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Book Review

Classical Economic Theory and the Modern Economy

Steven Kates
Edward Elgar, 2020. 264 pp.

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Steven Kates, historian of economic thought, is a persistent and vocal critic of Keynesian demand side economics. His recent book, *Classical Economic Theory and the Modern Economy* (Edward Elgar, 2020), connects the dots in his critique by explaining, elaborating on, and advocating for classical economic theory. Specifically, the aim is to explain economics as it was understood by John Stuart Mill in his *Principles of Political Economy* (1848), which to Kates is when "[e]conomic theory reached its highest level of analytical power and depth" (back matter). He does this by contrasting classical economics with Keynesian such.

It may seem strange that Kates chooses to use Keynesian dogma as backdrop for his defense for pre-marginalist economics. But the

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author notes that modern mainstream economics, especially macroeconomics, has drifted so far from the classical understanding of the economy that economists of today are incapable of comprehending the earlier analysis. Thus, the reader cannot simply be provided the classical analysis as is, but must be made aware of their fundamentally different perspective. Kates does this by both introducing the contrast, including references to the errors of the "false mythology," and elaborating on how and why economics came to adopt it. The book is therefore three books in one: an introduction to and explanation of classical economic thought; a debunking of Keynesian demand-side economics; and a discussion on the history of this fundamental shift in economic thought.

The book's eleven chapters plus afterword takes the reader through a blend of these three perspectives. It is an approach that works well for getting the point across and making sure the reader does not jump to conclusions. Some readers may find it repetitive at times, but this too is likely intentional as the author revisits arguments, concepts, and important points in order to ensure that the classical theory he presents is not distorted by being interpreted using a modern economics lens. In fact, as the author claims early in the book, the reader's modern conception of economics stands in the way of understanding classical economics.

Before the actual discussion starts (in chapter 3, "The background"), the first two chapters are the author's introduction and a statement about the unique nature of the problem addressed. Chapter 2 is titled "The purpose of this book and why only I could write it." It is both a brief personal history of how Kates discovered the meaning and importance of Say's Law and an overview of his substantial previous work on this topic along with a personal account of the power of applying sound economic theory in real-world policy and practice. It also underscores the difficulty of understanding classical economics the way J.S. Mill and his contemporaries understood it.

Chapter 3 "The background" gets the reader up to speed with the classical perspective. It starts with the author stating the problem that the book is intended to amend: "Modern economics is founded on classical fallacies of such an intricate nature and confounding depth that it is almost impossible to understand how it was ever different or to see the logic of the economics of the past" (p. 45). It then briefly explains what classical economics is and who the classical economists were. The chapter sets the boundaries for the discussion by noting the basic fallacies of modern economics and, therefore, what it misses.

Chapter 4 "The Keynesian revolution and classical theory" explains the Keynesian revolution in economics. Drawing from the author's previous work, the chapter quickly moves into discussing the folly of aggregate demand analysis and explains the true (classical) meaning of Say's Law, which refutes demand-side economics and policy. Kates does more than summarize his previous work, however. He takes an important next step by distinguishing between two laws attributed to Jean-Baptiste Say: the well-known *loi des débouchés*, found in Say's *A Treatise on Political Economy* (1803), and the modern-day conception of Say's Law that states the impossibility of general overproduction (demand deficiency). This discussion is then used to reconnect to Keynes's work and straw man assault on classical economics.

Chapter 5 "Understanding classical presuppositions, terminology and concepts" is something of a classical economics dictionary that explains core terms and concepts. The explanations are contrasted with how the concepts are misconstrued in Keynesian theory.

Chapter 6 "The classical theory of value and the marginal revolution" attempts to dispel the commonly held view that classical economics was based on the labor theory of value. Not so, argues Kates. J.S. Mill presented a theory of value in 17 points, reproduced in this chapter, that at least in part undermines the revolution of marginalist economics: the very first of Mill's elements states that "Value is a relative term." The chapter further discusses the classical economics perspective on the role of money, credit, and the business cycle.

