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## REVIEW ESSAY

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### CLASSICAL POLITICAL ECONOMY RESURGENT

**Susan K. Schroeder**

**Anwar M. Shaikh**

**Capitalism: Conflict, Competition, Crises,**

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It has long been recognized that the state of economic theory, particularly modern macroeconomics, is in disarray. With the release of *Capitalism: Competition, Conflict and Crises*, Anwar Shaikh attempts to place the discipline on a more secure footing. Without doubt, this is a very large and complex book. This review essay hopes to assist readers in unlocking its insights.

Anwar Shaikh has been a Professor of Economics at the New School for Social Research in New York for approximately 40 years. As a graduate student at Columbia University, he was stimulated by political and social unrest of the 1960s and 1970s, and began his exploration of alternative approaches to understanding how capitalism functions. He has been particularly intrigued by the surplus approach to theories of value and distribution, especially those that are grounded in some form of a labor theory of value. The New School's history of providing space to explore alternative, progressive approaches to a variety of disciplines has provided Shaikh with a natural home, encouraged by leading historians of economic thought and method, such as the late Robert Heilbroner and Adolph Lowe. *Capitalism* is the culmination of his life's work, his *magnum opus*.

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The book is grounded in the method of classical political economists, such as Adam Smith, David Ricardo and Karl Marx. Readers may or may not be aware that the method is much different than modern economics. Whereas modern economics is grounded in individual-based analysis, the classical political economists often rely on class-based analysis. Moreover, the determination of price is associated with some form of a labor theory of value. In 1977, Shaikh provided an iterative solution to the conversion of values, as established by socially necessary labor-time, into various forms of prices until the market prices are obtained. Prices are regulated by value, not equivalent to value as neoclassical microeconomic theory maintains. This foundation provides the basis for interesting insights as to how economic instability and crisis emanate, more often than not, from the creation of goods and services. Shaikh mentions the solution at various points in the book. The most substantive discussion takes place on pages 240-243. Readers may wish to supplement this material with one of his previous articles (Shaikh 1977) as the content of his prior work is apparently assumed knowledge for those who read the book.

The book introduces readers to a series of empirical phenomena that Shaikh explains as the book progresses. The phenomena include, for instance, the long-run patterns in output, employment, productivity, and long waves of growth and recession. Of course, the most tantalizing is the last long wave about which he argues that, as per the patterns exhibited by the United States, the recent financial crisis arrived 'on cue' in 2007. To explain the patterns, Shaikh begins with a discussion of economic methodology, particularly, how the concepts of equilibrium, rationality and uncertainty vary between orthodox (mainstream) and heterodox theoretical frameworks. With this basis, he proceeds to an analysis of the structure of (social) production and its relationship to the sphere of exchange, noting how economic categories are reflected in data series within national income accounting, such as gross operating surplus. Moreover, the analysis yields insights on the relationship between profit-maximization of firms and associated cost curves; specifically, the neoclassical variant is demonstrated to be of little use.

After examining the spheres of production and exchange, the concept and analysis of money are confronted. The analysis of inflation is deferred, however, until more of the analytical apparatus of his approach has been revealed. Shaikh analyzes capital and its need to expand through the creation of profit, contrasting his conception of capital with that found in

neoclassical economics. The neoclassical variant is defined by its qualities, that is, it is wealth of a durable nature. In his approach, capital is defined by processes associated with the circuit, and, as such, it is capable of assuming different forms such as money, inputs to production and outputs of goods and services. The source of profit emanates from the structure of the working day and other features of the labor or production process as they give rise to surplus labor-time and, thus, surplus value. The analysis is rounded out with a discussion of how aggregate profit is affected by shifts of wealth and value through the circuits of capital, contrasting profit obtained from productive activities with capital gains ('financial' profit).

