



The Betrayal of Liberal Economics

Volume I:
How Economics Betrayed Us

Amos Witztum

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Amos Witztum
Centre for Philosophy of Natural and Social Sciences
London School of Economics and Political Sciences
London, UK

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To the three pillars of my life:
My wife, Daphna
My son, Alon
My daughter, Tamar.

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Prologue: Introduction and Summary

There is something foreboding about the title of a book which contains the word *Betrayal*, but I would like to say from the outset that this is not about anything sinister, nor is it about intrigues or conspiracy. It is, in fact, far more serious than that. It is a lamentation on the state of our thinking about economics and society and a sense of loss due to the fact that we have reached this point because we have abandoned something which was richer, more relevant and far more promising.

In this respect, this book is a critique, mainly of modern economic thinking, but it has implications for broader issues in the domain of social organisation. It is, of course, not the first time that modern economics is being criticised, but the reason why there may be a need for a fresh approach is the fact that it has shown a remarkable resilience.¹ In spite of years of various forms of intellectual opposition, very little of substance has changed in what may be considered its intellectual agenda (or, in

¹ The resilience of economics' paradigmatic core is far more astonishing when one considers how vast the literature is in opposition to it. This, of course, is not the place to review all this, although it may be worthwhile pointing at the difference between my approach and that taken by most other critiques. In a nutshell, while others criticised economics because of its failings either to predict or to explain, we propose to examine the internal logic of the subject and suggest that what appears as failing is nothing but the footprint of a fallacious paradigm. In other words, it is the promise of economics that we would like to examine rather than its ability to deliver it in practice. Naturally, if the promise is false, so will be its delivery but there is a fundamental difference between a failing which is a problem of execution and a failing of purpose.

other words, its paradigmatic core).² This core, which is more about principles of economic and social *organisation* than it is about *predictions*, has also become increasingly more influential in the way it formed and informed political and ideological debates and, in this way, this doctrine exerts immeasurable power over the lives of so many of us. There are, perhaps, no better expressions to the power behind economics' paradigmatic core than the rapid spread of market economies in the world (both developed and developing): the spread of it into increasing areas of human lives (including education, research and culture), the rise in free trade agreements (culminating in the World Trade Organization) and, finally, the unstoppable spread of globalisation.³

It is true that the recent financial crisis and its aftermath have led to a rising opposition to globalisation, but there are two key elements in this opposition which put modern economics beyond the reach of these protestations. The first is the fact that much of the anger has been directed at

² Among the more prominent modern opposition, I would like to mention Keynes and the post-Keynesians. The former, as will be discussed later, was mainly concerned with what I would like to call 'correction' or policy issues, but some aspects of the latter—harking back to Keynes's earlier years—are also committed to a more fundamental disagreement about the general role of market analysis. There are also the Sraffian or neo-Ricardian, who are mainly focused on offering alternative—more classical—explanations to distribution variables and the return to capital in particular. As you will see as you read along, I have some sympathy to their supposition that classical economics offers a better analytical framework than modern economics. There is, of course, Polanyi (1944), with whose direction I also sympathise, although not necessarily with his analysis. As will be explored later in the book, I do not consider institutional or behavioural economics a real opposition to the modern paradigm. As you will see, the line we take is fundamentally different as it is focused neither on corrections or policy nor on the explanatory aspects of the theory. Instead, it is more focused on the organisational implications of the theory and the social significance of economic analysis. In this respect, it is worthwhile citing Marglin (2010), who confronts economics at this fundamental level by arguing that the markets replace and corrupt communities. Our line of reasoning, however, develops at somewhat different directions.

³ The term 'globalisation' is on many occasions used to describe the internationalisation of economic activities. Throughout this book, however, we shall make a distinction between the idea of free trade in which we refer to the international trade in goods and services only and the idea of globalisation in which we refer to the free movement of means of production (capital and labour). To some extent, one can refer to the former as an expression of globalisation during the Bretton-Woods era (which ended in the 1970s) and was mainly manifested in the various forms of tariffs agreements (General Agreement on Tariffs and Trade [GATT]) and the latter as the post Bretton-Woods period. There is a clear distinction between globalisation that includes the free mobility of factors and the one which only refers to free trade in goods and services. In the former case, the economic sovereignty of individual states will inevitably be restricted—both in terms of monetary policy (sometimes referred to as the monetary policy trilemma) and the ability to raise taxes (fiscal policy)—but not necessarily so in the latter.

the role of large corporations (and the corrupt behaviour of those with power) in the global system. However, there is nothing in economics' paradigmatic core which suggests that large corporations—or powerful agents—should play a role in any economic system. In fact, most economists would be in agreement with all attempts to curb large corporations, the powers of which undermine the essence of competitive decentralisation. Therefore, these kinds of attacks are not really attacks on the principles of economic thinking but rather an attack on the execution of it, which allows forces to act in a way that subverts the promise embedded in the paradigmatic core.

