What kinds of problems does a market economy create, and how should they be overcome?

Political and Economic Thought

Final Exam - Home assignment

BSc in International Business and Politics

Copenhagen Business School

Pages: 8 (front page and reference list excluded)

Reference system: APA 7th edition

Student number:

Characters: 21.558

17 January 2022

Introduction

In 1978 China started its transition from a planned economy to a market economy (Lin, et al., 1996). This marked the dominance of the market economy, which was further extended by the collapse of the Soviet Union in 1991. The modern market economy dates back to the classical economist Adam Smith (1723 - 1790). Since Smith, the number of market economies has only grown. As the most dominant economic system the market economy has caused an enormous expansion in wealth and extensive development of technology and humans in general.

A market economy is simply put an "economy in which a substantial proportion of goods are allocated by the use of markets" (Blac et al., 2017). The purest form of a market economy is a free market economy, where the production of goods and services is purely dependent on the forces of supply and demand. The free market economy's counterpart is a planned economy. Most economic systems today are mixed market economies, where the free market coexists with government intervention. The market economy has in a broad outline been the most dominant system since Smith. This raises questions as the following: how has the market economy kept its position as the most dominant economic system? And will it keep its position?

This paper seeks to answer what kinds of problems a market economy creates and how these problems should be overcome. The question will be answered in the framework of three prominent economic thinkers, in the chronological order of Thomas Robert Malthus, Karl Marx, and John Maynard Keynes. Their answers to the question will be analysed and discussed through the paper. The analysis will be followed by a discussion on the market economy and the growing problems of scarcity, a growing population, and environmental issues. The discussion will begin with a brief introduction to ecological economic thinking, followed by a discussion of the findings from the analysis. Lastly, a conclusion will be drawn.

This paper has chosen the given thinkers, due to their prominent positions in the history of economics. Additionally, they all represent different major economic schools and represent different stages of the development of the market economy from the late 18th century to the present.

A dismal economist - Thomas Robert Malthus

Adam Smith (1723 - 1790) is one of the most influential thinkers in the history of economics. In his famous work *An Inquiry into the Nature and Causes of the Wealth of Nations* from 1776, Smith laid out the foundation of the modern market economy, where he explained key concepts like the importance of economic growth, division of labour, laissez-faire, etc. This was the beginning of what has come to be known as classical economic thinking (Backhouse, 2002). The belief in the market was strong, and Smith's vision of the future was very optimistic, which reflected the increase in investment and production in the market of the late 18th century. However, this optimism was quickly challenged by the Englishman Thomas Robert Malthus (1766 - 1834), one of Smith's more controversial successors in the classical economic tradition, who is known for a more pessimistic approach to economics (Bruce & Grant, 2007).

Malthus was one of the first to address the problem of overproduction and excess of supply. In Book II of *Principles of Political Economy* from 1836, he described this problem which he labelled market gluts. He believed that they occurred due to a "rapid accumulation of capital" (Malthus, 1836, p. 398) and an inability to get an overview of the demand in the market (Lund, 2020a, min. 18:20). These gluts would cause economic stagnation, force factories to close down and cause unemployment and poverty, which was the reality of the late 18th century and the early 19th century (Bruce & Grant, 2007). According to Malthus, the solution to these market gluts lay in the hands of the landowners. This wealthy group of people should fulfil the lack of demand in the market economy. Malthus called this unproductive consumption. Malthus argued that rent (landowner's income) is a surplus between the price of agriculture and the cost of production. So, landowners' expenditures add to the effective demand but do not add to the cost of production, which workers' and capitalists' spending will, and thereby the nation will stay competitive in the international market (Bruce & Grant, 2007). Malthus therefor believed that the landowners and the aristocracy should be treated well. Malthus received contemporary critic among his colleagues including the classical economist Jean Baptiste Say (1767 - 1832). Say believed that supply can never exceed demand and therefor overproduction cannot occur. This is known as Say's law today (Bruce & Grant, 2007). However, Malthus's ideas might have inspired John Maynard Keynes (1883 - 1946) in his work and economic discoveries, which will be analysed later in this paper.

