

Chapter 2

Economics and Ethics: Evolution and Interaction

Abstract As a major discipline among social sciences economics has evolved remarkably in its theoretical and empirical deliberations over the past three to four centuries, though for a good part of it as a segment of moral philosophy. A distinct beginning was made with the book, *Wealth of Nations*, by Adam Smith which is frequently held responsible for putting economic theory on the wrong track with respect to its ethical foundation. The allegation is that the market system as a basis of economic theory rests on pure self interest depriving it of its ethical content. This has however, been strongly disputed by many scholars who think that Smith devised the market only as a socially useful institution. One who had earlier authored a remarkable treatise on morality could not have undermined the existence and role of ethics. Nevertheless, the question of whether economic theory should have incorporated ethics as a vital part of human behavior remained open for long as it grew through several different phases. The initial recognition of ethics as a significant theme got diluted over time particularly under mercantilism. The new line of deliberation which eventually led to neoclassical theory provided no place for ethics on a formal basis leading eventually to distinction between positive and normative economics. Also, onset of the industrial revolution not only marked a new beginning for economic affairs, but also led to a new set of problems for the society in its different spheres. The prevailing lines of thought could not deal with the emerging social issues like perceived exploitation of labor or growing unemployment. The need to reformulate theory in keeping with perceived empirical facets brought in Marx and Keynes who designed new theories not only to explain these problems but also to devise policies for solution. Though both dealt with ethical issues, neither of them explicitly recognized any need for ethics. The question of social justice has become more substantive in recent times calling for a greater role for social institutions, prominently for the state with its many agencies.

Keywords Philosophy • Market system • Morality • Ethical behavior • Exploitation • Unemployment • Social justice • State agencies • Industrial revolution

2.1 Early Economic Thought

It is important to understand how the basic human needs of individuals are viewed in the broader social context. Specifically, how different products and services are produced, secured and eventually utilized, has been of concern to human beings at all times and in all situations. How the resources to acquire these get distributed has an even greater impact on how the society gets organized, how it progresses and what conflicts keep arising and how these seem to get resolved from time to time. The recorded or, at least reliably known history for the last two and a half millennia bears witness to changes that have to be part of the process. No wonder, economic ideas related to these issues have been central to human thought at all ages even though economics as a separate academic discipline does not have a long history of existence.

Every turn of history brought forth new ideas, frequently close to well-articulated ideologies, which in turn gave rise to new institutions to help the society. Views on morality and ethics may not have been treated as distinct and prominent items in this context but these have been there as an important part of the discussion on how economies shaped, institutions developed and economic views emerged. For instance, one ethical question frequently posed relates to why the price of a product does not correspond to its value and, in any case, whether it is fair to charge that price. Similarly, there have been a lot of questions about who should do what and with what remuneration.

It has been customary to distinguish between positive and normative economics. While the distinction has been questioned on some grounds, the general perception has been that positive economics is concerned with description of economic issues including theories based on “agreed” premises relating to modes of behavior. On the other hand, normative economics involves value judgments implying what should be the desirable state of economic affairs and what would be the best way to attain it. More specifically, thinkers like Friedman (1953) hold that positive economics should not explain but only predict. The important, closely related and valid point to be noted is that predictions need to be checked empirically so that one may suitably modify the underlying theories of economic behavior.

On the other hand, ethics is primarily concerned with an evaluation of human behavior from a moral point of view, howsoever this may be articulated. In today’s world normative economics based on ethical considerations has turned out to be important in context of the role of the state regarding social, political and economic affairs. Much of this is based on the way markets and other institutions are structured and regulated. In each of these cases we may adopt different criteria giving us different points of view.¹ However, the emphasis on pure economic issues invariably tends to dominate because of their centrality to human life not

¹For a more detailed discussion see Dutt and Wilber (2013), Chap. 11.

only for all but also at all times. Nevertheless, we need to remember that human wellbeing goes considerably beyond the usual economic indicators like per capita income and changes in the pattern of production.