Secondly, the language of the debate is mostly about the way out of the crisis rather than a fundamental review of economic arrangements within countries and across them. In many respects, it is a return to the old debate between Keynesians and new classical economics. In simple terms, it is a debate about whether the system can recover from shocks by itself or it needs help in the form of increased government spending to be stimulated. The reason why this criticism does not touch the core of economic thinking is already present in Keynes's own writings. While in the end, Keynes identified only two areas where markets may chronically fail (financial markets and the labour market), he does acknowledge that in a world of full employment, competitive markets can be relied upon to successfully co-ordinate economic activities. The reasons why investment must be socialised (to use Keynes's own language) and governments pursue fiscal policies are mainly designed to help markets reach their equilibrium or point of full employment, rather than to propose alternative principles for economic organisation.⁴ Put differently, this is basically a

⁴ Keynes famously agreed, in his *General Theory (GT)*, that once we are in full employment, the classical school 'comes to its own' (GT, p. 378). To be fair to Keynes, however, the story of understanding his contribution has been quite complex and the debate about him has been stretching across two extremes (Backhouse 2006 provides a good summary of the history of this debate). At the one end Keynes seemed to have argued the complete abolition of equilibrium analysis, in which case he would have offered a structural alternative to modern economics. Townshend (1937), Shackle (1967) and Robinson (1974) picked up on Keynes's own response to the debate in the *Quarterly Journal of Economics (QJE)* to claim that the contribution of the GT was to introduce time and expectations into the market mechanism of *all* goods. Coupled with Keynes's insistence on the irreducibility of uncertainty by probability—and thus, a form of bounded rationality—this meant the introduction of a non-equilibrium approach to economic analysis. Leijonhufvud (1968) agreed that the contribution of the GT was about market failure but not just because of time and

policy debate rather than a structural one. Moreover, the Keynesian controversies are mainly about those who are left outside the competitive system (the involuntarily unemployed), or the victims of markets' failures; it is not about the fate of those who are in the system and where markets seem to work. Yes, a lip service is being paid to the fate of these people through other debates about redistribution of wealth and income⁵

expectations. It was a failure because of the absence of an 'auctioneer' and, thus, the GT is not merely about non-equilibrium but rather about disequilibrium economics. Together with time and expectations, this would be extended into an analysis of inter-temporal disequilibrium. In turn, a whole literature of disequilibrium macroeconomics developed (Solow and Stiglitz 1968; Barro and Grossman 1971; Benassy 1986), but from the point of view of the methodological debate, as captured by Leijonhufvud, this was not really a proper modelling of disequilibrium. These models were simply Walrasian models with rationing and, as such, they did not, in his view, capture the spirit of the GT or offered a serious challenge to the idea of markets. (A more localised and focused attempt at interpreting Keynes was concentrated upon in Chap. 2 (and 19) of the GT or the possibility of non-clearing labour market. However, here too, the focus of attention has been primarily methodological. Hoover (1995) provides a summary of this line of investigation). At the other extreme, the one which became more dominant, there were the less 'revolutionary' interpretations like Clower (1965), Patinkin (1965) and more recently Laidler (1999), where methodology was not at the heart of the discussion. For them, the main contribution of the GT was the role of money in exchange. Due to the fact that people exchange goods with money and labour with money, the presence of unemployment may trigger a co-ordination of decision failure. The seeds of these confusions about Keynes's contribution, in my view, rest in the ambiguities in Keynes's position on the 'classical' (should be read, neoclassical or modern) school. Skidelsky (1992) writes, 'the validity of Keynes's "general theory" rests on his assertion that the classical theory ... is, as he put it in his lectures, "nonsense". If [the classical theory] were true, the classical "special case" would in fact, be the "general theory", and Keynes's aggregative analysis ... empty and redundant' (p. 512). He then goes on to say that in the post-war period, Keynes's theory was indeed perceived as a special case of classical economics. But what exactly is meant by 'classical economics'? Davidson (2007) asserts, 'Classical economic theory ... provided the rationale for the laissez-faire or "no government intervention in the market place" philosophy that dominated discussions of how to cure the unemployment problem and promote prosperity' (p. 22). In fact, there are two aspects of classical economics to which Keynes is referring to. Firstly, it is the market clearing mechanism and, secondly, the perfunctory role which the theory ascribes to money. However, his analysis does not go beyond the role of money in plugging the gap in the labour market. In the end, in spite of Keynes's expressed motivation to contest the universality of what he calls the 'classical' conception of the labour market's mechanism, according to the GT he has not really parted way with that school. For one, he famously agreed that once we are in full employment the classical school 'comes to its own' (GT, p. 378). But more importantly, in spite of the failing of the labour market (and the unnecessary high demand for liquid assets), he clearly believed that the classical model allocates all the *employed* resources well (this point is clearly stated in Chap. 24 of the GT and will be discussed further later). But perhaps more than anything, the fact that Keynes's contribution remained only policy oriented rather than structural can be seen in the way it was absorbed in modern macroeconomics, where the distinction between new classical economics and Keynesian economics was reduced to a long-run, short-run distinction.

