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The Political Economy Challenge to Mainstream Economics

Discussions of contemporary capitalism have long been dominated by one line of thinking, which we will define below as the "mainstream" of economics. This mainstream has either ignored, or labored to discount, alternative ways of thinking about the economy, such as those that we described in our preface and that fill up this book. A major consequence of the mainstream refusal to take up alternative ways of seeing the economy is that most students taking economics courses in the United States today will not hear about them. We hope that this chapter will provide a good argument for our readers to push ahead to see what mainstream economists have been hiding from them.

WHAT IS MAINSTREAM ECONOMICS?

Like all areas of social inquiry the mainstream school of economics constitutes a broad spectrum of often-conflicting ideas. Thus, when we refer to "mainstream economists," we are necessarily lumping them into a single category that is an obvious distortion, much like that of any such categorization. Our critique in this chapter refers mostly—but not exclusively—to economic models that (1) are narrowly conceived, (2) are quantitative and expressed in complicated mathematical terms, and (3) depend upon certain restrictive assumptions about how people behave, always have behaved, and always will behave. Without question, there are mainstream economists who engage in lively debates on virtually all of the topics we take up in this chapter. Many of them move beyond the strict confines of models and assumptions to examine institutional aspects of the economy. And many em-

pirically investigate people's actual behavior, instead of assuming that they all behave in the same, predictable way.

Why, then, do we focus on those mainstream economists who most narrowly conceive the subject? There are two parts to our answer. The first is that this subset of economists dominates contemporary economics and exercises its dominance through its almost exclusive control over graduate training in economics and the most prestigious economics journals. It is also the subset that has produced all but a few of the Nobel Prize winners in economics. The second reason for our focus is that, of all schools of economic thought we know about, this one is *least* likely to produce results useful to the public. Therefore, a genuinely interesting irony underlies what we write about in this chapter: the very "best" economists, in the view of this dominating subset, produce some of the least useful kinds of economics. We recognize that this is a substantial conclusion, and we hope that reading this and the following chapters will lead our readers to consider it at least as reasonable.

A central part of our argument is that there is a critical distinction between *all* versions of mainstream economics and what we call political economy. This distinction is a matter of methodology, or "method of analysis." Mainstream economists are trained to limit the scope of their analyses—that is to limit the breadth of knowledge they bring to bear on an issue—much more than so than do political economists. In choosing a relatively narrow focus, almost all mainstream economists have gradually and systematically excluded from their studies the political economy point of view. The political economy critique presented here is both a general critique of the mainstream methodology, and a more specific critique of the subset of mainstream economics that is most narrow in its approach.

THE DIFFERENCE BETWEEN THE MAINSTREAM AND ALTERNATIVES

Let's consider the following example that demonstrates the wide chasm between mainstream economics and Marxist economics, a principal kind of political economy. How does each view the production of business profits in capitalism? A mainstream economist might put it like this:

> Profits are the payoff to private individuals for "entrepreneurship," for having saved, or borrowed, funds to invest in productive inputs, for having the foresight to know what goods or services to produce with these inputs and the talent to manage how the inputs are used and the goods marketed. Profit-making is the central vehicle by which capitalism is energized because: (1) by investing the funds, producing the goods, and making the profits, the enterprising capi-

talist gives jobs to people who are not capitalists themselves and who need those jobs in order to live; (2) the capitalist will make the highest profits only by producing goods and services most demanded by consumers; and (3) it is the competitive quest for profits that gives capitalism its extraordinary dynamism and proven ability to drive from the field all competing economic systems.

On the other hand, in the Marxist view, profit is looked upon in this different sort of way:

Over the past 400 years, through its drive to accumulate profits, the capitalist class—by pillage (such as the enclosure movements), murder (wars against and systematic impoverishment of Third World nations), and domination (of workers, consumers, and the political process)—has come to own the resources, factories, and other capital equipment needed to produce goods and services needed by all. Prior to the emergence of capitalism, most people were peasants who owned enough agricultural tools to produce a livelihood. Further, aside from land owned by great landowners like the church and the crown, most land was owned in common. However, gradually peasants were stripped of their tools and their access to land, and in order to live they necessarily became wage-workers for capitalists. At their jobs, workers must produce a value greater than their wage, and this excess is called surplus value. This value, created by labor, is seized by the owner and becomes the owner's profits. Competitive pressures generate the dynamic energy of the system and force capitalists to treat their workers as *things*, commodities to be bought and sold like steel ingots or sheets of plywood. Such pressures also shape many capitalists into predators working against the best interests of the larger society.

It is almost as if two different sets of academics were talking about two different worlds. How can such great divisions of opinion exist between economists when they take a look at something as central to capitalism as the profits that fuel it?

POLITICAL ECONOMY: A GENERAL DESCRIPTION

To describe political economy, in the way that we use the term (and there other schools of thought within the mainstream framework that describe it differently), we will repeat the one we used in the Preface:

Political economy…is more concerned [than mainstream economics] with the relationships of the economic system and its institutions to the rest of

> society and social development. It is sensitive to the influence of non-economic factors such as political and social institutions, morality, and ideology in determining economic events. It thus has a *much broader focus* than [mainstream] economics. (Riddell, Shackelford, Stamos, and Schneider, 2009, emphasis added)

Among those who now work in this political economy tradition, as we have described it, there is a variety of differing, often competing, notions about how capitalism works and which way it is heading. Even though there are important distinctions among them, we are able to talk in the same breath about differing schools of thought in political economy because they agree on the following critical points:

1. Although most mainstream economists claim that they are doing "economic science," their work often fails to explain and predict actual events in the real world—an essential test of any scientific work.
2. A principal reason for this inability to explain real events is the restrictive assumption of "economic man" in mainstream economics, along with a parallel assumption that human beings by nature have unlimited wants for consumer goods.
3. Mainstream models are typically not presented in the historical context that shapes all human events. Furthermore, most mainstream economists have not studied the history of economic ideas, and thus are unaware that the principal assumptions of their analyses have been challenged by political economists for over two centuries.
4. Mainstream economists typically presume a separation between economic activity and political power.
5. Graduate programs in economics are largely confined to mainstream instruction, and a particularly narrow version of that school of thought.

