

Deconstructing New Classical Economic Theory

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Introduction

- **Rationale for New Classical Economic Theory**
 - The fundamental presupposition of New Classical Economic Theory is that “greedy self-interested competition generates more social benefits than altruistic cooperation.”

Leland L. Glenna, 2002

Rationale

■ Purpose of this study

- Provide tools for social justice advocates to use in economic debates.
- Examine subtleties of economic theory that may be useful in trade negotiations.
- Identify the values that are implicit in New Classical Economic Theory.
- Identify the limitations of economic theory for bringing about a reduction in poverty and an increase in social and economic justice.

Background

- **Traditional critiques of free-market economic theory have come from two perspectives:**
 - Marxian dialectic of class struggle
 - Communism
 - Socialism
 - Utopian visions or experiments
 - Amana Colonies

Background

- **My challenge is from a Smithian perspective**
 - Tackle the question as a moral philosopher in the tradition of Adam Smith
 - Biographers note the Calvinist influence in his works
 - This Calvinism is mediated through Scottish Presbyterianism

Background

- **My challenge is from a Smithian perspective**
 - I, too, am an heir of the Calvinist tradition
 - My Calvinism is mediated through the Dissenter tradition that resulted in the Congregationalists
 - Further modified by the Pietism of the 17th Century,
 - The ecumenical vision of Friedrich Wilhelm III, Elector of Prussia, and
 - The modern ecumenical movement.
 - I am making my challenge as a moral philosopher.

Outline of Process

- **Challenge the hegemony of New Classical Economic Theory by examining it at the theoretical level not the operational level.**
- **The ideal outline would be to look at**
 - Philosophical constructs,
 - Definitions,
 - Assumptions, and
 - Topics and issues that are excluded from consideration.

Outline of Process

- **I am not able to organize it in that way at this time.**
- **The outline I will use is as follows**
 - Philosophical constructs,
 - Areas of limitations and exclusions
 - Structural issues,
 - Behavioral issues,
 - Values and beliefs,
 - Distributional issues, and
 - Power issues.

Philosophical Constructs

Examination of Philosophical Constructs

▪ Invisible hand of the marketplace

- Nothing that Adam Smith wrote is referred to more than his assertion that the “invisible hand” of the marketplace (people operating on the basis of their own self-interest) would bring about good for the whole of society.
- Adam Smith asserted that the action of people operating out of greed, which was seen by the Church as sin, could result in a greater good for the whole of society.

Philosophical Constructs

▪ Based on a portion of Stoic Philosophy

- Divine intervention could bring about good results even from ill-motivated actions.
- “The ancient stoics were of the opinion, that as the world was governed by the all-ruling providence of a wise, powerful, and good God, every single event ought to be regarded as making a necessary plan of the universe, and as tending to promote the general order and happiness of the whole: that the vices and follies of mankind, therefore made as necessary a part of this plan as their wisdom or their virtue; and by **the eternal art which educes good from ill**, were made to tend equally to the prosperity and perfection of the great system of nature.”

Adam Smith, *The Theory of Moral Sentiments*

Philosophical Constructs

- **Many ancient philosophers, including the Stoics, wrestled with the issue of the relationship between good and evil.**
 - Two of the possible relationship were self-evident:
 - Good intentions can be followed by good results.
 - Evil intentions can be followed by bad results.
 - These two situations are not philosophically problematic and thus receive little attention.

Philosophical Constructs

- **Ancient philosophers including the Stoics wrestled with the issue of the relationship between good and evil.**
 - Two others were quite perplexing:
 - How can ill intentions be followed by good results?
 - How can good intentions be followed by bad results?
 - These are the questions of Job and Ecclesiastes.
 - The Stoics sought a solution to this dilemma.

Philosophical Constructs

■ The Stoic Solution

- Divine action, in its infinite wisdom, can bring forth good results from ill intentions.
- Divine action, in its infinite wisdom, can bring forth bad results from good intentions.
- Adam Smith latched onto the first argument and his followers have used the second in arguing against government market intervention.
- Divine action (i.e. Invisible Hand) brings about good results even from ill-motivated (self-interest) actions

Philosophical Constructs

- **Asymmetric adoption of a portion of Stoic Philosophy**
 - Greedy self-interested competition generates more social benefits than altruistic cooperation.
 - That statement depends on two of the four possibilities.
 - Invisible hand **CAN** convert ill motives (self-interested greed) to good.
 - Invisible hand **CAN** convert good motives (altruism) to ill.
 - The other two are ignored.

