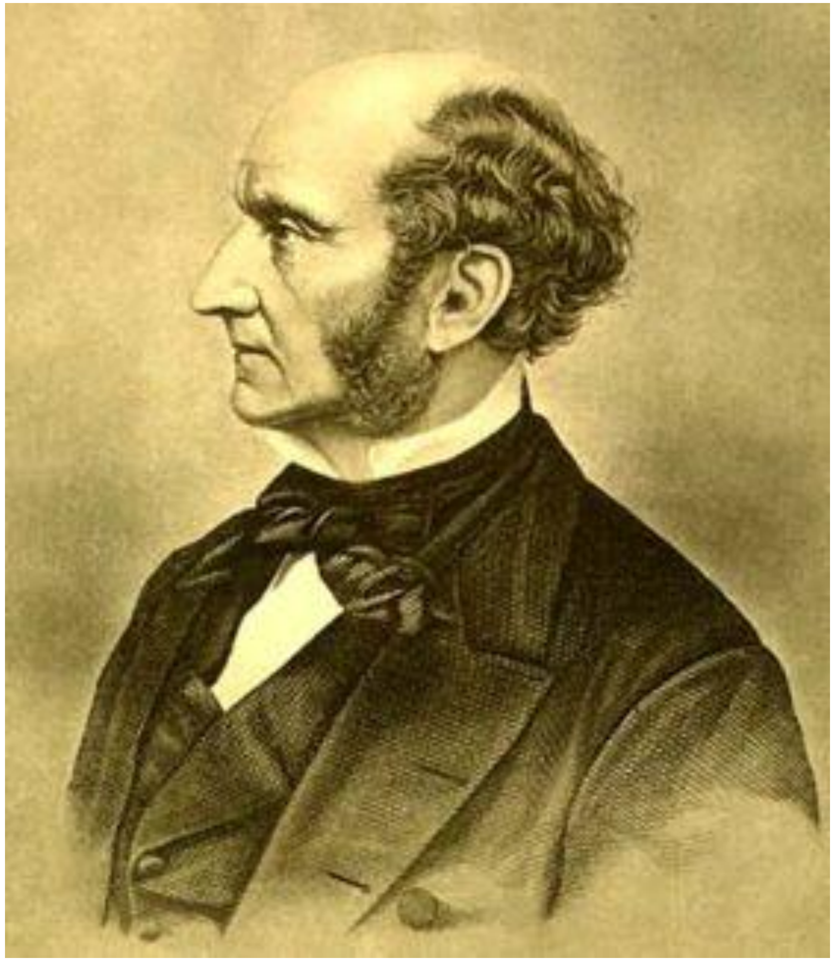
Lecture 5.
John Stuart Mill (1806-1873)

- *Principles of Political Economy*, 1848

- Contributed to economics, logic, political science, philosophy of science, ethics and political philosophy.

- A scientist, but also a social philosopher and a social reformer

John Stuart Mill (1806-1873)



Two social movements that influenced Mill

1. Socialism
2. Utilitarianism

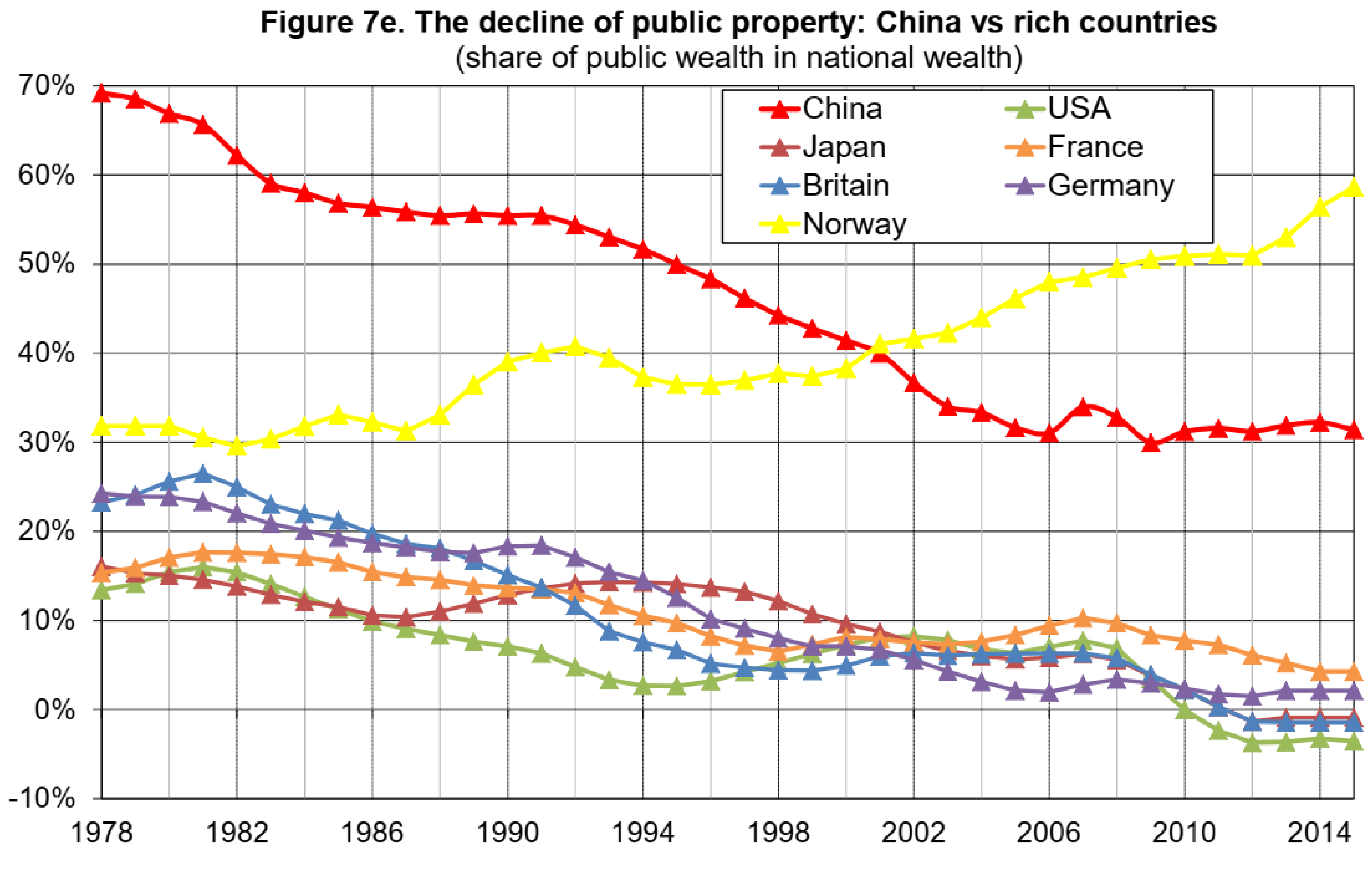
- Early (utopian) socialism (beginning of 19^{th} century):
  - Very diverse movement
  - Insisted that capitalism is disharmonious
  - Objected to capitalism on ethical basis (capitalism is unjust, there is too much poverty and inequality)

How to define capitalism, socialism and communism?

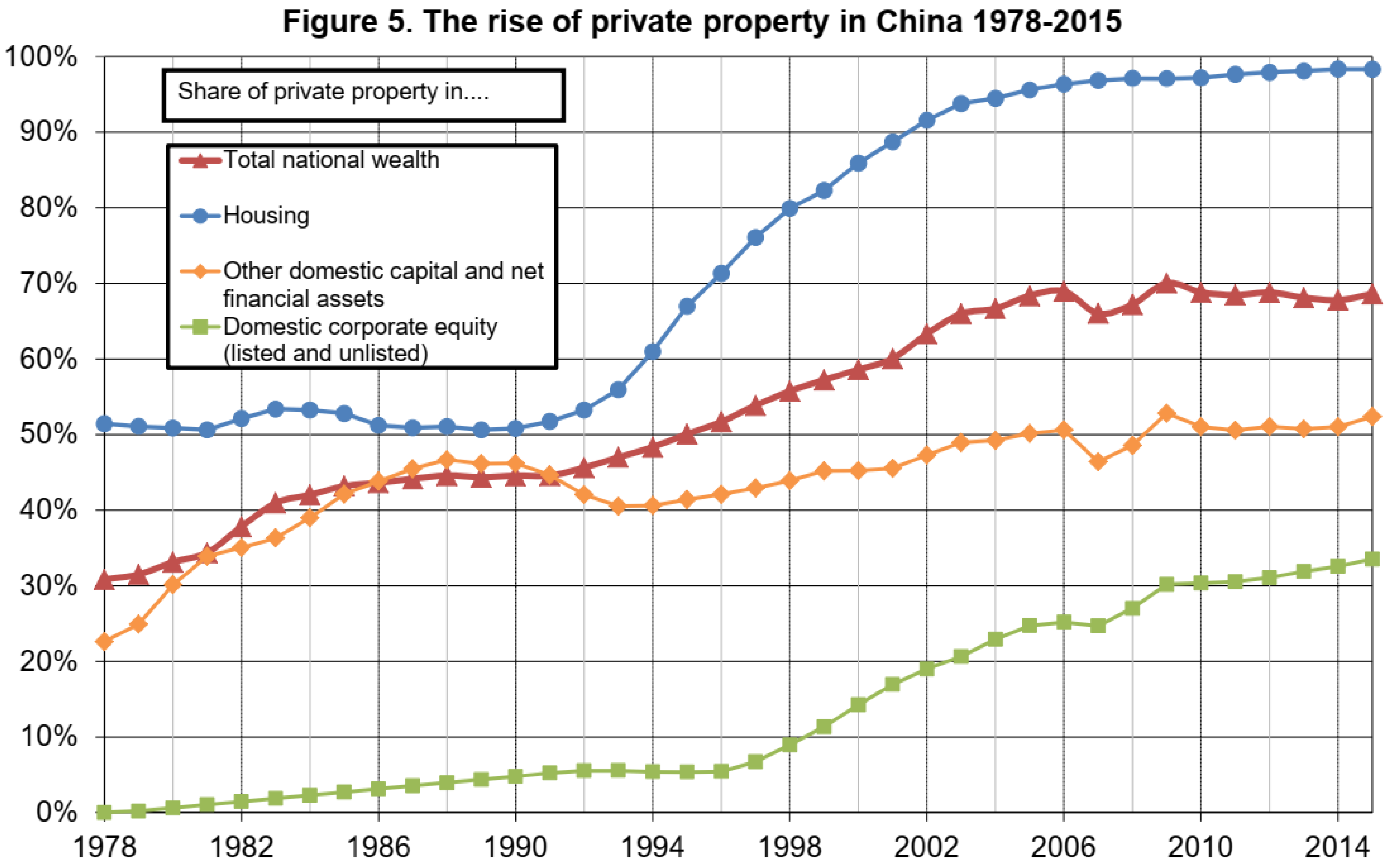
- Capitalism:
- *Private ownership of economic resources*
- *Market is an allocation and distribution mechanism*
- Socialism:
- *State or public ownership of resources (capital)*
- *Market still serves to some extent as mechanism of allocation and distribution*
- Communism:
- *State ownership of resources*
- *State (or central planner) decides on the allocation of resources and on the distribution of incomes ("from each according to his/her ability, to each according to her needs")*
  - Do you like this distributional principle?
  - What is wrong with it from the ethical perspective? From economic one?