ECONOMICS: THE SCIENCE THAT IS NOT SCIENTIFIC

The debate between the mainstream and political economists about methodology has been going on for a long time. The history of this dispute starts at least as early as the fifteenth and sixteenth century in Europe, when essentially religious explanations of the universe gradually gave way to scientific ones, and with stupendous effects on the world. Columbus'

voyage to the New World, Galileo's telescope, Harvey's findings about blood circulation, and Newton's discovery of certain laws of gravity—along with many similarly astounding discoveries in the seventeenth and eighteenth centuries—made inevitable the declining influence of non-scientific explanations of the world.

The horrific conditions for many workers crowding into European cities since the early eighteenth century led to the development of a new practical science, public health. The public health movement led governments to promote the habits of healthier living and, especially, to construct systems to protect water systems from sewage. This movement was complemented greatly by the discoveries in the nineteenth century of Louis Pasteur and others unveiling the role of invisible bacteria in the spread of disease. Together, public health and biological science led to a dramatic increase in the life span in industrializing nations after the late nineteenth century. The average life expectancy in the United States in 1776 was about 35 years; it was about 50 years in 1900; and by the year 2010, it had reached about 78 years. Research done by the Museum of Natural History shows that, "From 1900 to 1990 we have gained about 25 years of life expectancy; nearly equal to what had been obtained in the preceding 5000 years of human history!"

The success of physical scientists in describing the world and improving the quality and length of life in industrialized countries led others to imitate their work. Economists in particular tried to design regular, law-like models for social phenomena. It is true that in the case of the two most influential economists of the eighteenth and nineteenth centuries, Adam Smith and Karl Marx, the former wrote without mathematics, and Marx confined his quantitative analysis to a few simple algebraic notations. However, by the late nineteenth century most economists had adopted some version of the "scientific method" as their approach and, in doing so, marshaled the economics profession toward mathematics and statistics.

Also during the nineteenth century, economists borrowed the idea of "equilibrium" from physics. In doing so, economists made an extraordinary leap of faith about their ability to study and predict human activity. When social theorists use the idea of equilibrium in model building, they are implying that patterns of human life in a fundamental way are analogous to the equilibrating balance of forces in our solar system that keeps Mars from ramming us head on. That is, this idea presumes that the economy is typically *stable*, and when buffeted by forces of social change, will always return to that stability on its own. A critical implication here is that, if the economy is assumed to be stable and, thus, self-correcting, it is better to allow it to function on its own,

without extensive government interference. Equilibrating systems, whether among the planets or in people's activity, suggested to Adam Smith and to many economists after him, that they were "natural," and this meant they were "God's work." Smith also believed that individuals possessed a natural self-interest that would lead to "the best of all possible worlds," an idea whose modern embodiment we will take up in detail later on.

Alfred Marshall, an influential British economist writing in the late-nineteenth century, was particularly important to the shift from the imprecision of discursive economic language to the precision of quantitative models that incorporated the idea of equilibrium. Though Marshall warned that "economics cannot be compared with the exact physical sciences," he still believed that economics was specially "advantaged" over the other social sciences. He argued:

> [A] person's motives . . . can be approximately measured by the sum of money, which he will just give up in order to secure a desired satisfaction; or again by the sum which is just required to induce him to undergo a certain fatigue. (Quoted in Riddell, Shackelford, Stamos, and Schneider 2009, 8)

This means that the prices we pay for products, the amount we invest to try to make profits, and the wage that will induce us to go to work, are all *numbers*, that is, numerical *quantities* that can be manipulated by mathematics and analyzed by economists. Marshall and most of his contemporaries thought that the focus of economists should be the prices that emerge in what he called "the ordinary business of life." This meant, for example, learning how self-interested individuals established prices for products, labor (wages), and money (interest rates) in competitive markets.

Marshall and his contemporaries recognized the aggregate economy as cyclical; however, they also thought it was actually formed by all the individual markets added together, and essentially behaved no differently than would a single one of them. Competitive markets were thought to work with equilibrating precision, and in the hands of Marshall supply and demand, acting as "two blades of the same pair of scissors," were the prime determinants of market price.

Complementing Marshall's system, and developing along with it, was the work of economists who saw markets as driven by "marginal" decisions made by producers, consumers, and workers, that is, decisions about whether to produce an additional unit of production, to purchase an additional item of consumption, or to work an additional unit of labor time. In this

theoretical world, capitalists made decisions by projecting the revenue and cost—thus also the profit—of the next marginal unit to be produced; and consumers made decisions by comparing the marginal satisfaction anticipated from a product to its marginal cost. Some practitioners of this sort of analysis, who were called "marginalists," even imagined a system of mathematical notations incorporating the marginal decisions of all economic actors into one giant quantitative model.

The marginalists, in focusing their microscope on the margin of economic actions, were especially important in prompting economists to think narrowly, an ironic consequence of their desire to explain everything with a single giant model. Their method implied the fateful idea that the institutional structure of capitalism outside individual markets, such as its system of social classes and the distribution of income and power, was not within the scope of economics. Marginal analysis also implied an extremely limited role for government. If the system was the outcome of a limitless number of individual marginal decisions made in self-regulating markets, then the thick fist of the government could not be expected to solve any economic problem.

In 1879, Marshall published the prototype for the modern economics textbook, which he called *Industry and Trade*. By 1890, he was calling his book *Principles of Economics*, and in this version, the geometric models of supply and demand that all principles students must now learn appeared as footnotes. Though Marshall kept the diagrams in his footnotes, economists who followed with their own principles texts gradually moved the diagrams from the footnotes up to the text where they came to dominate. Thus began the joyful birth, or sad decline, depending on your point of view, of twentieth-century economics.