⁵ See, for instance, Piketty (2014) and Atkinson (2015).

but, as will be shown, these are not really criticisms of economics' paradigmatic core as they are attempts to make *corrections* which will allow the competitive system to become compatible with social values.⁶ As I will show in Chap. 2, there is nothing about this which is in any way a demand for a fundamental change in the way in which we think about economic organisation. We still perceive markets—or competitive decentralisation—as the best way to organise economic activities but as there are obstacles on the way to the Promised Land, society should interfere to make amends. Among other things, this book is more a critique of this fundamental way of thinking than it is about specific policies, corrections or means to alleviate temporary malaises which may be attributed to *market failures*. Instead, we would like to focus our attention on what we call *failures of the markets*. Namely, we are not interested in what happens when markets fail in the sense that they are unable to perform as we would expect them to do (which is the way in which the term 'market failure' is normally used); but we are interested in that which we should expect markets to achieve when they do work well. We would like to argue in this book that the problems which societies face are more acute when markets actually work well than they are when there is something which impedes their operation.

* * *

⁶In modern times, the idea of 'correction' (rather than replacement) starts already with Pigou's *The Economics of Welfare* (1920), where the need to correct arose from the apparent inefficiency of the competitive outcome in the presence of externalities (before Coase). Namely, the completely decentralised competitive system could not have reached an equilibrium which is Pareto-efficient without government intervention. This, inevitably, gave rise to a great debate about the measure of individual welfare and the subsequent discussion of how to judge outcomes. Once this has been achieved, the next type of correction is the one associated with redistribution and is aimed at reaching the socially desirable outcome without undermining the rule of markets as the key co-ordinators of human interactions. Indeed, in Pigou's own writing this did not represent a lack of confidence in the neoclassical message. Instead, it was, as it were, a mere correction which is necessary when we move from the 'light'—or the abstract science—into the 'fruit': its application. In other words, the key point in his argument was not the inefficiency of the actual outcome but rather the ability to correct it. To this end, it became imperative to be able to judge deviations from the efficient outcomes and the effects of measures taken to correct them. Hence, the practical focus of welfare economics became the measurement of wellbeing but this was all within the agenda of approaching the ideal: the benefits of the competitive outcome.

It may be useful to begin our examination by clarifying some elements in the title of this book. We need to explore what is meant by *liberal economics* as well as what we mean by *Betrayal*. Most modern economists may be surprised by the use of the term *liberal economics*. For them, modern economics is just **economics**. It is a science. They would like to think that it is a bit like physics, where we study how particles behave and how opposing forces lead to an equilibrium which produces the world of matter in front of us. Of course, we can mould this world and, through interference, change the shape of things, but the laws governing the behaviour of particles and the way in which forces are balanced are still the same.⁷ Therefore, the association of the word ‘liberal’ with the science of economics seems quite unsettling. After all, economics, as a science, should be ethically neutral and, therefore, compatible with all possible forms of social/political/ethical considerations, concepts which are more naturally embedded in notions like liberalism.

Notwithstanding the debate about the scientific nature of economics and whether it is indeed universal and ethically neutral—which is, of course, partly the subject of our examination—I use the term ‘liberal’ to help us locate modern economics in the broader context of the ways in which humanity has been thinking about this subject over centuries. As our study will span beyond mainstream contemporary thinking about economics, we have to acknowledge that throughout most of the history of human thought the study of economics seemed to have been significantly less detached from political/social/ethical considerations and, therefore, the kind of detachment we observe today may, in fact, be no more than wishful thinking.

To some extent, the difference in the disposition, within economic thinking, towards broader social considerations is well reflected in the difference in the meaning of the term *Political Economy* in classical and

⁷ Conveniently, economists prefer to look only at classical mechanics while completely ignoring other aspects of physics, like thermodynamics, which is a one-directional development that also influences the way in which particles interact. Needless to say, I do not for a moment suggest that there is any merit in such a position but I fear that the intellectual behaviour of many economists—such as it is—reflects this kind of belief in the nature and powers of the science of economics. Moreover, I do not wish to engage in any discussion about whether economics is or is not a science. The reference to physics is not a claim about the scientific nature of the subject as it is about its similarity with natural sciences. In general, I prefer the word ‘discipline’ to science but I feel that such semantics is a waste of time.

modern economics. During the classical period (in the eighteenth and nineteenth centuries), there was no other name for the dealing with economics than political economy. It was so because economics was always considered as something which is embedded—and, therefore, influenced—by a social, ethical and, hence, political context. With the development of neoclassical economics—perceived by many as an extension, or maturing, of one particular line of examination within classical political economy—there was quickly a shift towards economics as a discipline which can be treated separately and independently from all other social or ethical considerations. Subsequently, with the apparent success of economics as an academic discipline (mainly due to excessive formalism and the commercialisation of academia), it began to infiltrate other social disciplines including sociology and politics and, thus, gave birth to the new political economy in which economics' conceptual framework is used to analyse social and political issues. In other words, economics has shifted from being **in** context to becoming **the** context.

