EE401 Political Economics

Classical and Marxist Economics

Assignment 1

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I. Civil society and self-regulating market as believe by classical economist

Classical economics is considered to be the first school of economic thought. It is widely accepted throughout the world. Famous classical economists include Adam Smith, Jean-Baptiste Say, David Ricardo, Thomas Malthus and John Stuart Mill. Classical political economy is popularly associated with the idea that least government intervention is preferred—leaving free markets to regulate themselves. That is societies and economies would be better off with minimal government intervention. Whenever there is a disequilibrium, a self-correcting mechanism would kick in and work to get the economy back to equilibrium. (Patil, 2012) Governments are only legitimate when based upon the consent of the people within societies and when the government protects the rights and freedoms of the individuals.

Adam Smith asserted in his book called "An Inquiry into the Nature and Causes of the Wealth of Nations" that, "because an individual's identity and power rested on their perceived value within an arena of exchange, the whole of society would be better off if marketplace exchanges were unconstrained by the state." Smith also argued that independent price-adjusting results from producers competing given that they are pursuing their own interests. And this free price adjustment reflects the true costs of producing and consuming the goods. (Martinez, 2010) Transactions are positive-sum game. By making decisions on these accurate prices and true costs, consumers and producers create transactions in which the market always balances, the amount of goods produced will always be equal to the amount of goods purchased. This market equilibrium is pareto optimal—which cannot be improved. As a result, this equilibrium cannot be distorted or changed unless such action is done by the state or the government.

II. The new social order as believed by Marx

With the minimal role of government as believed by Classical economists, Marx condemned the free market to be ungoverned. The coordination of the exchanges of private properties in the market, through the laws of supply and demand, blocks the ability of people to take control of their individual and collective destinies. (Prychitko, 2008)

Marx believed that market economy is not so much a mechanism for maximizing the private welfare of individuals but is a means of facilitating the capitalists' extraction of surplus-value from labors and capital accumulation. (Caporaso&Levine, 1992) Therefore, the Private property must be abolished and replaced by a common utilization of all factors of production and the distribution of all products under the common agreement: the communal ownership of goods. In fact, the abolition of private property is the shortest way to revolution of the social order and is the most significant characteristic of revolution demanded by communists.

Under the new social order, all branches of production of the industry will be taken away from individuals in the competitive markets and replace by a system in which all the branches of productions are operated by society as a whole. It will be for the common account, according to a common plan and with the participation of all members within the society. The competitive system will be replaced by an association. With the common ownership, societies would eventually arrive at a stage where there is no class distinction.

III. Capitalism vs. Marxism

a. Specialization Leads to People Living Better Off vs. Exploitation of Workers

Classical Economists immensely focus on the importance of specialization and the exchange of goods. Through the provisions of goods or services that one is good at providing (specialized) with the others, people could consume better quality and higher quantity of products, thus a better welfare for the society. By pursuing their private interests of providing the goods that others demand, the whole society benefits from consumption of better produced goods at a lower price.

For Marx, specialization leads to labors depends on capitalists. With division of labor brought in by industrialization, workers can no longer perform the complete production process of goods by himself. Labors have no other option but to sell his labor to the capitalist who owns the factors of production. Marxist strongly insisted that once put to work, labor power soon fully compensates the capitalist for its cost to him. Yet, they have to keep on adding value to commodities, unpaid, for the remainder of the workday. In other words, capitalist, in order to maximize profit, would push down the wage given the fixed number of working hours or he would increase the number of working hours while keeping the wage constant. This tells us that the workers are being exploited—they have become worse off.

Marxist seemed to view the world as zero-sum game and overlooked the fact that exchanges in the economy is actually the positive sum embedded as we can all gain from trade. We cannot make everyone equal nor have the same amount of money in their halts. Rather, it is measured in relative term—where everyone can be better off in the different proportion. Another fact that proves Marxist's belief wrong is the exit option for workers. Obviously, workers have an option to quit their jobs and find new ones. Therefore, workers will not be worse off because they have been kept in subservience as Marx stated. Also, the economy is developed along with the arises of labor unions. Labor union helps the working class not to be taken advantage of by manufacturers. As a result, it is more likely that workers are better off. In addition, other law and regulations such as minimum wage and labor law also help protect the workers' right from being violated and being treated unfairly.

b. Private Property vs Communal Property

Classical school emphasized the importance of private property. Private property means that people could claim ownership over resources, they could transfer the ownership, and they have the right to deny others' usage of such resources. The private ownership and the exchangeability of goods provide incentives for the owners to allocate the resource to its best use.

Marx view the private property unfair since it leads to the distinction of classes into capitalist who owns large resource and labor who owns nothing. Thus it is important that private property be abolished and replaced with communal property. With such action, everyone is equal. And we would be living in a classless society.

As Marx seeks for the equality in the society though communal property, it also promised prosperity and security. Yet, equality was achieved only in the sense that everyone was equal in his or her misery. It is the system that completely ignores human incentives. Knowing that whatever the surplus one could produce will be taken away by the state, one would have an incentive to produce. Resources are not being used wisely, hinder the development and the overall economic growth of the country. On the other hand, under the free market economy with protection of property rights, there are incentives for firms to invest in research and development in order to surpass the competitors. The advancement in technology will therefore create positive externalities and spillover effect to the industries which would then stimulate further growth.

c. The Role of The State

Classical Economists believe that the role of government should be limited and refrain from participating in the economy. The market free from intervention of government through demand and supply market would clear and lead to efficiency. There are three main roles of the state; provision of national security to protect the violence and invasion of other states, provision of law and regulations to protect members from injustice or oppression of others, and to provide public goods in the area where the individuals lack the incentive to do so themselves.

Marx argued that the state should involve in the economic activities. Marx believed that the market left alone leads to inefficiency since firms will over produce and under produce certain goods. It is necessary that the government set up a central plan and determine how much of each goods are to be produced and at what price the products are to be sold. This would lead to efficiency since there will be no excess production of goods.

The problems arise since it is impossible for the government to correctly estimate the level of productions and price that will clear the market. Not foreseeing the changes in demand and supply due to shocks that occur within the economy, price of products set and fixed by the government is likely to result in market failure. For instance, when there are natural disasters which drive down production of crops, under the free market the price of crops would increase causing lower demand for crops and higher production for the next period and the market will clear. However, under Marx centrally-plan government, the price will not adjust to shock, farmers are not willing to sell the products with the current price and this could lead to famine.

IV. Conclusion

As can be perceived by reading this paper, we agree with the statement "the classical economists argued that capitalism would lead to people acting in a better, more co-operative way." Free market, with strong private property and limitation to the role of government would lead to people cooperation which leads to efficiency, improvement in productivity, economic growth and the better welfare for all.