

JE KINDLE-NOTITIES VOOR:

The Making of Modern Economics: The Lives and Ideas of the Great Thinkers

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49 Highlights

Highlight (Geel) | Locatie 574

> What constitutes this new economic freedom? Natural liberty includes, according to Smith, the right to buy goods from any source, including foreign products, without the restraints of tariffs or import quotas. It includes the right to be employed in whatever occupation a person wants and wherever desired. Smith

Highlight (Geel) | Locatie 578

> Natural liberty also includes the right to charge whatever wage the market may bear. Smith strongly opposed the state's efforts to regulate and artificially raise wages.

Highlight (Geel) | Locatie 582

> Finally, natural liberty includes the right to save, invest, and accumulate capital without government restraint—important keys to economic growth. Adam Smith endorsed the virtues of thrift, capital investment, and labor-saving machinery as essential ingredients to promote rising living standards (page 326). In his chapter on the accumulation of capital (chapter 3, book II) in The Wealth of Nations, Smith emphasized the need for saving and frugality as keys to economic growth, in addition to stable government policies, a competitive business environment, and sound business management.

Highlight (Geel) | Locatie 680

> What Adam Smith is saying is that you can only help yourself by helping others—the Golden Rule. Businesses that focus on fulfilling the needs and desires of their customers will be the most profitable. Although capitalists are motivated by the desire for personal gain, the way that they maximize their profits is by focusing their everyday attention on meeting the needs of the public. Thus, the successful capitalist inevitably orients his everyday conduct toward the task of helping and serving others. Self-interest leads to empathy.

Highlight (Geel) | Locatie 752

> Iannaccone's test produced a striking result: church attendance rate varied inversely with church concentration in Protestant nations. Church attendance among Protestants was high in freely competitive nations and low in countries monopolized by a single Protestant denomination. (However, it should be noted that there was no significant effect of monopoly on church attendance in Catholic countries.)

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Highlight (Geel) | Locatie 1244

> Thus Keynes was right to honor Montesquieu, but he did not do it for these reasons. Keynes was attracted to Montesquieu's embryonic liquidity-preference theory of interest (Montesquieu 1989: 420–21 [Part 4, Book 22, chapter 19]), his opposition to hoarding and his advocacy of a high level of money expenditure to maintain and promote economic welfare (Devletoglou 1963: 37).

Highlight (Geel) | Locatie 1328

> Say broke with his friend David Ricardo, leader of the British classical school, on another major issue—the labor theory of value. Ricardo, under the influence of Adam Smith, searched for an invariable standard of value and found it in labor. But Say wrote in his translated copy of Ricardo's Principles, "an invariable measure of value is pure chimera" (Rothbard 1995: 19). Instead, Say took a more positive approach by favoring a subjective utility theory of value. Utility, or the way consumers value a good or service, determines its production. Producers create value or utility by transforming inputs into outputs, sold at prices sufficient to cover costs. Unfortunately, the French economist did not discover the marginal theory of utility, but he did come close by recognizing that utility, not cost, determined the ultimate price or value

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Highlight (Geel) | Locatie 1336

> Say invented the term entrepreneur. Literally, it means "undertaker," but given the ambivalence of the word, entrepreneur was translated "adventurer." It suggests the image of a commercial adventurer or a venture capitalist, one who combines the inputs of capital, knowledge, and labor to launch and manage a business for profit. Adam Smith was a teacher and never ran a business. Not having any experience as an entrepreneur, Smith underplayed this vital subject in his Wealth of Nations. But J.-B. Say was an entrepreneur, a cotton manufacturer, and included the concept as an essential part of his economic model.

Highlight (Geel) | Locatie 1389

> Actually, it was John Maynard Keynes, not Say, who defined Say's law as "Supply creates its own demand" in The General Theory (1973: 18). Today most economists agree that Keynes gravely distorted the true meaning and deep implications of Say's law. As Australian economist Steven Kates, who has devoted an entire book to the subject, declared, "Keynes . . . misunderstood and misrepresented Say's Law. . . . This is Keynes's most enduring legacy and it is a legacy which has disfigured economic theory to this day" (Kates 1998: 1). (See box in chapter 13, page 348, "What Does Keynes Say About Say?")

Highlight (Geel) | Locatie 1400

> In chapter 15 of his textbook, Say attacked this scarcity-of-money doctrine by pointing out that it is not money that creates demand but the production of goods and services. Money is only a mechanism of exchange, and the real cause of economic depression isn't a shortage of money, but the lack of sales by farmers, manufacturers, and other producers of goods and services. As Say stated, "Sales cannot be said to be dull because money is scarce, but because other products are so. . . . To use a more hackneyed phrase, people have bought less, because they have made less profit" (Say 1971: 134). In an earlier edition, Say declared, "It is not the abundance of

money but the abundance of other products in general that facilitates sales. . . . Money performs no more than the role of a conduit in this double exchange. When the exchanges have been completed, it will be found that one has paid for products with products" (Kates 1998: 23). Say denied that there is any general "overproduction" or "glut" in an economic downturn, but claimed that production is merely "misdirected." Too much of some products are produced for which there is insufficient demand. Once prices and costs readjust themselves to the new demand structure, the economy will start growing again. Consumers will not start spending again, according to Say, until laborers go back to work and producers begin making a profit. This analysis led Say to make a remarkable discovery: Production is the cause of consumption, or in other words, increased output leads to higher consumer spending. In the words of Say, "a product is no sooner created, than it, from that instant, affords a market for other products to the full extent of its own value" (Say 1971: 134). When a seller produces and sells a product, the seller instantly becomes a buyer who has spendable income. To buy, one must first sell. In short, Say's law is this: Supply of X creates demand for Y. Say illustrated his law with the case of a good harvest by a farmer: "The greater the crop, the larger are the purchases of the growers. A bad harvest, on the contrary, hurts the sale of commodities at large" (1971: 135). Another example: When a profitable business moves into the area, it creates jobs and demand for goods and services. The increased consumption is ultimately derived from the new supply—a new business moving into the area.