Which modern country is communist or socialist according to our definitions?

Source: Piketty, T., Yang, L., & Zucman, G. (2019). Capital accumulation, private property, and rising inequality in China, 1978–2015. American Economic Review, 109(7), 2469-96.



Source: Piketty et al. (2019)



What is utilitarianism?

- Leader of the movement – Jeremy Bentham (1748-1832), economist and philosopher
- Utilitarianism is an ethical view that the only standard by which moral rules, civil laws, and economic actions or outcomes should be evaluated is *the principle of utility: maximization of the sum of the happiness (utility) of all members of the society.*
- In formal terms: max $\sum u_i$

How to measure utility?

- Measurability of utility
  - Bentham’s calculus of utility
  - Mill: leave it to the experts
  - Hedonimeter (Edgeworth at the end of 19^{th} cent.)
  - Psychogalvanometer (Ramsey, early 20^{th} cent.)
- Modern approaches
  - abandon cardinal utility, replace with ordinal utility
  - Save cardinal utility and use survey questions (e.g “Happiness: Taking all things together, would you say you are: 1 ‘Very happy’ 2 ‘Quite happy’ 3 ‘Not very happy’ 4 ‘Not at all happy’
  - neuroeconomics and scanning brain with neural imaging (e.g. MRI)

Problems with utilitarianism

- How interpresonal comparisons of utility (ICU) are to be made?
  - needed because you max $\sum u_i$ over different individuals
- People have different capacities for feeling happiness
- So, ICU are really hard, maybe impossible in science
- Is maximizing the sum of utilities always a good policy?
- What should we do with an evil neighbour Max, who is loved by nobody?

Utilitarianism and economic (in)equality

- How redistribution of income or wealth affects the utilitarian policy objective, i.e., the sum of utilities of all members of society $\sum u_i$?
- Let's assume diminishing MU (Marginal Utility)
- How the sum of utilities changes if we move 100 $ from a rich person to a poor person? (ceteris paribus = all other things remain constant and assuming ICU are possible)
- The change in utility of a rich person (MU_R – marginal utility) is negative, the MU_P of a poor one is positive
- How about the sum: $MU_R + MU_P$ - what is the sign here?
- Its probably positive, the sum of utilities increases in effect of redistribution
  - Assuming declining MU with higher income
- In this simple setting, utilitarianism prefers complete equality of income and wealth

Why inequality has been a problem?

Alfani, G. (2021). Economic inequality in preindustrial times: Europe and beyond. Journal of Economic Literature, 59(1), 3-44.

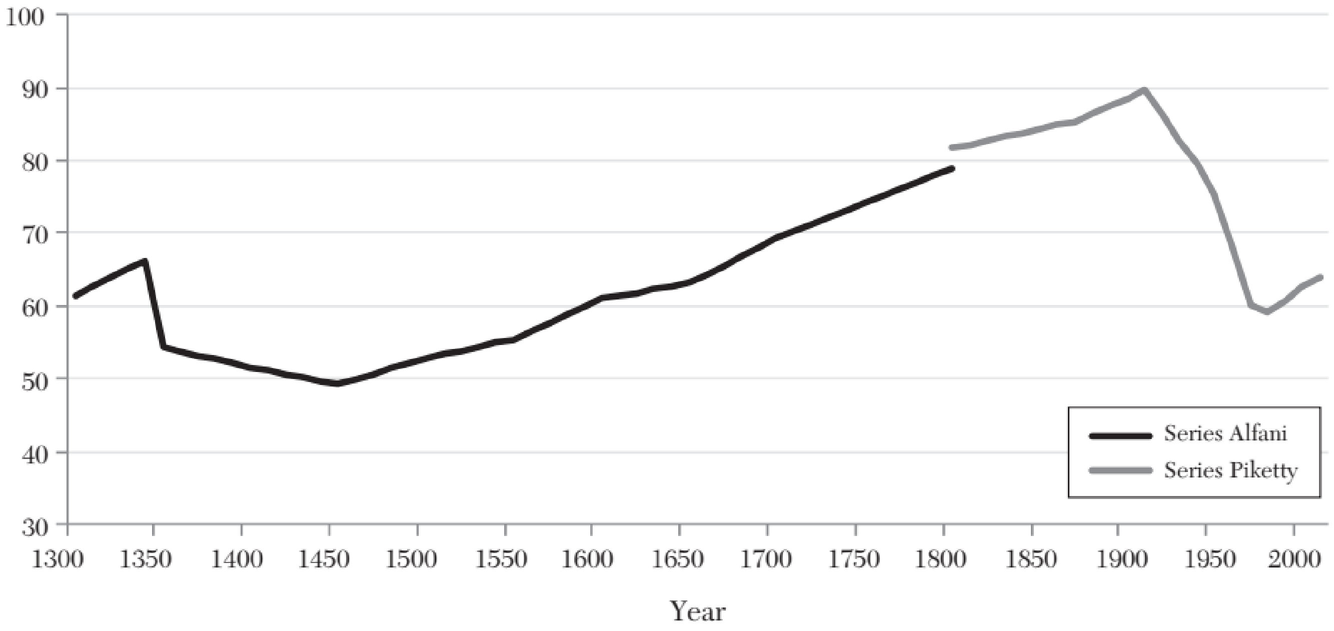


Figure 8. The Share of Wealth of the Top 10 Percent Rich in Europe, 1300–2010

Notes: The Alfani series is an average of the Sabaudian State, the Florentine State, the Kingdom of Naples (Apulia), and the Republic of Venice (the estimates for the Sabaudian State, the Florentine State, and the Kingdom of Naples have been adjusted to include those with no property). Before 1500, only information about the Florentine State and the Sabaudian State is available. The Piketty series is an average of France, the United Kingdom, and Sweden.

Sources: Alfani (2017), Alfani and Di Tullio (2019), Piketty (2014).

Reforms proposed by Mill (to acheive more equality in personal distribution of incomes)

- High rates of taxation on inheritances (but he opposed progressive taxation)
- Formation of industrial cooperatives, firms in which workers would participate in profits or shared the ownership of capital with capitalists.
- To reduce the growth of the population (enlighten the working class through education about birth control).
- To limit the right of property in land. A tax on all increases in land rent.

Mill on socialism vs. capitalism

- „If, therefore, the choice were to be made between Communism with all its chances, and the present [1852] state of society with all its sufferings and injustices; if the institution of private property necessarily carried with it as a consequence, that the produce of labour should be apportioned as we now see it, almost in an inverse ratio to the labour—the largest portions to those who have never worked at all, the next largest to those whose work is almost nominal, and so in a descending scale, the remuneration dwindling as the work grows harder and more disagreeable, until the most fatiguing and exhausting bodily labour cannot count with certainty on being able to earn even the necessaries of life; if this or Communism were the alternative, all the difficulties, great or small, of Communism would be but as dust in the balance. ”