Even as some writings and academic discussions did take place over a long period prior to the mid-eighteenth century, economics emerged effectively as a major academic discipline with the publication of the magnum opus, *Wealth of Nations*, by Adam Smith² mentioned earlier. While we shall come back to this later, it may nevertheless be useful to mention now that in response to the changing economic conditions and related developments in leading countries, economic thought also kept changing its focus from time to time. Prior to the appearance of the *Wealth of Nations* major writings over the sixteenth, seventeenth and part of the eighteenth century have been referred to as **Mercantilism**.

Physiocracy ruled the roost during the seventeenth and the eighteenth centuries. Clearly, each of these two approaches was closely related to the prominently prevailing major economic developments. **Classical Political Economy** blossomed over eighteenth and nineteenth centuries, **Marxism** over nineteenth and twentieth centuries. **Marginalism** eventually led to **Neoclassical Economic Theory** over the late nineteenth and earlier part of the twentieth centuries. This brings us up to the start of the Second World War which more or less coincides with the emergence of **Keynesianism** concerned with macroeconomic problems, focused on unemployment with its vital and pioneering policy implications (Keynes 1936).

The so-called ancient social thought, particularly that in Greece and India in the pre-Christian era was one way or the other focused on the modalities of the government with its multifarious agencies in coordination with the economic system. Again, in different ways both of these were closely related to codes of conduct in everyday life as dictated by religious masters; in Greece according to the **Old Testament**.³ This was sometimes explicit but many times implicit. In continuation of this, the first four to five centuries of the new era were greatly influenced by the advent of Christianity and the emergence of the Roman Empire. However, both of these forces with their concern for economic wellbeing and ethical values came to a close by about the end of the fifth century. Let us come back to this later.

The initial impact of the teachings of Jesus as the messiah emancipator of the poor, and one who stood against slavery, exploitation and other forms of injustice did not last long. Consequently, economic thought distanced itself from not only religion but even from the wider world of ethics and morality. In any case, even during the so called medieval period, spread over nearly ten centuries up to about the sixteenth century, we do not see much of new thoughts relating to economics.

²Adequate attention has not usually been paid to his equally remarkable work *The Theory of Moral Sentiments* (Smith 1759).

³Under the **Old Testament** the code of conduct enjoined upon members of the community was strict and included a recognition of certain overriding social obligations (Roll 1953). Similar though markedly distinct codes were formulated in ancient India over a long period under the caption, **Sanathana Dharma**.

In fact, since the medieval society was feudal and land based, the lavish and luxurious pattern of life followed by the king was invariably at greater social cost as it impoverished the ordinary citizen. Catholic Church itself turned out to be a big land owning institution across nearly the entire Europe. Attempts to harmonize Christianity with Aristotlian philosophy did not have much success in this regard.

Yet, the link between ethics and religious dictates cannot be denied. One needs to recognize the fact that the role of religion is too preponderant for all, not only believers but also nonbelievers. In the present context it has sometimes been argued that the goals of individual behavior and the matching social policy should come from ethics. But, how this can be done would have to be articulated on the basis of well designed positive economic analysis. However and fortunately, the two cannot be bifurcated in any neat way. It has, nevertheless, been said that

Religion has a profound influence on personal and social values, which affect even those without beliefs. Charles Dowis, sees fact and value as inextricably intertwined in the social sciences, so that nontrivial judgments of fact always presuppose some prior judgment of values.⁴

This reminds one of the so-called “Primitive Mind Hypothesis” put forward by European intellectuals led by Augustus Comte towards the end of the nineteenth century. Several predictions were made by these thinkers about religious thought and belief but none of these have come true. Let us come back to this in a later chapter.

2.2 Towards Classical Political Economy

It is not intended to outline here the history of economic thought as such. It is, nevertheless, necessary to sketch briefly how different waves of this subject emerged so that one can visualize how different institutions and theories which came into existence from time to time had some ethical content in varying degrees.⁵ One may see the development of economic thought broadly covering what is commonly referred to as classical political economy developed over the eighteenth and the nineteenth centuries and Marxian economic theory took shape towards the latter half of the nineteenth century. The prevailing marginalist economic methodology associated with Leon Walras from France, Stanley Jevons from Britain and Carl Menger from Germany grew over the second half of the nineteenth century and the early decades of the twentieth century. However, in response to changes in European economies there were other developments, as expected.

⁴Wilson (1997) outlines a treatise on Economics and ethics on the basis of religion focusing on Judaism, Islam and Christianity.