Highlight (Geel) | Locatie 1419

Say has a point. According to business-cycle statistics, when a downturn starts, production is the first to decline, ahead of consumption. And, when the economy begins to recover, it's because production starts up, followed by consumption. Economic growth begins with an increase in productivity, an increase in new products and new markets. Hence, production spending is always ahead of consumption spending and is therefore a leading indicator.

Highlight (Geel) | Locatie 1424

Say extended his argument to economic growth. Encouraging production of new and better products rather than simply increasing consumption is the key to economic performance. We can see why this is the case on an individual basis. The key to a higher standard of living is first to increase your income (i.e., your productivity) by getting a raise, changing jobs, going back to school, or starting a money-making business. It would be foolish for you to go out and spend more money on a bigger house or new automobile, by either spending your savings or going into debt, as a way to achieve a higher standard of living, before you increase your income. You may be able to live the Champagne life for a while, but eventually you will have to pay the piper—or the credit card bill.

According to Say, the same principle applies on a national basis. The creation of new and better products opens up new markets and increases consumption. Hence, "the encouragement of mere consumption is no benefit to commerce; for the difficulty lies in supplying the means, not in stimulating the desire of consumption; and we have seen that production alone, furnishes those means." Then Say added, "Thus, it is the aim of good government to stimulate production, of bad government to encourage consumption" (1971: 139).

Highlight (Geel) | Locatie 1442

Kates summarizes the conclusions of Say's law of markets (1998: 29): 1. A country cannot have too much capital. 2. Investment is the basis for economic growth. 3. Consumption not only provides no stimulus to wealth

creation but is actually contrary to it. 4. Demand is constituted by production. 5. Demand deficiency (i.e., over-production) is never the cause of economic disturbance. Economic disturbance arises only if goods are not produced in the correct proportions to each other.

Highlight (Geel) | Locatie 1834

However, in looking more deeply into the sharp rise in world population since 1800, we see that the cause is not Malthusian in nature. The rise in population has been due to two factors unforeseen by Malthus. First, there has been a sharp drop in the infant mortality rate due to the elimination of many life-threatening diseases and illnesses through medical technology. Second, there has been a steady rise in the average life span of individuals, due to higher living standards; medical breakthroughs; improvements in sanitation, health care, and nutrition; and a decline in the accident rate. As a result, more people are living into adulthood, and more adults are living longer. Both factors stand in opposition to Malthusian fears of misery and death. Figure 3.3 demonstrates the dramatic shift in the infant mortality rates

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Highlight (Geel) | Locatie 1841

Another flaw in the doomsday vision of Malthus and his followers is the slowing down of the birthrate in the second half of the twentieth century, both in the industrial world and in developing countries. Over the past fifty years, the birthrate in developed countries has fallen from 2.8 to 1.9, and in developing countries from 6.2 to 3.9. The trend is unmistakable: women are having fewer children and in some more developed countries, the birthrate is far below replacement. In sum, the geometric rate of population growth may be slowing down to an arithmetic rate.

Highlight (Geel) | Locatie 1850

Malthus argued that a higher income level would only encourage having more children. As per capita income rose, he said, the population would grow faster, which in turn would suppress per capita income down to the subsistence level. However, recent historical evidence indicates just the opposite. Wealthier people tend to have fewer children (see Figure 3.4). There are several reasons why wealthier families have fewer children in general. In many cultures, having as many children as possible increases the chance that the parents will be taken care of in old age. Thus, children are viewed as a powerful financial asset that can provide future income. With higher incomes, the need for more children declines, and, in fact, children are now often seen as expensive to raise. Moreover, increased income usually means higher levels of education and better understanding of birth control methods. The impact of higher income on birthrates has sent a clear message to developing nations concerned about population control: a better method of reducing the fertility rate is to encourage economic growth and “universal opulence,” as Adam Smith put it. A higher standard of living may be far superior to government invasion of personal privacy in family matters.

Highlight (Geel) | Locatie 1871

Malthus’s second “law of nature” was “subsistence increases only in an arithmetical ratio” (Malthus 1985: 71). This contention seems rather curious, if not patently false. Both plants and animals are far more fertile than humans. Women take nine months to deliver a child, and seldom give birth to twins or triplets, while many

> animals—especially cows, chickens, pigs, fish, and other animals that people use as food—are vastly more productive. Plants such as wheat, corn, and other crops are even more fertile than animals. As economist Julian Simon states, “Humans and wheat are both biological species, and the growth of each is constrained by various forces. There is no a priori reason why the two species should follow different growth patterns” (Simon 1996: 333).

