# ECON 409

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Marxian Political Economy and Keynesian Political Economy

- 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)

# Keynesian Political Economy

- What happens if my good is not sold in the markets? (Violation of Say's law)
- Neoclassical answer: it is an individual failure
- Keynesian answer: it is a systemic failure and unemployment can be persistent
- Markets generate instability
- Circular flow (short-run)
  - Resources are used to produce goods and services and they get income in return for their contribution (source of demand in a simple economy)
  - To keep up with demand, firms change their production levels and buy new inputs
  - Workers and firms use their revenues for consumption or savings
  - revenue—spending—demand—production--revenue

# Keynesian Political Economy

- Circular flow (long-run)
  - Investment in fixed capital
  - Depends on profitability expectation
    - Revenues over an extended production cycle
  - The level of capital stock is not adjustable in the short run
    - Fixed capital cannot be sold immediately (sunk costs)
  - You can make the right investment only if you know the future with full certainty
  - Is it possible to have perfect information?
  - How to make investment in fixed capital in the presence of "fundamental uncertainty"?
    - Expectations and social conventions play a much more important role
    - The more we expect prices to rise, the more we act in ways that make prices rise.
    - "Profit goes to those best able to anticipate 'what average opinion expects the average opinion to be'" (Keynes, 1936)

# Keynesian Political Economy

- Do corporations have a stabilizing influence on economy?
  - The individual can own the share (liquid) and managers can take care of fixed investment
  - Do the managers  necessarily have a long-term perspective?
    - The managers themselves get interested in short-term profits (Why?)
  - “Shareholder revolution”

# Keynesian Political Economy

- Instability in labor market due to instability in investment
  - What happens if there is a lack of demand in labor markets?
  - Is it a market failure or an individual failure?
  - If it is an individual failure then the workers are expected to find jobs by accepting positions at lower real wages/salaries
    - Workers cannot determine the real wage
    - They can only bargain over money wages
    - Low wages can result in lower demand for all g/s
  - Then participants on their own cannot correct failure in labor market
  - Without employment, they cannot purchase the goods they need. If they cannot purchase the goods, firms cannot make profit by selling them.

# Keynesian Political Economy

- Savings problem
- What would happen if the individuals start saving instead of counsuming in the presence of fundamental uncertainty?
  - Classical PE
    - How to justify inequality?
    - Accumulation depends on savings
    - Rich saves more out of her income
    - Therefore more savings -more capital- more growth
  - Neoclassical PE
    - Savings determine the rate of interest and hence, investment
    - Cost considerations (interest rate) rather then demand (expected sales or profitability) determines investment
  - Both approaches emphasize the positive effect of higher savings on growth

# Keynesian Political Economy

- Keynes
  - The higher savings out of a given income the less money available for consumption
  - Lower demand, lower output, lower income and lower savings
  - Paradox of thrift

# The role of the politics

- How to stabilize the economy?
- Investment is not reliable due to uncertainty and short-termism
- Consumption depends mostly on income and expectations about future
- Financial markets generate instability
- Government should step in
  - Demand management
    - Government spending
    - Tax
    - Monetary policy (interest rate)
  - Regulation of the financial markets