Given that classical economics, or the real political economy, conceived economic interactions as part of the more general social context, the way it developed was not independent of these other considerations. Therefore, there was a need to distinguish between the ways in which sociality affected economic analysis. The term *liberal economics* is used here to identify a broad line of reasoning where everything is channelled through the individual (basically, a form of methodological individualism). This predominantly individualistic—but not necessarily a-social—approach goes all the way from the French physiocrats and their *laissez-faire*, through Adam Smith, David Ricardo to John Stuart Mill, who also happened to be one of liberalism's greatest champions. This line is distinguished in both method and substance, from other classical economists who opted for a more explicit socially based analysis and who can be identified by scholars like Louis Blanc, Saint-Simon and culminating in Marx and his followers. In other words, classical economics has always been embedded in social and ethical analysis but there were different ways in which such connections have been manifested. We call liberal, that stream of thought which seems to be entirely focused on the individual and his or her private and social needs, and we call socialist, that stream where economic analysis was driven by social concepts or developments.

But by calling modern economics, liberal economics, we are actually doing more than just identifying the subject matter of our investigation, which is, of course, modern economics itself. We are, in some sense, defying its expressed purpose which is to advocate a presumed natural order as a universal and ethically neutral form of economic organisation and, thus, exposing some of its failings. By calling it liberal economics, we are suggesting that whether explicitly or implicitly even the brave attempt to make economics neutral cannot really hide the fact that it is a clear expression of a very particular position on things social and ethical. In this way, we are suggesting the removal of the pretence that competitive decentralisation is a form of economic organisation which is either universal or consistent with all possible conceptions of society, of culture and of political organisation everywhere in the world. Instead, we would like to expose modern economics for what it really is: a narrowly defined individualistic theory with a false conception of the natural and where sociality is purely functional and ethics, subservient to its functionality. As such, it is a conception of society and the economy which sits well with some approaches to social theory and ethics but not with others, and, hence, it cannot be universal or neutral. It certainly sits well with more recent expressions of liberal thinking as manifested in the idea of *civic society*. Such a society—being fundamentally functional—is merely a structure, the purpose of which is to keep the peace, facilitate prosperity (whatever this means⁸) and protect the individual from others and this very same structure. Everything else, in civic society, including sociality, is based on voluntary interactions. However, and this is where the betrayal will come in, it does not sit well at all with the tradition from which it claims to have sprung: *liberal classical economics*.

If you read the title again, you will see that there is a certain ambiguity in it. *The betrayal of liberal economics* can mean either that liberal economics has betrayed us or that we have betrayed it. In this book, we shall argue that both forms of betrayals have, sadly, taken place. On the one hand, modern economics has failed us in its promise, and what is even more worrying is that many who have recognised it have failed to act on

⁸ Normally interpreted as material wellbeing but, as such, is in no way a neutral objective and therefore not an obvious element of a universally functional society.

it. On the other hand, we failed economics by allowing it to twist the idea of liberal economics—as it was originally conceived in classical economics—in such a way that modern economics (and, to some extent, modern liberalism) based its promise on false conceptions of human sociality and, subsequently, on a wrong conception of methodological individualism which inevitably led to the wrong idea of natural order and wrong conclusions about the appropriate form of economic (and social) organisation.

The one thing which modern economics shares with more traditional approaches to liberal economics is the focus on the individual as the basic element of the social and economic system. And in this respect, there may be something to be said about potential universality. However, the way one conceives the individual may not always be the same, and even if the conception is the same, the manifestation of the notion may differ across societies and cultures. What is specifically implied by modern economics is that individuals—who are always rational in the sense that they seek the best means to an end—have interests which make the social or economic organisation useful to them. It is clearly a functional approach to society which is more Hobbesian in nature than it is Lockean. In the former, individuals *escape* into a social contract because they seek security and must escape the natural state of permanent violence; in the latter, they are *drawn* into the social arrangement to allow something in them to be fulfilled which cannot be fulfilled outside society.⁹ While there is an element of functionality in both approaches, there is nevertheless a meaningful distinction between them. The former is mercenary, and the latter is purposeful. It is not difficult to imagine that the social or economic organisation emanating (both in practise and as an ideal) from one form

⁹ Locke's position on the social contract is rather complex. There is no doubt that in his case, people are drawn to society but the reasons for this are not as straightforward as it may appear. He mentions the precariousness of the natural state, but Locke also cites the fact that people 'want and love society' as a reason why they enter the social contract. More importantly, in Locke, reason and theology are never far from each other. To some extent, the natural state corresponds to the *covenant of works*, which means the laws of nature and of actions as prescribed by the scriptures. The social bond is more akin to the *covenant of faith*, which is the more spiritual aspect of life. Not obeying the first covenant may make someone unrighteous (and this may cost him his life) but faith can compensate for it (see his *The Reasonableness of Christianity* 22) and give spiritual immortality. So, both in religion and in society, people part with some of their sovereignty for something better. As reason itself is divine and as it is the cause of the social contract, society must also entail a higher form of living than the natural state.

of sociality would be different from another. Moreover, if the social drive is altogether intrinsic, social and economic arrangements would certainly be different in these scenarios. Indeed, we can see this already in the case of Hobbes and Locke. In the mercenary society, individuals forgo most of their rights in favour of an authoritarian ruler, while in the case where individuals are drawn into society their rights (whatever they are) must be protected.