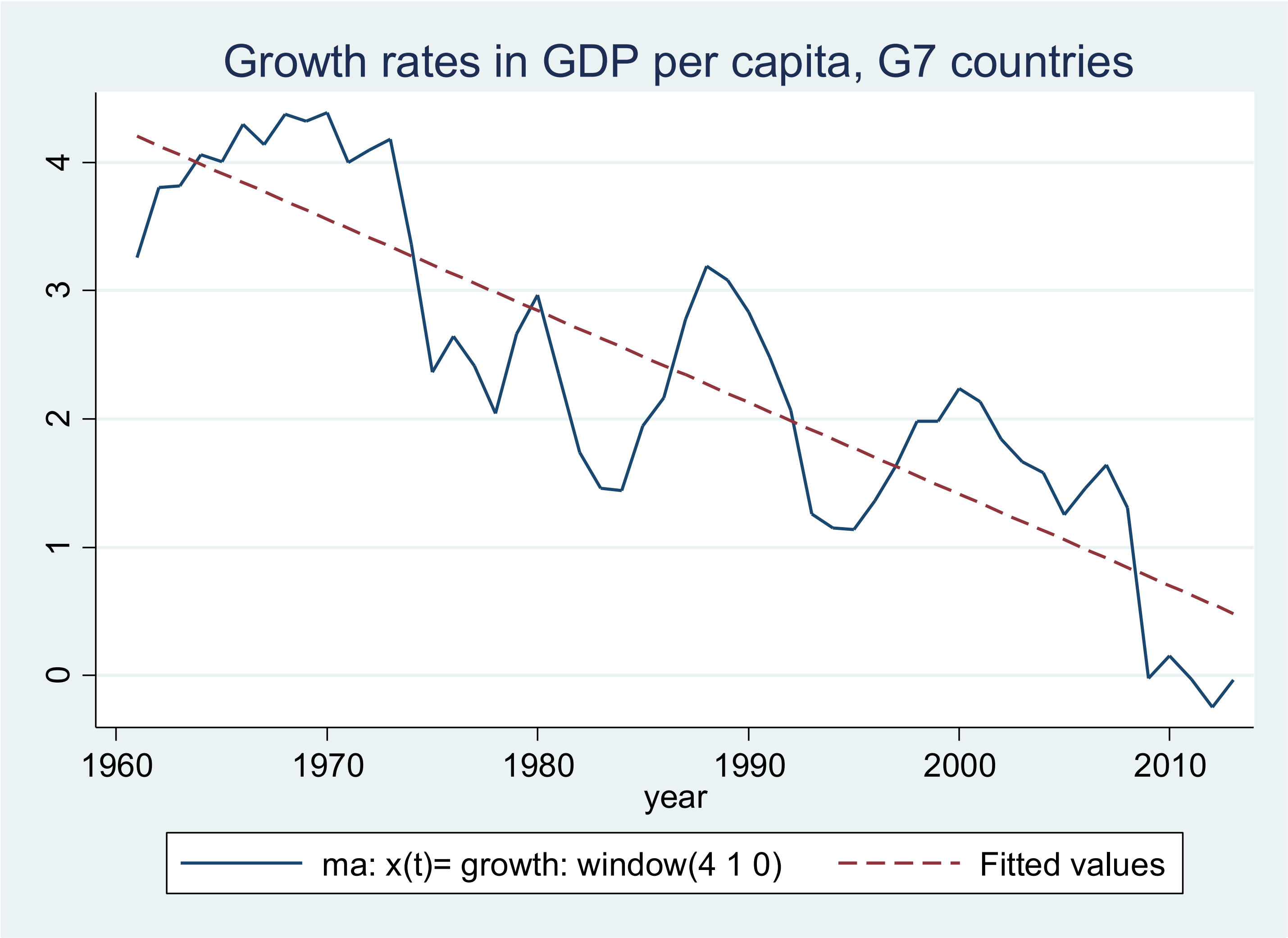
Mill on socialism vs. capitalism

- Ideal (theoretical) socialism is better than existing capitalism, but reformed capitalism is better even than the ideal socialism.
- Capitalism should be reformed – provision of universal education, limit the population growth, eliminate poverty and reduce inequality using reforms (tax and other) mentioned earlier
- Such reformed capitalism is better than ideal socialism, because capitalism assures greater individual freedom and diversity (of opinion, lifestyles etc.) among members of society.

Mill on the concept of stationary state

- „I cannot, therefore, regard the stationary state of capital and wealth with the unaffected aversion so generally manifested towards it by political economists of the old school. I am inclined to believe that it would be, on the whole, a very considerable improvement on our present condition. I confess I am not charmed with the ideal of life held out by those who think that the normal state of human beings is that of struggling to get on; that the trampling, crushing, elbowing, and treading on each other's heels, which form the existing type of social life, are the most desirable lot of human kind, or anything but the disagreeable symptoms of one of the phases of industrial progress."
- We may suppose, for instance (according to the suggestion thrown out in a former chapter), a limitation of the sum which any one person may acquire by gift or inheritance to the amount sufficient to constitute a moderate independence (MB: how much today?). Under this twofold influence society would exhibit these leading features: a well-paid and affluent body of labourers; no enormous fortunes, except what were earned and accumulated during a single lifetime; but a much larger body of persons than at present, not only exempt from the coarser toils, but with sufficient leisure, both physical and mental, from mechanical details, to cultivate freely the graces of life, and afford examples of them to the classes less favourably circumstanced for their growth
- It is scarcely necessary to remark that a stationary condition of capital and population implies no stationary state of human improvement. There would be as much scope as ever for all kinds of mental culture, and moral and social progress; as much room for improving the Art of Living, and much more likelihood of its being improved, when minds ceased to be engrossed by the art of getting on
- Would life really look like this in the stationary state?

Is economic growth getting slower?



Two sources of utility: 1) comparisons with other people and 2) with yourself from the past

Mill on the concept of stationary state

- Ever-growing economy has several objectionable properties – mainly people are too egoistic, competitive, treat others in a ruthless manner in order to become rich.

- On the other hand (Mill's view), the stationary state could be a highly desirable place to live – people could focus more on non-economic aspects of well-being, spiritual development
- Less materialistic culture develops.

Mill on economic policy

- eclectic inspirations;
- his view on economic policy are a mixture of various opinions and he can not be easily classified as an advocate of laissez-faire policy, socialist or a proponent of government interventionism;
- subtle, complex, but ambiguous writer;
- represents a midpoint between classical liberalism and socialism

Detailed analysis of Mill's economic policy

- In 'On Liberty' (1859) claimed that individual freedom is the most important social value (freedom is restricted only by not harming other people),
- He stated:
  - „Laissez-faire, in short, should be general practice, every departure form it, unless required by some great good, is a certain evil".
  - What this *great good* could be?
- But, in discussion of practical social actions Mill abandoned such strong liberal position and found exception upon exception to the general rule of freedom.
- Classified exceptions from laissez-faire as 'large' and listed 5 classes of justified government interventions in the economy

Exceptions to laissez-faire

1) Cases when individuals are not the best judges of their own interest (e.g. education of children)

2) Cases when individuals may not be able to judge future consequences of their actions (e.g. long-term job contracts, divorces)

3) State can intervene in joint-stock companies (corporations) – management can be ineffective

4) State can intervene when coordinated action is required (e.g. in case of reducing time of work for labourers)

5) Regulation of public charity, colonization and supplying some public goods like public roads, lighthouses etc.

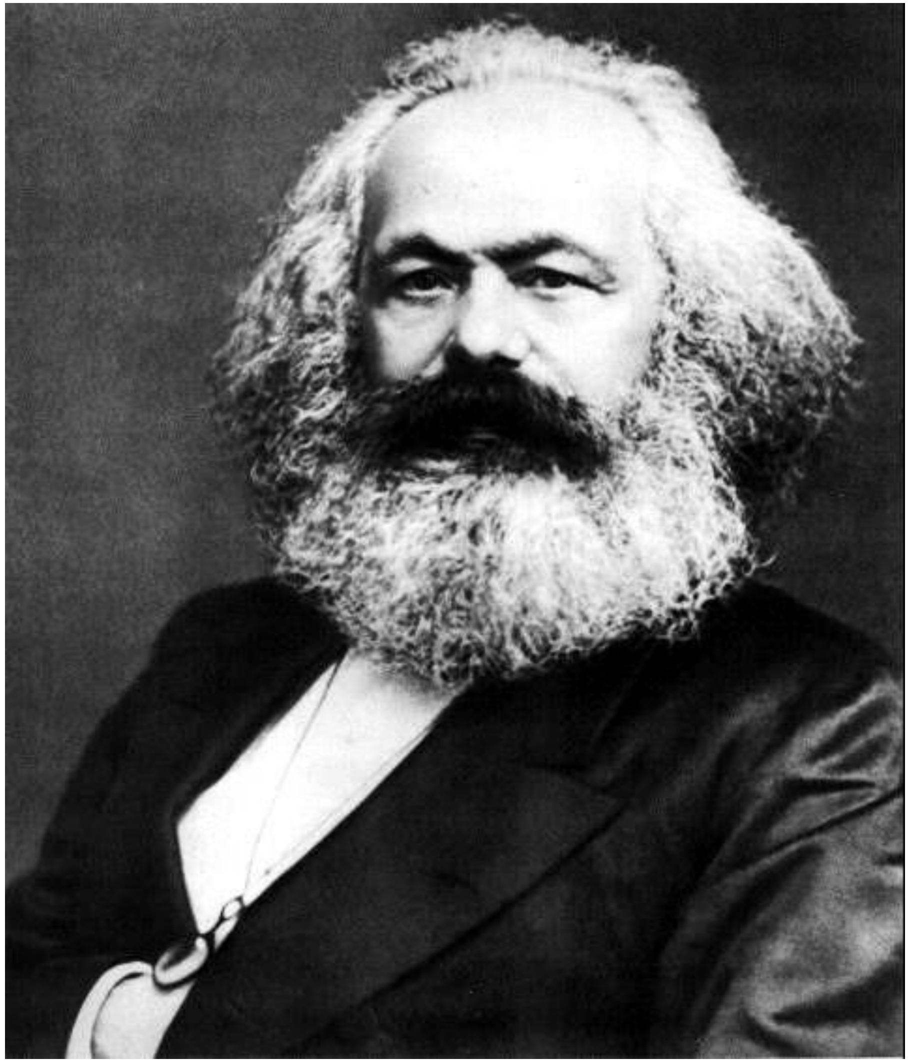
- This plus redistribution is much more than justified by other classical economists – Smith, in particular
- Many exceptions to laissez-faire, and many claim that Mill was a socialist thinker, **so is that true?**

Summary of Mill's economic thought

- Tried to combine classical economics with humanism of social reform to promote the improvement of welfare of the underprivileged
- Distinction between the laws of production and the laws of distribution
- Represents a midpoint between classical liberalism (laissez-faire policy) and socialism in matters of economic policy
- Argued that reformed capitalism is better even than ideal socialism
- Contributed to value theory, international trade theory and theory of wages.

Lecture 6.

Karl Marx (1818-1883)



Karl Marx

- Marx (1818-1883) – German economist, philosopher, sociologist and revolutionist.
- Enormous impact on arrangement of economies in the 20th century
- The strongest critic of capitalism and classical economics in history
- Major economic work – *Capital: Critique of Political Economy*
  - first volume – 1867
  - 2^{nd} and 3^{rd} vol. published by F. Engels in 1885 and 1894.
  - 4^{th} volume published by K. Kautsky in 1905-1910.

Karl Marx's thought

- Marx's economics is in a large part the application of his general theory of history to capitalism.
- Marx's theory of history is called <u>historical materialism (HM)</u>.

- HM asks how to explain the different ways in which societies have been organized in the past and how to use it to predict future forms of organization of society.

Life of Karl Marx

- Born in 1818 in Trier, into wealthy Jewish family.
- Studied law and philosophy,
- In 1842 became an editor of radical newspaper in Cologne.
- In 1843 ordered to leave Prussia, moved to France and there he began to work with Friedrich Engels (1844).
  - Engels (1820-1895) was a German philosopher, social scientist, Marx’s friend and collaborator. He worked in his father’s factory in Manchester and helped Marx financially.
  - Engels authored a book „The condition of the working class in England” (1845) based on his observations from Manchester.
- Marx was expelled from Paris in 1845, moved to Belgium and later in 1850 to London, where he spent the rest of his life working on his criticism of capitalism and classical political economy (died in 1883).

