.
- It states that the time, expense, and difficulty of learning a type of work, combined with the risk involved in the work, and the capacity and responsibility required of the worker, account for the variations in wages.
- Cantillon’s views underpinned the theory of wages later put forth by Scottish philosopher and economist Adam Smith.
- Cantillon contrasted *real value*, which arises from the cost of production, with *market value*, which depends on supply and demand.
- He also postulated that currency, either paper or coin, was not the true measure of a nation's wealth. Instead, he identified land as the source of wealth. This postulation was the basis of the Physiocratic doctrines, upheld by François Quesnay, founder of the Physiocratic school.

- Cantillon's book discussed such topics as barter, market prices, circulation of money in amount and rapidity, credit, interest and its causes, the rise and fall of interest rates, foreign trade, and banking. His treatment of some subjects clearly anticipated later ideas, such as the theory of population set forth by Thomas Robert Malthus at the end of the 18th century.
- Cantillon was the first to use the phrase real or intrinsic value (today called normal value) and showed its whole relation to market value.

- **Physiocracy**

- Physiocracy was briefly in vogue in France during the mid 1700 (or second half of the 18th century).
- It arose as a reaction against the narrow and restrictive policies of mercantilism.
- The founder of the school, François Quesnay, was a physician at the Royal Court of King Louis XV.
- His major book, the *Tableau Économique*, represented an attempt to trace income flows through the economy, which crudely anticipated 20th-century national income accounting.

- In the doctrine of the physiocrats, all wealth originated from agriculture.
- To the physiocrats, wealth was distributed through trade from farmers to other groups. The physiocrats were supporters of free trade and laissez-faire.
- They maintained that the revenue of the state should be raised by a single direct tax levied on the land.

- **Factors Responsible for the Rise of the Physiocratic School**
  - The growing importance of agriculture in France;
  - The disappointing results of the economic theory of mercantilism;
  - The poor state of French finances after the Seven Years' War (1756-1763);
  - The upsurge of liberalism in social and political thought.

— The influence of Richard Cantillon's book, *Essai sur la nature du commerce en général (Essay on the Nature of Trade in General, 1755)*, published after his death. Cantillon's essay emphasized the importance of land and labour in the creation of a healthy economy.

- **Tenets of Physiocracy**
- Physiocracy made impact in the study of economics through their broad outlook and deployment of scientific method in the study of economics;
- Physiocrats believed that LAND was the single most important source of wealth.
- They believed that commerce and industry were essentially non-productive and that only agriculture could increase wealth;

- Physiocrats believed that all wealth originated from agriculture and through trade, wealth was distributed from farmers to other groups;
- They opposed the mercantile system of tariffs and trade restrictions;
- In place of tariffs, physiocrats proposed a single land tax;
- Physiocrats supported free trade and laissez faire.

- **François Quesnay (1694-1774)**
- Quesnay was a French economist and the principal founder of the Physiocratic school.

- Quesnay, son of a landed proprietor, was born June 4, 1694, near Paris. He studied surgery in the French capital and became a doctor of medicine in 1744, subsequently being made physician-in-ordinary to Louis XV.
- Deeply interested in economics, Quesnay wrote (1756-57) articles on the subject for the renowned Encyclopédie of Denis Diderot.
- Quesnay wrote his book *Tableau Économique* in 1758.
- In his *Tableau Économique* (Economic Table), Quesnay presented what he considered the “natural law” of economics.

- Quesnay and his followers maintained that commerce and industry were essentially non-productive and only agriculture could increase wealth.
- In *Tableau Économique* (1758), Quesnay traced the flow of money and goods through the economy.
- This flow was seen to be both circular and self-sustaining.
- In *Tableau Économique* , Quesnay provided a chart of the economy.

- It was the first attempt to picture a nation's economy as an interrelated series of institutions through which capital moves in a continuous cycle.
- More important, however, was that it rested on the division of society into three main classes:
  - (1) The productive class was made up of those engaged in agriculture, fishing, and mining, representing one-half of the population.
  - (2) The proprietary class consisted of landed proprietors and those supported by them, which amounted to one-quarter of the population.
  - (3) The artisan, or sterile, class, made up the rest of the population.