Another discovery made by Malthus is found in his famous work on population growth, which gave him a dismal posthumous reputation. The rapid population growth emanates from the same phenomenon as above: an unhampered economic growth caused by a growing market economy. Economic growth calls for a greater workforce which calls for more people. Malthus used the rapid population growth in America as evidence to this (Brue & Grant, 2007). In *Essay on the Principle of Population* (1798), Malthus argued that the population, when unchecked, would outstrip resources, which would result in ongoing crises (Backhouse, 2002). According to Malthus, the solution was either preventive or positive checks. Preventive checks such as moral restraints, late marriages, etc. that seek to restrain reproduction, and positive checks such as wars, famines, economic crises, etc. that seek to raise death rates (Bruce & Grants, 2007). This rather harsh or dismal view was further extended in his critique of the poor laws, which he saw as counterproductive (Lund, 2020a, min. 15:25).

Critique of the market economy - Karl Marx

Karl Marx (1818 - 1883) has offered one of the most incisive and comprehensive critiques of capitalism and the free market economy through history. The economic system was labelled capitalism in the 19th century to signify the ownership of production by private individuals or businesses (Magnusson & Stråth, 2016). Marx consequently uses the term capitalism in his works. This paper understands most of Marx's critique of capitalism as a responding critique of the market economy. The structure of the market determines capitalists' behaviour and the allocation of resources.

Marx's criticism drew on concepts and ideas from classical economists such as David Riccardo (1772 - 1883) and Smith (Lund 2020b, min. 25:58). Through the 19th century, Marx witnessed a growing economy, a wide-ranging industrial revolution, capital accumulation, and concentration of wealth simultaneously with growing working organizations by the proletariat. Marx believed that these economic and social developments were the driving forces behind a class conflict between capitalists and the proletariat. Marx believed everyone was bound by the system - even the capitalist. In contrast, classical economic thinkers believed people were free due to the market economy. The growing inequality that Marx identified in the market economy caused him to focus on the social question. Besides creating revolutionary writings on capitalism, Marx anticipated the construction and organizing of international social unions like the International Working Men's Association (Brue & Grant, 2007).

In Marx's comprehensive work *Capital* from 1867, he made a systematic dialectic analysis of the economic system, which resulted in an inside criticism of capitalism in different stages. Marx moved from very abstract categories to a complex understanding of the system, which included its self-destruction

(Backhouse, 2002). In *Capital,* Marx describes one of the most fundamental problems of the market economy in his theory of exploitation and surplus value. Based on Smith's labour theory of value (the value of a good is equal to the labour needed to produce it), Marx argued that the surplus value of a good was to be found in the exploitation of workers. The capitalists made profits by underpaying and misusing their workers (Marx, 1887*).* This was possible because the capitalists owned the means of production (Backhouse, 2002). Marx said that "the production of surplus-value, or the extraction of surplus labour, is the specific end and aim, the sum and substance, of capitalist production." (Marx, 1887, p. 194). This surplus was used to accumulate capital due to the competition of the market (Brue & Grant, 2007). This capital accumulation, Marx claimed, would lead to repeating business crises of upswings and downswings. Marx was one of the first to explain this idea of business cycles. (Brue & Grant, 2007)

According to Marx, this problem of exploitation is overcome by the market economy's self-destruction. In the manifesto, Marx and Engels explain how exploitation leads to class conflict due to the concentration of wealth and production simultaneously with the organization of the proletariat, which at some point will cause a revolution (Marx and Engels, 1888). The proletariat will overthrow the capitalists and establish a communist society. As Marx and Engels ended the manifesto: "Let the ruling classes tremble at a Communistic revolution. The proletarians have nothing to lose but their chains. … Working men of all countries unite!" (Marx & Engels, 1888, p. 34). Marx provided a classical analysis of the economic system throughout his life, but his conclusion deviated from classical thinking, namely self-destruction of the political and economic system (Brue & Grant, 2007).

Despite fundamental differences, Marx and Malthus share minor similarities in their approach to the problems within the market economy. They both identify problems of poverty and a growing lower class. However, they counter these circumstances very differently. Malthus favoured the landowners and the aristocracy, whereas Marx expressed solidarity with the lower working class. Malthus was an advocate of the market economy and believed that it survived in the hand of the wealthy, in a system where poor people were "prevented". On the other hand, Marx believed that problems in the market economy were on account of the wealthiest (the capitalist), due to their exploitation of the working class. The solution was provided by the market economy: its self-destruction.

