A TURN TO REALITY

by John Bellamy Foster

Economics Without Equilibrium, by Nicholas Kaldor. Armonk, N.Y.: M. E. Sharpe, 1985, 79 pp., $14.50.

It would be impossible to discover a much greater gap between what poses as a modern scientific tradition and the underlying reality that it purports to explain than that which is currently disclosed by neoclassical economics. Indeed, "within today's standard economic theory, which is commonly called the neoclassical synthesis," as Hyman Minsky has observed in his new book, *Stabilizing an Unstable Economy,* "the question 'why is our economy so unstable?' is . . . a nonsense question. Standard economic theory not only does not lead to an explanation of instability as a system attribute, it really does not recognize that endogenous instability is a problem that a satisfactory theory must explain."[1]

The opposite of course was true of the work of John Maynard Keynes, the leading liberal economist of this century, whose *magnum opus, The General Theory of Employment, Interest, and Money,* now fifty years old, was designed not only to account for such endogenous sources of instability but also to uncover the powerful tendency toward "underemployment equilibrium" which forms an inherent part of the growth process under contemporary capitalism. But the "neoclassical synthesis" was intended from its inception, shortly after the publication of Keynes's book, to minimize the damage that his analysis had done to the original neoclassical framework, and ended up deemphasizing all that was

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most distinctive in his contribution. "Under these circumstances," to quote Paul Sweezy,

> it was only natural that critical thought in the field of economics should become more and more exclusively the realm of the Marxist opposition. The profession, having abandoned or denatured Keynes, purged itself of all radical impulses and soon moved sharply to the right, reviving two time-honored fallacies: Say's law of markets and the quantity theory of money, now respectively rechristened supply-side economics and monetarism.[2]

Still there are a handful of critical thinkers remaining among the disciples of Keynes. The stronghold for rebels of this type has been Cambridge University, where Keynes himself taught, and the staunch defenders of his theory who managed to hold out there include some of his earliest followers, among the most notable of whom were Joan Robinson and Nicholas (now Lord) Kaldor. Realizing that Keynes, in attacking Say's law (the erroneous notion that supply creates its own demand), made the serious mistake of refraining from throwing out the neoclassical framework altogether, thereby making it all too easy for later thinkers to sidestep his main concerns, these theorists have gone on to try to finish the job he had begun by incorporating his major theoretical breakthroughs within a more general critique that includes both classical notions of surplus appropriation and modern models of "imperfect competition." In its more radical version (represented by Joan Robinson), the resulting synthesis—generally known as "post-Keynesian theory"—includes a far-reaching attempt at reconciliation with Marxian economics. In its more cautious version (represented by Kaldor), it endeavors to avoid both an open reconciliation with Marx and an outright break with liberalism, while at the same time seeking to construct a realistic and workable economics.

It is only against this background that we can appreciate the strengths and weaknesses of Kaldor's new work, *Economics Without Equilibrium.* A mere seventy-nine pages long (including a preface by Nobel Prize winner James Tobin), this slim volume consists of three lectures delivered at Yale in 1983 as part of a continuing series dedicated to the memory of Arthur M. Okun, a prominent Yale economist who served on John F. Kennedy's Council of Economic Advisers. Although these lectures will seem abstract and perhaps unnecessarily difficult to those with little first-hand knowledge of orthodox economics, they actually reflect Kaldor's dismay concerning what Josef Steindl, in the February 1985 issue of MR, called the "counterrevolution" against Keynes, or "the return of the Bourbons" in economic theory. In an earlier study, *The Scourge of Monetarism,* Kaldor provided a withering attack on "the recrudescence of long-discredited ideas" in the form of monetarism in Britain and the United States, pointing to both the inanities of supply-side logic and the ignorance evident in "strength through misery" approaches to government policy[3] (p. 38). In *Economics Without Equilibrium,* however, his reach is much longer, taking in all three contemporary versions of "free market conservatism" (monetarism, rational expectations, and supply-side theory in its narrow, Reaganomic sense) and extending as far as an historical assessment of the general methodology of neoclassical economics.[4]

The general equilibrium system of equations worked out by Leon Walras, which was to form the core framework for neoclassical analysis, was, according to Kaldor, meant originally as a sort of "scaffolding" for a solid and lasting economics, which could be "removed step by step as the permanent building nears completion" (p. 13). No permanent building was ever constructed, however, and the scaffolding simply became more and more elaborate, until it actually became, in the minds of those who worked on it, a substitute for the building itself. And yet, while "the economic theorists' view of reality became increasingly distorted, so as to come closer to the theoretical image rather than the other way around," Kaldor nevertheless concedes, somewhat ironically, that in a "logical, mathematical sense, the present system of derived tautologies is enormously superior to Walras's original effort" (pp. 13, 61).

What actually constitutes the historic failure of neoclassical economics, in Kaldor's view, is its seeming inability (or unwillingness) to recognize that, since the late nineteenth-century rise of the big business corporation as the "representative" firm, the role of price has been displaced by quantity as the main regulative mechanism of the economy, making the whole conservative project of "equilibrium economics" an inherently abstract and irrelevant undertaking (pp. 14, 26, 50). Setting aside the special case of primary commodities, today's "sellers, whether manufacturers or distributors, are price-*makers* and not price-*takers,* and changes in supply are the result of quantity signals rather than price signals" (p. 23). The reason is that price in the age of big business is cost-determined; it consists of a mark-up on a standard volume of output designed to obtain a certain profit margin. Fluctuations in demand do not directly influence price as a rule, but show up in terms of variations in the level of excess capacity and unemployment.