Philosophical Constructs

- **Asymmetric adoption of a portion of Stoic Philosophy**
 - But not only that, there is a further subtle transformation in the use of these principles.
 - “The invisible hand **CAN** convert ill motives (self-interested greed) to good,” becomes “the invisible hand **CONVERTS** ill motives to good.”
 - The Stoic principle is converted from a **POSSIBILITY** to a **CERTAINTY** and it is that certainty that gives New Classical Economic Theory its power.

Philosophical Constructs

- **Asymmetric adoption of a portion of Stoic Philosophy**
 - The second principle gets transformed as well.
 - “The invisible hand **CAN** convert good motives (altruism) to ill,” becomes “the invisible hand **converts** good motives to ill.”
 - The rationale is now in place that “Do-gooders, by interfering in the marketplace, leave those they would help worse off than they would have been under full competition.”

Overview of Economic Theory

- And now the rationale for New Classical Economic Theory is in place
 - Greedy self-interested competition **generates** more social benefits than altruistic cooperation.
 - The assertion becomes an absolute statement of reality against which there can be no argument.
 - The conditionals of the Stoic principles are eliminated and the beliefs that “**Greed is good**” and “**Interference leads to inefficiency**” are given full sway in the marketplace.

Philosophical Constructs

- **Asymmetric adoption of a portion of Stoic Philosophy**
 - The less problematic relationships between good and ill are completely ignored in the structure of New Classical Economic Theory.
 - Ignored is the possibility that altruism might lead to social benefits.
 - Also ignored is the possibility that greed might lead to the loss of social benefits.

Philosophy of Good and Ill

- **Less than altruistic motives CAN produce good results**
 - Recognize that people operating on the basis of self-interest can bring about social benefits.
 - Not ignore the benefits that this perspective has brought to society.
 - At the same time not give it more sway or power than it deserves.
 - The statement identifies a possibility not a certainty.

Philosophy of Good and Ill

- **Less than altruistic motives can produce bad results**
 - Recognize that people operating on the basis of self-interest also can bring about the loss of social benefits.
 - Take seriously the social and ecological damage (externalized costs) that can result from people operating on the basis of self-interest.
 - Recognize that there is an appropriate role for democratic involvement in the economic system and in determining how to mitigate the damage.

Philosophy of Good and Ill

- **Altruistic motives can produce bad results**
 - Recognize that people operating on the basis of altruistic motives can result in the loss of social benefits.
 - The law of unintended consequences has not been repealed.
 - Some well intentioned programs in the past have brought about a loss of social benefits.

Philosophy of Good and Ill

- **Altruistic motives can produce good results**
 - Recognize that people operating on the basis of altruistic motives can act in ways that result in an increase in social benefits.
 - Altruism can influence and improve economic systems through democratic participation and power allocation.
 - Some well intentioned programs in the past have resulted in a gain in social benefits.

Philosophical Constructs

- **Asymmetric view of the role of government**
 - Dependent upon the benefits of government:
 - Stability of social structure
 - Protection from piracy and robbery
 - Infrastructure often supported by society as a whole
 - Provision of a stable, legal currency
 - Legal establishment of economic structures including corporations, banking systems and markets
 - Protection of patents, trademarks and property

Philosophical Constructs

- **Asymmetric view of the role of government**
 - Seeks to avoid or minimize government control.
 - Avoid or minimize taxation
 - Resists limitations on powers
 - Resists regulation, asserting markets do it better
 - Views property rights as absolutes and not at the discretion of society as a whole
 - Resists accountability to social non-market forces

Philosophical Constructs

- **Asymmetric view of the role of government**
 - Free-marketers need to acknowledge that government has an appropriate and necessary role in economics.
 - The marketplace cannot resolve all problems.
 - The benefits of a stable social system comes at a price (paying the piper).
 - Society has the right to set parameters on economic activity including social responsibility, social accountability, and limitations on power and privileges.