- Quesnay's Tableau is significant because it expressed the belief that only the agricultural classes are capable of producing a surplus or net product, out of which the state either could find the capital to support an expansion of the flow of goods and money or could levy taxes to meet its needs.
- Other activities, such as manufacturing, were regarded as essentially sterile, because they did not produce new wealth but simply transformed or circulated the output of the productive class.
- It was this aspect of physiocratic thought that was turned against mercantilism. If industry did not create wealth, then it was futile for the state to try to enhance society's wealth by a detailed regulation and direction of economic activity.

- **ANALYSIS OF THE TENETS**

- Several flaws characterised the physiocratic theory. These include:
  – The exaggerated importance which the physiocrats placed on the role of agriculture in economic wealth creation; and,
  – Faith in the natural economic order, leading to their defence of extremely limited government control..
- These flaws did not diminish the importance of the physiocratic school in laying the foundation of modern economics.

- **High Points of Physiocracy**
- The physiocrats established economics as a distinct and separate science, and exposed the basic fallacies of mercantilism.
- They also stimulated an active interest in the problems of distribution and taxation.
- Anne Robert Jacques Turgot, finance minister under French King Louis XVI, instituted a number of financial reforms based on the physiocratic school of economics.

- Most notably, Turgot introduced the substitution of a money tax for the ***corvée*** (a feudal law requiring the people of the district to contribute free labour for the construction and maintenance of roads).
- Although the doctrine of the physiocrats was only briefly popular, the writings of the group's leading members exerted a considerable influence upon later economic thought.
- Other important physiocrats included **Pierre Samuel du Pont de Nemours and Victor Riqueti, marquis de Mirabeau.**

- **Classicalism or Classical Theory**
- The Classical School of economics developed about 1750 and lasted as the mainstream of economic thought until the late 1800’s.
- Adam Smith's *Wealth of Nations, published in* 1776 can be used as the formal beginning of Classical Economics but it actually evolved over a period of time and was influenced by Mercantilist doctrines, Physiocracy, the enlightenment, classical liberalism and the early stages of the industrial revolution.
- As a coherent economic theory, classical economic theory is periodised to hold sway from the period of Adam Smith, and continues with the British economists Thomas Robert Malthus and David Ricardo, and culminates in the synthesis of John Stuart Mill, who as a young man was a follower of Ricardo.

- Major contributors to the Classical School include:
- **Adam Smith** [1723-1790, founder] *Theory Of Moral Sentiments (1759), Wealth Of Nations (1776),*
- **David Ricardo** [1772-1823], *On The Principles Of Political Economy And Taxation* (1817),
- **Thomas Malthus** [1766-1834], *An Essay On The Principle Of Population (1789), Principles of Political Economy (1820), The Measure of Value (1823), Definitions in Political Economy (1827),*

- **James Mill** [1773-1836], *Elements Of Political Economy(1821),*
- **Jean-Baptiste Say** [1767-1832], *Traite D'economie Politque (1803, English 1821),*
- **Nassau William Senior** [1790-1864], *An Outline Of The Science Of Political Economy (1836),*
- **Karl Marx** [1818-1883], *The Communist Manefesto (1848), Grundriss Der Kritik Politishen Okonomie (1859) Das Kapital (1867),*
- **John Stuart Mill** [1806-1873, son of James Mill], *Principles Of Political Economy (1848).*

- While ***Adam Smith*** would be regarded as the originator and leader of the school, ***David Ricardo*** [1772-1823] should be credited with establishing the form and methods of the school.
- The debates between Thomas Malthus [1766-1834] and David Ricardo about policy issues such as the "Corn Laws" and the "Poor Laws" contributed to the focus and form of the school.
- Smith was concerned about the nature of economic growth. Malthus, Ricardo and other classical economists were concerned about the question of “distribution.”

- Although differences of opinion were numerous among the classical economists in the three-quarters of a century between Smith's *Wealth of Nations (1776)* and Mill's *Principles of Political Economy (1848),* members of the group agreed on major principles.
- All believed in:
  - private property,
  - free markets, and, in Mill's words, that “only through the principle of competition has political economy any pretension to the character of a science.”

