



Sergio Cesaratto

HETERODOX CHALLENGES IN ECONOMICS

Theoretical Issues and the
Crisis of the Eurozone

 Springer

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This photo, taken in Tilton (Sussex, UK) in 1927, sums up the contents of this book. John Maynard Keynes, the most influential economist of the last century, opponent of laissez-faire and proponent of expansive monetary and fiscal policies in support of full employment, is flanked by two younger Cambridge economists. Like guardian angels, to the right of Keynes stands Dennis Robertson, who later became warden of economic orthodoxy, and to the left, Piero Sraffa (devil rather than angel) representing heterodoxy. Keynes, significantly, is in the middle.

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Contents

1	Economics: A Political and Mathematical Discipline	1
1.1	Economics and Politics	2
1.2	Through the Lens of the Theories	7
	Further Reading	10
	References	12
2	The Surplus Approach	13
2.1	The Classical Surplus Approach	13
2.2	In the Beginning Was the Surplus	14
2.3	From the Neolithic to Schäuble	18
2.4	The Global Minotaur and the European Minotaur	20
2.5	Adam Smith, Judicious Laissez-Faireism	21
2.6	Smith the Equaliser	24
2.7	The Price of the Class Struggle	27
2.8	Ricardo and His Vices	28
2.9	Ricardo the Land Surveyor	30
2.10	Ricardo the Labour Supporter	31
2.11	Ricardo the Criminal	32
2.12	Ricardo the Anti-Keynesian	33
2.13	Marx the Ricardian	36
2.14	Marx the Cost Accountant	39
2.15	Sraffa the Simultaneous	41
2.16	The Orphans of Labour Value	44
2.17	Marx in Crisis	44
2.18	The Proletariat Has No Nation...	47

Appendix	48
Marx the Transformer	48
Further Reading	53
References	56
3 Marginal Economics	59
3.1 The Journey of the Critical Economic Theory	60
3.2 Neo-classical, in Fact Anti-classical	62
3.3 Useless Curves, in Fact Marginal	63
3.4 Lots of Dangerous Curves	66
3.5 To Each His Own	70
3.6 The Best of All Worlds Is Possible	74
3.7 The Marginal Role of Money	76
3.8 Friedman's Tale	80
3.9 Tug-of-War	82
3.10 The Two Challenges to Marginalism	84
3.10.1 The Unfinished Keynesian Revolution	84
3.10.2 The Return to Classical Theory and the Capital Controversy	86
3.11 Where Are We Headed?	90
Further Reading	91
References	92
4 The Incomplete Revolution	95
4.1 Keynes: Two for the Price of One	96
4.2 Keynes the Copernican	97
4.3 Explain It Again, Gardner	99
4.4 The Hen or the Egg	100
4.5 Keynes Multiplied	101
4.6 Six of One, Half a Dozen of the Other	104
4.7 Implications for Economic Policy	107
4.8 Keynes in the Long Run	111
4.9 Keynes in the Trap	112
4.10 Keynes Assimilated	114
Appendix	116
Of Bread and Fishes	116
Further Reading	118
References	120

5 Money and the External Constraint	123
5.1 That Obscure Object of Desire	123
5.2 In the Beginning There Was a Bank	127
5.3 Keynes the Endogenous	132
5.4 Let Us Open Our Minds and Draw a Balance	135
5.5 The External Constraint	137
5.6 Socialists Are Autarkists	138
5.7 Adding Up the Bill	141
5.8 Opera Buffa	146
5.9 Original, That Sin!	148
5.10 Can Countries with Monetary Sovereignty Avoid the External Constraint?	152
Further Reading	156
References	158
6 Dying of Europe?	161
6.1 From Miracle to Decline	161
6.2 Italy, Argentinian Style	164
6.3 The “Historical Compromise”	168
6.4 1977 Blues	169
6.5 The New Regime	170
6.6 The Trap	173
6.7 Short- and Long-term Troubles of an Authoritarian Currency	174
6.8 The Frenkel Cycle at the Tour of Spain	175
6.9 Super Mario	180
6.10 Monetary Mercantilism	183
6.11 Can Europe Change?	187
6.12 Franciscan Italy	190
Further Reading	192
References	195
7 Count Draghila	199
7.1 An Unconventional Central Bank	200
7.2 Corridor Rates	201
7.3 Unconventional Weapons: 2008–2009	206
7.4 Monetary Hypocrisy, Muddles and Tricks: 2010–2011	210
7.5 Acronymia: 2012–2013	213
7.6 The Arcane Target2	215
7.7 The Meaning of Austerity	218

xii Contents

7.8	Dragon of Last Resort	220
7.9	Hysterical Deflation: 2014	221
7.10	Quantitative Fantasies	225
7.11	QE and Target2, or Buba Buys Italian Government Bonds	230
7.12	Chernobyl	235
	Appendix 1	238
	Draghi's Concertina	238
	Appendix 2	253
	The Strange Case of Target2	253
	Further Reading	261
	References	263
	Epilogue	267
	References	271
	Index	273

About the Author

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He is a well-known participant in the Italian and European debate on the fate of the eurozone. The Italian edition of this book has been well received and has had two editions and several reprints. Another book on this subject is currently being translated into German for Springer.