The rise of modern macroeconomics - John Maynard Keynes

John Maynard Keynes (1883 - 1946) was one of the most prominent economic thinkers of the 20th century and one of the leading developers behind modern macroeconomics. Like Marx, Keynes challenged classical economic thought, which dominated the relatively peaceful period of Pax Britannica between 1815 and 1914 (Flandreau and Flores, 2012). Keynes became known and acknowledges for his crisis management of the economy, which was needed due to the reality of World War I and II and the Great Depression in between. Keynes saw the market economy as unstable and broke with the dominant neoclassical approach that the market economy would recover by itself (Magnusson & Stråth, 2016). Instead, Keynes claimed the importance of state intervention.

According to Keynes, the market economy creates recurring economic crises, due to uncertainty in the market and shortage of effective demand. In Keynes' major work *The General Theory of Employment, Interest and Money* (1936) he argues that the uncertainty of the economic system will decrease the marginal propensity to consume, which causes a lack of effective demand (aggregate expenditure), which further causes a decrease in output and employment (Keynes, 1936). This was evident in the Great Depression of 1929. Keynes broke with a long tradition of classical economic thought that contributed to Say's law, which stated that supply creates its own demand (Galbraith, 1987). The focus shifted from supply to demand as the dominant determinant of output and employment (Keynes, 1936). Keynes partly agreed with Malthus and his work on the excess of supply, the counterpart to a lack of demand (Galbraith, 1987). However, Keynes would disagree with Malthus's solution of unproductive consumption by the landowner.

The answer to the inherent problems in the market economy was to actively control it, which controverted with that time dominating doctrine of laissez faire (Galbraith, 1987). According to Keynes, the government can intervene actively through either fiscal or monetary policies. In a time of economic recession, some of the Keynesian responses are increasing governmental spendings, a cut in taxes, and stimulation of private investments (Brue & Grant, 2007). These initiatives' common goal is to enhance demand and reach full employment. However, Keynes did not only believe in government intervention in times of crisis. The market economy moves in a business cycle, as Marx had described. The instability of the market economy will also create economic booms, due to a common belief in the future economy that results in excessive aggregate expenditures (Brue and Grant). Keynes argued, that in times of rapid growth governments should decrease effective demand to control inflation. Contrary to times of recession, the government should instead reduce its spending, increase taxes, etc.

A brief discussion of Malthus, Marx, and Keynes

Malthus, Marx, and Keynes all identified that the market economy created problems due to constant growth and uncertainty. Marx deviates from the two others by his theory of exploitation and his understanding of an inherent class conflict in the economic system. Keynes and Malthus agree that a shortage of demand creates crises of unemployment and recession. In broad outline, they both believed in the (mixed) market economy as the best economic system, however, they disagreed on the level of state intervention. The disagreements between Malthus and Keynes are evident in Malthus' negative view on poor laws, which he saw as counterproductive. Keynes would argue that such laws could stimulate the economy in times of recession due to increased effective demand. Malthus believed that the unproductive consumption of landowners was the solution. However, in *Principles of Political Economy*, Malthus claimed that he "should probably be accused of overrating their [landowners] importance." (Malthus, 1836, p. 217). In today's economics, consumption by all groups of society is seen as productive (Brue & Grant, 2007). These three great thinkers have all contributed individually to the study of economics and the market economy, from Malthus' discovery of overproduction crises to Marx's development of business cycles, which demonstrated the constant recurrence of such crisis and finally to Keynes' active control of the business cycle. Marx contributed a comprehensive critique of the economic system but failed to beat capitalism and the market economy, whereas Keynes more successfully convinced many leaders and public servants that a mixed market economy is a great middle course. Malthus's theory of population growth has not been supported by subsequent evidence, partly because he failed to recognize the role of technological innovation (Brue & Grant, 2007). However, Malthus's theory might prove its importance today in a time of rapid population growth.

Global scarcity and climate crisis - a new paradigm of economics?