At this point, the book enters into an analysis of competition. Here, a contrast is drawn between the conceptions of competition in the frameworks of neoclassical economics and classical political economy. Real competition – competition as warfare – characterizes classical political economy. It compels firms to engage in a war-like way on two fronts: against workers and against each other. The result is a conception of equilibrium, called turbulent equilibration, which is distinct from the conventional notion of equilibrium (a state of rest or balanced growth path). Whereas the forces of supply and demand determine market-clearing prices in neoclassical economics, these forces are only part of the process of price determination for classical political economy. The concept of the regulating capital (the structure of production that represents the most accessible point of entry for new firms for an industry) identifies price competition as competition for profit. After empirical evidence regarding the behavior of firms is presented to support this approach, Shaikh's analysis returns to consider the competitive process in other economic frameworks, such as monopoly capitalism, post-Keynesian (and the various strands within) and Austrian economics. Again, empirical evidence is presented to support the arguments made.

The focus of the book then shifts to the theories of finance and international trade. The pace of investment is said to be determined by the differences between the rate of profit and the rate of interest. Shaikh discusses the relationship between the determination of interest rates, bond prices and equity prices. Banks' profits are held to be regulated by the general rate of profit. If this is true, then the interest rate is determined by the general profit rate and the general price level. The yield curve is then established by arguing that the long-term rate of

interest and, hence, the interest rate structure is regulated by the general rate of profit. In other words, structural factors dominate in the long-run. The short-term rates are determined by supply and demand factors of various loan types.

From here, equity prices are demonstrated to be regulated by the (incremental) rate of return on new investment, while the rates of return on bonds tend to equality with bank interest rates (of similar maturities). This implies that, as bank rates are typically less than the general rate of profit, bond rates will tend to be less than the profit rate. Moreover, as equity and profit rates tend to equality, the bond rate of return will be less than the equity rate. Empirical evidence is presented to support these gravitational tendencies. The implications are drawn for the Efficient Markets Hypothesis, and contrasted with the critiques of that reasoning by Shiller and Soros. There is a digression on the history of thought about theories of the interest rate, wherein Shaikh contrasts his explanation of the bank interest rate with Panico's (also grounded in classical analysis).

Trade theory is another area in which Shaikh has provided, for years, insights that are both at odds with mainstream economics and more congruent with reality. Orthodox theory, he maintains, is grounded in the idea that free trade is driven by comparative costs, national endowments and free competition. The premises are questionable. Shaikh examines the empirical evidence and, reprising his earlier research efforts, argues that anomalies between the theory and experiences are due to issues with the comparative cost principle. If one were to relinquish the interpretation of Ricardo's comparative costs using the neoclassical conception of competition, that is, reinterpret it using 'real competition', one finds that absolute (cost) advantage is what drives trade flows. Shaikh points out that Ricardo, moreover, erred in conflating the trade balance with the balance of payments. Empirical evidence is presented to support the idea that the basis for trade is found in relative wages, relative productivities of regulating capitals, and relative national incomes. The exposition brings to the fore that countries with absolute cost advantages experience trade surpluses which can be recycled as foreign loans to countries with absolute cost disadvantages. An implication is that the real exchange rate is regulated by real unit labor costs, adjusted for the relationship between the prices of tradables and non-tradables. The empirical support for this perspective is stronger than for the purchasing power parity (PPP) hypothesis.

The last section of the book brings the analysis to bear on effective demand, as defined in Keynes's *General Theory*. There is considerable effort to provide a history of thought for mainstream macroeconomic frameworks. The discussion demonstrates that the frameworks are interrelated and adjust over time to reflect changes in economic and financial structures. The discussion then focuses on heterodox macroeconomic frameworks – particularly, Kalecki's and its incorporation of class relations, monopoly power and mark-up pricing. Shaikh identifies the following key elements associated with the variants of post-Keynesian economics: aggregate demand drives the system, endogenous money, equilibrium as characterized by underutilization of capacity and resources, and the role of the state to achieve full-employment. These processes and structures justify the use of fiscal and monetary policies to eliminate unemployment. The analysis then shifts to what is a normal rate of employment and whether driving the economy below that rate necessarily leads to inflation (it does not).