Further leading to quantification of economics was the theorizing of the British economist John Maynard Keynes. In his revolutionizing book, *The General Theory of Employment, Interest, and Money,* Keynes used geometry, mathematics, and compelling and elegant prose to revolutionize the way that modern economists think about the business cycle. Keynes' work gradually won over most economists in the capitalist world. He preferred a dense prose to mathematics or geometry as a way to express his economic theories, and he differed crucially from almost all his predecessors by arguing that capitalism was not a self-equilibrating system. Nevertheless, Keynes' followers constructed diagrams and formulae to carry his theories forward, and these "macroeconomic" models, like the market analysis of Alfred Marshall and the marginalists, successfully lured more and more economists into the encapsulating and often suffocating web of a geometric world.

In 1948, Paul Samuelson of MIT, using his own two-volume mathematical expression of mainstream economics as a model, wrote the first widely used economics textbook. He combined Marshallian analysis, by then called "microeconomics," and Keynesian macroeconomics and called his book *Economics*. This title was, of course, greatly misleading given all the many kinds of economic analysis, most especially political economy, that he simply ignored. Samuelson, in updating his book over the years, gradually added considerable non-quantitative materials, but the geometric models and other quantitative materials that make up the theoretical core of mainstream economics remained central. Samuelson's amalgamation of microeconomics and macroeconomics has come to be called "neoclassical" economics, and within the economics profession, this term is the common way to describe mainstream economics.

Is this mainstream amalgamation actually doing *science*? To the critique that they have left too many crucial aspects of social life out of their models, mainstream economists typically respond with something like this: "Our assumptions might be unrealistic, and our models might be narrowly conceived, but they work better to predict economic behavior than the theories of our competitors." That is, the proof of models is how well they work.

Well, then, how well *do* they work? A good way to answer this key question is to compare the predictions made by economists to those made by *real* scientists. Consider the example of physicists. It is beyond dispute that they know some things, such as the laws of gravity, more or less for sure. Similarly, while medical doctors may differ on particular diagnoses, they know countless things with a high degree of certainty, such as specific physiological dimensions of, and limitations of, the human body. On the basis of highly predictable outcomes, physicists, medical doctors, and other real scientists have enabled human beings to live longer and utterly transform their natural habitat. All these outcomes stem from a scientific method whereby scientists all over the world test hypotheses over and over again until there is wide-spread agreement about this or that aspect of the physical world, or in the case of medical scientists, this or that aspect of the human body.

Yet, and this is the point, there is nothing similar in the annals of economics, and there can never be a set of principles, models, theories, conclusions, or predictions comparable to those in the physical sciences on which economists base their methods of inquiry. We are not questioning whether mainstream economists work diligently and honestly, as real scientists do. Nonetheless, economists don't know with any degree of certainty what is going to happen in the next instance with respect to much of *anything*. And

that is why they always disagree about virtually *everything*. To make the point, we've constructed below a list of central questions about how the capitalist economy operates. As you study economics, no matter what version of it, you will discover that *there is not now, nor has there ever been*, widespread agreement on the answers to these questions among people calling themselves economists:

- How should we measure the unemployment rate, and what will it be next month?
- Will the economy expand and grow over the next month, or over the next year?
- What will happen to total output if the government increases or reduces personal income taxes?
- How do you measure inflation, and how does it affect different groups of people?
- What has caused capitalism to dominate its rivals? Is it economic freedom? Is it competition? Is it greed? Is it imperialism? Is it brilliant entrepreneurship? Is it the surplus value taken from the hands of workers and used to enrich capitalists and allow them to buy more machines, raw materials, labor-power and political influence?
- Why are people rich or poor in capitalism? Luck? Greed? Connections? Hard work and perseverance? Disadvantages due to race and gender?
- Does free-market capitalism generate the kind of competition that forces firms to operate in society's long-run interest, or do firms, unregulated, run roughshod over workers, small rivals, consumers, and needy politicians, and promote environmental degradation?
- Is economic power distinct from political power; and if they are not distinct, how are they meshed? How do they affect wages, profits, laws regulating the economy, interest rates, prices, exports, and imports?
- Is growth in Gross Domestic Product (GDP) a good thing, or a bad thing?
- Is the Federal Reserve System a "neutral monitor" of monetary policy, or primarily concerned with protecting the interests of wealthy bondholders?
- Is a certain amount of unemployment a good thing for capitalism?
- Does capitalism "provide economic freedom directly [and] also promote political freedom" (Milton Friedman, 1963)? Or is advocating capitalism "like the elephant running through the chicken yard, yelling, 'Everyone for himself!'" (Lester Pearson, past Prime Minister of Canada, 1963)?

If you were to choose at random any professional economist in the world and ask that person any question on the list above, *there is no way to know in advance what his or her answer will be.* If this were true, for example, of the science of physics, who among us would be brave enough to stroll across a bridge or fly in an airplane?

ECONOMIC MAN IN MAINSTREAM THEORIZING

In the view of political economists, the unrealistic treatment of how people behave in capitalist societies is a critical flaw in mainstream economics. The essential assumption of neoclassical economics is that people are self-interested, pleasure-maximizing automatons who respond in predictable ways to all stimuli. This theoretical creature is called "economic man," or sometimes "rational man," and this man is not the kind of human being the rest of us would ever know or want to be.