Highlight (Geel) | Locatie 1938

> Carlyle, the Victorian moralist, was heavily criticized for this fascist tendency. The pamphlet reported several citizens walking out on his speech in protest. Carlyle, always the “antiliberal” reactionary, made other controversial judgments. He opposed the universal right to vote, was anti-Semitic, and regarded the Irish as feckless and lazy. Because of his bigoted views, Carlyle lost many friends, including John Stuart Mill, who called his speech “a true work of the devil” (Stafford 1998: 113). It was during his controversial speech on West Indies blacks that Carlyle attacked economists who substituted “supply and demand” over “command and obedience” in analyzing labor unrest in the West Indies. He shouted, “And the Social Science— not a ‘gay science,’ but a rueful—which finds the secret of this Universe in ‘supply and demand,’ and reduces the duty of human governors to that of letting men alone, is also wonderful. Not a ‘gay science,’ I should say, like some we have heard of; no, a dreary, desolate, and indeed quite abject and distressing one; what we might call, by way of eminence, the dismal science” (Carlyle 1904: 353–54). On another occasion, Carlyle remarked, “Of all the quacks that ever quacked, the political economists are the loudest. Instead of telling us what is meant by one’s country, by what causes men are happy, moral, religious, or the contrary, they tell us how flannel jackets are exchanged for pork hams” (Viner 1963: 8–9). Ever since 1849, the designation has stuck, especially given the proclivity of many social scientists to assail the dynamics of global capitalism.

Highlight (Geel) | Locatie 2144

> Yet David Ricardo had a dark side. His analytical modeling is a two-edged sword. It gave us the quantity theory of money and the law of comparative advantage, but it also gave us the labor theory of value, the iron law of subsistence wages, and something economists call the “Ricardian vice,” defined as either the excessive use of abstract model building or the use of false and misleading assumptions to “prove” the results one desires (such as his labor theory of value). Some of the worst ideas picked up by Karl Marx and the socialists came directly from reading Ricardo’s Principles (1951). In fact, Marx hailed Ricardo as his intellectual mentor. A school of “neo-Ricardian” socialists has developed under the influence of Piero Sraffa, Ricardo’s official biographer.
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> Essentially, Ricardo, for all his love of Smith, took economics down a very different road, apart from his policy recommendations. He created a new economic way of thinking, away from the harmonious “growth” model of Adam Smith and toward an antagonistic “distribution” model, where workers, landlords, and capitalists fought over the economy’s desserts. Marx and the socialists exploited Ricardo’s hostile system to the fullest. Smith’s model focuses on how to make the economy grow, while Ricardo’s model stresses how the economy is divided up among various groups or classes. Ricardo emphasized class conflict rather than Smith’s “natural harmony” of interests.

Highlight (Geel) | Locatie 2160

> Simply put, it is the chronic divorcing of theory and history. It is stripping economics of the past, present, and future. It is pure deductive reasoning and high mathematical formulas without reference to history, sociology,

philosophy, or the institutional framework. It is abstract thinking and model building using unrealistic and even false assumptions. Take a look at Samuelson's Foundations of Economic Analysis (1947) or neoRicardian Piero Sraffa's Production of Commodities by Means of Commodities (1960). Samuelson's book is practically nothing but differential equations and assumptions far removed from reality. Sraffa's work has hardly a single sentence that refers to the real world (see the box on Sraffa, page 110). They are both very much in the tradition of Ricardo. "The origin of the misapprehension upon which the whole of economic theory is based must be traced to David Ricardo," wrote Elton Mayo, a business professor at Harvard (1945: 38). Mayo blamed Ricardo's unrealistic theorizing on his background as a stockbroker, far removed from the realities of the producing economy (1945: 39).

Highlight (Geel) | Locatie 2443

What was the flaw in Ricardo's thinking? His corn model ignored the benefits that workers accrue from technological advances that made workers more productive. Their wages would tend to rise as companies became more profitable. (Empirical studies demonstrate that industries with high profit margins tend to pay workers more.) He failed to see landlord rents as price signals determining the highest value or opportunity cost of land. Yet most economists would not recognize these insights for another generation. Meanwhile, Marx and the socialists picked up on Ricardo's attack on the idle landlords. Ricardo's critique also encouraged Henry George's land nationalization and single tax movement (see chapter 9).

Highlight (Geel) | Locatie 2474

In 1960, Cambridge University Press published Sraffa's oddly titled work, Production of Commodities by Means of Commodities. This slim book established Sraffa as the leader of a "neo-Ricardian" school. Sraffa's thesis, like Ricardo's, is very abstract, with no empirical studies and no marginal analysis. Sraffa used a Ricardian "corn" model, with severely limited assumptions of homogeneous labor, a single commodity, and a single production technique. There are no references to demand, prices, or human action. Everything is mechanical. Blaug concluded elsewhere, "Sraffa's book is after all a perfect example of what some economists have come to believe is wrong with economics: there is hardly a sentence in the book which refers to the real world" (Blaug 1975: 28). Sraffa concluded that national output is virtually independent of wages and prices. In his model, relative product demand has no effect on prices. Monopolistic businesses can pass along their costs in higher prices without hurting profits. Only inputs determine prices. The implications of this "neo-Ricardian" (also known as "PostKeynesian") model are strong: the state can engage in massive and radical wealth and income distribution schemes—through taxation, regulation, and confiscation— without doing undue harm to the productive capability of the nation. Sraffian economics is a strange mixture of Ricardo, Marx, and Keynes, in the end rejecting orthodox neoclassical economics, the theory of consumer demand, and marginal utility. It is an ideal document for wholesale government interventionism and totalitarian central planning. Needless to say, Sraffian economists represent a very small percentage of the economics profession.