⁵A comprehensive outline of economic thought may be found in Roll (1953), Newman et al. (1954), Galbraith (1987) and Rima (1991).

First of all, as agriculture got gradually replaced by industry and consequently trade increased in response to much greater industrial production economies witnessed what is called merchandise capitalism. Trade and commerce became important during the sixteenth seventeenth and eighteenth centuries. A good part of economic discussion eventually got related to pricing of products and systems of exchange. There was a significant increase in trade on a global basis across continents with increased availability of shipping facilities. Barter system had to be replaced markedly by use of money as the medium of exchange; money could also serve as a store of value through accumulation. Agencies like the Hudson Bay Company for United States and East India Company for India were set up by the British to benefit from trade. These, in turn, led to colonization with its significant economic and political implications. “**Mercantilism**” thus emerged as a significant part of economic thought. It has been pointed out that this marked a break with the then prevailing ethical considerations associated with thinkers concerned with economic issues. Since merchants were socially dominant and clearly in pursuit of wealth “religious faith was accommodated to economic circumstance and need ... Pursuit of wealth became respectable.”⁶

With increasing spectrum of economic activities like trade, commerce and industry there was increasing appreciation of interdependence across the economy,⁷ giving rise to “**Physiocracy**” during the seventeenth and the eighteenth centuries. This enriched the general understanding of how an economy functions and thus laid the first steps towards the notion of a general equilibrium, but took much longer to fructify substantively. Since none of this involved ethics with any prominence we need not follow this any further. It is nevertheless important to remember that changes that economies underwent meant a further progress to new institutions prominently the market systems, trading and commercial organizations, modern industrial structures and, on top of it all, an increased role of the state. While this is of considerable interest in the present context, there was practically no discussion of moral and ethical issues under these new economic paradigms.

It would be no exaggeration to say that economic thought with all its innovations and complexities reached a definite state of maturity only with the publication of the *Wealth of Nations* as highlighted earlier. Prominent contributors to the body of literature, who followed Smith include David Ricardo, T R Malthus and J B Say. Major innovation primarily due to Smith has been the concretization of the market as a dominant and beneficial institution in an economy. The central point for us to note about economic agents is the collective dependence on each other but every one driven by self-interest at the individual level. A good part of the theory articulated in the *Wealth of Nations* was applied by David Ricardo to trade and labor markets relatively more rigorously than by his contemporaries.

⁶Galbraith (1987) p. 37.

⁷Tableau Economique by Quesnay, very much like today’s input-output analysis, depicts the circular flow of goods and services in the production process.

T R Malthus was primarily concerned with population in relation to the availability of food. J B Say is widely known for having argued that demand did not matter because it had to adjust to supply implying that all concerns must relate to production and supply conditions.

Adam Smith is frequently held responsible for formulating economic theory based on pure self-interest wiping out all ethical concerns. The oft quoted assertion by him has been,

...It is not from the **benevolence** of the butcher, the brewer or the baker that we expect our dinner; but from the regard to their own **self-interest**...⁸

However, Sen (1987) argues convincingly that this is an unfair evaluation in so far as it is based on a misunderstanding of the main thrust of Smith's perception of how the system functions. The argument that a baker produces bread because he knows that a butcher will need it, and the butcher takes pains to make meat available because the baker would ask for it, does not imply pure selfishness. It needs to be seen more as a process of decision making in an interdependent society amounting to mutual concern. Smith could not have ignored the moral and ethical issues embedded in the theory that he was putting forward. Commenting on this Galbraith (1987) expresses his implicit disapproval of how "the market system has today acquired an undesirable theological beneficence which Smith would not have approved."⁹

Let us briefly turn to another major development that transformed the society across Europe and gave a new meaning and a fresh motivation for economic thought. This was the great industrial revolution which swept England and Europe for nearly a century starting with the middle of the eighteenth century. It, more or less, coincided with the emergence of classical political economy. In considering some aspects of this development we shall confine this discussion to England. In all countries and regions thereof the industrial revolution changed practically everything. Agriculture declined as a means of subsistence, wholesale migration took place from rural to the then existing and newly established urban settlements. The household set up in cottages which were the location for small scale handicrafts and manufacturing were replaced by industrial houses. The community life ceased to be what it was and new social classes distinguished by power and property came into existence. One must add that the process was not at all the same everywhere. As expected, it differed across time and location. However, the change could not have been and was not smooth, anywhere. Social disorder could, by no means, have been avoided.