Abbreviations

AES	Alternative economic strategy
APP	Asset Purchase Programme, ECB's securities purchasing programme, also known as QE; it includes Public sector purchase programme (<i>PSPP</i>), Asset-backed securities purchase programme (<i>ASSPP</i>) and Covered bond purchase programme 3 (<i>CBPP3</i>)
BTP	Buono del Tesoro Poliennale (Italian 10-year Treasury Bond)
Buba	Nickname given to <i>Bundesbank</i> , the Central Bank of Germany.
CAC	Class action clause
CBPP	Covered bond purchase programme (ECB's bank bond purchase programme)
CGIL	Confederazione generale italiana lavoratori (the Italian left wing union)
DB	Deutsche Bank
DM	Deutsche Mark
ECB	European Central Bank
EDIS	European deposit insurance scheme
EMS	European Monetary System (European system of fixed but adjustable exchange rates 1979–1998)
EMU	European Economic and Monetary Union
EONIA	Euro OverNight Index Average (interbank interest rate)
ESM	European Stability Mechanism (financial fund by the euro area Member States to rescue euro area countries in severe financial distress)
EU	European Union
Fed	Abbreviation of Federal Reserve, central bank of the USA
FMI	International Monetary Fund
GDP	Gross domestic product
IOU	Abbreviation of <i>I owe you</i> ; document acknowledging debt
LTRO	Longer-term refinancing operations (long-term operations by the ECB to provide reserves to the banking system); they include Very longer-term

xvi **Abbreviations**

	refinancing operations (<i>VLTRO</i>) and Targeted longer-term refinancing operations (<i>TLTRO</i>)
MMT	Modern Money Theory (ultra-Keynesian theory)
MRO	Main refinancing operations (short-term operations by the ECB to provide reserves to the banking system)
OMT	Outright market transactions (a programme of the ECB consisting of the direct purchase by the <i>ECB</i> of short-term sovereign bonds issued by EMU countries with macroeconomic difficulties, under certain conditions)
QE	Quantitative easing (popular definition of the APP)
SMP	Securities Markets Programme (ECB sovereign bond purchase programme 2010–2012)
Target2	Trans-European Automated Real-Time Gross Settlement Express Transfer System, electronic platform for the euro area interbank payment system
ZLB	Zero lower bound



1

Economics: A Political and Mathematical Discipline

If not completely right, almost nothing wrong.

Fabrizio De André

Abstract This introductory chapter discusses the nature of the economic discipline. Economics has to do with the production and reproduction of the material living conditions of society, and is therefore at the crossroads between natural, quantitative and political sciences. The central theme of economics is income distribution, how output is distributed among the components of society. This theme has obvious political implications, and it is not surprising that in the history of economic thought several theories have arisen in this regard. These theories influence our social–political beliefs. The issue of income distribution has implications for other central themes, such as economic development. We introduce two approaches: the surplus approach characteristic of the classical economists of the eighteenth and nineteenth centuries and of Marx; and the neoclassical or marginalist approach that arose as a reaction to the former at the end of the nineteenth century, which is mainstream today. There is also a third theory, that of John Maynard Keynes, which brought a considerable upheaval in the dominant theory and is, in many ways, closer to the surplus approach.

Finally, the chapter presents our work plan, from the analysis of distribution theories, through monetary analysis, to the debate on the eurozone crisis.

1.1 Economics and Politics

The aim of these chapters, or lessons as they were called in the Italian edition, was to answer the simple question: “What should an informed and committed citizen know about economics?” The lessons were also directed at students of economics and other disciplines who are bored with conventional teaching or are simply curious. They were also aimed at many opinion leaders and politicians who express views on everything, but who privately confide that they have never understood economics. Above all, they were for the thousands of people who in these difficult years, particularly in Italy, have done their best to grasp and then clear away the mountain of lies that has buried us, primarily the idea that fiscal austerity was necessary in the name of Europe. My aim was to reinforce this effort by providing a sound analytical background for rejecting mainstream economic recipes. In this context, I wanted to convince my friends that support Modern Money Theory (MMT) that heterodox economics is much broader than they believe (I will return to the MMT in the fifth chapter).