- They shared Smith's strong suspicion of government and his ardent confidence in the power of self-interest represented by his famous “invisible hand,” which reconciled public benefit with individual pursuit of private gain.
- The invisible hand connotes an automatic mechanism that moves markets towards a natural equilibrium, without the requirement of any intervention at all

- From Ricardo, classicists derived the notion of diminishing returns, which held that as more labour and capital were applied to land, yields after “a certain and not very advanced stage in the progress of agriculture steadily diminished.
- Through Smith's emphasis on consumption, rather than on production, the scope of economics was considerably broadened.
- Smith was optimistic about the chances of improving general standards of life.
- He called attention to the importance of permitting individuals to follow their self-interest as a means of promoting national prosperity.

- **The Assumptions of Classical Economic Theory**

  There are three basic assumptions of classical economic theory. These are:
  - **Flexible Prices**: The prices of everything, the commodities, labour (wages), land (rent), etc., must be both upwardly and downwardly mobile. Unfortunately, in reality, it has been observed that these prices are not as readily flexible downwards as they are upwards, due a variety of market imperfections, like laws, unions, etc.
  - **Say's Law**: 'Supply creates its own demand'. The Say's law suggests that the aggregate production in an economy must generate an income enough to purchase all the economy's output.

- In other words, if a good is produced, it has to be bought.
- Unfortunately, this assumption also does not hold good today, as most economies today are demand driven (production is based on demand. Demand is not based on production or supply).
- **Savings - Investment Equality**: This assumption requires the household savings to equal the capital investment expenditures.
- Now it takes no genius to know, that this is rarely the case. Yet, should the savings not equal the investment, the 'flexible' interest rates should be able to restore the equilibrium.

- **Neoclassical Theory**
- Neoclassical economics, as its name implies, developed from the classical economics dominant in the eighteenth and nineteenth centuries.
- Its beginning can be traced to the Marginal revolution of the 1860s, which brought the concept of utility as the key factor in determining value in contrast to the classical view that the costs involved in production were value's determinant.
- The neo-classical school of economic thought is a wide ranging school of ideas from which modern economic theory evolved.

- The method is clearly **scientific**, with assumptions, and hypotheses and attempts to derive general rules or principles about the behaviour of firms and consumers.
- **Neoclassical Economics** focuses on how the perception of efficacy or usefulness of products affects market forces; supply and demand.
- It suggests that because the consumer's goal is utility maximization, or customer satisfaction, and that the organization's goal is profit maximization, the customer is ultimately in control of market forces such as price and demand.
- Dating from the 1870s, neoclassical economists such as William Stanley Jevons in Britain, Léon Walras in France, and Karl Menger in Austria shifted emphasis from limitations on supply to interpretations of consumer choice in psychological terms.

- The neoclassicists explained market prices according to the utility or satisfaction rendered by the last, or marginal, unit consumed.
- The British economist Alfred Marshall, particularly in his masterly neoclassicist work *Principles of Economics (1890*), explained demand by the principle of marginal utility, and supply by the rule of marginal productivity (the cost of producing the last item of a given quantity).
- In competitive markets, consumer preferences for low prices of goods and seller preferences for high prices were adjusted to some mutually agreeable level.
- At any actual price, then, buyers were willing to purchase precisely the quantity of goods that sellers were prepared to offer.

- Marginal utility refers to the change in satisfaction resulting from consuming a little more or a little less of a commodity.
- For example, the marginal utility of the first glass of water is greater than that of the third glass. As each glass of water is consumed, the marginal utility (desire for one more) diminishes.

- **Assumptions of Neoclassical Theory**
- The following are the basic assumptions of the neoclassical theory:
- **i) Rationality:**
- Decisions on economic issues are always made rationally, based on full information on the usefulness of the product or service.
- Rational economic man has objectives and attempts to maximize them.
- In neo-classical economics, both the consumers and producers tend to act rationally to maximize their interests.
- *• The consumers allocate their incomes in order to maximize their satisfaction (or utility);*
- *• And the producers allocate resources in order to maximize their profits.*

- **ii) Perfect Knowledge:**
- Neoclassical model assumes that economic agents act in the light of perfect knowledge.
- Buyers and sellers know all the prices of all the goods in the market, know everything they need to know about the quality of goods, the character of the other economic agents, what the government is going to do next, and so on.
- Consumers compare goods and then make purchase decisions based on the perceived utility.

- **iii) Unique Equilibrium:**
- Equilibrium is reached when all economic agents are content with their actions and feel no reason to change them.
- In the neoclassical model, price changes until sellers are happy to sell and buyers are happy to buy.
- Market equilibrium is achieved only when both the customer and the company achieve their respective goals.