Highlight (Geel) | Locatie 2815

However, on the bad side, Mill's economics strictly correlated with the Ricardian theory of distribution: wages and profits varied inversely, prices were determined by labor costs, and long-run wages would fall to subsistence levels. Mill adopted the Ricardian rent theory, which was highly antilandlord. Mill accordingly advocated the

> nationalization of land in India when he worked for the East India Company. Moreover, in terms of property in general, Mill favored complete confiscation of land and property in the case of individuals who died with no heirs. In addition, according to Mill, there was no justification for the speculative holding of unused land, a theme enjoined by Henry George. “When land is not intended to be cultivated, no good reason can in general be given for its being private property at all” (Mill 1884 [1848]: 173).

Highlight (Geel) | Locatie 2828

> According to Hayek, it was this kind of thinking that has led intellectuals to support all kinds of attacks on property and wealth, and grandiose tax and confiscation schemes aimed at redistributing wealth and income, thinking that such radical schemes can be accomplished without hurting economic growth. “I am personally convinced that the reason which led the intellectuals to socialism, was John Stuart Mill” (Boaz 1997: 50). Mill influenced intellectuals from H.G.Wells to the Webbs toward socialist thinking, so much so that Sir William Harcourt, chancellor of the exchequer, could say in 1894, “we are all socialists now” (Stafford 1998: 18). It would be years later before economists, educated in marginal analysis, would counter the redistributionists, arguing that the theory of distribution cannot be separated from the theory of production. According to the marginalist revolution, the producers of goods and services are paid according to the fruits of their labor, based on their discounted marginal product.

Highlight (Geel) | Locatie 2856

> In introducing the theory of distribution, Mill immediately began with a discussion of the virtues of socialism. He had serious reservations about capitalism and felt that private property is not always justly or properly owned. He described three types of socialism: 1. Utopian socialism: cooperative communities, such as those developed by Robert Owen, Saint-Simon, and Fourier (see the box on page 129). 2. Revolutionary socialism: radical groups, including communists, who seek to seize power by force, nationalize industry, and abolish private property (see chapter 6 on Marx). 3. Fascist socialism: bureaucratic regulation and control of industry and the means of production, distribution and exchange, as advocated later by the Fabian Society and the British Labour Party.

Highlight (Geel) | Locatie 3081

> (Padover 1978: 169). Marx’s racial slander never let up. He never retracted his 1843 defamation of the Jews. “On the contrary,” wrote biographer Saul Padover, “he harbored a lifelong hostility toward them. . . . His letters are replete with anti-Semitic remarks, caricatures, and crude epithets: ‘Levy’s Jewish nose,’ ‘usurers,’ ‘Jew-boy,’ ‘nigger-Jew,’ etc. For reasons perhaps explainable by the German concept Selbsthass [self-hate], Marx’s hatred of Jews was a canker which neither time nor experience ever eradicated from his soul” (Padover 1978: 171).

Highlight (Geel) | Locatie 3260

> Marx was apparently taken in by the pseudoscience of phrenology, the practice of examining a person’s skull to determine his or her character, developed during the early 1800s by two German physicians (see the diagram in Figure 6.1). Marx wasn’t the only person who believed in phrenology. Queen Victoria in Great Britain and American poets Walt Whitman and Edgar Allan Poe also believed in it.

Highlight (Geel) | Locatie 3474

> But all this was not to be. Marx's predictions have gone awry, though not all right away. As late as 1937, Wassily Leontief, the Russian émigré who later won the Nobel Prize for his input-output analysis, proclaimed that Marx's record was "impressive" and "correct" (Leontief 1938: 5, 8). But Leontief's praise was premature. Since then, as Leszek Kolakowski, former leading Polish Marxist philosopher, declared, "All of Marx's important prophecies turned out to be false" (Denby 1996: 339). To review: 1. Under capitalism, the rate of profit has failed to decline, even while more and more capital has been accumulated over the centuries. 2. The working class has not fallen into greater and greater misery. Wages have risen substantially above the subsistence level. The industrial nations have seen a dramatic rise in the standard of living of the average worker. The middle class has not disappeared, but has expanded. As Paul Samuelson concludes, "The immiserization of the working class . . . simply never took place. As a prophet Marx was colossally unlucky and his system colossally useless" (1967: 622). 3. There is little evidence of increased concentration of industries in advanced capitalist societies, especially during the growing trend toward globalization. 4. Socialist utopian societies have not flourished, nor has the proletarian revolution inevitably occurred. 5. Despite business cycles and even an occasional great depression, capitalism appears to be flourishing as never before (see "Update: Marxists as Modern-Day Doomsdayers" in the box on page 158).