* * *

So, what is the promise that modern economics hides in its paradigmatic core and in what way has it betrayed us? It is certainly not the ideas of demand and supply, though modern economics has a lot to say about it (and most of it not very new). One must bear in mind that the basic notions of demand and supply and how they affect prices have been known for centuries. One can already find them discussed in Aristotle and St Thomas of Aquinas; they were certainly well understood by classical economists of both liberal and socialist persuasions. It is true that modern economics has introduced a high level of sophistication which allows for more subtle and complex (though not necessarily empirically true) analysis of demand and supply but the essence of the idea has not changed much over the centuries. Nor has the idea of markets as such (or competitive decentralised decision-making) been the great revelation of modern economics. It is not a secret that the market phenomenon is a natural phenomenon in the sense that across cultures and throughout time there have always been markets in the forms of bazaars or markets in town squares. But the fact that markets may be a natural phenomenon does not mean that it is something that should be praised, promoted or idealised.¹⁰ Indeed, the difference between the entire history of human thought about economics and modern economics is that until now markets were seen as a natural phenomenon which may, sometime, be good for society but often not good at all. In modern economics, on the other hand, markets have become an *ideal*. While much of the work of contemporary economists is dealing with the details of how markets operate, the overarching

¹⁰ There are many natural phenomena which humanity has struggled to contain rather than abet.

message of modern economics is organisational: the pursuit of competitive decentralisation is the ideal form of economic organisation.

If we take a cursory look at the evolution of economic thinking, we will find repeatedly that while scholars show a remarkable understanding of the way in which markets operate, the focus of their attention was not the mechanism itself but how it serves a broader, social, purpose. Thus, we can find in Aristotle recognition that demand and supply determine prices, but also a definition of what may be seen as a just price.¹¹ However, market prices may or may not conform to the just price. When they do, the economy performs in a manner consistent with the broader social/ethical context; when they do not, markets cannot be deemed as working in line with social objectives and need to be corrected.¹² Clearly, the reason why an ethical concept becomes the reference point for his economic investigation is because economic interactions are part of the institutions that create the 'good society' which, according to Aristotle, is the purpose of social organisation. Hence, economics analysis is not focused on how markets work but rather, given that they exist, on whether and under what conditions will markets comply with some exogenous benchmark which is socially or ethically determined.¹³ These ideas were carried through into the Middle Ages through the doctrines of St Thomas of Aquinas, who was a follower of Aristotle. In post-Enlightenment Europe, in Adam Smith, who is also (wrongly) considered to be the founding father of modern economics,¹⁴ the commentary about the working of markets is far from complimentary. It is true that Smith saw competitive markets as a much

¹¹ Aristotle does not use this terminology but he does refer to an exchange which is consistent with justice. It was St Thomas of Aquinas, heavily influenced by Aristotle, who develops the notion of a just price.

¹² The discussion of prices is conducted in the context of what Aristotle calls corrective justice.

¹³ Although not explicit, Aristotle provides some hints regarding the cases where market prices are more likely to deviate from their just values. According to him, people can satisfy their need either through home production or through exchange. But he also identifies demand which originates from want (rather than need) and which he deems to be immoral. It is thus implied that when demand and supply are comprised of those who seek merely to satisfy their needs, exchange will lead to the just price. But when demand and supply are comprised also of those who seek things to satisfy their wants, market prices are likely to deviate and thus reflect the immorality which he associates with such (excessive) behaviour.

¹⁴ The desire to connect to classical economics is both a reflection of the inadequacy of the modern conceptual framework and the lack of scholarship among modern economists.

better way to organise society in comparison with Mercantilism, but this does not mean that he considered the natural phenomenon of the markets as something which is inherently socially beneficial.¹⁵ Like Aristotle and St Thomas, he too has two competing concepts of price. One is the market price as is understood from the fluctuating interactions between demand and supply, and the other a notion of the natural price which was, in many respects, a benchmark for whether markets work in a manner which is socially beneficial.¹⁶ Smith was quite clear that while market prices may tend to gravitate towards the natural rates, they can nevertheless deviate from them for centuries (to use his own words).

Marx, too, should be understood as following the same line of reasoning even though he was clearly influenced by Ricardo, who, unlike Smith, sought in natural prices (or absolute values) only the long-run technological conditions which govern the fluctuation of market prices. For Marx, as for Smith, there were values (or prices) which reflected social circumstances rather than just technological ones. Nevertheless, the difference between them is that unlike Smith, whose analysis is based on the individual agent, Marx derived the social benchmark for market interac-

¹⁵ There is a certain ambiguity in what one may mean by the natural phenomenon of the market. We normally refer to it in the form of competitive markets (a bit like a bazaar) in the sense that people can enter or leave at will and there is no one who exerts any power over the other. It is, of course, true that the natural form of the market could be one in which agents are trying to acquire power over the others but this is not what is generally meant by *laissez-faire*. It is the outcome of people of equal power engaging in economic interactions. It assumes, of course, that it is natural for people to interact with others on the basis of equality. We do not think that this is true—and it is part of the problem—but we will not expand on these matters here. Instead, when we talk about the natural phenomenon of the markets, we talk about the natural outcome of equally sovereign individuals which interact for economic purposes.