The purpose of this English edition is to share these considerations with a larger international public interested in a fresh combination of theoretical and political arguments in view of the euro area crisis.

Economics actually does not have enormous entry requirements. The mathematical latinorum with which it is often adorned is designed to intimidate people, making them feel inept and keeping them away from the truth (and lies) that are basically simple to understand. Knowledge and counter-information are annoying to those in power. They prefer people to think that their pronouncements issue from mysteries reserved for the initiated, administered by modern wizards or high priests called economists. We shall see, for example, that all mainstream economic analysis is based on a handful of accessible concepts, the foundations of which were laid in the late nineteenth century and have been handed down unchanged. Two distinguished heterodox economists, Aldo Barba and Giancarlo De Vivo, likened mainstream economics to the goldfish that lives happily in its glass bowl since its memory is so short that it discovers a new world each time it goes round.¹ I do not know whether this is true, but it certainly applies to the serious economist who prescribes us solutions that are one and a half centuries old, while presenting them as cutting-edge science. But don't be surprised if the alternative I offer has even older intellectual roots in the ideas of “classical economists” at the turn of the eighteenth and nineteenth centuries. In the day of these

¹ Barba and De Vivo (2010).

economists, economic conversation consisted of reasoning and disputes between learned people interested in politics and culture. Marx admired them greatly, and for obvious reasons considered it also fundamental that truths and lies in economic theory be disclosed to the working class (to ordinary people, if you prefer less militant language). It is of course true that economic analysis of any orientation has complex aspects that may require sophisticated mathematics. But it is also true that any reasonably informed person, used to reading good books, can master the core of economic analysis irrespective of his or her level of education, and indeed should be invited to do so as an informed citizen. After all, what is politics about? In the words of an amusing morning programme on Italian Radio 24, it is about “heart and money”, that is to say, civil rights and economic policy. Now Europe only lets us discuss the former, which is a good reason to delve into the latter.

Economics *and* politics then!

But Prof, if economics is a key to politics (and vice versa), can it be considered a science?

Good question! Alfred Marshall (1842–1924), one of the founders of mainstream theory, introduced that strange creature, the *representative firm*.² I fear that you, as a *representative reader*, will ask many questions during my exposition. Let us distinguish two aspects of your question.

Firstly, many economic phenomena have a quantitative manifestation. Thus we speak of prices, quantities produced, incomes, investment, saving and so forth. This numerical manifestation not only invites statistical quantification, but also representation of its interactions by variably complex logical/mathematical models. This gives economics a certain analytical rigour, a pattern of consequential reasoning. In conversation I often hear the comment: “I can tell you are an economist”. I like both aspects of economics: rigour in reasoning combined with strong political implications—a founder of the discipline, William Petty, called it Political Arithmetic—but certainly, mathematics is not everything. The true pleasure of economics is above all in its strict verbal reasoning. A famous suggestion from Marshall is to use maths as abbreviated notation and for checking ideas, not as an end in itself. The results must be translated into words and checked against the facts.³ In fact, Marshall skilfully pursued the social penetration of mainstream theory by presenting it comprehensibly and linked to the real world. Leaving aside his promotional motives, we can agree with the method Marshall suggests.

²In 1930 Marshall’s representative firm was the subject of a famous symposium in the “Economic Journal”, then directed by Keynes (Robertson et al. 1930).

³Alfred Marshall had a degree in mathematics. His indications on the use, or rather against abuse, of mathematics in economics are in Pigou (1966).

Secondly, the quantitative relations studied in economics are not just interactions between numbers, but are the ultimate manifestations of the relations between individuals, social groups, institutions, and the evolution of these relations. Prices represent relations between producers and consumers; wages express a relation between entrepreneurs and workers; the balance of payments expresses a relation between countries and so forth. The organization of economic life cannot be separated from the political institutions that give it legitimacy. Think of economies founded on slavery or serfdom that derived their legitimacy from a given political order; but also a market economy draws its legitimacy from the legal institutions that protect material and intellectual property rights.

Whether our analysis starts from the individual, or from society as an arena of interactions between social groups depends on the theories in use. The ABC of the philosophy of science warns that we interpret the world through the lens of a theory, even when we are unaware of doing so. The theories of classical economists and of Marx led them to talk about social classes, that is of groups of individuals defined on the basis of property relations with the instruments of production: the class of landowners; capitalists, owners of means of production; workers, owners of nothing but their own labour. In general, “modern” economics prefers to move from the individual. Famously Margaret Thatcher, inspired by Friedrich Hayek, maintained that “there is no such thing as society”, that is to say, society is the result of individual choices, from which analysis should therefore begin. Nonetheless, even for mainstream economists, it is impossible to avoid referring to social classes, grouping people on the basis of the different nature of their income, e.g. wage earners and capitalists receiving profits. (Of course, mainstream economists prefer to refer to less politically sensitive social groupings such as consumers or savers.)