Historical context for Marx's thought

- Engels (1844), *The Condition of the Working Class in England*: the Industrial Revolution made factory workers worse off
  - Incomes are lower than before the revolution
  - Mortality from diseases is four times higher than in the countryside
  - Housing conditions are poor, longevity is shorter, workers are overworked (up to 18 hours per day, 6 days a weak), children are forced to work (first „factory act" passed in Britain in 1802 stipulated that children under 9 are not allowed to work, while aged 9-13 are allowed to work only 8 hours per day, aged 14-18 – max. 12h/day), etc.
- In 1848 we had „Spring of Nations" – series of democratic revolutions aiming at abolishing absolute monarchies in Europe; in general they were unsuccessful

Allen, R. C. (2009). Engels' pause: Technical change, capital accumulation, and inequality in the british industrial revolution. Explorations in Economic History, 46(4), 418-435.

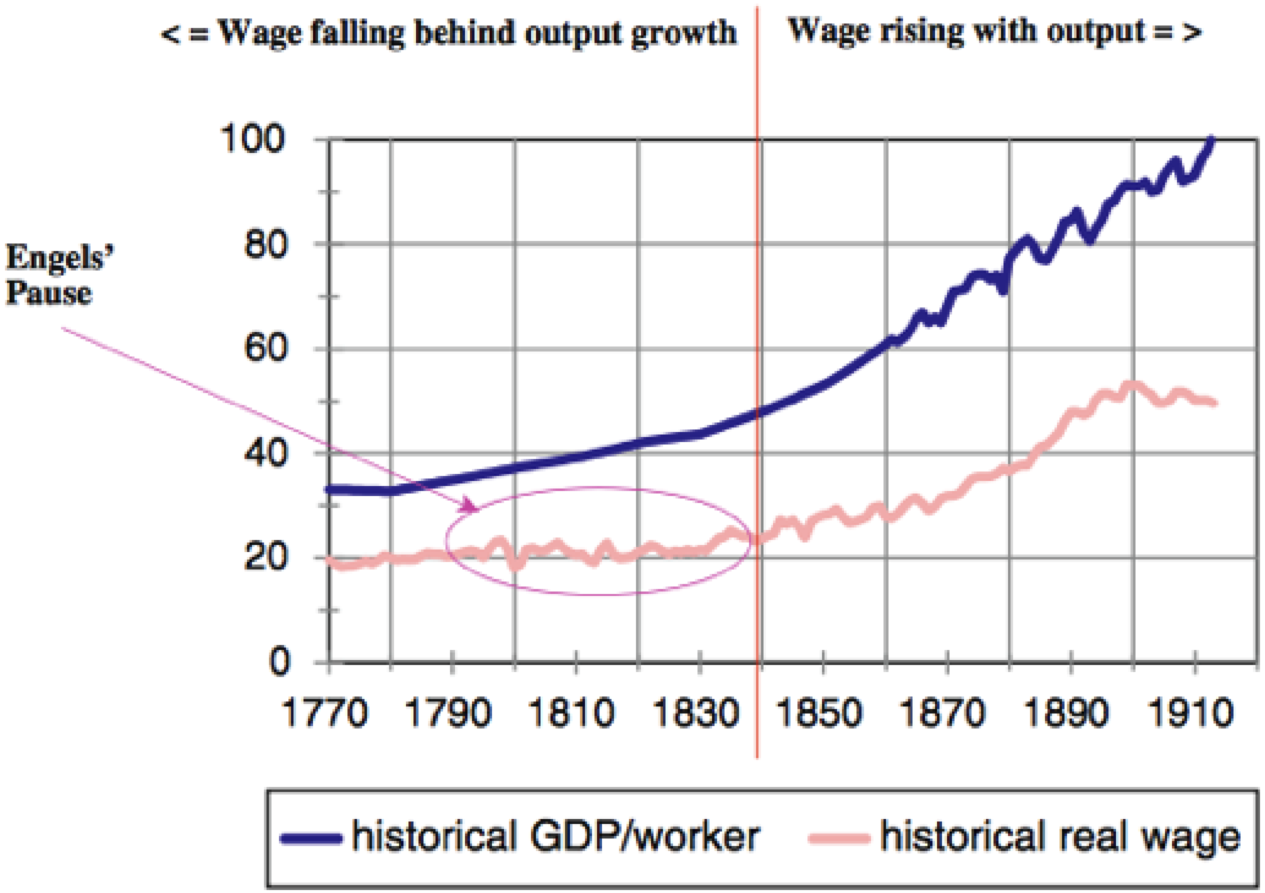


Fig. 1. The two phases of the British industrial revolution.

Historical materialism

- The theory aims at explaining what are the causes of historical changes in the modes of production (hunter-gatherers, agricultural slavery-based ancient systems, feudalism, capitalism… and in the future socialism, and finally communism)
- Predicts that history inevitably leads to the collapse of capitalism and the coming of socialism and ultimately communism
- History is neither governed by some ideal power (God, Reason, fate), nor it is a series of accidents
- All societies can be analytically divided into three parts:
  - FP: forces of production (technology, labour skills, scientific knowledge, tools, capital goods etc.)
  - RP: relations of production (social relations and relations between people and things, for example work relations and property rights)
  - SS: social superstructure (culture, the art, philosophy, science, religion, legal system etc.)

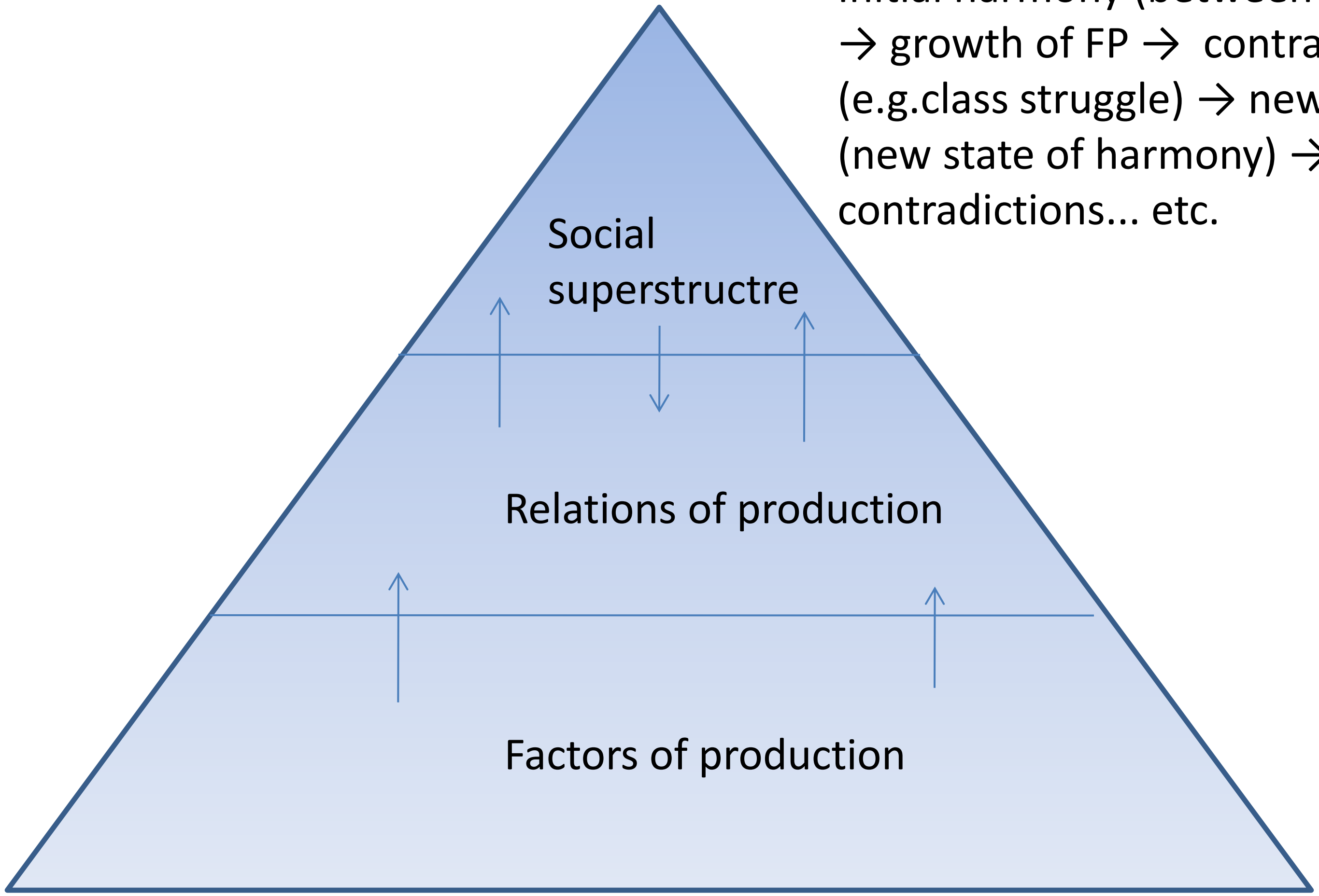
Historical materialism, cont.

- FP are inherently dynamic – they are the main source of changes in the history of societies.
- FP determine RP
- RP are static, they are always from the past, never fully adjusted to the continuously changing FP.
- RP determine SS, but SS has a feedback effect on RP
- SS reinforces the static nature of RP. Its purpose is to keep RP intact, to maintain the status quo.

Historical materialism, cont.

- After the initial harmony between FP and RP, continuously developing FP bring about contradictions in the system, which manifest themselves in the class struggle (in capitalism struggle between capitalists and labourers).
- Finally, when those contradictions are too intense, there is a period of social revolution in the social system.
- In communism there are no social classes, so communism will be the <u>end of social history</u> (no other forms of social organization in the future).

Historical materialism



Initial harmony (between FP and RP) → growth of FP → contradictions (e.g.class struggle) → new RP emerge (new state of harmony) → new contradictions... etc.

Is historical materialism a good theory of history?

- If understood in a strict way (technology is the only factor determining RP and SS) then it is absurd.
- If treated loosely (technology is one among many factors determining RP and SS) then it is obvious and trivial.