¹⁶ There is some disagreement about the meaning of the natural rate in Adam Smith. From the perspective of modern economics, many think that it is simply what they call, the long-run equilibrium price. However, Smith was not a modern economist and such an interpretation does not seem right for anyone who properly investigates his complete writings. It is true that some of these views have been tainted by Ricardo's interpretation of 'natural price' as some kind of an absolute value which is the real value of goods and to which prices will always gravitate. But while Smith too saw in natural price a focal point for prices, the construction of that value is not technologically based but, rather, socially inspired. I will defend this interpretation in greater details in Chap. 8. At this stage, I would say only that the natural price, in Smith, was the one where all those who participate in the production process consume a socially constructed subsistence and the entire surplus is being invested which, in Smith, means an increase in wages. This, as will be explained later on, is an ethical requirement for markets not to violate the true sense of morality (the conscience) of those who are in the system.

tions from more metaphysical concepts based on what he considered to be the *essence* of commodities.¹⁷ As he declared labour to be the essence of commodities, he shows how in the presence of money-driven market interactions, the surplus created by workers (the amount of work they put in above that which they need for their own subsistence) is expropriated by capitalists. Hence, labour values should not be understood as an attempt to explain market prices; Marx was fully aware of the dynamics which determines them.¹⁸ Instead, labour values should be understood as a reference point, like the Aristotelian just price or the Smithian natural rate. In Marx's case, whenever there are profits—an expropriation of surplus values—market prices will not be the same as labour values.¹⁹ More generally put, for all these scholars, when prices deviated from their reference point, the natural phenomenon of markets was socially harmful. When prices conform to the benchmark, the natural phenomenon of markets is beneficial. The main question, of course, is whether market prices have indeed a tendency to converge to, and actually reach, their benchmark values. If such a process exists, it would make sense to argue that the natural phenomenon of the market is socially desirable.

¹⁷ There are, of course, serious methodological differences between them as Smith seems to be more of an empiricist, while Marx was clearly a rationalist. The former based his analysis on experience and observations, while the latter, who felt that we cannot trust our senses, believes in a priori knowledge. The strange thing is—and we will not have the space to examine this here—that there are rationalistic elements in Smith's thinking and the real founding father of modern economics (Leon Walras) was, like Marx, a rationalist.

¹⁸ Though the attempts to use labour values as an explanation of market prices have been quite considerable and are captured by the literature on the problem of transformation, their somewhat misguided nature can be understood from the fact that Marx himself did not bother about the problem of transformation until the third volume of *Das Kapital*, which, to a great extent, was influenced by others and represents a much less coherent contribution to his writings than the first two volumes. Nevertheless, one must acknowledge that Marx was, to an extent, following Ricardo, for whom the idea of the absolute value was an attempt to explore the underlying technological causes of market prices. In this respect, the problem of transformation is very important. But still, one cannot ignore the fact that for Marx a C-C exchange (a commodity-commodity—barter—exchange) will, like in Aristotle, lead to an exchange reflecting labour values. It is when we face an M-C-M exchange that the expropriation takes place and money prices will inevitably deviate from labour values.

¹⁹ We reiterate that Marx was really using labour values to expose the fact that prices entail, in terms of labour values, exploitation (in profits); in other words, he was using labour values to unmask market prices. The way we present this idea here is somewhat different but still true to the spirit of his writing and in conjunction with the problem of transformation which he has himself acknowledged in the third volume of *Das Kapital*.

Naturally, the question here is not whether Marx, Smith or even Aristotle were right or wrong in the way they constructed their social/ethical benchmark or whether we find their proposed contents of it appealing. It is about the fact that until very recently many scholars did not think that their role is to refine their understanding of how markets operate.²⁰ Instead, they considered their role as passing judgement on the natural phenomenon called markets by comparing their consequences to a certain yardstick. It is therefore interesting to note that one of the founders of modern economics seemed to have followed a similar line of reasoning but the interpretation of his work has led to a complete change in the way people think about economics without a very good reason. I am referring here to Leon Walras.

Walras was a rationalist and, like Marx, he too was searching for the essence of things (and in particular, economic goods). But unlike Marx, he thought that utility (what Marx would have called value in use) is the essence of things. He then asked whether market prices will indeed yield outcomes which reflect these relative utilities and to answer this question he examined the logical limit of the natural phenomenon of the market by looking at a world with perfect (or complete) competition. His model of general equilibrium—which lies at the heart of the modern paradigmatic core²¹—suggests that when competition is complete (or perfect), the phenomenon of markets will lead to pricing of goods which reflects their essence. Goods will exchange according to the relative utility of the units exchanged (what we call marginal utilities) and all rational plans will coincide. This means that all individuals will achieve that which they had reason to expect. In modern days, this has also been associated with *efficiency* and the *general solution of the economic problem* which society faces.