Yet, the usual claim that human beings became self-centered, avaricious and antisocial is strongly disputed by Ashton (1948). He does, however, go on to add that

⁸Smith (1776).

⁹p. 64.

...It may, with some justice, be maintained that it was an age of *laissez faire*...Some of Adam Smith's followers intoxicated by the new doctrine, were disposed to confine the role of the state to defense and preservation of order; *laissez-faire* was extended from the economy to the society at large...¹⁰

It seems that the forum for social issues was neither the individual nor the state but the club.

Men grow up in the environment of institutions ranging from cock and hen clubs to the bar of the village inn...¹¹

Apparently there was increased human unhappiness and especially because of the hard conditions through which children had to go. The need for regulation of factories regarding hours of work, facilities for hygienic needs, education and several other things was hardly recognized. With his commitment and tireless efforts one Mr. Peel, helped by a Manchester physician, Thomas Percival, was eventually able to make the parliament do the needful by passing the Health and Morals of Apprentices Act in 1802. Unfortunately, it came too late to be of much help. One may mention that the number of children working in some factories was more than half of total workers employed. It must, nevertheless, be accepted that,

Industrial Revolution marked a major turning point in man's history... and how industrialization, in turn is at the heart of a larger more complex process often designated as Modernization...¹²

Dealing with the great advantages of the new industrial regime Landes goes on to elaborate on the massive problems that were built into the process. Many changes in the society were indeed painful. These related to the distribution of income and to the structure of power, and more than all these or because of all these to human misery across the world.

One important aspect of the industrial revolution has been the onset of specialization leading to division of labor (DOL) necessary for large scale manufacturing. This has historically been very important from the social view point. At the level of an individual a strongly argued and widely held view has been that DOL eliminated creative instinct and made life less exciting. One such assertion is that,

... (More jobs today have) compartmentalized specialized work which is monotonous and repetitive and which, above all, enlists a small proportion of the worker's total talent and understanding...¹³

Nevertheless, the other view is that DOL has increasingly, until today, become a precondition for progress and development. More importantly, it has made people work together, understand and interact with each other. Writing more than a century back Durkheim (1893, 1930) asserts a view that is quite important in the present context.

¹⁰Ashton (1948) pp. 138–139.

¹¹op. cit. p. 127.

¹²Landes (1969).

¹³Keniston (1963), p. 84.

...This subordination of particular interests to the general interest is, indeed, the source of all moral activity. As the sentiment grows more precise and determined, applying itself to the most ordinary and the most important circumstances of life, it is translated into definitive formulae and thus a body of moral rules in process of establishment...¹⁴

How far it will work this way in today's world cannot be taken for granted. Durkheim goes further to argue that DOL creates a system of rights and obligations which link people in a durable way (p. 406).

2.3 The Agenda for Social Justice

Turning back to the classical political economy we need to note that its seminal contribution was the central role it created for the market as the most overriding economic institution with enormous social implications. From our point of view it also paid adequate attention to issues relating to ethics and morality. However, these were not integrated into the central paradigm, even as they continued to be invoked in several contexts. By and large, these remained only side issues though important in different situations. Understandably, this had to be the case because there was no substantive deliberation of policy issues in most countries. One could at best dwell on such things as a "fair price" or "justice" for the consumer or, the producer in the context of alternative conditions under which markets functioned. It is in this context that state comes into focus as a powerful institution.

This has sharply and comprehensively been brought out by Atkinson (1983) by focusing on social justice, with a deep ethical content, as an objective of the state, enriched by analytical as well as empirical insights. Specifically, facets of public policy taken up include conceptual and empirical measurement of inequality, distribution of income and wealth; the availability of opportunities for well-being; taxation of income and wealth; inheritance; structure of indirect taxation; provision of public goods; social and economic mobility; social security system; availability and nature of employment.