Structural Limitations

Structural Limitations - 1

■ Crop agricultural sector

- Does not conform to the requirements of a perfectly competitive market.
 - Producers are price takers
 - Inelasticity of supply
 - Inelasticity of demand
 - Fixity of resources
 - Only option for individual producer is to maximize production in order to reduce per unit cost
 - Production decisions can be made only once a year
 - Basic resource (land) remains in production

Structural Limitations - 2

- **Balance between buyer and seller**
 - Perfect knowledge by both parties
 - Equal skill in negotiation
 - Equal resource base
 - Equal access to alternatives

Structural Limitations - 2

- **Imbalance between buyer and seller**
 - With a 1% advantage, a casino, after enough transactions, will end up with all of the money.
 - Same impact is true in the marketplace whether it is brought about by
 - A difference in knowledge base;
 - A difference in the ability to negotiate;
 - An unequal access to resources; or
 - The lack of access to alternate choices.

Structural Limitations - 2

- **Gross imbalances between buyer and seller**
 - Gross imbalances gain legal recognition in laws that
 - Limit the ability of juveniles and vulnerable adults to enter into contracts;
 - Provide for protection against fraud;
 - Provide full disclosure on corporate financial statements;
 - Provide for full disclosure of terms on loan, mortgage, and credit card contracts; and
 - Numerous other consumer protection laws.
 - Case by case adjudication.

Structural Limitations - 2

- **Lesser imbalances between buyer and seller**
 - Lesser imbalances gain legal recognition in laws that
 - Seek to ameliorate financial imbalances within society via;
 - **Graduated income tax;**
 - **Estate taxes;**
 - **Social welfare programs.**
 - No allegation of individual fraud or deceit.
 - Recognition of inherent imbalance.
 - Offers social solutions for redress of the effects of imbalance.

Structural Limitations - 3

- **Well documented, but not accounted for, limitations**
 - Instantaneous change,
 - Uniformity of goods and services,
 - Costless entry and exit from the marketplace on the part of firms,
 - Rejection of knife's edge solutions.

Structural Limitations - 4

- **Friedman's “as if” argument**

- It does not matter if people make decisions in the manner prescribed by economic theory as long as they behave “as if” they were.
- This argument limits the ability of economists to examine and test the core assumptions of their theory.
- Allows economists to ignore subtleties in behavior and operation that might provide significant insights into the operation and anomalies of the economic system.

Behavioral Observations

Behavioral Observations

▪ Adam Smith

- Smith is a keen observer of human behavior beginning with his observations on the pin-maker.

▪ Lionel Robbins

- He defines economics as “the science which studies *human behavior* (emphasis added) as a relationship between scarce means which have alternative uses.”

▪ Nobel Laureates

- Several recent Nobel winners have focused their work in the area of behavioral economics.

Behavioral Observations

■ Contemporary situation

- Little in contemporary mainline economic theory that reflects any use of behavioral studies.
- Need to take into account the vagaries of human behavior.
- Need to draw upon the resources of both clinical and behavioral psychology as well as anthropology and sociology.

Behavioral Observations - 1

- **Rational decision making**

- If people were as rational as economists assume they are, all psychologists and psychiatrists would be broke.
- Cultural norms, religion, behavioral conditioning, and individual genetics all have a significant impact on decision making and what is “rational” within that system.

Behavioral Observations - 2

▪ Rational decision making

- In their quest for novelty some people will make decisions not on their indifference curve because they want to avoid boredom.
- Who would root for the Chicago Cubs if fan support depended upon rational decision making?

Behavioral Observations - 3

- **Rational decision making and Inventiveness**
 - Inventions often take place because people step outside the perceived rational base and take a chance with no supporting data.
 - Is financial reward the only stimulus to inventiveness?
 - Curiosity and the quest for novelty as stimuli for inventiveness.

Behavioral Observations - 4

- **Behavioral conditioning of farmer**
 - Behavior reinforced by variable rate reward is the hardest behavior to extinguish.
 - Vagaries of weather provide the variable reward mechanism.
 - Like the wheat farmer who says he keeps on farming because he has had two good years in his lifetime, 1973 and next year.
 - Self-selection of those individuals who respond to that kind of risk system.