²⁰ Even Ricardo, who could have been seen as pursuing this end, the overall purpose of his study was nevertheless to explore a fundamental social issue: the distribution of income.

²¹ There are those, like Colander (2000), who claim that modern economics has nothing to do with neoclassical economics. I fear that I completely disagree. As will be demonstrated in Chap. 2, economics' textbooks are thoroughly neoclassical. The fact that economists are not researching general equilibrium does not mean that they are not using concepts and criteria which are derived from it. Conducting a partial equilibrium analysis does not mean that there is no general equilibrium behind it.

But by saying that there exists a price where all goods exchange according to their socially constructed values,²² one does not tell us much about whether the reality of markets will indeed lead to such prices. As we saw in the previous cases, the fact that there is a just price in Aristotle, a natural price in Smith and labour value prices in Marx was only part of the economists' exercise. The real question was whether or not market prices deviate or converge to these social benchmarks. In the case of Marx, prices will always deviate from their true labour value as long as there is profit in the system (i.e. a positive return on capital); for Smith, this depended on the behaviour of those who possess the surplus, which means that they are likely to deviate for a long time and, therefore, markets will not conform to the social criterion. So what about Walras? He was, of course, acutely aware of the fact that while there exists a vector of prices such that all markets are in equilibrium and all goods are exchanged at their real relative value (value in use or marginal utility), it is not entirely clear how actual market dynamics will produce these prices. In other words, while it was clear that there exists a price vector that is consistent with the socially constructed benchmark, it is not clear whether the process of price formation, which takes place within the natural phenomenon of the markets, will form these ideal prices. In this respect, Walrasian general equilibrium prices are the equivalents of Smith's natural prices, Marx's labour values and Aristotle's just price.

To address the question of whether there exists a process which would lead to the formation of Walrasian general equilibrium prices, Walras suggested the mechanism of *Tatonnement* (or groping). He thought that he had proven that such a mechanism will indeed lead to the formation of those equilibrium prices but the mechanism is so remote from anything real (i.e. any market process), as well as fundamentally wrong (as was demonstrated later on), that the meaning of the general equilibrium prices became unclear.²³ In many respects, it was less clear than Marx's

²²The fact that labour or utility is the intrinsic value of goods is not an observation as it is a social construct.

²³Though our discussion is in general terms, which can include a variety of processes, it is all part of the more general problem captured in the discussions about stability of general equilibrium. Franklin Fisher wrote: 'The search for stability at great level of generality is probably a hopeless one. This does not justify economists dealing only with equilibrium models and assuming the problem

labour values. We knew what we had to do to produce them (abolish profits) but we had no idea whatsoever what to do to obtain Walrasian prices. Equally, we know what needs to happen for Smith's natural rate to be obtained even though we have little control over it (the behaviour of those who possess the surplus). In the case of Walras, there was no mechanism which connected what actually happens in markets and the social benchmark of his analysis. This led to a fallacious belief that if we only made sure that all markets were perfectly competitive as they are in Walras's abstract framework, then surely Walrasian equilibrium prices will emerge. Alternatively, they attribute the properties of Walrasian prices to the actual competitive prices even though we know with certainty that they are not the same.

The contribution of Walrasian general equilibrium to the paradigmatic core of modern economics is crucial. It provided it with the fundamental organisational principle in the sense that competitive decentralisation is a form of economic organisation which produces outcomes that are consistent with the social benchmark *whatever are the social values* from which it has been derived. The fact that utility (or value in use) is the essence of economic goods is sufficiently universal and the only difference which may appear across societies and cultures is the specifics of those values. As Robbins (1935, pp. 25–26) claimed, the only difference between a community of sybarites and a community of ascetics is that the prices of wine and ecclesiastical artefacts are going to be different, reflecting the difference in the value (utility) which members of society lay on these types of goods. This means that in every society the price of goods will always reflect—in a perfectly competitive environment—the subjective values of things to members of that society. This, of course, is associated with the

away. It is central to the theory of value' (Fisher 2011, p. 43). Some would argue that there is a difference between stability and price formation and may cite the idea of temporary equilibrium—conceived by Marshall and expanded by Hicks—as the place to look for an answer but here too the outcome was not helpful. Hicks himself recanted his theory on two grounds which reflect this kind of disappointment: firstly, because he thought it wrong to discard a slow process of equilibrium (which is indeed what we refer to as price formation mechanism), and secondly, because he felt that it was far too removed from the world it was supposed to conceive. More generally, he realised, correctly in our view, that there is nothing between this story and Walras: 'Where I now feel that I went wrong was in my attempt to represent the markets of that week as being in equilibrium, even in 'general equilibrium' in the sense of my static theory' (Hicks 1977, VI).

