ECON 409

October 10, 2012

Neoclassical Political Economy and Marxian Political Economy

IMPORTANT

- Do not forget to send me (deger.eryar@ieu.edu.tr) the name list of your group (2 or 3 people) for the term project by OCTOBER 24. After the deadline, points will be deducted!

- Distribution of income:
  - Each factor of production deserves what it contributes to the production
  - Wage, rent, profit etc.
  - Different from classical liberal political economy
  - What about initial distribution of resources?
- What about social welfare?
  - We cannot impose any preference on the group as a whole
  - If exchange makes some individuals better-off without making someone else worse-off, then this exchange will improve social welfare (Pareto)
  - But initial distribution of resources is a given

Neoclassical Political Economy

- Why is the market outcome the best outcome for all of us?
- For consumers, there is a large number of bundles of consumer goods from which to choose
- For producers, there is a possibility of combining resources in different ways
- This process of substitution will go on until all resources yielded maximum profit for producers and maximum utility for consumers
- MC=P=MB

Neoclassical Political Economy

- What is the role of the state?
  - Property rights (of ownership, use, sale etc.)
    - Important for smooth functioning of market exchange
    - Creation of incentives (what can I do with my capital or with my labor?)
    - The political process establishes property rights and set their limits
- Market Failures (markets are not always optimal)
  - Externalities
    - If my objective is affected by another transaction which I am not part of
    - Negative or positive externalities
    - Inefficient production

Neoclassical Political Economy

- Public goods
  - Non-excludability and non-rivalry
  - -- Free rider problem
  - Underproduction
- Imperfect competition
  - Monopoly or oligopoly
  - Higher prices and lower output
- Asymmetric information
  - Two parties to the exchange have asymmetrical access to the information
  - Health insurance, loan contracts
  - Not market clearing price (e.g.,higher premiums)

Neoclassical Political Economy

- Can Government correct market failures?
  - Is the efficiency only criterion to evaluate economic processes or government intervention?
  - What about government failures?
- What about the role of power in neoclassical PE?
  - Only market power is acknowledged (perfect competition against monopoly)
  - What about power in labor-capital relationship?
    - Fallback position of the worker
    - Mobility of resources

Marxian Political Economy

- Karl Marx (19th Century)
- What is the economy according to classical (and later to neoclassical) economists ?
  - Accumulation of commodities
  - Owned by individuals
  - Exchange relations among individuals
  - What's missing in this picture?
  - Social relations of production
- C-M-C simple circulation
  - C stands for commodity
  - M stands for money
- M-C-M' circuit of capital
  - M' greater than M
  - (M'-M) = surplus value
  - Surplus value is the source of profit

- Labor is the source of value
  - The exchange value of a commodity is determined by the socially necessary abstract labor time it embodies.
    - Average amount of time
    - Average degree of skill and intensity
    - Most advanced technology
- Like any other product, tools are produced by work.
  - "Fixed capital and intermediate good": Something that is produced to then produce something else (rather than consumed).
- Think of working with tools as a two-stage, "indirect" way of working:
  1. First we work to produce the tool.
  2. Then we use the tool to perform our end task.
- But remember: Humans did all the work.
  - The tools themselves are not productive. Therefore they cannot be the source of profit.
- And merely *owning* a tool is not a productive act.

- Distinction between labor and labor power
  - Labor power is a commodity
  - C-M-C (workers sell their labor power)
- What is labor power?
- A misleading ideology suggests that you're not a "worker" unless you work in manual labor (factory, blue-collar, etc.).
- This is objectively false.
- Workers with higher education, who work in offices, who earn salaries, still fit the definition of a worker:
  - Performing work for someone else, under their direction, in return for payment.
- They are still fully dependent on their employer, and still face an inherent tussle with them over the terms & conditions of work.

- Value of a commodity consists of:
  - Constant capital (c): value of machinery, raw materials etc.
  - Variable capital (v): value of labor power
  - Surplus value (s): value created by labor power beyond the value of labor power

Value of a commodity = C + v + s

  - 12 hrs = 4hrs 4hrs 4 hrs
  - Worker creates value worth 8 hours but is paid wage worth only 4 hours
  - M—C—M′ where C is the labor power
  - Surplus value is created by the worker but obtained by the capitalist (exploitation)
  - Value created by labor power is *different* from the value of labor power

- How to increase surplus value ?
  - Absolute surplus
    - Extend the working time
  - Relative surplus (increase productivity)
    - Lower the value of labor power (v) by increasing the productivity in the wage-goods sector
    - machinery increases the productivity of labour. Thus technological change, more advanced machinery, will reduce the amount of time -- *the amount of socially necessary labour* -- that the worker takes to reproduce his/her own exchange-value, the cost of his/her wages to the capitalist.
    - This strategy will be sucessfull only if all the firms in wage-goods industry improve their productivity
    - Example: If workers consume mostly electronics, and if it is possible to produce new electronics at lower cost (due to higher productivity), then S/V will increase.

- Or apply a better method to produce the same good at a lower value (increase firm's productivity)

  - Produce at lower individual value but sell it at social value or somewhere between individual and social value

  - For example:

  - Total daily value= 4 hrs (c) + 4 hrs (v)+ 4 hrs (s)

  - If the daily output is 4 units then the social value of one unit is 3 hrs = 1 hr (c)+1 hr(v)+1hr(s)

- Suppose that the individual producer tries to raise the labor productivity by 100% (i.e. 8 units per day instead of 4 units) and buys more C.
- Now the individual value of one unit becomes 2hrs = 1hr(c)+1/2 hr(v)+1/2hr(s). In other words, half of the pervious labor value is added to each unit of good.
- In the markets, the same product is sold at 3 hrs (its social value), and as long as the individual producer sells it below 3 but above 2, s/he will gain more surplus value
- If all the goods are sold at 2.5 hrs, then total daily value will be (8*2.5)=20 hrs= 8hrs(c)+4hrs(v)+8hrs(s). Now s is 8 hrs rather than 4 hrs!

- Profit rate = S /(C + V) or dividing everything by V we get
  - (S/V)/[(C/V)+1]

- Thus as capital accumulated from the creation of surplus value in production, capitalists in competition with each other would normally reinvest more of that surplus-value into constant capital as machinery than into variable capital (i.e. hiring more labour).
- In other words (C/V) can increase faster than (S/V), and there will be a tendency for profit to fall
- Given the falling rate of profit, there will be less investment, less employment, and crisis will emerge.
- Profits have a tendency to fall

- How to avoid it?
- A fall in c/v or a rise in s/v
  - Globalization
    - Access to other markets for more surplus (free trade)
    - Access to cheap c or v (FDI, globalization of production and free trade)
  - State
    - Generates additional demand (budget deficit) for more surplus
    - Access to cheap c or v (privatization)
  - Finance (additional funds for more investment and consumpiton leading to higher surplus)
  - Crises (access to cheap c or v)