- **iv) Equality of Sales and Purchases:**
- We must assume that whatever is bought equals whatever is sold.
- If goods are put into the store, we must count them as either being part of what is bought, or exclude them from the market calculation all together. Otherwise an equilibrium will never be discovered.
- **v) Diminishing Returns:**
- It means that on the buyer's side, the more and more they buy, the smaller and smaller the increment in satisfaction becomes.

- What do you think it means on the seller’s side of the market? The more and more that is sold, the smaller the increment in extra profits.
- Put together this gives the likelihood of an equilibrium position. That is, a stable position, from which the market has no reason to depart, other things remaining the same.
- Without the law, consumers could happily keep buying forever, and suppliers happily supplying forever!

- **vi) Many Participants, Freedom of Entry and Exit:**
- These assumptions ensure that a market is freely competitive.
- If a few buyers or sellers dominate, this means the outcome may be equilibrium, but it may not be the best, or optimal outcome for the economy as a whole. It is an inefficient equilibrium.
- Similarly if a market is to be truly competitive, there must be freedom of entry and exit, that is, there must be room for new buyers and sellers to enter a market, and for old participants to leave and find other markets.

- This, of course, applies to markets for resources like labour as well as markets for goods and services.
- If the wages of plumbers are high compared to the wages of water engineers, the latter will leave their job and look for jobs as plumbers.
- We speak of ‘resource mobility’ in this respect.
- **vii) Independence of Demand and Supply:**
- We assume that buyers are quite distinct from sellers, so that the act of buying does not affect selling, and selling does not affect buying, except through the mechanism of the market.
- The time when it does get relaxed is in the analysis of peasant farms which are partially self sufficient.
- In this case the farm is responsible for supplying the household and the market, so the household is both a buyer (from its farm and from the market) and a seller.

- **Attributes Of Neoclassical School**
- The neoclassical doctrine tends to be politically conservative.
- Its advocates distinctly prefer competitive markets to government intervention and, at least until the Great Depression of the 1930s, insisted that the best public policies were : low taxes, thrift in public spending, and annually balanced budgets.
- Neoclassical economists do not inquire into the origins of wealth. They explain disparities in income as well as wealth for the most part by parallel differences among human beings in talent, intelligence, energy, and ambition.

- Hence, men and women succeed or fail because of their individual attributes, not because they are either beneficiaries of special advantage or victims of special handicaps.
- In capitalist societies, neoclassical economics is the generally accepted textbook explanation of price and income determination.

- **Critique**
- Neoclassical economics has been criticized in several ways.
- John Maynard Keynes argued that even if equilibrium would be restored eventually through market forces the time required for this to occur was too long.
- Others, such as Thorstein Veblen, said that the neoclassical view of the economic world is unrealistic.
- The assumption of rationality is often confused with real, purposive behaviour. In fact, the consumer routinely makes decisions in undefined contexts. They muddle through, they adapt, they copy, they try what worked in the past, they gamble, they take uncalculated risks, they engage in costly altruistic activities, and regularly make unpredictable, even unexplainable, decisions (Sandven 1995).

- Many economists have criticized the neoclassical vision of economic humanity.
- Tversky and Kahneman (1979, 1986) in their "prospect theory," argued that people are not as calculating as economic models assume.
- Instead, people repeatedly make errors in judgment, and such errors can be predicted and categorized. Their 1979 paper in *Econometrica* is one of the most widely cited papers in economics.

- Thus, the rationality assumption, originating in classical economics and restated by the neoclassical economists fails to remove psychological factors from the equation. While mathematical analyses can indeed be carried out, as Tversky and Kahneman showed, these must include the forces that drive real people's decision-making behaviour.
- No matter how hard neoclassical economists try to drive away the world of complexity, it continues to confront them.
- Yet, to the frustration of "heterogeneous" antagonists the neoclassical paradigm remains dominant (Thompson 1997).

- **Key theorists**
- In the years immediately following Karl Marx's publication of *Das Kapital,* a revolution took place in economics.
- Marx's development of a theory of exploitation from the labour theory of value, which had been taken as fundamental by economists since John Locke, coincided with labour theory's abandonment.
- The new orthodoxy became the theory of marginal utility.