Once income distribution between the social classes is introduced, economics becomes politics, and in politics (to return to our previous simplification) two things are discussed: how to divide the pie produced (and perhaps how to increase it), and civil rights. The current mainstream theory actually tries to expunge politics from economics by speaking of a *natural* distribution of income, meaning that there are economic laws that indicate exactly what slice of the pie must go to workers and what slice to capitalists (and related classes). There is a “natural” division of the pie: that is, to each his own; end of story. In this way, politics is relegated to the debate on civil rights.

Summing up, social relations and political choices (often) manifest in economics through quantitative relations of a logical/mathematical nature. While this makes the economic discourse more precise, we should not let it cause us

to forget the deep bond between economics, history and politics, of which these relations are manifestations.

Does the involvement of politics in economics make the latter less scientific? Not according to David Ricardo (1772–1823), the most refined of the classical economists, nor according to his “pupil” Marx (1818–1883). On the contrary, for Ricardo the laws governing income distribution are what economic investigation is about. Ricardo is a good example of what we want to say: he shows that there is an inverse relation between wages and profit (if one grows, the other declines) that can be expressed mathematically. Behind the mathematics, this inverse function represents a social relation between labour and capital. At what point on the curve a society will historically lie—that is, what the actual distribution of income will be—will depend on the balance of power between the two social groups, workers and capitalists. That’s politics, baby! In fact, in mainstream theory it is the opposite, politics must adapt to laissez-faire, it is economics that dictates to politics. That’s the market, baby!

Certainly, Prof, it is complicated to talk about scientific research in economics with all the interests at play! Yes, Marx had no doubts on the subject and it is worth citing a famous passage in the Preface the first German edition to *Das Kapital*:

In the domain of Political Economy, free scientific inquiry meets not merely the same enemies as in all other domains. The peculiar nature of the materials it deals with, summons as foes into the field of battle the most violent, mean and malignant passions of the human breast, the Furies of private interest.⁴

In other words, specific material interests condition “free inquiry”. And how could it be otherwise if the object of study is no less than the conflict between material interests?

Marx has very clear ideas about when political economy ceased to be science. This happened after the death of Ricardo in 1823. Ricardo had given logical/mathematical expression to the conflict between the capitalist bourgeoisie and the rural landlords in England. The latter lobbied for duties on cheaper imported corn, so as to make their own crops, from which they extracted land rent, more competitive (corn is the expression used at the time to refer to cereal grain, such as wheat and barley). However, duties on cheap imported corn would have increased corn prices in England, especially for workers whose subsistence depended above all on corn (used, for example, to

⁴Marx (1974 [1887], p. 21).

produce bread and beer). This would force manufacturing capitalists to pay higher wages, reducing their profits.

Ricardo, who was also a member of parliament, sided with the capitalists and not the rural landholders, because he held that the accumulation of capital, namely the investments that would advance the economy, depended on profits. He was therefore in favour of corn imports. The rentiers would suffer but profits and accumulation would benefit.

However, Marx recounts that once it had achieved political power, the bourgeoisie rejected Ricardo's economic theory, and for good reason. Indeed some early socialists had begun to realise that if there was no natural distribution of income between rents (landed aristocracy) and profits (capitalists), this principle also applied to distribution between wages (workers) and profits (capitalists). In the first case, it was a question of power balance between industrialists and landed aristocracy in Parliament, and between industrialists and workers in the labour market in the second case. The term "exploitation" began to appear well before Marx, such that a few years after Ricardo's death an American economist, Henry Carey (1793–1879), defined Ricardo's theory as the theory of class "discord".⁵ For the same reasons, George Poulett Scrope (1797–1876), an English economist, defined the spread of Ricardian theory as a "crime".⁶ Thus Marx concludes in the Afterword to the Second German edition to *Das Kapital*:

In France and in England the bourgeoisie had conquered political power. Thenceforth, the class struggle, practically as well as theoretically, took on more and more outspoken and threatening forms. It sounded the knell of scientific bourgeois economy. It was thenceforth no longer a question, whether this theorem or that was true, but whether it was useful to capital or harmful, expedient or inexpedient, politically dangerous or not. In place of disinterested inquirers, there were hired prize fighters; in place of genuine scientific research, the bad conscience and the evil intent of apologetic.⁷

But is this enough to criticise mainstream economics? Evidently not. Indeed the same accusation of bending scientific inquiry to ideological prejudices or to class interests can easily be turned back on the critics of mainstream economics. We must, therefore, work hard to demonstrate that mainstream

⁵ Henry Carey writes that: "Mr. Ricardo's system is one of discords ... its whole tends to the production of hostility among classes and nations" in Carey (1963 [1848], pp. 74–75).