Behavioral Observations - 5

■ Behavioral conditioning of farmer

- Human existence has depended upon this conditioned willingness of farmers to plant a crop in the face of almost certain adversity.
- Farms often stay in the hands of the same families for generations if not centuries.
- Sometimes decisions are based on heritage and not losing what grandpa managed to keep through the Great Depression.
- The optimization problem is different depending on whether the goal is profit maximization or survival.

Values and Beliefs

Values and Beliefs

▪ New Classical Economic Theory

- This theory is not value free as some would argue.
- The values are implicit in the structure of the system and thus not open to debate.
- The implicit values are simply accepted as the norm.

Values and Beliefs

■ Implicit values and beliefs

- Individual rights take priority above community rights
- Greed is good or at least acceptable
- A specific understanding of property rights is inviolable
- Property rights can be attached to life forms
- Competition is the norm not cooperation
- Those who succeed are those who work hard and therefore deserve the rewards they receive
- The poor must be that way because they are lazy, unskilled, and undisciplined and deserve what they get

Values and Beliefs

- **The free market system brings with it the current set of Western merchandise**
 - Music
 - Clothes
 - Movies
- **This merchandise inherently brings with it a set of values about what is right and acceptable.**

Values and Beliefs

- **The aggressive pressure for the expansion of “market liberalization” may be seen by some nations and cultures as an imposition of Western cultural imperialism upon their societies.**
 - They may not be ready for it and the consequences may be devastating
 - Goes a long ways to explaining the conflicts in Islamic nations and India

Values and Beliefs

■ Who makes the decisions?

- About pollution in Less Capitalized Countries?
- About how a given nation defines property rights?
- About long hours and low wages?
- About the best way to meet the development needs of a Less Capitalized Country?
- Are the decisions to be made democratically or by the marketplace?

Values and Beliefs

■ Why?

- Are individual property rights given priority over community property rights?
- Does capital hire labor rather than labor hiring capital?
- Is labor idled in an economic downturn when the problem may be caused by over exuberance in the capital markets? The workers are still providing goods and services.

Values and Beliefs

■ Who?

- Owns the unenclosed public commons (land, seed varieties, knowledge base)?
- Has the right to use and market the knowledge of indigenous people?
- Has the right to use and market the seed base of indigenous peoples?
- Who has the right to produce and market goods using traditional Geographic Indicators in the name of the product?

Values and Beliefs

- **All of these are issues that involve values and beliefs that fall outside the framework of New Classical Economic Theory**
- **Businesses, under the guise of market liberalization, have proposed solutions to all of these issues. And, all to the advantage of the businesses involved.**
- **Their attitude: we don't need to talk about it, free markets will provide the optimal solution.**

Distributional Issues

Distributional Issues

- **New Classical Economic Theory does not look at distributional issues**
 - Pareto Optimum makes no distinction between the rich for whom one extra dollar is inconsequential and the very poor for whom one dollar is the difference between life and immediate death from starvation
 - Marginal utility of money

Distributional Issues

■ **Two kinds of issues**

- Inequality in the existing distribution of resources
 - At the individual level
 - At the national level, especially with regard to trade issues
- Inequality in the ongoing accumulation (distribution) of resources
 - At the individual level
 - At the national level, especially with regard to trade issues

Distributional Issues

- **Unequal distribution of resources, both at the initial stage and at the operational stage, is a natural and fundamental consequence of the theory**
 - The basic assumed goal of a firm (individual, country) is to maximize profit
 - The ultimate goal is the accumulation of wealth in and of itself

Distributional Issues

- **Maximizing profit and wealth**
 - Textbook means of achieving this
 - Minimize cost of production
 - Innovate to stay ahead of competition
 - Find ways to maximize price

Distributional Issues

- **Maximizing profit and wealth**
 - Other inevitable means of achieving this
 - Gain maximal allocation and control of initial resource distribution
 - Maximize share of ongoing transactions
 - Cheat, bribe, lie, steal
 - Corrupt (influence) political system to gain legal sanction for policies that give advantage
 - Organized crime is a natural consequence of a system based on greed and focused on profit and wealth

Distributional Issues

- **No ongoing mechanisms for balancing out the inequities in the existing distribution of wealth and resources**
 - Problem of colonial usurpation of assets
 - How to achieve land redistribution – Who pays?
 - Present distribution gives colonial descendants a clear advantage in market liberalization
 - Problem of inherited wealth
- **Options**
 - Riots and rebellions
 - Inheritance taxes