The first two-thirds of the book is essentially a clearing process. That is, it confronts and critiques the predominant, mainly conservative, interpretations of how a capitalist market economy and its financial system should behave. Keynes engaged in a similar process in *The General Theory*, but his clearing process was incomplete. He retained enough of neoclassical marginalism to permit his ideas to be re-absorbed or 'contained' by variants of the classical (pre-Keynesian) framework that he sought to supplant. Hence, the emergence of the neo-Keynesians using IS-LM analysis (incorporating Keynesian macro in a neoclassical synthesis) and all the other theoretical frameworks that followed within mainstream economics.

To be clear, what Keynes called the 'classical' (pre-Keynesian) framework is not the same as classical political economy. The former is based upon neoclassical marginalism for the explanation of price (which is synonymous with value), where the sphere of exchange is the main context of that explanation (implicitly treating the sphere of production as secondary). The latter is based upon some variant of a labor theory of value (in which value is not the same as price), and the sphere of production is the main context. The sphere of exchange is incorporated through a process of concretization, a process by which abstract categories are gradually modified into forms that increasingly reflect the world we observe. Shaikh's solution is not the only attempt to transform values into prices. Both Smith and Ricardo, for instance, worked with

some form of a labor theory of value. However, Shaikh's solution is one of the best attempts to date, particularly because its iterative approach captures the concretization of abstract, socially necessary labor, the basis of value, into intermediate forms of price that result in prices of production and, with recognition of the influences of imbalances between supplies and demands in the sphere of exchange, the market prices we observe.

It is in chapter 13, part III, where one finds Shaikh's 'classical approach' to macroeconomics, a framework which is grounded in real competition (and a labor theory of value). The basic proposition is that expected profitability of investment drives capitalism. Both supply and demand are regulated by it. Capital accumulation is dependent on the strength of expected profitability, which, in turn, is regulated by normal profitability. Further, the actual rate of capacity utilization is regulated by normal rate of utilization. The balance of supply and demand of output (and capacity) determines the relationships of savings to output and of investment to output. Even though saving and investment may depend on the interest rate, Shaikh argues that the interest rate, itself, is influenced by the profit rate.

Based upon these propositions, Shaikh constructs the classical multiplier, and a dynamical system in which labor's social-historical strength influences the wage share and the normal rate of unemployment. He demonstrates that attempts to manage aggregate demand to eliminate unemployment will only be temporary because of dynamics that seek to return the level of unemployment to its normal rate. An implication of a normal rate of involuntary unemployment is a Phillips-type relation in terms of the rate of change of the nominal wage relative to inflation *and* productivity growth. Further, the real wage rate is stable if productivity growth is stable. With this analysis in hand, Shaikh examines the empirical evidence and proceeds to examine theories of inflation under fiat money. He combines demand-pull and supply-side arguments into a classical theory of inflation in which inflation is sensitive to changes in purchasing power, net profitability, and 'growth-utilization potential.' With this he discusses both the experiences in selected OECD countries and the relationship to the non-accelerating inflation rate of unemployment (NAIRU), which has been a pillar of orthodoxy since the influence of monetarism began four decades ago.

The book closes with a classical interpretation of the recent global crisis and governments' responses to it. Shaikh considers the debate on austerity versus stimulus, widening income distributions and Piketty's *Capital in the Twenty-First Century*. Throughout these discussions he makes clear that theory is crucial to economic analysis and policy. If the theory is misconceived, the analysis and resulting policy recommendations will be flawed, doing more harm than good.