⁶ See Blaug (1958, pp. 149–150).

⁷ Marx (1974 [1887], pp. 24–25).

theory has serious analytical inconsistencies, namely it is analytically wrong and not just ideologically biased.

The “mainstream theory” facing Marx was actually a hotchpotch of post-Ricardian theories that he defined as “vulgar”. In fact, it was not until towards the end of the nineteenth century that bourgeois economists sorted out a new and more coherent theory. To give it some noble blood, it was later defined neo-classical, though it had little to do with the classics, and for reasons we shall see, it would be better to give it its early label of *marginalist theory*. But Marx did not become aware of this theory, the full-blown form of vulgar economics.

Marginalism encountered two great challenges in the course of the twentieth century. The first was the “Keynesian revolution” initiated by the *General theory of employment, interest and money* that John Maynard Keynes (1883–1946) published in 1936. The second was brought by the great Italian economist Piero Sraffa (1898–1983), who in the 1960s shook the analytical foundations of the marginalist edifice. We rely mainly on the work of these two economists to see what is analytically wrong with mainstream theory.

1.2 Through the Lens of the Theories

For the next three chapters I have decided to follow a historical line. I will show how mainstream theory emerges at the end of the nineteenth century as a reaction to the theory of Ricardo and Marx. Note that Marx could be seen as a close follower of Ricardo, as well as a critic. Since the nucleus of his economic theory was the same as that of Ricardo, who was considered the most rigorous bourgeois economist until then, Marx could honestly say that he did not invent anything on the basis of anti-bourgeois prejudice: it was already all in Ricardo! This made Marx’s theory very dangerous. Naturally, Marx gives a historical context to the theory of Ricardo, as he did not consider the laws under which bourgeois society worked to be eternal and immutable. However, the economic theory of Marx is basically that of Ricardo. After explaining the approach of classical economists and Marx in Chap. 2, in the third we look at mainstream theory, showing its implications for contemporary debate, for example, on the flexibility of the labour market and on the economic constitution of Europe. In Chap. 4, we see how the combination of classical theory and the critique of Keynes are a formidable instrument for analysing economic crises. In Chap. 5, we discuss the role of money, seeking to show that there is nothing mysterious or mystical about it. In this chapter, we also illustrate what for non-conformist economists is the central node of economic policy, the balance of payments constraint (here my MMT friends will

disagree with me). Fortified by these notions, in the last two chapters we return to the question of Europe and the crisis in the eurozone.

If at the end of these chapters I hear you say: “I already felt I knew all this, but now it is clearer”, I will have fulfilled my goal. In these years, under the impulse of the European crisis, there has been a massive amount written about economics, favoured also by the social media. The aim of these chapters is to strengthen the analytical background of the work done in these years with a group of tenacious heterodox economists, starting with the topic of Europe. We shall never lose contact with reality, hopefully confirming that knowledge is first and foremost a pleasure that confirms our convictions, preparing us for the political struggle for change.

Let me end this introduction by commenting on two possible sources of misunderstanding about economics.

When like many young people I began my economic studies in the 1970s, we were very interested in the theoretical debates that raged at the time. We were well aware that the world is interpreted through the lens of theory. We implicitly agreed with Keynes in this regard (although we studied Marx more). According to Keynes, politicians (and for that matter everyone) argue, without realising it, on the basis of theories formulated by some economist who died decades earlier. In the post-ideological epoch we believe we belong to, young people regard theoretical debates with less tolerance and consider certain social categories, such as capital and labour, to be things of the past. My impression is that this leads them to consider economics a purely empirical science, and indeed they are often good at econometrics (the discipline that seeks to estimate theoretical models empirically), viewing theory as a toolkit, a menu with a little of everything that can be ordered *à la carte*. This idea of economic theory as a toolkit is also found in Keynes, confirming his mental versatility, which was sometimes, however, muddled. The empirical testing of theories is obviously important, and historical analysis and mere observation of data are often much more important than the mechanical methods of econometrics, but preliminary theoretical analysis is just as important. In fact, those economic debates conducted solely in the empirical-econometric dimension are often the most inconclusive (the results depend on what data and variables are considered, and on the estimation methods applied to enormous masses of data, ignoring historical and political contexts, etc.). In any case, no empirical test can be taken as valid if conducted on the basis of a wrong theory. “He who speaks ill, thinks ill”, the Italian film director Nanni Moretti once said. Being able to point out the inconsistencies of theories makes it easier to settle practical questions. If I succeed in convincing a few young people to be more sensitive to theoretical analysis, this book will have achieved its aim.

