

# Problems with neoclassical economics a case study in china



## 1. Introduction

Economics is the study of exchange between goods and services. However, many people do not know about the development of modern economics and what neoclassical economics is. This article will discuss the evolution of neoclassical economics, the three axioms, the problems associated with the three axioms of neoclassical economics, and finally, how a case study about educational fairness in China shows that there are many problems with neoclassical economics.

## 2. A Brief History of Neoclassical Economics

Neoclassical economics was born out of classical economics. The term “classical” was first termed by Karl Marx, who was referring to David Ricardo’s theories on economics, such as the theory of value. The British economy collapsed in the 1870’s due to the classical economic approach that value was based on the affiliation between costs of production and the supply and demand. The Marginalist Revolution was founded by three economists; Jevons, Walras, and Mengar, which led to neoclassical economics. These economic scholars found that Marginalism and utilitarianism became more significant in dealing with the modern economics of the time. They also realized that there needed to be a new economic category to define these new approaches in economics and to be able to differentiate between classical economics from this new qualitative approach to economics. This new category of economics, neoclassic economics, was first used by Thorstein Veblen in his published a book called “ Preconceptions of Economic Science.” His only intention in using this term was to characterize the

theories of classical economists, while being critical to their theories (Colander, 131).

### 3. Definition of Neoclassical Economics: The Three Axioms

According to Christian Arnsperger and Yanis Varoufakis, in order to define neoclassical economics, there are three axioms; methodological individualism, methodological instrumentalism, and the axiomatic imposition of equilibrium. Methodological individualism is the “ body” of neoclassical economics, stating that everyone is well informed and rational.

Methodological instrumentalism describes how preference is used to maximize the demand of goods, services, and/or profit. The axiomatic imposition of equilibrium is described as when a ... “ agent’s instrumental behavior is coordinated in a manner that aggregate behavior becomes sufficiently regular to give rise to solid predictions” (Arnsperger and Varoufakis, 5).

The neoclassical approach can be better explained by using an example from E. Roy Weintraub .

“ Buyers try to maximize their gains from getting goods, and they do this by increasing their purchases of a good until what they gain from an extra unit is just balanced by what they have to give up to obtain it. In this way they maximize “ utility.” The satisfaction associated with the consumption of goods and services. Likewise, individuals provide labor to firms that wish to employ them; by balancing the gains from offering the marginal unit of their services (the wage they would receive) with the disutility of labor itself the loss of leisure. Individuals make choices at the margin. This results in a <https://assignbuster.com/problems-with-neoclassical-economics-a-case-study-in-china/>

theory of demand for goods, and supply of productive factors” – E. Roy Weintraub.

#### 4. Problems with Neoclassical Economics: The Three Axioms

There are many problems with the neoclassical economic theory. First, methodological individualism assumes that everyone has a rational way of thinking and is thoroughly informed, but this axiom is dubious. Humans are vulnerable in situations they are put in, which causes them to be irrational. Second, according to methodological instrumentalism, humans usually use their first choices of action in order to maximize the situation, such as in acquiring goods, services, and products. If taken into consideration that humans can be irrational, then how will they know if their preferences will maximize their situation? Third, the axiomatic imposition of equilibrium focuses on the fact that when the key behavior works with the collective behavior in a consistent manner predications will be stable. Nonetheless, it does not consider that if humans are vulnerable in a given situation, then they can react in an unpredictable way that can imbalance the collective’s behavior.

##### 4. 1 Educational Fairness in China: A Case Study

Educational fairness has become a bigger issue over the years in China. The meaning of educational fairness considers equality in education, whether it be regarding finances or the access to education. Because this article is only focusing on an economic aspect, it will concentrate on the financial aspect concerning the equality of regional educational funding. Concerning the fairness of the Chinese educational system, there are four major problems; <https://assignbuster.com/problems-with-neoclassical-economics-a-case-study-in-china/>

educational funding in rural areas, the allocation of funds, inequality of funds between private and public schools and the uneven acceptance of examination scores (Peng, 2009).