Distributional Issues

- **No ongoing mechanisms for balancing out the inequities in the ongoing distribution of wealth and resources**
 - For whatever reason some people and or countries gain control over a significantly smaller amount of financial resources than others
- **Options**
 - Bankruptcy
 - Homelessness
 - Currency devaluation

Distributional Issues

- **Redistributive mechanisms**

- Philanthropy – No means of ensuring that this is effective in redistributing a significant amount of resources
- Progressive taxation

- **Huron society**

- “The Huron enjoyed giving and attending feasts. Generosity was an important means of winning the respect and approval of others. For this reason, families worked hard to grow corn, obtain meat, and accumulate the presents necessary to entertain and oblige their friends and neighbors. The desire to excel at this was probably the main incentive for hard work among the Huron.”

The Huron: Farmers of the North, Bruce G. Trigger

Distributional Issues

■ Distributional research issues

- What is an optimal distribution of income and resources such that no one lives in poverty and the economy continues to move forward?
- What would be the effect upon an economy of a significant gap in wealth between the rich and the poor?
- The ultimate way to maximize profit is to pay a \$0 wage. But then who could afford to buy goods and services? Is there a wage limit below which the system begins to collapse in on itself?

Power Issues

Power Issues

- **Some power issues have been touched on in other sections**
 - Power between two parties is almost always unequal
 - Power advantage tends to compound itself like interest
 - Distributional issues
 - Existing (original)
 - Ongoing

Power Issues

■ Corporate charters

- Grant the ability to amass capital and organize an enterprise by exempting individual investors from personal legal liability
- No limitations on the power that such an exemption creates
- No responsibilities required in exchange for the liability exemption
- Corporations should not have the same inherent rights as an individual person.
- Human rights should come before corporate rights.

Power Issues

- **Corporate charters**

- Power differential between single individual and a corporation
 - Labor
 - Consumer

Power Issues

■ Corporate charters

- How do workers achieve a balance of power?
 - Unions can be seen as labor's equivalent of the corporate charter
- How do customers achieve a balance of power?
 - Trial lawyers and class action lawsuits may be consumers' attempt to balance the scale
- Are there better ways to achieve the needed balance?

Power Issues

■ Corporate charters

- Multinational corporations pose an additional set of problems
 - When they cross the border, whose rules apply?
 - How do smaller countries call them to accountability when the multinationals have an inside track with the international agencies (WTO, IMF, World Bank) who are writing the rules?
 - How do smaller countries call them to accountability when the multinational's annual income is greater than the country's GNP?

Conclusions

Conclusions

- **New Classical Economic Theory . . .**
 - Has significant vulnerabilities that must be addressed
 - And the theory of comparative advantage need not be seen as offering the best solutions for developing countries
 - Can result in significant social economic externalities

Conclusions

▪ New Classical Economic Theory

- What we would like to think of as unusual economic aberrations are in reality the natural, inevitable consequence of the theory when it is operated by real, fallible human beings.
- Externalized costs are not accidental, but rather the inevitable consequence of the theory.

Conclusions

- **New Classical Economic Theory . . .**
 - Maintains its moral authority only to the extent that greedy self-interested competition generates social benefits.
 - Loses moral authority to the extent that it generates social and ecological (externalized) costs.

Conclusions

- **Global trade negotiations**
 - One may need to look at a mixed economy in which all four possible relationships between good and ill are taken into account.
 - The process needs to be democratized so that those without access to resources can participate in the process.

Personal Observations

Personal Observations

- **New Classical Economic Theory . . .**
 - As a moral philosophy should be as concerned about market inequality as it is about market efficiency; as concerned about human rights as it is property rights; as concerned about minimizing poverty as it is maximizing profit.

Personal Observations

▪ Adam Smith

- One can see Adam Smith as a pragmatic moral philosopher dealing with a real set of issues for his day.
- I would argue that he would be critical of the Procrustean application of an economic theory that is attributed to him.

Personal Observations

▪ Adam Smith

- I would argue that the key to Smith's only-twice-referred-to "Invisible Hand" of the marketplace may not be greed but rather the act of allowing a redundancy in the decision making process.
- Look at nature (say a maple tree), redundancy, not efficiency is the name of the game.