One example is the growing inequality, an issue that certainly fascinates the most politically sensitive young people. Superficially it does not seem to require any complex theoretical analysis, but only statistical measurements. But in actual fact the theme cannot be tackled without understanding the transformations of capitalism, without having a theory. After all, the French scholar Thomas Piketty, who has made the subject even more popular, adopts rather neoclassical patterns of thought, which can only make the interpretation of its important empirical findings spurious.

Another misapprehension regarding economics, perhaps the most popular above all among the grandchildren of the anti-globalisation movements, comes from confusing Fairtrade, microcredit, zero-miles products, local currencies, *empresas recuperadas* and so forth with “alternative economics”. Attempts to create a non-capitalist economy are meritorious, albeit often rather ingenuous. Economics, as we shall endeavour to understand it together, belongs to a more macro level concerned with the dynamics of output and income distribution, rather than the micro level of single experiences. If you think this is too abstract, this book is not for you. But remember that you run the risk of adopting the ideas of someone you have delegated to think for you. Small exemplary experiences are destined to remain just that, for the very reason that they lack a broader and more informed (and therefore realistic) political and economic perspective. A finger pointing at the moon is not the moon.

Polanyi moment. Ricardo gives a very clear definition of economic science: “In different stages of society, the proportions of the whole produce of the earth which will be allotted to each of these classes, under the names of rent, profit and wages, will be essentially different... To determine the laws which regulate this distribution, is the principal problem in Political Economy”.⁸

Also for the marginalists the question of the distribution of income is central, but it is better to mask it a little, so Lionel Robbins (1898–1984) in the Thirties took charge of giving the “official” definition of economics according to the dominant theory: “Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses”.⁹ In other words: humanity suffers from a scarcity of resources—more specifically of the “production factors” labour, capital and natural resources—which have a limited endowment in each period of time, so their use must be chosen rationally, for example, between the satisfaction of current needs (consumption) or greater future well-being (investment). These choices include the distribution of the product obtained from those resources to their owners, i.e. to labour (wages),

⁸Ricardo (1951 [1817], p. 5).

⁹Robbins (1932, p. 15).

capital (interest/profits) and natural resources (rent). All these rational choices will depend on objective factors such as the initial endowments of the “production factors”, the prevailing tastes of consumers, and technology. There is no room for social conflict. As we shall see, objective laws will dictate “to each his own”. Economics is reduced to an “engineering” exercise on how to allocate scarce resources between alternative purposes.

Karl Polanyi (1886–1964), a well-known economic anthropologist, is famous for criticizing the anthropological foundation of liberalism according to which the inborn drive of economic activity is, following Smith, the “propensity to barter, trade and exchange one thing for another”.¹⁰ On the contrary, says Polanyi: “In spite of the chorus of academic incantations so persistent in the nineteenth century, gain and profit made on exchange never before played an important part in human economy. Although the institution of the market was fairly common since the later Stone Age, its role was no more than incidental to economic life”.¹¹ Polanyi looked at welfare state institutions as a defensive reaction of the working classes to the unleashed *laissez-faire*. In this sense he spoke of society’s “double movement”: to an extension of *laissez-faire*, society reacts by trying to rebuild institutions of solidarity. The success in the last decade of “populist” movements, have been interpreted as a reaction in the direction foreseen by Polanyi, a social *¡Ya basta!* Polanyi had also foreseen that the reaction to unleashing of the free market could also take equivocal right-wing expressions.

The considerations on the eurozone crisis in the last 10 years were still current events at the time the book was written, but are history in light of the COVID-19 pandemic. However, what Europe does or does not do in the face of this unprecedented crisis can be better understood in the light of that first dramatic experience that revealed all the political fragility of the old continent. We do not yet know whether a new and better chapter will open for Europe, or a worse one in continuity with the past.

Further Reading

I have borrowed from the textbooks of Augusto Graziani (1933–2014), a great Italian heterodox economist, the idea of concluding the chapters with small guides to the literature. The reading recommendations complement the main text and roughly follow the order in which the subjects are presented. Old Italian textbooks, like Graziani’s, compared the different theories progressively formulated in the history of thought. This comparison

¹⁰ Smith (1904 [1776], p. 15).