On this point of human behavior and mainstream models, we can usefully turn to John Kenneth Galbraith, one of the most famous modern American political economists, and about whom there is a chapter in this book. Galbraith, a long-time critic of mainstream economics, wrote that the idea of economic man forms part of a rigid system of thought. According to him, this system:

> ...requires that the ultimately valid propositions of economics be essentially given, like the structure of neutrons, protons, atoms and molecules. Once fully discovered they are known forever. Unchanging also, it is held, is human motivation in a competitive market economy. Such fixed and permanent truths allow economists to view their subject as a science... From this closed intellectual exercise, which is fascinating to its participants, intruders and critics are excluded often by their own choice, as being technically unqualified. And, a more significant matter, so is the reality of economic life, which, alas, is not, in its varied disorder, suitable for mathematical replication. (Galbraith 1987, 284-5)

Along with Galbraith, we do not contest the idea that most human beings will try to serve their own long-term interests as well as they can. It is reasonable to assume that in capitalist societies, most of us will seek rewards from the marketplace, whatever our role in it. Yet this readily-observable fact cannot help us to know, simply by looking at another human being, what he or she will do in the market *at the next moment.* It is the central practice of real scientists to experiment with the objects of their study until,

in their labs, they come to know with some confidence what consistently will happen to Y if they change X. This is not what mainstream economists do because their subject is human behavior, something we have never been able to predict with the kind of confidence that makes real science possible. Therefore, while the scientists are doing science, economists are, as John Maynard Keynes argued, engaging in an exercise in logic based on assumptions that are adopted because they can be quantified, not because they are true or even sensible.

We want to make our point carefully here, so repetition is in order. We recognize that there are broad patterns of behavior in capitalist markets that are predictable. In fact, almost all of us order our individual worlds in terms of these patterns of behavior. However, to go from *broadly predictable* patterns of behavior to the assumption that all of us, all the time, have the knowledge, time, and inclination to maximize economic gains, carries us from reasonable observation to basing economic models on a badly distorted mirror of real human activity. For example, in order to predict consumer behavior, neoclassical models usually assume that all people have perfect information about all of the goods that they might want to buy, they know all of the prices and qualities involved, they know how much satisfaction they will receive from each product if they buy it, and they are completely rational and self-centered. These assumptions imply that when we shop we are not influenced by store displays or impulses that might interfere with the rational calculation of which good will bring the greatest satisfaction to us per dollar we spend. The assumptions also deny that some of us might actually buy more expensive or slightly lower-quality goods because they are produced under better environmental and labor conditions; that is, they ignore the idea that people might value justice, and not just pleasure. The mainstream view of how human beings shop in modern capitalist cultures is, to put the best light on it, quixotic.

There is a further problem here. In mainstream economics, economic man has also long been the idea of "man with unlimited wants." William Rohlf reveals this central assumption in his mainstream introductory text. As he argues:

> The fundamental problem facing individuals and societies alike is the fact that our wants exceed our capacity for satisfying those wants. (Rohlf 1998, 4.)

What is wrong with this statement? Notably, it is outside history: it is constructed for the sake of analysis rather than inferred from what human beings

have actually done. As such, Rohlf bases the economic analysis that follows in his book on a "made-up" human being. Thorstein Veblen, whose ideas we will take up in a later chapter, recognized the failure of this model to explain the complicated ways in which people's desires are actually shaped. Veblen saw economic man as central to what he called "the hedonistic approach" to economics, his description of the central economics tradition in his own day. By using the term "hedonistic," Veblen meant that humans are looked upon as simple "pleasure machines," looking only to maximize their own happiness. In 1919, Veblen wrote that he saw actual human beings instead as "products of...hereditary traits and past experience cumulatively wrought out under a given body of traditions, eventualities, and material circumstances." (Veblen 1919)

What, then, do we think human beings actually are, for the purposes of studying their economic behavior? For an answer from political economy, we extend these comments from Veblen with some evidence from history.

ECONOMIC MAN AND HUMAN HISTORY

One of the most renowned economists of the twentieth century, Joseph Schumpeter, proclaimed that:

> What distinguishes the "scientific" economist from all other people who think, talk, and write about economic topics is a command of techniques that we class under three heads: history, statistics, and theory...Of these fundamental fields, economic history—which issues into and includes present-day facts—is by far the most important...If starting my work in economics afresh, I were told that I could study only one of these three but could have my choice, it would be economic history that I should choose. (Schumpeter 1954, 12)

History was an essential part of economic analysis, according to Schumpeter, for three reasons. First, a grounding in economic history allows the analyst to understand present economic activity as a key element in the evolutionary changes inherent to social life, and that today is but a single point in the life process; and all that makes up society will be different tomorrow. Second, historical analysis incorporates important institutional "data" that are often excluded from mainstream economic analysis. Finally, Schumpeter argued that those who fail to examine the historical record are likely to commit "fundamental errors" of analysis.

One of the more fundamental errors of mainstream economics has been to insist that the "hedonistic" tendencies of human beings were present from the dawn of time. In fact, the dominant role of these habits has

developed in the relatively short era of world history since the rise of capitalism, mostly by those living after 1500 A.D. in Western Europe and North America. Adam Smith, by observing people in his own time, concluded that human beings "naturally" (which, to him, meant innately and God-given) made exchanges based on self-interested behavior. He subsequently decided that the "propensity to truck, barter and exchange"—to offer a good or service to someone else only in exchange for an equally valued good, service, or the equivalent in money—must also be a natural instinct. Moreover, Smith argued that the self-interested trader would only trade to become better off, due to the profit motive. Hence, transactions between humans in the capitalist age came to be seen as exchanges between two flinty-eyed, rationally-calculating, self-interested beings who were always looking to profit on any deal. Though Smith, in other writing, had argued that people were often motivated by other kinds of sentiment, his followers developed the model of human behavior that we have now, one that leaves little room for other human inclinations such as altruism, sentimentality, or a concern for justice.