Marx's economic theory

- Advancement in theory of labour value (TLV).
- TLV states that relative values of commodities equal to the relative amount of labour needed to produce those commodities
- Marx followed many Ricardo suggestions in labour theory of value:
  - treated capital as accumulated, stored-up labour;
  - agreed that land rent does not influence values (prices)

Marx on TLV

- Dealt better than Ricardo with the problem of quantifying the amount of labour needed to produce a unit of a good.

- According to Marx the amount of labour needed to produce a unit of a good is the so-called *socially necessary labour time* – the time taken by a worker with the average skills and with the help of the average available techniques

Marx on TLV

- For Marx, value of a commodity can be divided into 3 parts:

  Value = c + v + s,

  where: *c* – expenses on constant capital, *v*– expenses on variable capital, *s* – surplus value
- Marx's assumptions:
- Expenses on *c* are not productive
- Expenses on *v* are productive; they give in return amount of v*+s*
- *s* is created by labour only, but it is owned by capitalists. So it is unpaid labour and labourers are exploited (kizsákmányolt) under capitalism

Marx on TLV – transformation problem

- Can Marx's TLV explain prices in capitalist economies? Can Marxian values (c+v+s) be transformed into market prices?
- Marx offered numerical examples supporting his arguments
- All variables are measured in hours of labour time
- Two industries exist, each of which advances the same capital of 100, but proportions of *c* and *v* differ
- Rate of surplus value (s/v) is uniform and equal to 100%
- Market rate of profit is equal accross inqustries (e.g. r=20%)

Industry	c	v	k=c+v	s (s=v)	Value =k+s	Profits	Market prices
1	70	30	100	30	130	20	120
2	90	10	100	10	110	20	120
Total economy	160	40	200	40	240	40	240

Marx on TLV and exploitation

- But TLV was also used by Marx for other purpose, not for explaining prices (positive aim), but for showing that workers are exploited under capitalism (normative, ethical aim)
- Value of commodities (c+v+s) is greater than the value of cost of production (c+v), so capitalists is left with a surplus. This arises because capitalists buys labour at its market value (*v* – covering subsistence wages), not at its social value (v+s).
- Marx used surplus value in explaining exploitation due to the necessity of unpaid labour
- Labourers are exploited by capitalist because they do not receive all value of their work (they get only v, while producing value v+s).

Marx on exploitation, cont.

- Notice, that workers are forced to produce *s* in Marx’s system
- Example:

  - it takes 8 hours of labour to produce v

  - capitalists demands that workers worked for 12 hours a day

  - so workers are forced to produce surplus value equivalent to 4 hours of labour a day

  - rate of exploitation (s/v) is equal to 4/8 = 0.5 (or 50%)
- Workers are deprived of part of value they create
- Workers do not have freedom to choose the length of the working day
- Exploitation is necessary in capitalism.
- Exploitation is ethically wrong, unjust. TLV is used by Marx for ethical criticism of capitalism.
- Do you agree that capitalism is exploitative?
- Imagine a profitable company. When Marxian exploitation disappears?

Marx on other evils of capitalism

- Alienation (elidegenedés)
- Commodity (árucikk) fetishism

Marx on alienation

- Alienation – feeling of being separated, being apart
- Several meanings of alienation in capitalism (mass production in factories with extensive specialization vs. production for own purposes in small group of co-workers as friends or family):
  - alienation of the worker from his or her humanity (being a machine rather than a human being)
  - alienation between workers, since capitalism reduces labour to a commodity to be traded on the market, rather than a social relationship;
  - alienation of the worker from the product, since this is appropriated by the capitalist class, and so escapes the worker's control;
  - alienation from the act of production itself, such that work comes to be a meaningless activity, offering little or no intrinsic satisfactions.
- It is a systematic result of capitalism
- Was Marx right about the existence and evils of alienations?

Commodity fetishism according to Marx

- In capitalism lives are organized through the medium of commodities
- People trade their labour power (a commodity itself) for another commodity (money) and then exchange it for other commodities
- People start to perceive commodities as having lives and movements of their own to which humans and their behaviuor merely adapt
- Commodities become fetishes that rule actions of humans
- People desire more and more commodities and social relations (including family ones) become ruined
- Production and consumption grows without limits while basic community goals (like alleviation of poverty) are not realized
- Does commodity fetishism really exist in market economies? If so, it is bad?

Marx’s ‘Laws of motion’ of capitalism

- These are the contradictions between FP and RP described in Marx’s historical materialism.
- Five ‘laws of motion’:
  - law of a reserve army of the unemployed
  - law of a falling rate of profit
  - law of increasing concentration and centralization of capital
  - law of business cycles
  - law of increasing misery within of proletariat.
- Not scientific laws, rather rough predictions, often based on analytical errors, rarely falsifiable.

Marx’s ‘laws of motion’ of capitalism: (1)

1. law of a reserve army of the unemployed

- There is always excess supply (túlkínálat) of labour in the markets in order to keep wages low.
- Recruited from several sources:
  - workers displaced by new machines
  - young people entering labour markets, housewives etc.
- Reserve army will increase in number over time in capitalism.
- Hard to falsify – what is the reserve army precisely?
- Unemployed:
  - unemployed if they do not have a job, have actively looked for work in the prior 4 weeks, and are currently available for work (US Bureau of Labor Statistics definition)

But, not only unemployed could be in the Marx's reserve army

- U-4= total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers;
- U-5= total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus all marginally attached workers; and
- U-6 = total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers.
  - Discouraged workers (U-4, U-5, and U-6 measures) are persons who are not in the labor force, want and are available for work, and had looked for a job sometime in the prior 12 months. They are not counted as unemployed because they had not searched for work in the prior 4 weeks, for the specific reason that they believed no jobs were available for them.
  - The marginally attached (U-5 and U-6 measures) are a group that includes discouraged workers. The criteria for the marginally attached are the same as for discouraged workers, with the exception that any reason could have been cited for the lack of job search in the prior 4 weeks.
  - Persons employed part time for economic reasons (U-6 measure) are those working less than 35 hours per week who want to work full time, are available to do so, and gave an economic reason (their hours had been cut back or they were unable to find a full-time job) for working part time. These individuals are sometimes referred to as involuntary part-time workers.

Unemployment rate in the US

source: Washington Post

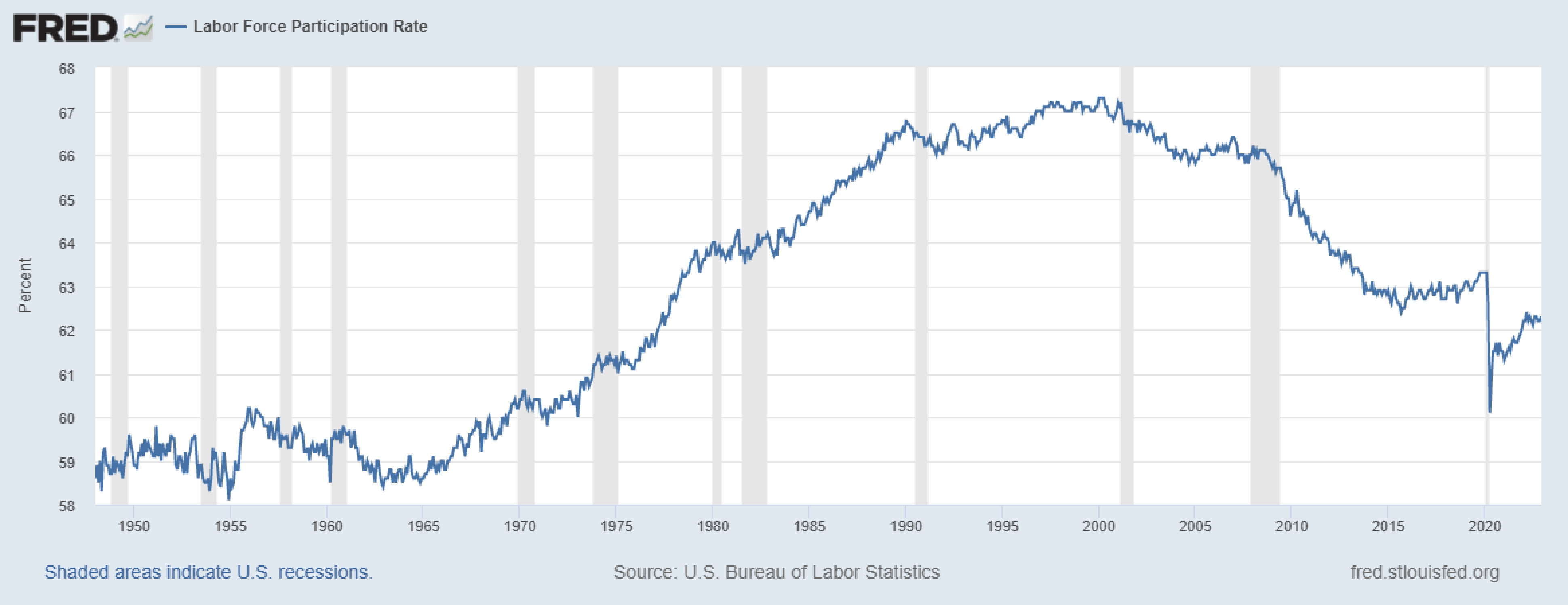
Note: Seasonally adjusted; figures from before 1948 are estimates

Sources: Labor Department (1948-present); Annual estimates from David Weir (University of Michigan) in Research in Economic History disaggregated to monthly data by Nicolas Petrosky-Nadeau (San Francisco Fed) and Lu Zhang (Ohio State University) in Journal of Monetary Economics

THE WASHINGTON POST

US labor force participation rate

(% of working-age population employed and actively looking for job)
Source: https://fred.stlouisfed.org/series/CIVPART#