Highlight (Geel) | Locatie 3531

> Marx also faced a dilemma which became known as the "transformation problem," also known as the profit rate and value problem. A conflict arises under Marx's system because some industries are labor intensive and others are capital intensive. (In Marxist language, they have a higher organic composition of capital.) In volume 1 of Capital, Marx insisted that prices varied directly with labor time, concluding therefore that capitalintensive industries should be less profitable than labor-intensive industries. Yet the evidence seemed to indicate similar profitability across all industries over the long run, since capital and investment could migrate from less to more profitable industries. Marx never could resolve this thorny issue, which Rothbard called "the most glaring single hole in the Marxian model" (1995: 413).

Highlight (Geel) | Locatie 4135

> In short, Menger had reversed the direction of causation between value and cost. A consumer good is not valued because of the labor and other means of production used. Rather, the means of production are valued because of the prospective value of the consumption goods. The values of all producer and capital goods are ultimately consumer driven. Menger wanted the German antitheoretical economists to know that the law of imputation was valid in all circumstances. "This principle of value determination is universally valid, and no exception to it can be found in human economy" (page 147).

Highlight (Geel) | Locatie 4943

> What to do about this perversity? Blaug urges the abandonment of the perfect competition model, general equilibrium, and welfare economics, to be replaced by a neo-Austrian model of market processes as taught by Mises, Hayek, and Kirzner (1997: 79–81). "I have come slowly and extremely reluctantly to the view that they [the Austrians] are right and that we have all been wrong. . . . Adam Smith's 'invisible hand' referred to the

dynamic process of competition and not to the static, end-state conception of perfect competition that came into economics with Cournot" (page 189).

Highlight (Geel) | Locatie 5384

Fetter did not agree with everything the Austrians preached. For example, he disagreed with Böhm-Bawerk, who argued that interest rates were also influenced by the productivity of capital. Fetter's theory of interest laid exclusive emphasis on time preference, and he stated that "present goods are, as a rule, worth more than future goods" (Fetter 1977: 173). Yet Böhm-Bawerk's argument should not be dismissed entirely. It is quite probable that productivity and economic growth do have an indirect effect on interest rates. In developing countries intent on high capital-intensive growth, interest rates are often very high in order to attract much-needed domestic and foreign investment. Then, as nations become more developed and reach a high standard of living, interest rates often decline. Why? Because nations with higher income and living standards tend to have higher rates of saving, and a steady increase in the supply of savings causes interest rates to fall (assuming the demand for capital remains constant). Even Fetter admitted, according to Murray Rothbard, that "as the economy advances and more present goods are produced, the preference for present goods is lowered, and the interest rate therefore may be expected to fall" (Fetter 1977: 16). Thus, economic growth and productivity influence indirectly the degree of time preference and interest rates.

Highlight (Geel) | Locatie 5726

Veblen ignored the benefits of wealth creation—the expansion of capital, the investment in new technology, the funding of higher education, and the philanthropic generosity of the business community. Rather, he lumped them all together in a disdainful "leisure class." Veblen saw absolutely no improvement in the standard of living of the common man during his lifetime (Dorfman 1934: 414). He cited approvingly the view first expressed by John Stuart Mill, who wrote in his Principles of Political Economy textbook, "Hitherto it is questionable if all the mechanical inventions yet made have lightened the day's toil of any human being" (Mill 1891 [1848]: 516). This same quote is found in Karl Marx's Capital (1976 [1860]: 492). We can forgive Mill and Marx for making such uninformed statements in the mid-nineteenth century, but for Veblen it demonstrates astonishing ignorance of consumer statistics. By 1918, when Veblen made this statement, millions of American consumers were beginning to enjoy refrigeration, electricity, the telephone, running water, indoor toilets, and automobiles. No wonder Veblen left this life in a depressed state—his gloomy view of capitalism transpired during the Roaring Twenties, when American consumers were making tremendous advances.

Highlight (Geel) | Locatie 5736

Veblen's main failure was his inability to look beyond the frivolous tastes of the leisure class. More importantly, the existence of a growing wealthy class provides numerous benefits to the entire economy: 1. Wealthy people are the first to finance expensive new consumer products. They are the only ones who can afford to pay for automobiles, televisions, personal computers, cellphones, and other technological breakthroughs when they are first introduced as high-priced prototypes. The profits from the wealthy are used to expand operations and cut prices so that eventually everyone can afford them. As Andrew Carnegie stated, "Capitalism is about turning luxuries into necessities." 2. The wealthy class is the main source for investment capital. The rich provide the capital base for investing in new technologies, improved production processes, and job creation. Without the

> wealthy, there would be little or no surplus wealth for an expanding economy. 3. People in the higher income class use much of their surplus wealth to finance higher education, libraries, churches, galleries, and charitable organizations. 4. Today the wealthy pay most of the federal income taxes. For example, the top 1 percent of U.S. income earners pay 34 percent of federal income taxes.

Highlight (Geel) | Locatie 5765

> the Democratic Party.1 Galbraith was a prolific writer, and many of his works are still in print. One of his most enduring books is The Great Crash, 1929, which blames the stock market crash and subsequent financial crisis primarily on “bad” distribution of income, “bad” corporate structure, and a “bad” banking system. Unfortunately, it doesn’t blame enough of the crisis on the major cause—“bad” monetary policy by the Federal Reserve (Galbraith 1955: 173–93). Galbraith is best known for his trilogy on American

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Highlight (Geel) | Locatie 5780

> Critics have asked a more basic question: Why is the public sector always underfinanced and underperforming relative to the private sector? This question is even more perplexing given that government has grown faster than private enterprise during the past hundred years. The source of public indulgence lies in the fundamental flaw of government programs—their lack of competition and market incentives. The solution, then, is not to transfer more private wealth to the public sector but to apply private-sector principles to the public sector, such as privatizing government programs and imposing user fees on public services.