With regard to a substantive role for ethical and moral conduct one had to look at the economic system in considerably different ways. In particular, it was argued by some that one had to talk of classes and conflicts howsoever defined and articulated. This got done with the arrival of Karl Marx. Unlike others who preceded him he looked at the economy as one part of the wider social system. The role of socio-political systems had to get properly internalized. The industrial revolution, as already noted, had transformed the society substantially. In particular, inequalities in power and wealth across¹⁵ groups had considerably increased. Owners of the industrial structures were capitalists; those who provided the hard effort were laborers. In between were those who supervised the work, designed new products

¹⁴op. cit. p. 14.

¹⁵For more recent times it has been pointed out by Galbraith (1987) that in the United States the largest one thousand enterprises account for two thirds of total production.

and managed the enterprise in different ways. They were also employees but with a different status and a higher pay off. As mentioned earlier, it turned out that labor was not provided even with adequate facilities for living nor, presumably paid a proper wage. This gave rise to a distinct class structure with its associated problems.

It may be noted that in 1954 the reputed economic historian, Simon Kuznets, delivering the Presidential Address to the American Economic Association asserted that, “Growth is a rising tide that lifts all boats.” According to his theory income inequality would automatically decrease in advanced phases of capitalist development, regardless of economic policy chosen or other differences between countries, until eventually it stabilized at an acceptable level. However, this has not turned out to be the case; the so called Kuznets curve has, indeed, not materialized. This is clear if we look at the different phases through which the distribution of income in the United States has passed since the start of the twentieth century. The figures in the table below give us approximate averages of the percentage of income that accrued to the richest 10 % of the population over different decades.¹⁶ For the period between 1980 and 1998 the income share of the top decile income earners kept steadily increasing. It is quite clear that the best period was indeed from mid-forties to late eighties. The period mentioned above was indeed the one in which governments not only regulated but even controlled the corporate business and ensured better access to education and health care to all. There is no way one can agree with Kuznets that policies would not matter.

Changes in Income Inequality: United States

Period	Percent income	Period	Percent income
1910–1920	41	1945–1980	33
1920–1940	45	1998–2010	47

The view articulated by Karl Marx in his several seminal writings, particularly, *Das Kapital* was the so called “**labor theory of value**” according to which only a small part of the value added was paid by way of wages. Going by the standard classification of value addition as described in the introductory text books, most of what remains accrued as profit and some of it as rent and interest. According to Marx this was even more unfair because historically capital itself was merely an accumulation of profits over the past. Why was somebody the owner of it and even more emphatically why was he or she being compensated for allowing it to be utilized. This is a basic question which had to come up. Needless to say that formally, the factors of production were labor and capital. The way Marx looked at the role of natural resources like land differed considerably from the way it was treated in classical political economy (Desai 1979). This is more broadly true of not only the production process but of what is known as “value theory”.

¹⁶See Piketty (2014) p. 24, Fig. 1.1.

Marxist ideology created two totally opposite camps consisting of, on the one hand, his followers who think that Marx had the last word on everything that is important, and, on the opposite side, those who think that Marxist ideas have, long back, been proved to be totally false. This has gone too far with the result that we live with the incredible fact that hardly anyone nowadays reads what Marx wrote and fewer, if any, who try to understand it in adequate depth. It needs to be emphasized that unlike neoclassical economics Marxian labor theory of value is not a theory of relative prices or of resource allocation but a new approach which treats value as a social relationship.¹⁷

We need not follow this discussion any further because our present focus is on the emergence of state as an institution for economic policy. In this context, we should start by pointing out that at its very start Adam Smith did not assign any significant role to the state. The economic system indeed functioned independently of the state. This is a widely held view in classical economics. Rather surprising, as it looks today, Marx also saw it, more or less the same way. It has been pointed out that Marx and Hegel his contemporary and noted ideologue holding totally opposite ideologies, nevertheless, agreed that state and the civil society were separate entities. Corroborating this, we have the following observation.

...we must remember that Marx, like Hegel accepted the separation of Man (homme) and citizen (citoyen), the division between state and civil society as a fact. Hegel thought the French Revolution (in 1848) had failed to bridge the gap, while Marx thought that it had confirmed the gap.... This separation of economic and the political (facet) of the state from the civil society was thus a starting point of Marx's thought...¹⁸

This view point changed subsequently as the capitalist system got increasingly dominated by monopoly power moving away from the competitive market system.