2. Law of the falling rate of profit

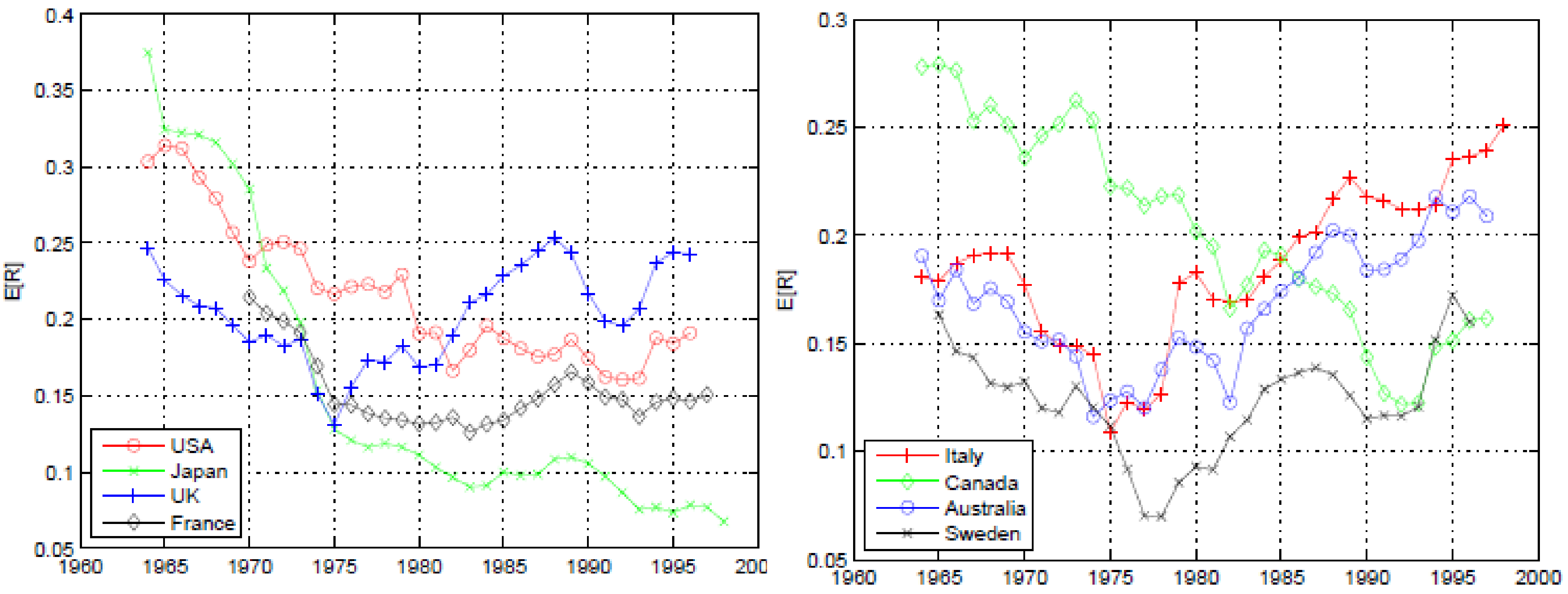
- Rate of profit falls in time because of increasing mechanization (increased used of machines in production)
- Rate of profit, $r = s/(c+v)$
- Divide numerator and denominator of right-hand side by v:

  $r = (s/v)/(c/v+1)$
- Hence, $r = e/(k+1)$, with

  $e=s/v$ being exploitation rate, and

  $k=c/v$ is capital intensity of production
- From above: If mechanization (k) rises with time faster than exploitation rate (e), Marx's result follows – r decreases
- According to Marx, mechanization constantly deepens (k is rising), but exploitation rate (e) is rather constant
- Is that right?
- No, mechanization raises labour productivity, so e should rise as well

Law of the falling rate of profit empirically



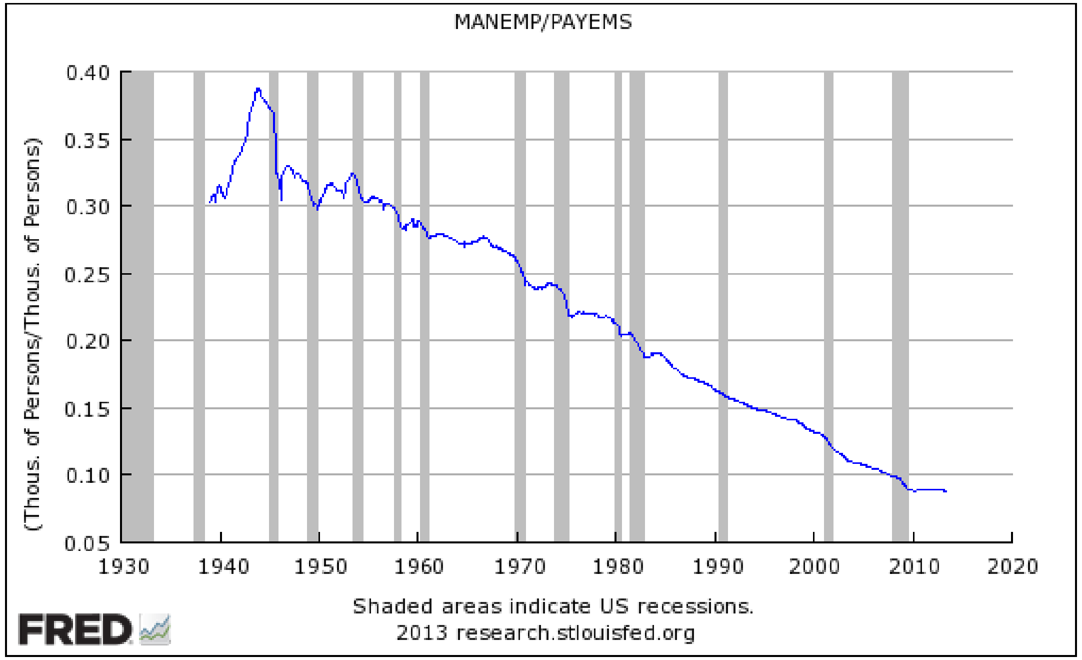
3. Law of increasing concentration and centralization of capital

- Capitalists accumulate more and more capital, the size of firms is increasing and the degree of competition in the markets tends to be diminished – there is growing concentration of capital.

Law of growing concentration and centralization of capital

Figure shows the Number and Percentage of U.S. Manufacturing Industries in which Largest Four Companies Accounted for at Least 50 Percent of Shipment Value in Their Industries, 1947-2007