- Writing simultaneously and independently, a Frenchman (Leon Walras), an Austrian (Carl Menger), and an Englishman (William Stanley Jevons) wrote that instead of the value of goods or services reflecting the labour that produced them, value reflects the usefulness (utility) of the last purchase (before the "margin" at which people find things useful no longer).
- This meant that an equilibrium of people's preferences determined prices, including the price of labour, so there was no question of exploitation.
- According to the marginalists, in a competitive economy, people get what they have paid, or worked, for.

- ***Carl Menger*** **(1840-1921),** an Austrian economist stated the basic principle of marginal utility in *Grundsätze der Volkswirtschaftslehre* (Menger 1871). Consumers act rationally by seeking to maximize satisfaction of all their preferences. People allocate their spending so that the last unit of a commodity bought creates no more than a last unit bought of something else.
- ***William Stanley Jevons*** **(1835-1882)** was his English counterpart. He emphasized in the *Theory of Political Economy* (1871) that at the margin, the satisfaction of goods and services decreases. An example of the theory of diminishing returns is that for every orange one eats, the less pleasure one gets from the last orange (until one stops eating).

- ***Leon Walras* (1834-1910),** again working independently, generalized marginal theory across the economy in *Elements of Pure Economics* (1874). Small changes in people's preferences, for instance shifting from beef to mushrooms, would lead to a mushroom price rise, and beef price fall. This stimulates producers to shift production, increasing mushrooming investment, which would increase market supply leading to a new lower mushroom price and a new price equilibrium between the products.

- **Marxism**
- Opposition to the classical school of economics came first from early socialist writers such as the French social philosopher, Comte de Saint-Simon and the British reformer, Robert Owen.
- It was Karl Marx, however, who provided the most important social theories.
- Marx used Ricardo’s labour theory of value as a clue to the inner workings of capitalism, the master key to the inequities and exploitation of an unjust system.
- Marx was an exile from Germany and spent most of his mature years in London.

- He was supported by his friend and collaborator, the German revolutionist Friedrich Engels and by the proceeds from occasional contributions to newspapers.
- He conducted his extensive research in the reading room of the British museum.
- Marx’s historical studies convinced him that profit and other property income were the proceeds from force and fraud inflicted by the strong on the weak.
- Primitive accumulation in English economic history was epitomised by land enclosures.
- Enclosure was a process known in many European countries, by which commonly held or unoccupied lands or wastelands passed into private ownership.

- Stimulated by improved agricultural methods, the rise of a landlord class that farmed for profit rather than for subsistence, and the growth of cities as large markets for agricultural products, enclosure resulted in a tremendous increase in agricultural productivity and income.
- The process also resulted in problems for tenant farmers, who were often displaced without reason or compensation by landlords who wanted the land to serve their own interests.
- However, in its broadest aspect, enclosure was a key element in the transition from feudal, subsistence agriculture to modern, commercial agriculture.

- In the 17th and 18th centuries, land owners used their control of the parliament to rob their tenants of traditional rights to common lands and thus, forced them to beg or work for wages.
- Thus, Marxist perspective focused on the mode of production with particular emphasis on the character of capitalism.
- There are **four** distinguishing elements of Marxist perspective:

- **1)** Its methodology is ***dialectical***.
- All social phenomena are conceived in terms of processes, changingness and stages of unfolding.
- Dialectical approach assumes that social phenomena are dynamic and conflictual.

- The dynamism of social phenomena is attributed by the Marxist perspective to the inherent contradictions in every social phenomenon.
- More concretely, the Marxist perspective explains social and economic development in terms of contradictions, conflicts and struggles among antagonistic social classes.

- **2)** The second element is **historical materialism**
- Marxist approach is interested in the historical origin of all social phenomena as well as their historical development.

- Marxists trace how things began, how they matured, how they decayed and became qualitatively transformed (thesis, antithesis and synthesis).
- In looking at history, they specially emphasize on the condition of man or more especially, the relationship between productive forces and the relations of production.
- The Marxist perspective therefore transcends economism in the sense that it explores the dialectical interconnectedness between the economy, society and state with specific reference to capitalism.

- The third element is its operation according to some laws of motion or some law of change. There are several major laws of motion:
  - A) **Law of Disproportionality**:
  - This is contrary to Say's law of markets which holds that supply equals demand)
    - **Disproportionality** is the theory that capitalist anarchy leads to the overproduction of some commodities and the underproduction of others, in essentially random fashion.
    - This too is based on correct observations that reflect the atomized character of capitalist ownership.