Chapter 7 "Keynesian theory overruns the classics" explains how Keynes's *The Theory General Theory of Employment, Interest and Money* (1936) in merely a decade and a half could change economics to the core. The chapter provides a historical overview of the core players and their roles in producing the revolution. It thereby explains the mechanics by which the Keynesian revolution was brought about.

Chapter 8 "The basis for Keynes's success: why was Keynes able to succeed" continues where chapter 7 left off by taking the discussion of “who” to “how.” Kates here discusses Keynes’s position and influence in the economics discipline, the temper of the times, the connection with Kuznets’s development of the GDP measure and how it was implemented as “basically a reflection of Keynesian theory” (p. 179), and the role of statistics and mathematics.

Chapter 9 “Classical theory and the role of government” deals with another common misconception of classical economics: that the classical economists were highly skeptical of government and public spending. Kates here argues that classical economics was not *laissez faire* economics but, in contrast, that the classical economists saw a major role for government and public spending.

Chapter 10 “Austrian economic theory and the classical economic tradition” addresses the special role of Austrian economics, which, by placing entrepreneurship at the center of a market process of production, is arguably the most classical of contemporary schools of thought in economics. Nevertheless, although Kates notes that “Austrian economists to a large extent assume the whole of the classical supply-side understanding of the operation of a market economy” (p. 11) and that “[t]he Austrian theory of the cycle sits entirely within the classical framework” (p. 213), he also maintains that “[t]he Austrian tradition, especially given how it has evolved since the nineteenth century, is entirely different from the classical tradition in the English-speaking world” and, Kates says, “[t]his cannot be emphasized enough” (p. 208). This difference primarily rests on the Austrians’ focus on marginal utility, which Kates argues necessarily shifts economic theorizing away from the supply side.

Chapter 11 “An overview of classical economic theory” is a proper conclusion to the book’s argument. The three main perspectives in the book come together in an enlightening discussion on how classical economics understands the operations of an economy, the process of economic growth, and, importantly, the classical theory of the business cycle. This is also where the classical understanding gets to stand on its own, independently and without supports. Contrasted with the marginal and Keynesian revolutions, the classical framework is presented as a valid and relevant alternative despite its 150 years of obscurity.

This book is the natural conclusion and apex of Kates’s decades-long provocative research program intent on resurrecting

Say's Law and reviving the classical understanding of the economy. The work ties together and extends several of the arguments from the author's previous books and articles and does so in a readable and interesting format. Many of the arguments are well received and both interesting and thought-provoking. Kates goes well beyond his previous writings and takes several of the arguments to their logical conclusion.

Although the book is excellent, it is not entirely without flaws. Several of the points could have benefited from elaboration whereas others could have been stated more effectively. Some readers might find the indirect and elaborate "European" style of writing frustrating, especially if they are used to the "American" style.

In this reviewer's humble opinion, the only major weakness of the book is the chapter on Austrian economics. Kates uses too much space to discuss the politics of Austrian economists, which, because the chapter directly follows chapter 9's discussion on the role of government for classical economists, gives the impression that the critique is primarily political. But this is not the case. Kates's critique is based in the school's founding contribution to the marginal revolution. Because marginal analysis is based on marginal utility, the economic analysis necessarily moves from supply-side in the direction of demand-side reasoning. Therefore, Kates reasons, the Austrian school is complicit in the shift away from proper classical economics. The argument is interesting but would require more elaboration to be persuasive. It is not helped by the author's seeming urgency to side with Hayek against Mises while the actual discussion, at least in this reviewer's reading, appears to align more closely with Mises. But this is mostly a somewhat puzzling detail, which does not take away from the main argument.

Classical Economic Theory and the Modern Economy should be a welcome addition to the reading lists of both amateurs and professional economists, whether one's interest is in macroeconomics or the history of economic thought. Although the book is a worthwhile read on its own without familiarity with Kates's work, this reviewer believes it really shines when read as a sequel and conclusion to the author's previous contributions.