Was self-interested exchange a "natural" tendency of humans? When Smith wrote in 1776, he was ignorant of, or ignored, the writings of those historians of the ancient world who had described a very different system of exchange in the economies of Greece and Rome. In these civilizations, exchange most often took the form of elaborate systems of reciprocity or redistribution. Ancient Babylon and Egypt both operated systems of redistribution whereby most of the produce of the nation was collected, recorded, and then placed in centralized storehouses. In lean times (to which these primarily agricultural civilizations were especially susceptible), the stored produce was not sold to the highest bidder, but redistributed to all of the citizens, be they peasant, weaver, or potter, according to their needs. These economies were organized along the lines of gigantic households, in which all members of the society were expected to make their contribution to the household and in turn to share in the nation's produce. The Biblical story of Joseph describes just such a redistributive system as well as the rationale for the redistribution based on collective capacities and collective needs, rather than individualistic exchange. Recall that the brothers of Joseph, after selling him into slavery years before, came to Egypt in hopes of asking for some of the stored grains so that they could survive the famine in their native land of Canaan. Joseph, in his capacity as manager of the Pharaoh's stores of grains, gave generously to his brothers, despite their mistreatment of him so many years earlier.

Other exchanges often took place for honorific or social purposes, rather than for economic gain. Another Biblical example describes the honorific exchange between King Solomon of Israel and King Hiram of Tyre. Hiram offered Solomon all the cedar and fir trees that he needed for the temple he planned to build, and in exchange Solomon offered him wheat and oil. This was not economic exchange but an exchange of tributes. (1 Kings, 5) Economic historian Karl Polanyi described many such systems of reciprocity—for example, giving gifts of fruit to kin and receiving in return gifts of fish—which existed in pre-capitalist societies. Polanyi argued that this was not barter and trade, but rather a socially organized system of reciprocity, based on sharing with the rest of the community. To sum up, in *The Great Transformation*, Polanyi argued:

> [A]ll economic systems known to us up to the end of feudalism in Western Europe were organized either on the principles of reciprocity or redistribution, or householding, or some combination of the three....In this framework, the orderly production and distribution of goods was secured through a great variety of individual motives...Among these motives gain was not prominent. (Polanyi 1944, 55)

The obvious implication of Polanyi's point is that the mainstream argument—that self-interest and the instinct to barter and trade is a *natural* trait of human beings—is at odds with historical evidence. The most we can say is that self-interested behavior came to be rewarded in pecuniary terms during the short span of human history that has elapsed since the rise of capitalism, and that five hundred years of capitalism have probably reinforced self-interested behavior in ways that make it difficult to suppress. But the latter is a very different proposition than to argue that self-interest is inherent in human behavior. And, in some societies even though most economic activity is carried out by private firms—such as in Sweden—public policy is nevertheless based upon such human motivation as generosity and reciprocity, rather than on the assumption that all people are greedy in all their transactions. Furthermore, as Adam Smith and others have argued, even those individuals who normally engaged in self-interested behavior often act selflessly on behalf of friends, family and the community.

Space does not allow us to tell the stories of how the first markets emerged and then became the ubiquitous markets of economic theory, or how the human yearning to be productive and creative came to be twisted into a labor-leisure tradeoff in modern economics. Suffice it to say that a careful study of

history is an essential part of economic analysis and, to borrow an idea from philosopher George Santayana, we might say that economists who ignore history are doomed grievously to misinterpret it. Whether using the lessons of history in formulating present-day policies to make a better future, or testing the theories of modern economics against all of the learning of historians, history is indeed an essential part of the study of economics.

THE MYTHICAL SEPARATION IN THE MAINSTREAM BETWEEN ECONOMICS AND POLITICAL POWER

In addition to concluding that mainstream economics has peopled its models with creatures existing in a historical, psychological, and cultural vacuum, political economists are also highly critical of the mainstream presumption that economics is distinct from politics or power. As a typical example from one economic principles text (an example picked at random from a shelf of them), consider the following statement:

> How did the very wealthy get that way? Of the 400 people on the *Forbes* magazine list of the richest people in America (with an average wealth of about $500 million each), about one-fourth got rich through inheritance. The other three-fourths, such as Bill Gates of Microsoft, got rich through working, starting their own businesses, inventing new products, and so on. (Stockman 1999, 425)

In this excerpt and throughout his book, Stockman avoids mention of government, the legal system, or any other institutions related to political power that might have played a role in helping the Fortune 400 amass their wealth. In fact, wealth accumulates in any society, either from inheritance or some other way, *because the laws allow it to happen.* For instance, as recently as 1959 the highest federal marginal tax rate was *91%* for all personal income over $200,000! Since then, the laws have been changed, and in 2015 the highest marginal rate—for a couple's income over $466,951—was 39.6%. In other words, in 2015 the Fortune 400 accumulated their wealth faster than in 1959 partly because lawmakers changed the laws on their behalf. By comparison, Sweden's welfare state provides all citizens, among other benefits, health care and schooling, and to pay for these benefits Swedes pay over *half* their income in the form of taxes. In the United States, the average tax rate is about 21%, meaning that we have a very different set of rules regarding how much wealth and income individuals keep for themselves and how much will be used for broader, social purposes.

Journalists Donald Bartlett and James Steele (in *America: Who* Really *Pays the Taxes?*, 1994) demonstrated the extent to which U.S. corporations are subsidized by governments through low or even nonexistent taxes, and by direct subsidy payments. They discovered innumerable examples of this practice, such as government subsidies totaling over $100 million a year to McDonald's, M&M/Mars, and other companies marketing their goods abroad. In 1999, *Time* magazine updated this research and concluded that in 1997 corporations received almost $200 *billion* in subsidies from state, local, and federal agencies. This huge flow of government payments exemplifies the power of corporations to shape political decisions in their favor, a power that is denied to virtually all citizens except the very wealthy. When did *you* last impose your economic interests on a U.S. senator or the president, as the owners of large corporations do on a regular basis?