¹¹ Polanyi (2001 [1944], p. 45).

was useful to have clearer ideas and to acquire a better appreciation of the world. My university department prescribes the Core Team (2017) as an introductory economics text with the idea of stimulating the interest of young students of economics. Edited by S. Bowles, W. Carlin and M. Stevens, the first edition was funded by the Institute for New Economic Thinking (INET). The strategy of the Core Team is to “be realistic”, to refer to “hard facts”, especially inequality. Arguably, what is missing from the most popular mainstream textbooks is not empirical evidence. What is missing is a serious discussion of the different theories, such as to allow us to interpret the economic “facts” and thus place our understanding of capitalism and inequality on solid foundations. Fortunately, INET also supports more courageous lines of research.

The difference between the *vulgar* economists of the late classical period and marginalists is that the former had no theory underlying their argument that everything is determined by supply and demand. That is why Marx called them vulgar. Since marginalism constructed a theory to justify these statements, it is not strictly vulgar in the Marxian sense. Marshall even tried to establish continuity between the new marginalist approach and classical economics. For a critique of this attempt, see Bharadwaj (1986). Highly esteemed by Piero Sraffa, Krishna Bharadwaj (1935–1992) was an extraordinary Indian economist who applied her passion for classical political economy to the study of the concrete problems of her country. This small volume is of enormous value because it is based on conversations with Sraffa.

A critical analysis of Piketty’s influential book (Piketty 2014) can be found in Stirati (2016), where other unorthodox reviews including those of Gary Mongiovi and Tony Aspromourgos are cited.

As the foundation of economic relations, Polanyi replaced Smith’s innate “propensity to barter, trade and exchange” with other innate values such as altruism, reciprocity and gifts. However, in the volume cited above, Krishna Bharadwaj argues that like the marginalists, Polanyi slips from the primacy of production proper of the classical economists to that of “circulation”, the term Marx uses to indicate the sphere of exchange of goods. One must look to the sphere of production, where control of the means of production is defined, in order to understand the social relations of a society (see Cesaratto and Di Bucchianico 2020).

Finally, good histories of economic thought are Screpanti and Zamagni (1993) and Roncaglia (2005), while a summary of the theories presented in this book is in Cesaratto (2019).

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2

The Surplus Approach

Abstract This chapter introduces the surplus approach. The surplus is that part of the social product that is available to the community, or its élite, once it has set aside what is needed to reproduce the same output, that is, for replacement of the means of production and for the subsistence of the working class. The chapter examines some applications of the concept in relation to the birth of ancient civilizations and German mercantilism. Next, it explains the evolution of the ideas of the classical economists and Marx. These economists shared the idea that income distribution depends on power relations between the social classes. A solution to some of the difficulties they encountered was suggested by Piero Sraffa, an economist who was close to Gramsci, Keynes and Wittgenstein. In addition to rediscovering the classical approach, Sraffa also challenged mainstream theory on the basis of analytical problems in its fundamentals. In the 1960s, this criticism led to the so called “two Cambridges controversy”, which involved the brightest economists of the time. The most prominent, Paul Samuelson, admitted that the criticism was correct. Today the controversy is rarely mentioned in university courses, evidently because it has uncomfortable implications for mainstream theory.

2.1 The Classical Surplus Approach

Theories of surplus-value is the title Marx gave to what was to be the fourth volume of *Capital*, his history of economic thought. He defined the prevalent theories up to Ricardo as surplus theories. The concept of surplus will be

central in all chapters, so it is a good idea to master it now. The simplest definition is:

Social surplus is that part of the product that society can freely use once the amount needed to reproduce the same output in the next period has been set aside.

To master the concept, let us ask the following question.

Many of our ancestors were farmers. What did our peasant ancestor, or if you are one of the lucky few, your princely landlord ancestor, do with the corn he produced?¹ Let us consider the latter case, so we have two classes, peasants and landlords (and don't call me a communist, although I won't be offended if you do). Once the corn produced has been harvested, the landlord set aside an amount to sow next season and a part to feed the peasant families until the next crop. He could then do what he liked with what was left, the surplus: make bread and pastries for the family and maintain the servants; exchange it for other goods, such as elegant clothes and books; or he could cultivate more land or make technical innovations to his fiefdom, in other words invest it, that is use the surplus as new capital. The surplus is, therefore, the difference between the final product and the replacement of what was consumed to produce it, namely what is necessary to repeat production at least on the same scale (corn to sow and to feed the peasants):

$$\text{Social product} - \text{Replacements} = \text{Social surplus} \quad (2.1)$$

Does this seem banal? Let us see some fascinating applications of this simple idea.