- But like underconsumptionism, disproportionality is a *constant* fact of capitalist life that cannot account for *periodic* crises.
- Marx’s analysis shows that capitalism’s drive to accumulate creates cyclical overproduction in all areas, even assuming disproportions between spheres
- **B) Underconsumptionism**
- The idea that capitalism tends to produce insufficient demand for consumption goods in particular.
- Its basic version argues that crises occur because of the excessive exploitation of the workers.

- Since workers are paid for only part of the value they produce, they cannot possibly buy back the whole product of their labour.
- Moreover, the capitalists who appropriate the “excess” surplus value are too few to consume the remainder.
- Hence many commodities cannot find buyers, and crisis ensues.
- C) **Law of Concentration of Capital or Law of Accumulation**
- The growth of the value of capital means that each successful capitalist firm will be operating with more and more capital.
- Marx calls this the tendency towards growing concentration of capital.

- But in the competitive process, there are victors and vanquished. The victors grow. The vanquished go bankrupt or are absorbed by the victors.
- This process Marx calls the centralisation of capital. It results in a declining number of firms which survive in each of the key fields of production.
- Many small and medium-sized capitalists disappear as independent business men and women.
- They become in turn salary earners, employed by successful capitalist firms. Capitalism itself is the big ‘expropriating’ force, suppressing private property of the means of production for many, in favour of private property for few.

***D) The Capitalist's Compulsion to Accumulate*.**

- Capital appears in the form of accumulated money, thrown into circulation in order to increase in value.
- No owner of money capital will engage in business in order to recover exactly the sum initially invested, and nothing more than that.
- By definition, the search for profit is at the basis of all economic operations by owners of capital.

- **E) Law of Falling Rate of Profit**

- As capital accumulates and becomes more abundant, the rate of return declines, thereby decreasing the incentive to invest.
- Capitalists therefore lose their incentive to invest in productive ventures and to create employment.
- This results in economic stagnation and increasing unemployment which will make workers to rebel.

- **F) Monopoly capitalism tends to expand (V.I. Lenin)**
- In the capitalist mode of production, accumulation of capital is in the first place accumulation of productive capital, or capital invested to produce more and more commodities.
- Competition is therefore above all competition between productive capitals, i.e. ‘many capitals’ engaged in mining, manufacturing, transportation, agriculture, telecommunications.
- The main weapon in competition between capitalist firms is cutting production costs.
- More advanced production techniques and more ‘rational’ labour organisation are the main means to achieve that purpose.

- The basic trend of capital accumulation in the capitalist mode of production is therefore a trend towards more and more sophisticated machinery.
- Capital growth takes the dual form of higher and higher value of capital and of constant revolutions in the techniques of production, of constant technological progress.

- The ***fourth element*** is normative commitment to the idea of the inevitability of the transformation of capitalist system to a higher mode of production.
- One of the most impressive projections by Marx was that of the inevitability of elementary class struggle under capitalism.

- Irrespective of the social global framework or of their own historical background, wage-earners will fight everywhere for higher real wages and a shorter work day.
- They will form elementary organisations for the collective instead of the individual sale of the commodity labour power, i.e., trade unions.
- While at the moment Marx made that projection there were less than half a million organised workers in at the most half a dozen countries in the world, today trade unions encompass hundreds of millions of wage-earners spread around the globe.
- There is no country, however, remote it might be, where the introduction of wage labour has not led to the appearance of worker's coalitions.

- **Keynesianism**
- Keynesian economics is the approach to macroeconomics that grew out of John Maynard Keynes's work, especially his *The General Theory of Employment, Interest and Money* (1936) written during the Great Depression.
- Keynesian economics dominated the study of economics for 40 years after it was introduced.
- It fell out of favour in the 1980s largely because it did not adequately explain the simultaneous occurrence of high rates of unemployment and inflation that came to be known as stagflation.

- **Highlights of Keynesian Economics include**:
- ***One***, Keynesian Economics offers a theoretical explanation of, and a remedy for, persistent unemployment problems, especially those occurring during the Great Depression.
- ***Two***, the theoretical structure of Keynesian Economics is based on a view that the macro-economy is a distinct entity operating according to a set of principles distinct from those governing microeconomic phenomena. The macroeconomy is more than just a collection of markets.