Corporations are able to impose their agendas in this way partly because through their lobbyists they channel enormous sums of money to politicians. One effect of these payments in the past several decades has been lax enforcement of anti-monopoly laws by the anti-trust division of the U.S. Justice Department. Presidents Ronald Reagan, George Bush, Bill Clinton, George W. Bush, and Barack Obama, who in succession directed anti-trust policy, encouraged the marriage of mammoth corporations, such as the $170 billion merger between Exxon and one of its major rivals, Mobil Oil, and the one between Time/Warner and America Online, which created a $350 billion behemoth (and subsequently failed). Mergers of this order are sold to the public on the grounds that only giant conglomerates can provide the high-quality, low-priced goods for which we are supposed to clamor. Yet, mergers can as often as not mean less competition, higher prices, and a growing challenge to democratic rights in areas where they operate. The social consequences of allowing mergers and other forms of deregulation were exemplified most dramatically by the financial crisis of 2007-2010 where a long, successful lobbying effort led to the deregulation of certain activities of financial firms, and in turn led to the financial crisis and Great Recession.

Our point here is important if we are to distinguish adequately between mainstream economics and political economy. To the former, political power is most often considered part of the background institutional structure which is, as they put it, "taken as a given" and thus is left to political "scientists" or others to worry about. It is this determination to ignore the political consequences of concentrated economic power in capitalism that allows conservative mainstream economists such as Milton Friedman to argue that capitalism always

"promotes political freedom." For their part, political economists see capitalism as *intrinsically political*: the capitalist workplace often is a rigid hierarchy of control, and the allegedly "neutral" government acts disproportionately—as even reasonably alert children now know—in the service of the rich and powerful.

Karl Marx suggested that the government in modern capitalist countries is "the executive committee of the capitalist class," that is, of the rich and the powerful. As you will likely discover in an economics principles course, income inequality is now greater in the United States than in any other advanced capitalist society, and it has consistently been among the most unequal for over two centuries. This is the case because our laws allow it. The political economist might explain why Bill Gates is worth over $80 *billion*, while in 2015 over *twenty-eight million* people in the United States did not have health insurance: powerful people and corporations have consistently led efforts in the United States to fight the Affordable Care Act, while they have spent lavishly to ensure that lawmakers make rules of the capitalist game that allow individuals to accumulate vast fortunes. This political economy view is quite a different explanation from the theory of income distribution that Stockman suggests—the idea that most people get what they earn primarily through hard work and creativity.

THE SPREAD OF MAINSTREAM ECONOMICS AND ITS PROBLEMS WITH REALITY

Despite the many serious limitations of mainstream economics, it has maintained its dominance over economic thinking in the U.S., both off and on the campus. It's a cat with considerably more than nine lives, but the "Great Recession" of 2007-2010 proved once again that this body of quasi-scientific ideology cannot adequately explain the real world.

As we noted earlier, MIT economist Paul Samuelson fused Marshallian microeconomics with a mathematized version of the macroeconomics of John Maynard Keynes to construct what he and others called the "neoclassical synthesis." He used this foundation to publish the first edition of a textbook called, simply, *Economics*, one that set the stage for the eventual dominance of mainstream economics over all its heterodox competitors. Its basic template also became the one used for almost all economic principles texts thereafter. The mind-numbing narrowness of this synthesis was surpassed only by the arrogance of its title, *Economics*, implying that everything that might legitimately be said about the subject was *inside the book*. In the first and later editions of the text Samuelson mentioned heterodox ideas rarely, and when he did it was usually in order to demean them (as we shall see).

Other influential textbook writers adopted a similar approach, ignoring or caricaturing heterodox ideas. For example, among the most popular principles texts through the 1960-1980 period was *Economics: Principles, Problems, Decisions*, by Edwin Mansfield, an expert on efficiency who consulted for such firms as Exxon and Mobil. As an example of Mansfield's dismissal of the relevance of heterodox economics, his 1974 version had 717 pages, and only four of them were dedicated to alternative ideas, with most of the language used as an opportunity to dismiss Marx. Mansfield later expanded to intermediate economics textbooks, and altogether he sold "several million copies [that were] adopted at over 1,000 U.S. colleges and universities, and were translated and widely used abroad." (University of Pennsylvania, *Almanac*, November 25, 1997) This flight from alternative economic ideas in textbooks imposed on students, and especially the flight from the ideas of Marx, occurred during the Cold War starting in the late 1940s and continuing until the late 1980s. It was likely safer to dismiss his ideas as those of the evil parent of communism than to see him, like much of the rest of the world does, as a powerful social theorist and historian.

By 1980, Samuelson, responding to the kind of radical political economy that had begun to emerge in then turbulent 1960s, sank to banal sarcasm in his treatment of ideas outside his neoclassical synthesis. Of the 829 pages of that year's edition, sixteen were allocated to the "evolution of economic doctrines." He had this to say about the ideas of John Kenneth Galbraith, one of the most important heterodox economists of the 20th century:

> Galbraith's "criticism" cannot itself kill. But, it acts like a virus, softening the way for more deadly critiques by the New Left and its professional radical economists.

This comment was made two decades after Galbraith had written *The Affluent Society* (1958), where he argued prophetically that by championing "free" markets and limited government, mainstream economists were an important cause of the "social imbalance," by which we overwhelm our society with too many consumer goods and too few public ones. Samuelson also added a twelve-page appendix summarizing his view of the principal ideas in the thousands of pages of Marx's books, pamphlets, letters, and speeches. In the conclusion, he wrote that, "The use of Marxian categories did all too often addle the wits of those hoping to understand the realistic laws of motion of Western Economic Systems." Without question, these are the words of someone who, for all his clever-

ness, was badly misled by the idea that he was doing science, where economic laws are the equivalent of those in physics.