But in the meantime industry’s role has declined

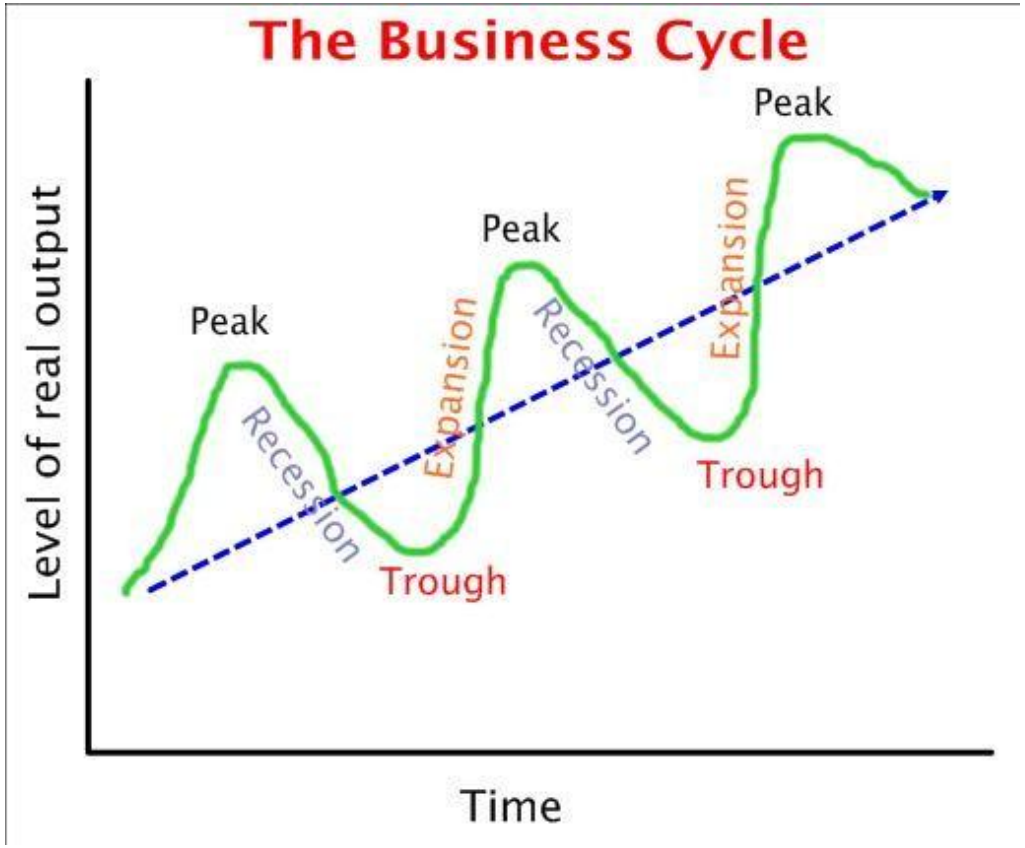


Law of business cycles

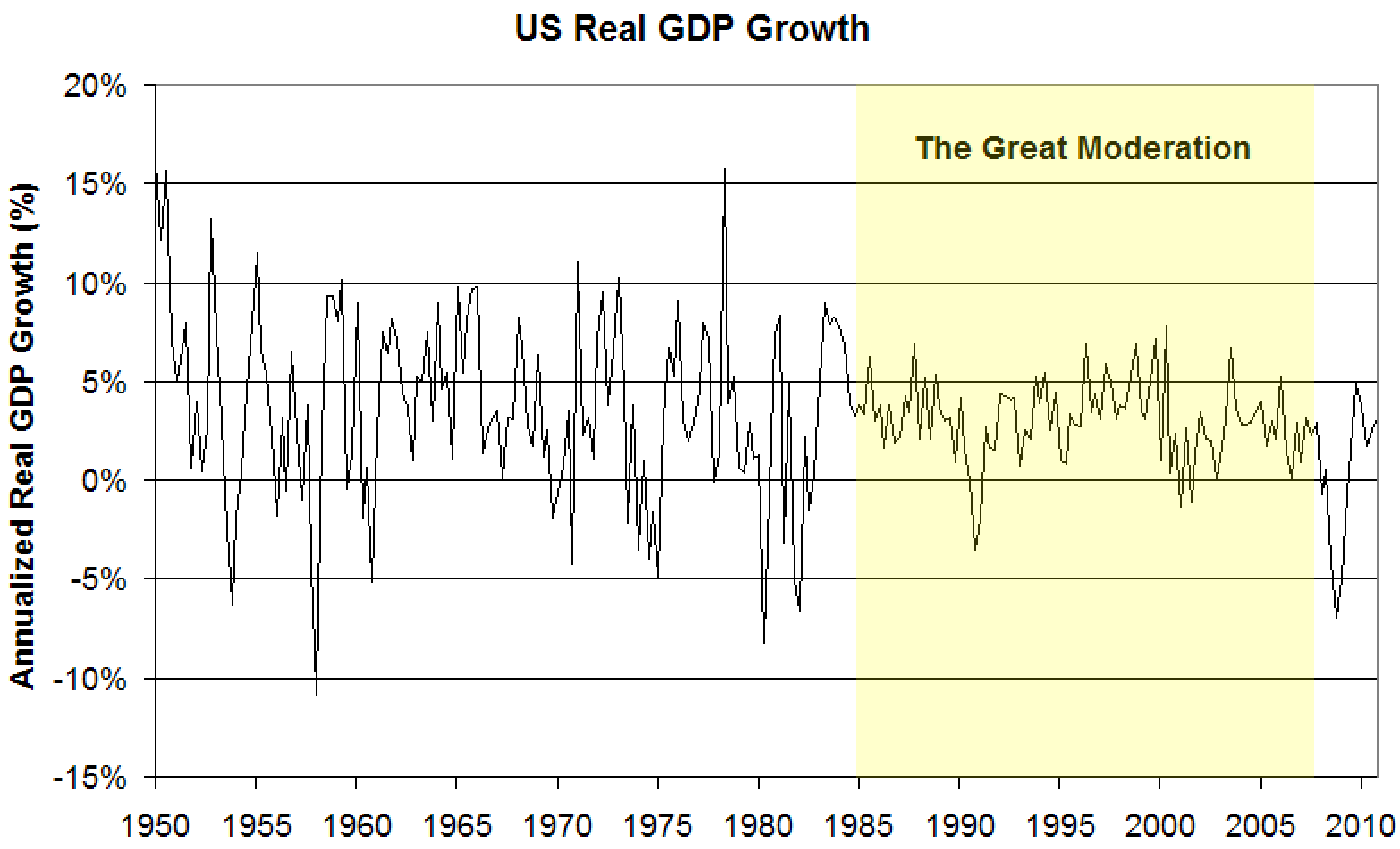
Business cycles will develop in capitalism and would become increasingly severe.

Reasons:

1) Uneven introduction of technological change in industries
2) Spread of a depression in one industry throughout the economy
3) Falling rate of profit



4. Law of business cycles



Source: https://www.forbes.com/sites/briandomitrovic/2012/10/02/the-modern-cycle-of-economic-boom-and-bust/#14782fd420d3

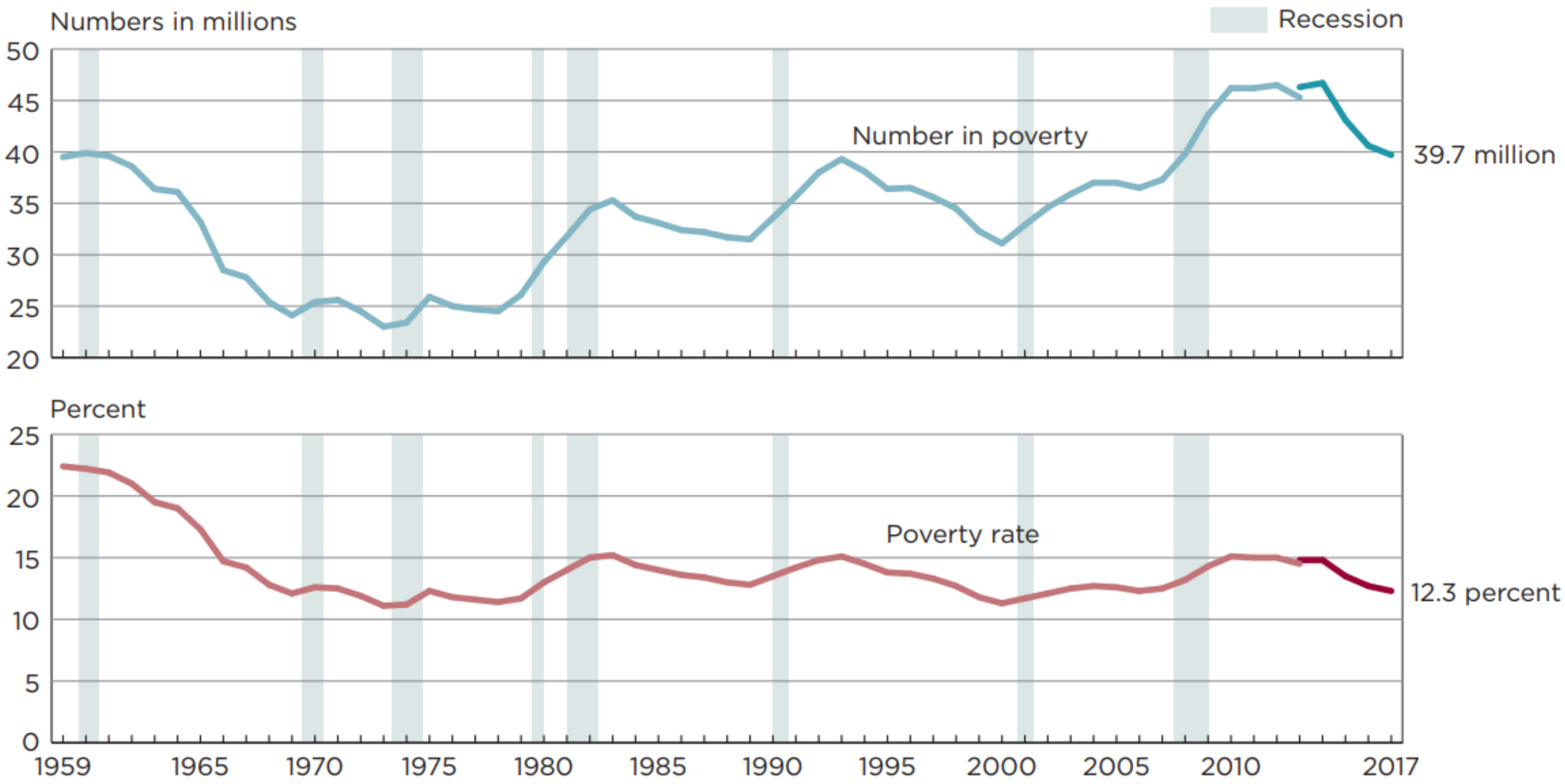
Marx’s ‘laws of motion’ of capitalism: (5)

5. Law of increasing misery (poverty) within of proletariat.

- Three interpretations:
  - Increasing absolute poverty (real income of labourers decreases over time)
  - Increasing relative poverty (working class’ share of national income declines over time)
  - Quality of life of proletariat decreases over time

Absolute poverty in the US

Figure 4.
Number in Poverty and Poverty Rate: 1959 to 2017

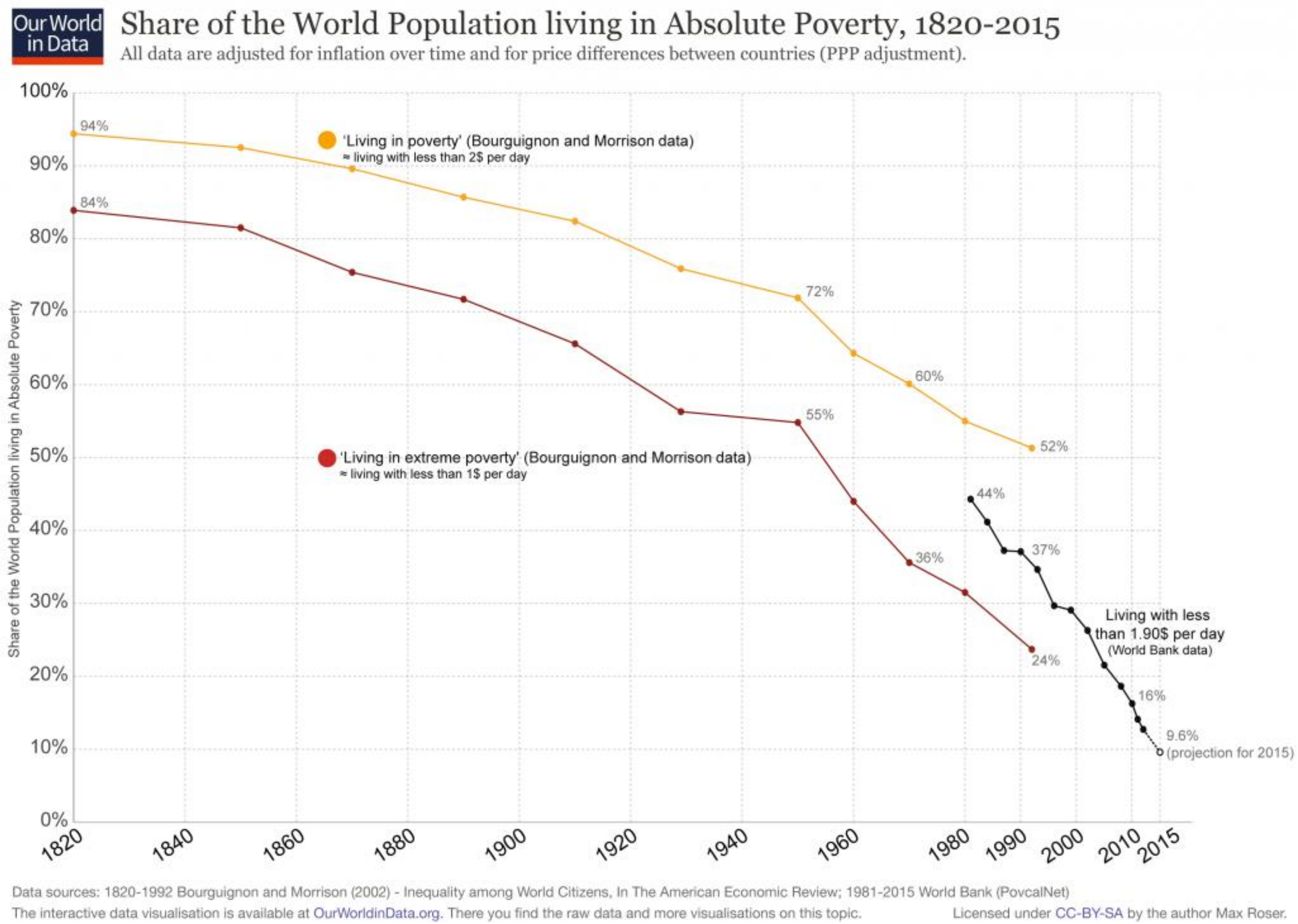


Note: The data for 2013 and beyond reflect the implementation of the redesigned income questions. The data points are placed at the midpoints of the respective years. For information on recessions, see Appendix A. For information on confidentiality protection, sampling error, nonsampling error, and definitions, see <www2.census.gov/programs-surveys/cps/techdocs/cpsmar18.pdf>.