Marx saw the capitalist system breaking down one day when the era of dictatorship of the proletariat would get established. The conception of state as a powerful institution was not the prominent part of his system. This was so, in a way, because the state was not a distinct identity in his framework. The central focus was on the breakdown of the capitalist system. It may be recalled here that the capitalist society evolved out of feudalism with the advancement of technology and was expected to get transformed into communism as a result of the unavoidable proletariat revolution.

From our point of view the next stage, namely, socialism is even more important. For, this was expected to be a state of perfect altruism with no violence, no dictatorship and no exploitation. Everybody in such a system was presumably prone to work for the society with perfect commitment so much so that the state itself had to wither away, as there would be no need for it. It is sometimes said that in this system the ethical norms would indeed be overpowering. Everyone received what he or she needed and everyone contributed as much as he or she was capable of. One wonders if Joan Robinson, who was as much a Marxist as a Keynesian, meant this when she wrote, about social justice.

¹⁷This is very forcefully argued by Desai (1979).

¹⁸Desai (1979) p. 201.

If all form part of a single political community (whether a nation or a group of nations subject to a common 'world opinion') imbued with modern democratic notion of social justice, the view is likely to prevail that, in principle, those in a favorable position should not be allowed to indulge in restrictions to make themselves still more wealthy and that those in a weak position should somehow be helped...

Significantly she goes on to add,

...It should be arranged so that the whole community contributes in an equitable way. But the means to arrange this may not be easy to find and the rough justice of a restriction scheme to raise intolerably low incomes may be the best that comes to hand...¹⁹

2.4 On to Keynes

It is interesting to note that on the need for state the ideology put forward by Marx turns out to be a precursor of the views later put forward by Keynes in quite a different way. However, in actuality the 1917 Bolshevik Revolution in Russia led by Lenin gave rise to a new political structure in which state practically controlled every aspect of public life. Ideas of liberty and democracy seemed to have got lost for ever, in keeping with what was known as dictatorship of the working class. Turning to economics it may also be pointed out that in his later writings Marx, like Malthus, had anticipated situations in which aggregate demand could constrain the level of economic activity and lead to unemployment. As noted in most textbooks today, Say held a totally opposite view under which there was no way demand could fall short of supply. For him and many others the problem did not exist and was in no way a question of wage-price rigidity.

The lines on which Keynes deconstructed the classical theory as attributed to Ricardo²⁰ and other prominent economists involved considerable modifications in the way one looked at the economy and the way it functions. Clearly, his focus was on aggregates so as to devise macroeconomic relationships, though the underlying rationale was based on microeconomic behavior as it has remained till today. From our point of view the major new development was role for the state as an economic policy agent though, once again, it is not prominently highlighted in the *General Theory*. It is only towards the end of this masterpiece that Keynes goes into issues relating to the state by invoking the ideas of the relatively unknown German author, Silvio Gesell²¹ rather than Marx, as he writes.

¹⁹Robinson (1962) p. 165.

²⁰It is interesting that Keynes does not mention Adam Smith as the proponent of "classical theory" presumably because it was Ricardo who gave it a sharper analytical edge and is also believed to have bereft it of all ethical issues.

²¹"It is convenient to mention at this point the strange, unduly neglected prophet Silvio Gesell (1862–1930) whose work contains flashes of deep insight and who only just failed to reach down to the essence of the matter."

... The purpose of this book as a whole may be described as the establishment of an anti-Marxian socialism, a reaction against laissez-faire built on theoretical foundations totally unlike those of Marx in being based on a repudiation instead of an acceptance of the classical hypotheses, and on an unfettering of completion instead of its abolition. I believe that the future will learn more from the spirit of Gesell than from that of Marx. The preface to *The Nature of Economic Order* will indicate to the reader, if he will refer to it, the moral quality of Gesell.²²

Keynes reemphasizes the role of the state, the way we understand it today, as he pens down chapter 24, the last one of the *General Theory* entitled “Concluding Notes on the Social Philosophy Towards which The General Theory Might Lead”. It is in this chapter that he argues, as follows,

...the state will have to exercise a guiding influence on the propensity to consume partly through its scheme of taxation, partly by fixing the rate of interest and partly, in other ways... a somewhat comprehensive socialization of investment will prove the only means of securing an approximation to full employment... It is not the ownership of the instruments of production which is important for the state to assume...