The flood of neoclassical texts that followed Samuelson's 1948 book cemented the overwhelming dominance of the mainstream version of economics in U.S. higher education. There were alternatives that came along, and there were many more textbooks in the specialized fields that included, or were based on, heterodox ideas. But the mainstream won the textbook war due to its control of graduate programs and economics departments, rather than the usefulness of its ideas. In the early 2000s the most popular mainstream principles textbook was *Principles of Economics* by N. Gregory Mankiw. Its 2015 edition has 800 pages, but does not mention Marx and completely ignores virtually every other heterodox luminary in the history of Western economic thought. Exemplifying the underlying market-worship in Mankiw's book, an all-pervasive prejudice that he clearly does not recognize, he writes that, "Although some of the arguments [for foreign trade restrictions] have some merit in some cases, *economists* believe that free trade is usually the better policy" (emphasis supplied). Similarly, he states, "*Economists* view the United States as an ongoing experiment that confirms the benefits of free trade" (Mankiw, *Principles of Economics*, Cengage, 2015, p. 188, emphasis supplied). Heterodox economists have long documented the many negative effects of free trade, including the practice of international firms to seek out the cheapest possible wages no matter the effect on domestic and foreign labor markets, to ignore environmental regulations in countries that can't control them, and often to add dramatically to income inequality. Mankiw's combination of arrogance and ignorance is clear in his claim that to be an "economist" one must believe in free trade, an idea we explore in the box on the theory of comparative advantage on p. 20.

It is impossible to know for sure, but a reasonable guess is that well over 90% of all economics students in the United States are currently grilled in the mainstream of economics, and alternative views, at best, are tacked on along the way. The fact that the overwhelming majority of economics students in the United States will have learned about demand elasticity but not about Marx, Veblen, Galbraith, or the sharp criticism of quantitative economics made by Keynes, is brainwashing, no matter how you look at it.

FREE-MARKET IDEOLOGY AND THE REAL WORLD

Because so much of mainstream economics is dream work, rather than plausible arguments based on what people actually do, its theories and models are bound at times to fail quite miserably. One of the most dramatic examples was the failure of mainstream economists to foresee the financial melt-

down that began in 2005 and led to the deep recession beginning in 2007. Though there were many causes for this crisis, it began with the collapse of the U.S. financial markets, and that occurred in large part because of lack of adequate regulation of the financial industry.

As early as 1994, members of Congress and later some federal regulators called for stricter rules to deal with the huge growth in very complex financial instruments, especially those known as derivatives. In 1998, one such

THE THEORY OF COMPARATIVE ADVANTAGE
Or, A Simpleton's Guide to International Trade

Mainstream economists' support for unregulated ("free") trade can be traced back to the Theory of Comparative Advantage, developed by David Ricardo in 1817. According to this theory, a country should specialize in producing those goods that it can produce for the lowest opportunity cost. In essence, each country should specialize in and export what it can produce for the least cost, and import goods that other countries are better at producing. That way, unregulated trade will result in maximum global productivity and increased standards of living. If that story seems too simplistic to you, then you are on your way to becoming a political economist.

What's wrong with this story? Political economists have written many thousands of pages on that topic. But let's briefly go through a few key problems.

First, the idea that free trade is a positive economic development policy for countries to follow is ahistorical and inaccurate. Ricardo and others living in England in the 1800s promoted unregulated trade at a time when such policies were clearly advantageous to England! As the world's first country to industrialize, England had an advantage over other countries and unregulated trade would allow British industries to dominate manufacturing industries in other countries. As Ha-Joon Chang, a political economist at the University of Cambridge, has pointed out in numerous books and articles, today's wealthiest countries successfully developed not via unregulated trade but by protecting and promoting key industries. No country has successfully developed its economy via unregulated trade.

Second, the theory of comparative advantage is mostly wrong when it comes to explaining global trade patterns. For example, it is true that African countries tend to specialize in producing raw materials and that European countries tend to specialize in manufactured goods. But it is impossible to discount the role of colonialism in destroying manufacturing in Africa and supporting manufacturing in Europe as an essential reason for this outcome, not the "efficiency" of the market system and free trade. Also, countries like the United States both import and export manufactured goods—we simultaneously have comparative advantages and disadvantages in the same products! Thus, the theory of comparative advantage offers little that is useful in understanding international trade. And yet, it remains a cornerstone of the ideological artifice of mainstream economics and leads to such comments as the one by Gregory Mankiw with which we prefaced this analysis of such trade.

regulator, Brooksley Born, vigorously pressed for rules to regulate the derivatives market, but she met with stiff resistance from Robert Rubin, the Treasury Secretary, and Alan Greenspan, head of the Federal Reserve System (known as "the Fed"). Both of Born's critics were adamant that a federally regulated financial system could not possibly compete with the wonderful outcomes that they were certain would come from free markets. In holding this view, they were, of course, marching arm-in-arm with the majority of mainstream economists for whom deregulation is a crucial element in the path to free market utopia. In fact, two such economists, Myron Scholes and Robert Merton, won the 1997 Nobel Prize for Economic Science for creating a mathematical model for evaluating derivatives. Ironically, a principal reason given for awarding Scholes and Merton the prize was that their model had, "generated new types of financial instruments and facilitated more efficient risk management in society."

We will focus on the major player in this battle over regulation, Alan Greenspan, because he was an economist with mainstream, pro-market biases, and his role in this crisis was pivotal. His actions also provide cautionary evidence of what can happen when people with these ideas in their heads get real political power. As background experience to become head of the Fed, and thus the presumed neutral arbitrator of U.S. economic policy, Greenspan had been a financial consultant for thirty years before he joined the Fed. He was also a long-time fan of Ayn Rand, a defender of individualism and free market capitalism, and he has described himself as a "libertarian Republican." Along his libertarian way, he was an advisor to Richard Nixon, and was a corporate director for such giants as Aluminum Company of America (Alcoa); Automatic Data Processing, Inc.; Capital Cities/ABC, Inc.; J.P. Morgan & Co., Inc.; Mobil Corporation; and The Pittston Company.