A central theme of the book is differences in the conceptions of competition – contrasting the conception found in mainstream economics, and in much of heterodox economics, with the conception found in classical political economy. The mainstream's textbook definition of perfect competition is characterized by a homogeneous product, perfect information, free entry and exit of firms into markets, infinitely many firms and price-taking behavior. Any variation on these assumptions shifts the analysis onto imperfect competition. Although an analysis based on imperfect competition would seem more realistic, the mainstream ideal is still envisioned to be a free market system in which prices are flexible. Shaikh discusses how heterodox economists, including post-Keynesians, came to incorporate the mainstream's conception of imperfect competition because of the lack of a clear articulation of real competition. This is just part of the story, though, as heterodox economics is also found to incorporate, at times, similar conceptions of equilibrium, such as the distinction between the short-period and long-period.

However, resting the source of the distinctiveness between Shaikh's approach and the approaches found within mainstream and heterodox economics on the different conceptions of competition and equilibrium does not go deep enough. Rather, it is more helpful to examine what lies beneath the differences in economic methodologies and identify their associated visions of capitalism. That is, are the conceptions of equilibrium, time and uncertainty – and competition – supporting a vision of inherent stability of a market economy or a vision of inherent instability? The methodology that supports mainstream economic frameworks is grounded in a vision of inherent stability. The flexibility of markets is assumed to be enough to ensure the system will drive itself towards full employment of resources, including labor, and capacity. While the forms of imperfect competition are attempts to make this vision more congruent with reality, the vision is still the same – a socio-

economic system, based upon a generalized process of exchange that is inherently stable.

Heterodox economic frameworks, on the other hand, are more apt to depict a capitalist economy as inherently unstable. Unfortunately, while their underlying value theories may help to explain why the system is unable to drive itself towards full employment of resources and capacity, ultimately they rest on conceptions of equilibrium – and competition – that suggest inherent balance or stability. Keynes, Minsky and Kalecki, for instance, envision the economy as inherently unstable, but their choice of value theories – Marshallian for Keynes and Kaleckian for Minsky – slips in elements that undercut their ability to fully articulate why. Heterodox economics may share certain methodological elements of the mainstream, such as imperfect competition, but they do not necessarily share the same vision.

Moreover, there needs to be more explicit recognition that heterodox economics – like Shaikh's modern variant of classical political economy – employ open systems of analysis, in which their structures rest on analyses of class, sectors, institutions, or gender, and from which conclusions are drawn using chains of reasoning (not necessarily deductive logic) and applications. In contrast, the closed system structures of mainstream economics rest on the analysis of the individual or agent and draw conclusions (such as theorems) through the application of deductive logic. Rather than abandon heterodox frameworks with flawed methodological elements, a challenge for current and future heterodox economists is to reprise the structures of their frameworks with elements that *Capitalism* provides in order to reinforce their vision of instability.

It is a tremendous achievement to dedicate a good part of one's life to put forth a book of this magnitude. The book is not unproblematic, but, then, neither was Keynes's *General Theory*, Hayek's *The Pure Theory of Capital*, Ricardo's *Principles of Political Economy* nor Adam Smith's *Wealth of Nations*. In spots the history of thought (for instance, on the yield curve) is not fully developed. Moreover, to soundly relegate economic theory based on general equilibrium foundations into the realm of special cases necessarily entails philosophical debates over economic methodology. Debates such as these have not been experienced by the economic community for quite some time. They are long overdue.

Although Shaikh's book does not enter into the realm of philosophical debate, my hope is that it will facilitate that entry.

In sum, *Capitalism* is reminiscent of Schumpeter's *History of Economic Analysis* in terms of its size, scope of analysis and intricate discussions that bring forth the contrasts and similarities of the economic frameworks developed to date. As such, it provides a basis upon which heterodox economists can work together with sociologists, anthropologists, political scientists, policymakers and practitioners to create a new paradigm from which more socially-just policies can be designed.

*Susan K. Schroeder is a Senior Lecturer in the Department of Political Economy at the University of Sydney.*

*susan.schroeder@sydney.edu.au*

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