In a way the last sentence in the preceding assertion sharply distinguishes Keynes from Marx.

It is tempting to quote once again from the *General Theory* (p. 381) as it declares:

...It is certain that the world will not much longer tolerate the unemployment which is,... inevitably associated with present day capitalistic individualism. But it may be possible by a right analysis of the problem to cure the disease while preserving efficiency and freedom...

It must, however, be noted that the way *General Theory* is structured Keynes does not appear to start with the role of the state as his basic theme. It is born out of the new analytical framework he adopts to deal with macroeconomic phenomena. The central point in the new paradigm has been the notion of effective demand.²³ The second major ingredient is that market equilibrium cannot be taken to imply equality between potential supply and anticipated demand as a necessary outcome. This was particularly the case with the labor market. Attributing this to wage rigidity has not been seen to be justified. Again, it is important to note that there is a sharper focus on the fact that in the real world the state turned out to be a very important economic institution as it taxed the private sector and thereby was able to provide important public services. In addition, it could effectively control the quantity of money in circulation at any point of time. This may not be correct in today's economic systems due to many familiar but complex developments.

It is important to note that Keynesian economics arrived at the right time. The post war period marked a new era for economics for modern times. The state played a major role in most advanced economies across the world for nearly three decades after the Second World War when it had become necessary to reconstruct

²²*General Theory*, p. 353.

²³See Klein (1947) and Modigliani (1944).

massive public infrastructure facilities damaged by the war and to revitalize the unbalanced economies. The United States played a major role in the task to build the war ravaged economic systems in the capitalist world. Once this task was nearly accomplished the industrialized economies in Europe and North America settled on an economic system conceding a major role for the state in many ways. This phase lasted for about a quarter century before a new era dominated by the market systems with an increased space for finance took over. What were the consequences is considerably indicated by the following figures Dow (1998) gives us for twenty leading economies.

Growth and Unemployment: Twenty Leading Economies

Period	Annual growth rate	Unemployment rate
1920–1938	2.2	7.5
1950–1973	4.8	2.6
1973–1990	2.9	5.7

It is quite clear that the third quarter of the twentieth century which was dominated by the Keynesian economic policy paradigm recorded the highest growth and a fairly low rate of unemployment in the developed capitalist world.²⁴ These results are in conformity with those quoted earlier from Piketty (2014) in relation to the Kuznets hypothesis.

Those going back to the history of economic thought point out that Keynes was not a believer in moral codes earlier in his life as he had a great faith in the power of human reason. But under the influence of G. E. Moore he came to regard economics as “a brand of ethics”. In fact, he and Lionel Robbins are reported to have agreed that economists should be trained in a moral science framework in which a large part of education should be added on top of techniques special to economics for a better perspective of economic problems (Skedelsky 1995). It must, however, be noted that the macroeconomic policy issues at both theoretical as well as operational levels remained divided between Keynesianism and the so called monetarism though the former dominated not only the general public but also the wide class of policy makers for three decades. For a quick look at this we may note that the critical question, as expected, turned out to be the relative effectiveness of activist fiscal and monetary policies. Monetarists believed strongly in the relevance of market forces, though it was conceded that state policy may have some role in the short run.

However, in the mid-seventies monetarism under the new paradigm of rational expectations went considerably beyond its familiar discourse giving birth to New Classical Economics (NCE) under which the role of economic policy by the state or any related agency was argued to be totally irrelevant even in the short run. This marked a major turning point not only in economic theory but substantively on the content and modality of economic policy for social welfare. The key element

²⁴It was also about the same time that large parts of Asia and Africa got free from colonization and democracy took roots in many countries.

in the new theory was the belief that all behavioral patterns must be guided by rational expectations rather than just expectations as in the preceding theories. Under NCE it is shown that policy made no difference to outcomes. All markets were driven by competitive forces so that the outcomes are the same with or without government economic policy because of rational expectations built into the pattern of behavior for all relevant agents for all decisions.