Source: U.S. Census Bureau, Current Population Survey, 1960 to 2018 Annual Social and Economic Supplements.

Global extreme poverty

https://www.gapminder.org/data/documentation/epovrate/



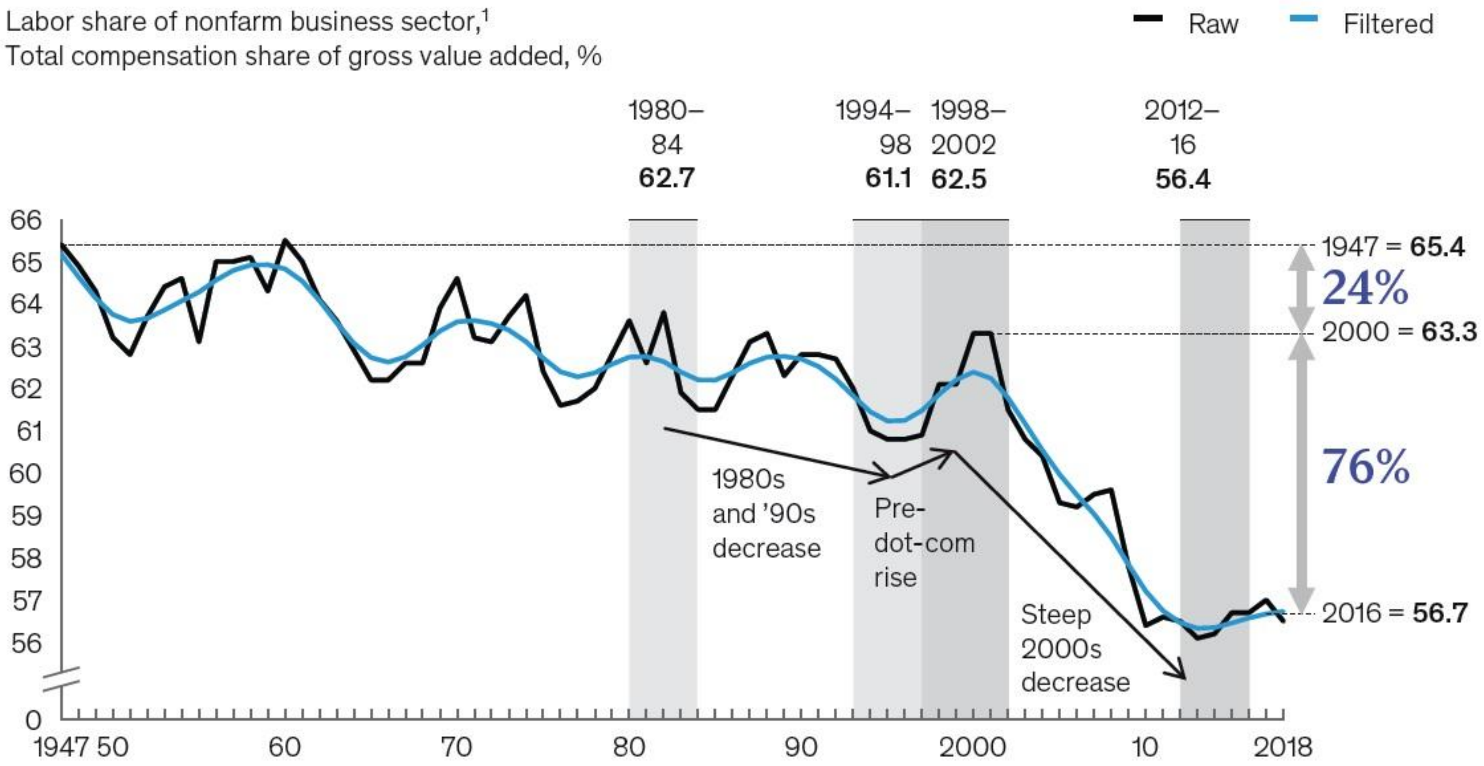
But labor share in GDP in many countries fell…

Manyika, J., Mischke, J., Bughin, J., Woetzel, J., Krishnan, M., & Cudre, S. (2019). A new look at the declining labor share of income in the United States. *McKinsey Global Institute Discussion Paper*, 1-64.

Exhibit 2

Three-fourths of the decrease in labor share in the United States since 1947 has come since 2000.

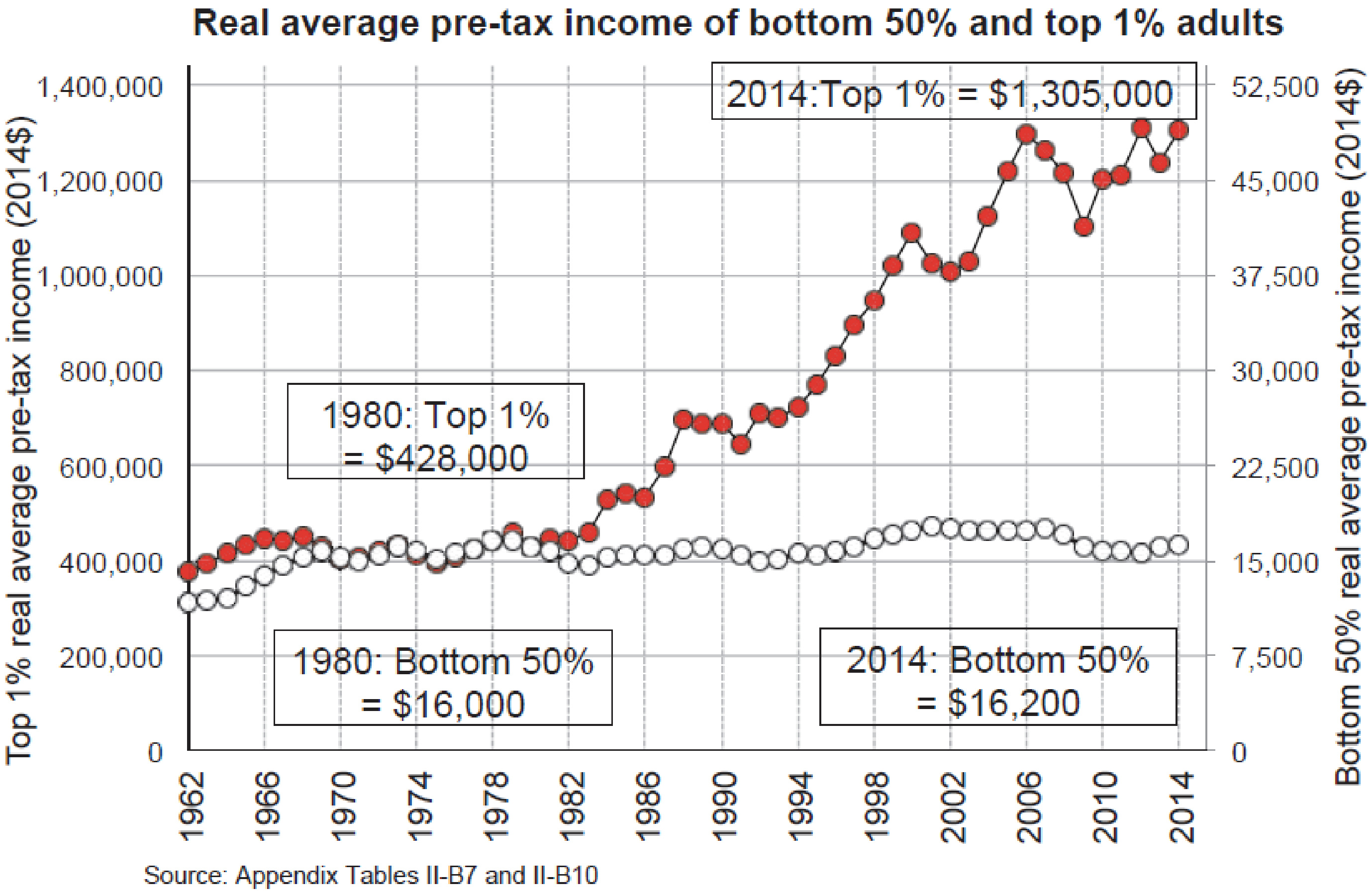
The accelerating decline in labor share in the United States



[1] Detrended using Hodrick-Prescott filter (restriction parameter = 6); adjusted for self-employed income (non-farm business sector, 75% of total economy), from Labor Productivity and Costs database, Bureau of Labor Statistics.

Source: BLS (March 2019 release); McKinsey Global Institute analysis

Average pre-tax incomes of bottom 50% of the US population vs top 1%



Source: Piketty, T., Saez, E., & Zucman, G. (2016). Distributional national accounts: Methods and estimates for the United States (No. w22945). Cambridge, MA: National Bureau of Economic Research.

Practice 6.

- Kadar era (3)
- (537) What was life like under Communism? The story of a Hungarian. – YouTube
- (537) A Future Beyond Capitalism? Socialism Explained. – YouTube (4)
- POLITICAL THEORY - Karl Marx (1)
- Hungary under the Kádár regime – Wikipedia (2)
- János Kádár – wikipédia
- Goulash Communism.