2.2 In the Beginning Was the Surplus

It is not always easy to be a “heterodox” economist. One is often assailed by doubts about how one can be right when most of the profession has another opinion, at least on basic topics. Reading a book that many of you already know has nevertheless strengthened my convictions. It is the famous work by Jared Diamond *Arms, steel and germs*.² Dear me, I shouldn't have mentioned it, if you start reading it you will certainly lay my book down. Diamond, a

¹The word “corn” in nineteenth Britain indicated all cereals grains like wheat or barley; corn has also become a favourite “representative product” for economists since it is both a wage-good and an investment-good, when used to sow.

²Diamond (1997).

multidisciplinary biologist, ambitiously sets out to explain why different areas of the world developed differently, to the extent that some civilisations prevailed over others. Diamond does not cite any economists. So, his multidisciplinaryity stops on the threshold of the Department of Economics of UC Berkeley, the university where he teaches. We will explain this. So that you are not distracted by reading Diamond directly, here is a brief summary.

Until about 11,000 years ago, the human population consisted of hunter-gatherers. Agriculture and domestication of animals, and with them more stable and complex sedentary social structures had not yet developed. Indeed, only with agriculture did humans begin to produce a storable food surplus that enabled them to reduce mortality, increase in numbers and support a larger population, part of which consisting of a class of “unproductive” workers dedicated to political–military organisation and to the discovery and preservation of knowledge: food surplus makes it possible to support unproductive groups of bureaucrats, scholars and soldiers, but also artisans. The emergence of the surplus is therefore also associated with the appearance of social stratification.

The production of a food surplus did not however occur in all the regions inhabited by *Homo sapiens*. Leaving aside the fact that homo sapiens arrived at different parts of the earth at different times, giving a head-start advantage to some, according to Diamond only some regions had a sufficient variety of plants and animal species suitable for domestication to make it worthwhile for hunter-gatherers to become farmers. With regard to agriculture, consider that only a tiny minority of the thousands of plant species are edible, nourishing and suitable for cultivation, or otherwise allowing a range of crops that could be readily cultivated with a high yield. These species did not occur in all regions of the world. Only in a few areas was there an array or *package* of varieties with nutritional properties (for example, the right combination of carbohydrates and proteins), cultivability and yield such as to make farming more advantageous than hunting and gathering. The discovery that plants could be grown from seeds was not enough to convert humans to farming; it was the geographical availability of suitable varieties that determined which populations developed agriculture and which did not. Similar considerations hold for animals, of which only very few species can be raised in captivity, and among these even fewer large ones can be domesticated for transport, work and war, as well as for producing milk, hides, etc. A substantial package of such animal species only occurred in certain parts of the world due to appropriate climatic conditions, giving those fortunate populations another enormous advantage. Food surplus generated population growth and a surplus of manpower that could be diverted from material reproduction and allocated to

higher activities such as politics (yes!), war and the accumulation of knowledge, among the latter the invention of writing and numbers (probably emerging from the need to keep records of the amount of agricultural surplus in storage). Sedentary life rendered advantageous the development of constructions and complex artefacts that could not be transported and were therefore of no use to nomadic peoples.

The generation of a food surplus occurred in the Fertile Crescent (Mesopotamia), China, Central America, the Andes and what is now the eastern United States. Mesopotamia developed the “wheat-barley-peas-lentils” package, China “rice-millet-soy”, and central America the less nutritious “maize-beans”. The number and quality of animal species suitable for domestication made the difference: in the Americas, there were only turkeys and lamas (the latter in the Andes). In those lands, there were no beasts of burden and so the wheel was not invented or at least not used, and their absence also held back agriculture and the development of ploughing, transport and so forth. There was also a lack of close contact with domestic animals. In other places, this proximity transmitted major epidemic diseases such as smallpox, measles, influenza and the plague to man, leading to resistance and immunity in survivors. The spread of these viruses in lands conquered by Europeans amounted to a biological weapon that almost exterminated native populations.

The geographical disposition of Eurasia also enabled a faster spread of natural species and human knowledge between regions with a relatively similar climate at similar latitudes. In contrast, the longitudinal disposition of the Americas, interspersed with deserts, impeded this spread. And of course, other lands were isolated by oceans.

The thesis of Diamond is therefore that agriculture was the fundamental step by which certain populations achieved demographic growth and the possibility of supporting an unproductive élite (in the sense that they were not involved in subsistence production). Besides politicians and soldiers, this unproductive part of population included what Adam Smith would have called the class of “philosophers”, producers of knowledge. The larger populations in turn increased the scale on which activities were conducted and the probability of innovative ideas. The limited number of useful domesticable plant and animal species only made this possible in certain parts of the world.

In conclusion, notice the language used by Diamond—surplus, subsistence, productive and unproductive labour—the same we find used by classical economists. As I said, Diamond does not cite any economist, classical or marginalist. This demonstrates how little use “modern” economics was to him. At the same time, however, we can presume that Diamond was hardly