The upshot is that the modern monopolistic or oligopolistic economy—in which the "representative group of firms" consists of price-makers and quantity-takers (rather than price-takers and quantity-makers)—is not resource constrained but demand constrained. Here Kaldor points out that *even if* the economy were to reach a near full-employment level, according to current statistical measures, it might still be demand-constrained in actual fact, since there is a large and growing amount of "disguised unemployment" in the low-paid service sector. "The usual explanation for the growth of the service sector," he tells us,

> is that with the progress of real incomes per head, people want fewer goods and more services and that productivity growth in services is notoriously low. It is quite possible, however, that the big rise in employment in small-scale service enterprises was a *consequence* of a lower overall demand for labor, or a lower demand in the relatively high earning manufacturing industries (pp. 36-37).

Essentially the same point, on the ambiguous character of unemployment statistics, is made in a different way later on, when Kaldor notes that "the fact that the gross national product in real terms doubled in the United States in the three years beween the last prewar year and the first postwar year shows that the conventional measure underestimated the extent to which actual output fell short of potential output" (p. 76).

The existence of increasing amounts of excess capacity (and real unemployment), which is an inherent feature of the regime of "monopolistic competition," suggests not only that the main constraints on accumulation are on the demand side, but also that a situation of increasing returns (and not decreasing returns—the single most important axiom of neoclassical economics) is a fundamental characteristic of the system in this stage. In other words, as capacity utilization goes up productivity and profits go up more than proportionately, since overhead costs (all costs other than unit labor costs and raw materials) are spread over a larger volume of output.[5]

Keynes, Kaldor notes, had assumed decreasing returns "in the *General Theory,* and, when he was finally persuaded that this assumption did not hold, he exclaimed in despair that he 'always regarded decreasing physical returns in the short period as one of the incontrovertible propositions of our miserable subject!' " (p. 47). In fact, the reason for Keynes' failure to discover this flaw in neoclassical analysis when he was working on the *General Theory* is that he had also taken the rather dubious step of assuming away monopoly by adopting the postulate of free competition. It is the prevalence of monopoly power in the modern economy that leads to the general applicability of increasing returns. But as Kaldor states, there is in this case "no inherent tendency to anything that could be called an equilibrium, or an equilibrium path" (p. 68).

Faced with this conflict between theory and reality, neoclassical theorists have generally found it advisable to deny altogether the prevalence of monopoly in today's economy.[6] "If Mahomet cannot go to the mountain," Kaldor wryly observes,

> then the mountain must be brought to Mahomet. So neoclassical theorists increasingly claim to believe that competition is virtually, if not actually, perfect, that production functions are linear and that markets *are* continuously market-clearing; and everyone behaves as if one has the right answer to every question, except for stochastic misperceptions (p. 61).

In endeavoring to form a wider assessment of Kaldor's work, it is useful to recall a statement once made by Paul Baran: "The trouble with economics," he wrote, "is not that it does not yet 'know enough,' as many of its practitioners love to repeat. Its fatal shortcoming is that it does not incorporate in its knowledge the understanding of what is necessary for the attainment of a better, more rational economic order."[7] From a radical perspective, Kaldor's analysis, while providing a trenchant critique of standard economics, seems altogether too superficial—getting down to earth in comparison to the elaborate flights of fancy that characterize neoclassical thought, but still failing to penetrate to the root of the matter in class-based exploitation. Doubtless this is the price that has to be paid if one wishes to retain a modicum of respectability within the profession. But the price is nevertheless too high, since it precludes any "longer view" of the historical process, denying all categories that point beyond the system itself.

However, there is much in Kaldor's book that radicals need to be aware of. Despite the prevailing supply-side rhetoric, "the economy," to quote a recent issue of *Business Week*, is facing "an oversupply problem, not unlike the one experienced in the 1920s. 'I see our economic problems in terms of gluts—we've simply got too many products chasing too few consumers,' says Edward E. Yardeni, chief economist at Prudential-Bache Securities Inc."[8] Unlike the vast majority of mainstream and radical economists today, Kaldor has not lost sight of the fact that this is the main characteristic of the economic stagnation of our times, and his little book has the virtue of telling us at least some of the reasons why.

NOTES

1. Hyman P. Minsky, *Stabilizing an Unstable Economy* (New Haven: Yale University Press, 1986), p. 99.
2. Paul M. Sweezy, "The Regime of Capital," *Monthly Review* 37, no. 8 (January 1986): 3.
3. Nicholas Kaldor, *The Scourge of Monetarism* (Oxford: Oxford University Press, 1982), pp. 64-68.
4. A detailed treatment of conservative trends in economic theory in the 1970s and 1980s is provided in Edward J. Nell, ed., *Free Market Conservatism* (London: George Allen & Unwin, 1984).
5. For a concrete illustration of this in terms of "profitability schedules" for U.S. Steel, see Paul A. Baran and Paul M. Sweezy, *Monopoly Capital* (New York: Monthly Review Press, 1966), pp. 81-88.
6. See, for example, J. R. Hicks, *Value and Capital* (Oxford: Oxford University Press, 1946), pp. 83-85.
7. Quoted in John O'Neill's introduction to Paul A. Baran, *The Longer View* (New York: Monthly Review Press, 1969), p. xxvi.
8. *Business Week*, 9 June 1986, p. 62.