Personal Observations

■ University economics . . .

- In its role of transferring knowledge to succeeding generations has failed at one of its essential tasks.
 - It has focused on increasingly teasing out the subtleties of one theoretical system,
 - While failing to push the theoretical envelope by looking at and teaching students how to develop and examine alternate assumptions and economic systems

Personal Observations

- **University economics might examine these questions:**
 - How can one maximize the availability of goods and services such that differences in wealth and resource allocation are minimized?
 - What might an economic system look like if an individual's decisions are as influenced by operant conditioning (or values or beliefs) as by rational self-interest?
 - What is the optimal distribution of wealth that brings the greatest social benefit for all?
 - Do the economic systems documented by cultural anthropologists offer any insights into solving today's economic challenges?

Personal Observations

- **University economics . . .**
 - Needs to reclaim its roots in moral philosophy.
 - Might consider moving from the College of Business to the College of Liberal Arts rejoining the other social sciences like anthropology, sociology, political science and history.

Personal Observations

- **Business economics . . .**
 - Can keep on doing what it does.

Personal Observations

- **The two great economic systems of our day fall short because they fail to take the human condition (sin) seriously**
 - Communism fails to take sloth seriously and as a result productivity and initiative suffer
 - New Classical Economic Theory fails to take envy and greed seriously and risks smothering itself in its own externalized social and ecological costs

Overview of Economic Theory

- **Rationale for New Classical Economic Theory**
 - The fundamental presupposition of New Classical Economic Theory is that greedy self-interested competition generates more social benefits than altruistic cooperation.

Rationale and Introduction

- **Oxfam's "Make Trade Fair Campaign"**
 - "Ending poverty requires a citizens' movement for economic and social justice."
 - Concern about impact of U.S. crop subsidies on U.S. production and world crop prices.
 - Small producers in Less Capitalized Countries have been suffering from low prices since 1996.
 - Will competitive markets, including a reduction in U.S. crop subsidies, benefit small producers in Less Capitalized Countries?

Rationale and Introduction

■ Oxfam

- Operates on beliefs and values that are outside the bounds of New Classical Economic Theory and the principles of the perfectly competitive market
- Oxfam cannot directly address its goals simply through the use of standard economic theory

Rationale and Introduction

▪ New Classical Economic Theory

- The closest it gets to concepts of justice and fairness is the Pareto Optimum.
- A Pareto Optimum is an economic condition in which it is impossible to make someone better off without making someone else worse off.
- The closest that standard theory gets to explicit value determinations is a preference for Pareto Optimum conditions as compared to non-Pareto Optimum conditions.

Overview of Economic Theory

- **Economic systems can be identified in two major ways**
 - The nature of the structure of the system
 - The functionality of the system

Overview of Economic Theory

- **An economic system can be identified by the nature of its structure**
 - Rational postulate systems
 - Characteristics
 - Definitions and assumptions
 - Uses deductive logic to establish principle of the system
 - Prominent examples
 - New Classical Economic Theory
 - Free Trade
 - Marxist Economic Theory
 - Command Economy

Overview of Economic Theory

- **An economic system can be identified by the nature of its structure**
 - Traditional systems
 - Characteristics
 - Need not have a formally described structure
 - Based upon traditional customs and practices
 - Prominent examples
 - Barter economies
 - Pre-capitalist systems of ancient world
 - Variety of traditional systems in countries like India

Overview of Economic Theory

- **An economic system can be identified by its functionality**
 - Positive economics
 - Descriptive
 - Focuses on the way economic systems really operate
 - Normative economics
 - Prescriptive
 - Focuses on the way the system should work
 - Welfare economics

Overview of Economic Theory

- **Interplay between structure and functionality**
 - New Classical Economists operate on the basis that they engage in positive economics.
 - But, for that to be true
 1. People would have to make economic decisions on a rational basis.
 2. There would have to be a perfect symmetry between the buyer and the seller.
 3. There would have to be costless entry and exit of firms from the marketplace.
 4. A host of other conditions would have to hold as well.

Overview of Economic Theory

- **Interplay between structure and functionality**
 - Amartya Sen has suggested that New Classical Economists are really engaged in normative economics.
 - Daryll Ray's identification of the unique characteristics of the agricultural sector is consistent with this contention.