This bundle of experiences apparently strengthened Greenspan's view that government regulation was to be resisted at all costs, and there is ample evidence that he was among the most important foes, if not *the most* important foe, of regulation of the financial markets during his time at the Fed. Key details of his role in the matter are supplied in an article entitled, "What Went Wrong," written by Anthony Faiola, Ellen Nakashima and Jill Drew (*Washington Post*, Oct. 15, 2008). They argue that while derivatives did not trigger the collapse, their "proliferation, and uncertainty about their real values, accelerated the collapse of the [huge investment firms] and magnified the panic that has since crippled the global financial system." These writers suggest strongly that no one worked harder than Greenspan to keep derivatives from being regulated. In one 1998 meeting with Brooksley Born, when

she said her agency was under attack for pushing for regulations of derivatives, Greenspan responded to her sharply and said, "Regulation of derivatives transactions that are privately negotiated by professionals is unnecessary. Regulation that serves no useful purpose hinders the efficiency of markets to enlarge standards of living." Arthur Levitt, who was head of the Securities and Exchange Commission and frequently met with Greenspan to discuss regulating derivatives said that, "The Fed was really adamantly opposed to any form of regulation whatsoever."

Ten years after dressing down Born, after the financial crisis had begun, Greenspan appeared in congressional hearings led by Henry Waxman, a Democrat from California. Here is how that exchange is reported by David Leonhardt in the *New York Times*, Oct. 23, 2008:

> Greenspan admitted fault in opposing regulation of derivatives and acknowledged that financial institutions didn't protect shareholders and investments as well as he expected. [Waxman asked him] "In other words, you found that your view of the world, your ideology, was not right, it was not working." "Absolutely, precisely," Greenspan replied. "You know, that's precisely the reason I was shocked, because I have been going for 40 years or more with very considerable evidence that it was working exceptionally well."

Things had, indeed, been going well for Alan Greenspan from 1968 to 1987 while he was consulting for investment firms and helping to direct huge capitalist firms. The good times continued for him during his years running the Fed, from 1987 to 2006. During that period, the economy mostly expanded, and though the truth of the matter is not known or knowable, Greenspan was given a good deal of the credit for that expansion. Corporations enjoyed growing profits and shared Greenspan's affection for deregulation; politicians found it easier to be elected with a growing economy; and the media had already started mixing up celebrity gossip with other news, and they became central to making Greenspan an economic hero. None of this cheering crowd, however, took a look at other things that were happening. And none of this crowd heeded the warnings of Marx, Veblen, Keynes, and Galbraith that market speculation regularly results in economic crises.

In fact, during Greenspan's tenure at the Fed real wages for workers remained virtually the same while the income of the corporate elite and other rich people skyrocketed. In those two decades, one of the two greatest *upward* redistributions of income occurred; as one consequence, the ratio of CEO sal-

aries to the average wage of their workers went from about 40:1 to about 500:1. The stagnation of wages at the bottom which prompted greater and greater consumer indebtedness, and the increasingly rampant speculation at the top during the era of deregulation, created the environment for a financial crisis that many heterodox economists (and almost no mainstream economists) saw coming. The great "Maestro," as Bob Woodward called Greenspan in his adoring book of that title, was a key player in establishing the inequality and unregulated environment that brought us all down into a recession that badly threatened the welfare of much of the population of the world.

All this raises an interesting question: has any of this real-world experience, that seems to make a mockery of much of mainstream economics, with its rational actors, equilibrating markets, and championing of the unregulated free market, diminished its parishioners' faith in their way of doing things? Probably not.

Patricia Cohen, who took a look at the matter, summarizes her conclusion with the title of an article, "Ivory Tower Unswayed by Crashing Economy?" in the *New York Times*, March 5, 2009. She writes this essential summary of her argument:

> [In the wake of the financial collapse] prominent economics professors say their academic discipline isn't shifting nearly as much as some people might think. Free market theory, mathematical models and hostility to government regulation still reign in most economics departments at colleges and universities around the country. True, some new approaches have been explored in recent years, particularly by behavioral economists who argue that human psychology is a crucial element in economic decision making. But the belief that people make rational economic decisions and the market automatically adjusts to respond to them still prevails.

She quotes James K. Galbraith, a leading heterodox economist, as saying, "I don't detect any change at all." He described the profession as "like an ostrich with its head in the sand.... It's business as usual. ... I'm not conscious that there is a fundamental re-examination going on in journals."

These ostriches, to use James Galbraith's metaphor, are not likely to be pushed aside by graduate students with different ideas, at least not for a long while. Robert Shiller, a Yale economist, told Cohen that graduate students who stray too far from the dominant theory and methods seriously reduce their chances of getting an academic job. He concludes: "I fear that there will not be much change in basic paradigms... The basic curriculum will not change."

Cohen also reports, "In addition to Berkeley and the University of Texas, professors at a number of departments including those at the University of Chicago, Harvard, Yale and Stanford, say they are unaware of any plans to reassess their curriculums and reading lists, or to rethink the way introductory courses are organized." Dani Rodrick, a Harvard economist, told her, "The problem wasn't with the economics but with the economists... We have fixated on one of the possible hundreds of models and elevated that above the others."

Fixated, indeed, is the right word, and the word becomes "catastrophic" when an economist like Alan Greenspan, fixated on those ideas, maneuvers his way into a position of great power.

WHAT SHOULD ECONOMISTS ACTUALLY DO?

As heterodox economists, we suggest a way of doing economics—a basic methodology—that recognizes the political economy approach from the mainstream one in the following four different ways:

1. We believe that human nature is pliable and conditional, rather than fixed.
2. We make explicit value judgments about the way we think the world ought to be and do not pretend to be purely objective scientists.
3. A central basis of our analysis is empirical and historical (and thus inconclusive), rather than theoretical models typically aimed at being conclusive.
4. We use data and economic models when appropriate, but we pay close attention to the assumptions involved and the limitations of such data and models.
5. The questions we ask, our method of answering them, and all the other aspects of our investigations, are couched in a language designed for all people who want to build a more reasonable world, rather than symbolic jargon accessible only to the few.

The best way we can demonstrate these basic principles is to turn to the work of those political economists whom we consider among the greatest such practitioners, Adam Smith, Karl Marx, Thorstein Veblen, John Maynard Keynes, John Kenneth Galbraith, and the other voices we draw upon in our survey. They will show us how it's done.

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