The figures on growth and unemployment given earlier indicate clearly that the new economic regime with reduced role for the state has not gone well. This was also the time when the world economy changed drastically by getting highly globalized. It moved from fixed to market determined exchange rate, reduced tariffs on imports, and free capital movements across the world. On top of it came a major growth of and a larger agenda for the financial system with its novel and increased abilities to innovate. This has, by itself, added to the complexities of the policy formulation and implementation process.

The Soviet Union collapsed as a communist system breaking back into independent nations of which it was constituted earlier. Though China remained a socialist republic, its economic agenda has changed drastically. In systemic economic terms we are now in a world where markets dominate, state policies have shrunk, and the world economy is globalized. Individual states have, on their own, a considerably reduced competence to deal with their economic affairs. Also, innovative financial systems have increased the preponderance of risk in all economic activities; all this with enormously powerful information technology. What are the consequences? Growth rates have declined and so have the rates of employment. The last quarter century has been marked by two major international economic crises; one in 1997 affecting East Asian giants and another more recently in 2008 involving almost all developed countries. There have been many somewhat smaller crises from time to time in many parts of the world all along. We have, indeed, yet to recover from these catastrophic developments.²⁵

2.5 Marx and Keynes

It has frequently been pointed out that the ideas propounded by Karl Marx kept evolving almost till the end of his life. Many of the issues were further deliberated by Engels who outlived Marx by thirteen years. Also, what comes under Marxism includes the deliberation of Lenin who led the Bolshevik revolution and ruled the Soviet Union for many years following the Marxian ideology. The subsequent ideological polarization which persists till today has been unfortunate from an academic point of view. It has been pointed out that, as mentioned earlier, those on the Marxist side of the line have uncritically accepted whatever was there in the package, whereas those on the other side have rejected it totally. One exception to

²⁵For an ethical perspective of the recent crisis see Pandit (2012).

this has been Klein (1947) whose work has been remarkably rigorous and clear in all respects. Though an admirer of Keynes, Klein asserts that Marx can be called the pioneer of macroeconomics.²⁶ However, he proceeds to clarify that the Marxian macroeconomic system differs substantially from that of Keynes.

It needs to be reiterated that Klein has been fairly rigorous not only in the way he formulates the macroeconomic system, unlike many Marxists but also in the way he substantiates his view on clear empirical grounds.²⁷ To quote him we have,

...Moreover, the model fits the observed data very closely... Workers and capitalists have, in fact, behaved as the Marxian model says they behave...²⁸

It appears important at this stage to highlight that under the Marxian system the society is not a collection of independently behaving individuals. In his “Critique of Political Economy” Horowitz (1968) clearly stated as follows.

... To consider society as a single individual is a false mode of speculative reasoning. With an individual production and consumption appear as different aspects of one act.... In society, however, the relation of the producer to his product, as soon as it is completed, is an outward one, and the return of the product to the individual depends on his relation to the other individuals.... That is to say, distribution steps in between production and consumption...²⁹

Similar views have been expressed by reputed economists particularly in the context of business cycles. For example Leontief (1968) argues that, “unlike the theory of prices, the present day business cycle analysis is clearly indebted to Marxian economics.” One very basic difference between Marxian and non-Marxian theories has been the way Marx emphasized the evolution process. Lange who is known to have been a Marxist regards Schumpeter as the only non-Marxist who looked at this problem in a Marxist way.³⁰ See Horowitz (1968) p. 74. We also have a very authoritative and balanced view from Joan Robinson who considers Keynesian and Marxian approaches to economics as unavoidably complementary despite their mutual differences. The argument is that Keynesian view of the economy is correct by itself but restricted in so far as it does not face the wider problem of class conflict in the society. Similarly, Marxism does not address itself to issue that Keynes takes up.³¹

²⁶Klein says “Instead of studying the behavior of individuals, Marx studied the behavior of classes directly. His theory is probably the origin of macroeconomics.” See Klein (1947) reprinted in Horowitz (1968) p. 154.

²⁷Some of the related issues are highlighted in Pandit (2014).

²⁸Op. cit. p. 168.

²⁹Horowitz (1968) pp. 32–33.

³⁰Lange (1935) asserts that “Schumpeter is the only economist outside the Marxist camp who has formulated a theory of economic evolution. However, the close connection of his theory with Marxian ideas is obvious.”

³¹Robinson (1968) see p. 115.

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