Highlight (Geel) | Locatie 5784

> Unfortunately, privatization and other market solutions are absent from Galbraith’s agenda, even in his fortieth-anniversary edition.

Highlight (Geel) | Locatie 5792

> THE NEW INDUSTRIAL STATE The final volume of Galbraith’s trilogy, The New Industrial State (1967), has created the most controversy, and many critics argue that it led to his downfall as a credible economist. He made three basic hypotheses: 1. Big business has become bigger and more concentrated. Many important markets are dominated by only a few giant firms. 2. Major corporations are run by skilled engineer-managers, creating a “technostructure” unbeholden to shareholders; they seek to maximize power, not necessarily profits. 3. The technostructure of big business seeks to reduce risk by controlling its markets through planning; prices and output are no longer determined by supply and demand, despite the “conventional wisdom.” Recent empirical work has disputed all three hypotheses of Galbraith. There is no evidence that industry has become more concentrated; in fact, globalization has increased the number of competitors in major industries, such as automobiles. Big business has not been immune to the forces of competition or shareholder dissatisfaction. Since The New Industrial State was published in 1967, shareholder demands for increased performance have led to major restructuring of big corporations, including downsizing and leveraged buyouts. Finally, big firms influence but do not control their customers through advertising (what Galbraith calls the “dependence effect”). As William Breit and Roger L. Ransom note, “If it [the large firm] can control demand, it need not incur the enormous costs of developing new products; it need only convince buyers to continue to purchase existing models” (1971: 184).

Highlight (Geel) | Locatie 5893

> According to Weber, it was not unbridled avarice and the unfettered pursuit of gain that brought about the age of capitalism. Such an impulse has existed in all societies of the past. That "greed" is the driving force behind capitalism is a "naive idea" that "should be taught in the kindergarten of cultural history." Echoing Montesquieu and Adam Smith, Weber exclaimed, "Unlimited greed for gain is not in the least identical with capitalism, and is still less its spirit. Capitalism may even be identical with the restraint, or at least a rational tempering, of this irrational impulse" (Weber 1930: 17). So what did cause the historical development of modern capitalism, especially in the West? Weber's basic thesis is that religion, which had a firm grip on people's minds for centuries, kept capitalism back until the Protestant reformation of the seventeenth century. Until then, the making of money was looked down upon by almost all religions, including Christianity. Medieval Catholicism, under the influence of St. Paul, St. Augustine, and St. Thomas Aquinas, stressed the monastic order and vows of poverty. Their motto was, "Let the ungodly run after gain" (Weber 1930: 83). All that changed, according to Weber, with the Lutheran doctrine of the "calling," the Calvinist and Puritan doctrine of labor to promote the glory of God ("You may labor to be rich to God, though not for the flesh and sin"), and the Methodist admonition against idleness. Only among the Protestants could the devout Christian hear John Wesley's sermon on wealth: "Earn all you can, save all you can, give all you can" (Weber 1930: 175–76). Weber had to overcome the Protestant appearance of a gloomy, fatalistic outlook on mankind. After all, didn't ascetic Calvinism preach predestination, that no one but God knew who the elect were? But Weber discovered that Calvinism, despite its emphasis of faith over works, had in fact encouraged worldly gain as a means of easing earthly pain. What did Protestant theology lead to? The calling to the business world ("God blesseth his Trade") meant constant self-control, honesty, and hard work. Begging and slothfulness were forbidden. "To wish to be poor was, it was often argued, the same as wishing to be unhealthy" (Weber 1930: 163).
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> Protestantism not only promoted industry; it also stressed a critical element in economic growth, the virtue of thrift. Wesley preached, "Earn all you can, save all you can, give all you can." Wesley did not say, "spend all you can." As Weber explained, Christianity proclaimed self-denial and abstinence while warning against materialism and pride. Protestant preachers disapproved of "conspicuous consumption," and so capitalists and workers saved and saved and saved. As John Maynard Keynes commented, "Herein lay, in fact, the main justification of the Capitalist System. If the rich had spent their new wealth on their own enjoyments, the world would long ago have found such a regime intolerable. But like bees they saved and accumulated, not less to the advantage of the whole community because they themselves held narrower ends in prospect" (Keynes 1920: 19). The laboring classes were enjoined to save also. "The duty of 'saving' became nine tenths of virtue and the growth of the cake the object of true religion. . . . Individuals would be exhorted not so much to abstain as to defer, and to cultivate the pleasures of security and anticipation" (page 20).

Highlight (Geel) | Locatie 5941

> Critics also point to Weber's oddly chosen examples—Benjamin Franklin and Jacob Fugger. Granted, Franklin promoted the old-fashioned virtues of frugality and asceticism in Poor Richard's Almanac, but Weber completely ignored Franklin's lust for life and his pleasure-seeking passions throughout his long career as a businessman, statesman, and ambassador. Indeed, Franklin was no great lover of toil and preferred to multiply the comforts of American life. Meanwhile, Weber's attack on Jacob Fugger is ill-founded. Fugger, a practicing Catholic from southern Germany, worked all his life and refused to retire, announcing that "he would make money as long as he could." If anyone represents Weber's ideal type, it is Jacob Fugger (Rothbard 1995: 142).