- ***Three***, these macroeconomic principles of Keynesian economics indicate that aggregated markets, especially resource markets, do not automatically achieve equilibrium, meaning full employment is not guaranteed.
- ***Four,*** Keynesian economics indicates that the recommended way to achieve full employment is through government intervention, especially fiscal policy.

- **Assumptions of Keynesianism**
- Keynesian economics relies on a set of fundamental assumptions.
- The three most noted assumptions are:
- i) rigid or inflexible prices;
- ii) effective demand; and,
- iii) important savings and investment determinants other than the interest rate.
- These three assumptions are in direct contrast, and in response, to three assumptions underlying classical economics, namely--flexible prices, Say's law, and savings-investment equality.

- **i) Rigid Prices**
- The first of three key assumptions underlying Keynesian economics is the presumption that prices are inflexible or rigid, especially in the downward direction.
- This price rigidity is fundamental to the Keynesian implication of sustained unemployment.
- If prices, especially wages, do not decline, then the resulting labour market surplus means unemployment.
- Rigid prices can exist for a number of reasons:
  - First, producers often have long-term, multi-year contracts with resource suppliers that stabilize resource prices. These agreements prevent prices from changing.

- Second, workers tend to view wages as an indication of intrinsic self-worth and thus resist attempts to lower wages. Workers might opt for temporary unemployment, rather than working at lower wages.
- Third, the employment and payment system is guided by inertia or apathy. Employers are often reluctant to change wages because doing so can be costly.
- Fourth, firms often reduce employment rather than wages to "clean house" and get rid of the least productive workers.
- Fifth, many firms, especially small ones, are price takers in resource markets. They have NO control over the resource prices set by the market.

- **ii) Effective Demand**
- The second key Keynesian assumption is the notion of effective demand, that consumption expenditures are based on the disposable income actually available to the household sector rather than income that would be available at full employment.
- Effective demand means that people spend the income that they actually have not the income that they could have under other circumstances.
- This assumption means that changes in income, especially disposable income, are the prime influence on consumption expenditures.
- If the household sector has more income because the economy is expanding, then they increase consumption expenditures.

- If the household sector has less income because the economy is contracting and a large group of workers is unemployed, then they decrease consumption expenditures.
- This effective demand proposition is embodied in a key Keynesian principle, termed the ***consumption function***, which is the relation between household consumption expenditures and household income.
- More specially, as specified by the so-called psychological law, the consumption function indicates that people use only a fraction of any extra income for consumption.

- ***iii) Saving and Investment Determinants***
- The third important Keynesian assumption is that saving and investment are influenced by factors other than the interest rate.
- These other factors can prevent the equality between saving and investment, or perhaps allow equilibrium ONLY at a negative interest rate.
- The lack of equality between saving and investment can lead to a cumulatively reinforcing downward spiral of declining production and income.
- The most important non-interest-rate determinant of household saving is disposable income.
- As the disposable income changes, not only does the household sector change consumption expenditures, it also changes saving.

- Keynesian economics assumes that the relation between *saving* and *income* is a great deal more important than that between *saving* and the *interest rate.*
- Another key non-interest-rate determinant of saving is *expectation*. That is, the household is motivated to save in anticipation of future spending (saving for college, saving for retirement, saving to buy a house, etc.), regardless of the interest rate.
- The most important non-interest-rate determinant of **business investment** are expectations, especially expectations of future production and profitability.
- That is, the business sector is primarily motivated to undertake investment expenditures on capital goods if they anticipate a profitable return.

- A booming economy can ensure profitable returns even with a high interest rate.
- Moreover, a stagnant economy can prevent profitable returns even with a low interest rate.
- **Keynesian assumptions are in direct contrast to classical assumptions:**
- ***Whereas*** classical economics assumes that prices are flexible and quickly adjust to equilibrium, Keynesian economics assumes that prices are inflexible and do not quickly adjust to equilibrium.

- ***Whereas*** classical economics assumes that supply creates its own demand, termed Say's law, Keynesian economics assumes that demand, especially consumption expenditures, depends on actual income received by the household sector.
- ***Whereas*** classical economics assumes that saving and investment achieve equality through flexible adjustment of the interest rate, Keynesian economics assumes that saving and investment depend on factors other than the interest rate and might not achieve equilibrium.