The world faces new and growing issues such as scarcity of resources, growing population, and the climate crisis. These issues have caused a global call for climate action and a growing environmental movement. Critics, as the young front figure Greta Thunberg, have blamed the existing political and economic system and call for systemic changes (Cannon, 2019). Capitalism and the market economic system have an insatiable hunger for economic growth that drains global resources. The discussion on economic growth and its consequences was particularly kick-started by the Roman Club's publishment of *The Limits to Growth* from 1972, which concluded that economic and population growth rates would outstrip global resources around the year 2100

(Meadows, et al., 1972). *The limits to growth* laid the foundational work for the modern study of ecological economics. Ecological economics is concerned with the interaction between economic systems and ecological systems (Common, 2005). The limitations of the ecological systems are the main focus. The allocation and distribution of resources cannot only depend on forces of supply and demand, as in the market economy. As an alternative to the existing system, the economist Kate Raworth (1970 -) presented the doughnut economy. This system is constructed of two driving factors: the outer boundary, which is based on an ecological ceiling, and an inner circle, which is based on a social foundation. The goal is to stay within the doughnut where humanity can live in coexistence with a well-functioning ecological system (Krauss, 2018).

None of the three economic thinkers, discussed through this paper, spoke directly of an environmental crisis, but they still provide valuable considerations on the subject. Malthus' concerns of rapid population growth and scarce resources are returning as some of the most pushing questions of today. However, Malthus' solutions of preventive and positive checks are not suitable in today's societies. The views on morality have changed, and societies have developed advanced technologies that can moderate the catastrophic consequences of positive checks. Marx did not share Malthus' destructive and dismal view of man and nature. Instead, he would agree with ecological economists, who believe humans should coexist healthily with nature, which capitalism ruins (Benton, 2018). In *Capital,* Marx described how exploitation of workers in capitalistic agriculture would correspond to the exploitation of the soil (Marx, 1887). Marx's solution, a planned economy, would possibly be more successful at allocating resources more effectively and more sustainable than the market economy. However, a proposal of planned economy, would not be met with sympathy in the light of the relatively current collapse of the Soviet Union, where communism lost, and the free market economy won.

If the planned economy is crossed out and the market economy is declared unable to save itself from its crises, what is then left? Keynes and his controlled market economy may provide plausible answers. He argued that government regulations are crucial in times of crisis. Keynesian answers to the environmental crises of today would be policies such as green taxations, green governmental investments, and general policies that encourage an effective demand for sustainable goods. World leaders of today use such initiatives. However, this approach still has a significant flaw: it is growth-oriented, which contradicts the scarcity and environmental crisis humans face, according to ecological economists. So, maybe none of the three thinkers provide solutions to the growing environmental crisis that are either sufficient enough or applicable to the world. The solutions might be found in ecological economics. This all may suggest that a new paradigm in economics is needed - a paradigm that does not necessarily involve a market economy.

Conclusion

Since its establishment, the modern market economy has been a subject of great discussion. Although Malthus, Marx, and Keynes viewed the market economy differently, they all identified problems caused by a growing and uncertain market. They individually approached these problems very differently.

Malthus identified problems of market gluts or overproduction, which he believed was solved by the unproductive consumption of the landowners. Malthus generally favoured the aristocratic class, which stood in glaring contrast to Marx, who expressed solidarity with the proletariat. According to Marx, capitalists exploit the proletariat. This would be overcome by class struggle, which would lead to the destruction of the market economy and the establishment of a communistic society. Marx additionally identified that economic crises (as Malthus's market gluts) would reappear constantly in the market economy, which he labelled a business cycle. Keynes shared this understanding of the cycles but had a more positive view of the market than Marx. Keynes used Malthus' theory of market gluts to identify a lack of demand in the market, whereas Malthus had addressed its counterpart: an excess of supply. Keynes believed the lack of demand occurred due to uncertainty in the market, which would cause recessions or, in the worst-case depression. Keynes's solution was to control the market economy through state intervention.

Malthus was one of the first to address the limitation of the market economy in his theory of population growth. His theory is more important than ever, due to the rising problem of overpopulation and the global lack of resources. These growing issues combined with the climate crisis have caused ecological economist as Kate Raworth to raise awareness. Out of the three discussed economists, Keynes offers the most suitable solution to societies of today. However, the world may not need suitable solutions, but revolutionary solutions that do not involve a market economy that is centred around economic growth.

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