Highlight (Geel) | Locatie 6247

> Fisher's work was excessively macro from the very beginning. His first books on capital and interest, published in 1906–7, treated capital as a large conglomerate fund that could be easily manipulated and moved around as interest rates rise and fall and the economic structure changes. "Capital is a fund and income a flow," he wrote (Fisher 1906: 52). Thus, according to Fisher, capital was fluid enough that the economy could adjust quickly to any kind of capital dislocation and economic crisis. He took the same view as John Bates Clark (and later Frank Knight): that capital was a homogeneous fund that could be shifted around efficiently to its most productive use without much dislocation. It was like a reservoir where the water would quickly seek the appropriate equilibrium. This view was in sharp contrast to the views of Eugen Böhm-Bawerk and the Austrians, who argued that capital was largely heterogeneous and highly illiquid. The Austrians argued that capital in the form of money and investment funds is homogeneous and highly liquid, but that capital invested in buildings, equipment, and machinery is heterogeneous and illiquid. Austrians recognized a huge distinction between capital investment and capital goods. The nature of capital was a major debate issue at the turn of the twentieth century because economists wanted to know how quickly the economy could adjust and recover from a depression. If capital were homogeneous and highly liquid, then the adjustment process should not take long and the economy could soon be back on its feet. But if capital were heterogeneous and not easily transferable to other uses, then the adjustment process could take much longer and it might take years for a nation to recover from a depression. Fisher took the optimistic view—capital heterogeneity and liquidity were not significant problems and were unlikely to cause a major depression. It would turn out to be his Achilles' heel.

Highlight (Geel) | Locatie 7277

> Keynes's predilection for men may have affected his attitudes toward women. Like Marshall, he disliked the presence of female students in his classes. In 1909, while teaching at Cambridge, he wrote, "I think I shall have to give up teaching females after this year. The nervous irritation caused by two hours' contact with them is intense. I seem to hate every movement of their minds. The minds of the men, even when they are stupid and ugly, never appear to me so repellent" (Moggridge 1992: 183–84). Historians Elizabeth and Harry Johnson even went so far as to suggest that Keynes's misogynistic attitude extended to his theories about saving and investing. The Johnsons noted that Keynes and his followers often referred to savings as female and investment as male. Female saving was usually seen in a negative light and male investment in a positive way. "The maleness of investment is attested to by among other things the frequent references by Joan Robinson and other Cambridge writers to 'the animal spirits' of entrepreneurs; the femaleness of savings is evident in the passive role assigned to savings in the analysis of the determination of employment equilibrium" (Johnson and Johnson 1978: 121). Keynes himself wrote in his Treatise on Money, "Thus, thrift may be the handmaid and nurse of enterprise. But equally she may not" (1930, 2: 132). However, Keynes was sometimes ambiguous about the sexual identity of saving. In the same Treatise, Keynes commented on the lack of economic progress in Europe in the 1920s. "Ten years have elapsed since the end of the war. Savings have been on an unexampled scale. But a proportion of them has been wasted, spilt on the ground" (1930, 2: 185). This is an allusion to the biblical story of Onan, who spilled his seed on the ground (Genesis 38: 8–9).

Highlight (Geel) | Locatie 7320

> Like Fisher, Keynes was a New Era advocate who was bullish on stocks and commodities in the 1920s. In 1926, he met with Swiss banker Felix Somary, anxious to buy stocks. When Somary expressed pessimism about the

future of the stock market, Keynes declared firmly, “We will not have any more crashes in our time” (Somary 1986 [1960]: 146–47). Somary had been trained in Austrian economics at the University of Vienna and knew that the New Era boom was unsustainable. But Keynes, like Irving Fisher, ignored the Austrians and pinned his hopes on the Federal Reserve and price stabilization. In late 1928, Keynes wrote two papers

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Highlight (Geel) | Locatie 7340

Tragically, Keynes misread the times and failed to anticipate the crash. His portfolio was almost wiped out: He lost three-quarters of his net worth, primarily due to commodity losses (Moggridge 1983: 15–17; Skidelsky 1992: 338–43). In his Treatise on Money, published in 1930–31, he admitted that he had been misled by stable price indices in the 1920s, and that a “profit inflation” had developed (1930: 190–98). However, Keynes, a stubborn investor, held onto his stocks and added substantially to his portfolio starting in 1932. Although he was incapable of getting out at the top, he had an uncanny ability to acquire stocks at the bottom of the market (Skousen 1992: 161–69). He bought securities that were clearly out of favor, such as utilities and gold stocks, and was so sure of his strategy that he bought heavily on margin. In 1944, he wrote a fellow money manager, “My central principle of investment is to go contrary to general opinion, on the ground that, if everyone is agreed about its merits, the investment is inevitably too dear and therefore unattractive” (Moggridge 1983: 111).