Rural areas of China have been less developed in their education system compared to the metropolitan areas because of inadequate resources available for the local governments to give to the mandatory, nine year education system. This falling behind is also due the economic and social changes in the last half millennium. Pertaining to the distribution of funds, most of the funds of education go to universities (Peng, 2009). According to Wang Shanmai, a pedagogical economist, "...the money input in higher education accounts for 20% and middle and junior education 80%. For higher education, 80% of the expenditure comes from the government funding. However, only 60% is allocated for compulsory education" (Ping, 200).

Another problem with China's educational fairness is that public schools receive more funds than private schools. Private schools do not have any rights to compete fairly in development, such as awarding certified diplomas independently, students receiving discounts, and receiving student loans (Peng, 2009).

The last problem concerning educational fairness in China comes from admitting students with different college entrance examination scores. The main concern is that many students cheat on their college entrance exams in order to be accepted at a university, and there is hardly any supervision when giving out the entrance examinations. The reason why many students

get away with it is because the laws related to cheating are not strict enough and the consequence received is only at the minimal level (Peng, 2009).

In order to prove that the neoclassical approach in economics is not reliable, Peng used two separate sets of data; one concerning educational spending and the other about public attitude in China concerning educational fairness. In the educational spending data, there are two parts. The first part was about the yearly educational spending from 1978-2007 and the second part was about the yearly educational spending in 2006 for different provinces in China (Peng 2009)

Concerning the public interest, Peng created two indexes. The first index was about how many academic articles there were with the term “ educational fairness” in their title and the other index was about how many public posts that had educational fairness as their subject. Figure 1 and 2 showed that the more money spent on education, the more likely people consider educational fairness as a more important issue in China. Even though the spending increased every year, the public’s reaction about educational fairness became more indignant. In Figures 3 and 4, they show that the more money the region receives for education, the more public would discuss about education fairness in that region (Peng, 2009).

FIG. 1. Annual Education Spending (in billions) (Peng, 2009)

FIG. 2. Annual Publications on Educational Fairness (Peng, 2009)

FIG. 3. Educational Spending in 2006 by Provinces (Peng, 2009)

FIG. 4. Number of Posts on Educational Fairness Online by Provinces (Peng, 2009)

In order to show that the neoclassical theory is unreliable, the case study concerning educational fairness in China and the three axioms will be used to prove that the theory has many pitfalls. According to methodological individualism, everyone is rational in thinking and is well informed. However, according to the study, although the educational spending increased every year, public sentiment about educational fairness became more resentful. This is irrational because more people should be content with receiving more money from the government. One reason why the people might be unsatisfied might be because they were not well informed about which area it will go to in the education program, but this is just a theory. According to methodological instrumentalism, the first choice is used to get the most out of the demand of goods and services. So if the Chinese government prefers to give more money to urban areas and public schools to maximize the profit in investing into the young generation for a stronger economy in the future, then why not invest in rural areas as well? For the Chinese government to give more money to urban areas and public schools than rural areas is irrational and hurts the neoclassical theoretical way of thinking. The last axiom, the axiomatic imposition of equilibrium, believes that when an individual person works with a group without fail, predications will be steady. China is a collectivist nation, meaning that they do not take into account of their own interests but think of only of the interest of the collective, whether it may be for family, community and/or government. So according to the axiomatic imposition of equilibrium, an individual in China working with the

collective should bring a stable predication that the more money a region receives for education, the collective should be more content. Predications should have been stable but were not. The people became disgruntled when they received more money so this predication was not constant.

## 5. Conclusion

In conclusion, neoclassical economics can be defined by merging the three axioms; it is the supply and demand to an individual's rationality and preference by means of their ability to maximize utility and/or profit. However, using Peng's study about the educational fairness in China, the neoclassical theory in economics has many pitfalls. People should be rational, informed, work with the collective, and use their preferences to gain the most profit; however, this is not the case with China. The Chinese people should be more content with receiving more money for their education, but Chinese citizens gave the opposite reaction than expected. Even though regions are getting more money for education, there is still inequality where cities and public schools are receiving more money. If the government wants to invest in the future, they should also invest in the education in rural areas so that the country will benefit economically in the future. In conclusion, neoclassical economics can be very disputable because of the fact that this theory does not take into consideration that humans can be irrational and unpredictable.