Highlight (Geel) | Locatie 7350

Keynes was so spectacularly successful in choosing stocks that his net worth reached £411,000 by the time he died in 1946. Given that his portfolio was worth only £16,315 in 1920, that’s a 13 percent compounded annual return, far superior to what most professional money managers achieve and an amazing feat during an era when there was little or no inflation and, in fact, much deflation. And this extraordinary return was achieved despite fantastic setbacks in 1929–32 and 1937–38. Only David Ricardo had a superior record as a financial economist.

Highlight (Geel) | Locatie 7496

Keynes was, in fact, a social millennialist who ultimately envisioned a world evolving to the point of infinite accumulation of capital. His utopian vision is best expressed in his essay, “Economic Possibilities for Our Grandchildren” (1963: 358–73). By progressively expanding credit to promote full employment, Keynes believed that the universal economic problem of scarcity would finally be overcome. Interest rates would fall to zero, and mankind would reenter the Garden of Eden. In Keynes’s mind, the gold standard severely limited credit expansion and preserved the status quo of scarcity. Thus, gold’s inelasticity—which the classical economists considered its primary virtue—stood in the way of Keynes’s paradise and must be abandoned in favor of fiat-money inflation (1963: 360–73). The Bretton Woods agreement was the first step toward removing gold from the world’s monetary system. Undoubtedly Keynes would be pleased to see gold playing such a moribund role in international monetary affairs in the twenty-first century. In short, Keynes’s goal was not to save Adam Smith’s house, as his adherents contended, but to build another house entirely—the house that Keynes built. It was his belief that economists would live and work most of the time in Keynes’s house, while using Smith’s house occasionally, perhaps as a vacation home.

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kindle

Highlight (Geel) | Locatie 8229

> Historically, the evidence is overwhelming: higher saving rates lead to higher growth rates, just the opposite of the standard Keynesian prediction. As one recent Keynesian textbook declared after teaching students about the paradox of thrift: "The fact that governments do not discourage saving suggests that the paradox of thrift generally is not a real-world problem" (Boyes and Melvin 1999: 265). But then why teach the paradox of thrift at all? Not only is it historically unproved, but it is fundamentally flawed. The problem is that Keynesians treat savings as if it disappears from the economy, that it is simply hoarded or left languishing in bank vaults uninvested. In reality, saving is simply another form of spending, not on current consumption, but on future consumption. The Keynesians stress only the negative side of saving, the sacrifice of current consumption, while ignoring the positive side, the investment in productive enterprise. As noted in chapter 7, the Austrian economist Eugen Böhm-Bawerk stressed the positive side of saving: "For an economically advanced nation does not engage in hoarding, but invests its savings. It buys securities, it deposits its money at interest in savings banks or commercial banks, puts it out on loan, etc." (1959: 113).

Highlight (Geel) | Locatie 8241

> Saving is in fact a better form of spending because it offers a potentially infinite payoff in future productivity (thus Franklin's refrain, "A penny saved is a penny earned"). If the public saves more generally, the pool of savings enlarges, interest rates decline, old equipment is replaced, and more research and development, new technology, and new production processes evolve. The future benefits are incalculable. Meanwhile, funds spent on pure consumer goods are used up within a certain period, or depreciated over time. The Keynesian multiplier k is higher as the public consumes more. But proponents assume that the savings remain uninvested, a false assumption under normal conditions. In truth, both components of income—consumption and savings—are spent. Thus, the multiplier k is infinite! The saving component also has a multiplier effect in the economy as it is invested in the intermediate production stages. Moreover, the savings k is theoretically more productive than the consumption k because it is not used up as fast. Going back to Samuelson's hydraulic model (Figure 14.3), saving does not leak out of the system, but goes back into the system to improve the factors of production (land, labor, and capital) through new technology, education, and training. Figure 14.5 demonstrates how saving, consumption, and the economy really operate. The diagram in Figure 14.5 is what Samuelson should have published over the years in his textbook instead of the hydraulic model. Here in this chart, the ultimate purpose of economic activity is to provide increasing utility. Note how in this diagram, consumption is used up. It is consumption—not saving—that "leaks" out and is consumed as utility. Saving, on the other hand, is invested back into the economic process over and over again, facilitating new investment and improving our standard of living (utility/welfare). An amazing contrast.

Highlight (Geel) | Locatie 8306

> This myth of a consumer-driven economy persists in part because of a misunderstanding of national income accounting. The media frequently reports that consumer spending accounts for 70 percent of GDP. Recall from chapter 13 that GDP = C + I + G, and typically in the United States (figures do not add up to 100 percent because net exports are negative): C = 70 percent I = 17 percent G = 18 percent Therefore, the media concludes that, since consumption accounts for approximately 70 percent of GDP, the economy must be consumer-driven.
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> Not so. GDP is defined as the value of all final goods and services produced in a year. It ignores all

intermediate production in the economy at the wholesale, manufacturing, and natural-resource stages. If one measures spending at all levels of production, the results are surprisingly different. I have created a national income statistic called gross domestic expenditures (GDE), which measures gross sales at all stages of production.5 Using this new, broader definition of total spending in the economy, it becomes apparent that consumption represents only about one-third of economic activity, and business spending (investment plus goods-in-process spending) accounts for more than half of the economy. Thus, business investment is far more important than consumer spending in the United States (and in most other nations). The Keynesian macroeconomic model suffers from the defect of oversimplification—it assumes only two stages, consumption and investment, and it assumes that investment is a direct function of current consumption only. If current consumption increases, so will investment, and vice versa.