fact that all individuals are rational in the sense that they choose the best means to an end and they have, therefore, all solved their economic problem which is how to reconcile the fact that they desire things which are scarce. Moreover, as the meaning of Walrasian equilibrium is that the value in use per pound spent on its purchase will be the same across all markets, it also means that no individual can become better off without harming another (something which later on became the concept of Pareto-efficiency). Therefore, the principle of competitive decentralisation, or the pursuit of competitive markets, promises not only that prices will reflect the true socially constructed values of goods but also that all agents will solve their individual economic problem and no single agent can become better off without making someone else worse off, which means that there is no waste in potential benefits from trading in the market.²⁴

So, the great promise of modern economics' paradigmatic core is that the relentless pursuit of competitive decentralisation will lead to Walrasian equilibrium prices and, with it, to all the benefits associated with such prices as they are, of course, equal to the social benchmark for economic performance.²⁵ If until the neoclassical revolution, economics was about commenting on the reality of the natural phenomenon of markets from some social or ethical perspectives so that one can form an opinion about the social value of markets, in the modern era all caution has been thrown to the wind. Competitive markets not only are a natural phenomenon but also have an ideal form which is the notion of perfect competition. If the implications of Smith's analysis of markets and natural prices were that markets, even when perfectly competitive, are not always working in tandem with social objectives, the modern conclusion is that the social objective should be to make markets work.

²⁴ Naturally, to say that such an outcome satisfies a social benchmark, we must also suppose that society has means by which to direct the outcomes of competitive interactions. In modern economics, as will be explored in Chap. 2, this is done through the second welfare theorem, which allows us to achieve whatever outcome society prefers through competitive markets. In Walras, this appeared in the form of his subsequent writings about social economics in which he expects society to own all land and use the rent to fund social projects that will help adjust outcomes to whatever it is that society deems as important.

²⁵ In fact, even though most work nowadays is not directly conducted on general equilibrium, much of it is about finding ways (institutional or contractual) to make the dream of universal competitiveness a reality.

There are many reasons to doubt the promise of general equilibrium—which we will discuss later on—however, the reason why we consider this a betrayal is because the ideal—those promising Walrasian prices—are, in fact, not reachable. It is not because there are problems in creating the perfectly competitive markets (and there are plenty); it is because of the absence of a sensible or realistic price formation process which will lead us to these prices. Even if all markets were perfectly competitive and there was no problem of incomplete markets, there is still no realistic conception of any price formation process which will produce those prices that promise all the benefits encapsulated in the social benchmark.²⁶ Worse still, not only that there is no process to lead us towards the Walrasian prices but even if we can approach them asymptotically, it is not at all clear that one can argue that as we approach Walrasian prices we also begin to reap the benefits which await us at those prices. In other words, all the benefits of competitive decentralisation will materialise at one point only, and this point seems to be beyond our reach; even if all markets were perfectly competitive, prices will forever oscillate around the values that will produce efficiency, but not even once will land at a point which is efficient (or a solution to the economic problem). So, one may wonder, what are the grounds for the insistence on competitive practices? If in the Smithian or Marxian system there was something, in principle, which could be done to make markets comply with social objectives, here it seems that there is nothing at all that can be done. Markets will always deviate from what could have been their social purpose, the benefits of competition will forever evade us and, therefore, the natural phenomenon of market should be viewed as a problem to be contained rather than an ideal to be promoted. *The betrayal of modern economics, therefore, is not so much the failure to see these difficulties—and economists are fully aware of them*²⁷*—but the blatant refusal to draw from it the right conclusions.*

²⁶ And this goes well beyond the question of stability which we mentioned earlier.

²⁷ Being aware of these difficulties allows economics, in principle, to unleash the arsenal of mechanism design, the aim of which is to help markets reach the socially desirable solution. But there is a certain circularity here. The beauty of competitive interactions and markets is that they reveal the socially desirable prices without a need for a central authority to gather a great deal of information or guide the economy. For mechanism design to work, the designer needs to know where it is they wish to guide the economy (as it seems to go to the wrong place otherwise) and thus become a central planner. In this respect, it seems to invoke parallels with the *socialist calculation debate*; only

Instead of concluding that competitive decentralisation will never lead to a socially desirable solution, that the reality of markets is forever inefficient and cannot constitute the solution to the economic problem, we still recommend them as a universal and ethically neutral form of organisation. Instead of recognising that competitive markets are the problem, we are constantly seeking to expand them and increase competitiveness rather than struggle to contain them and look for alternative, more beneficial, forms of economic and social organisation.

Of course, one may argue that the main benefit of competitive markets is the plenty to which they give rise. But for an individualistic theory, this is not saying much. The purpose of modern economics is to solve individuals' economic problem, which is not about the mere creation of aggregate plenty but, rather, its distribution. It is for this reason that in modern economics the most important criterion of economic performance is allocative efficiency rather than productive efficiency. Moreover, if the objective of society is to maximise aggregate economic output, it is difficult to argue that such an objective is ethically neutral or value free. If fulfilling greed is the objective of market-based economic organisation, then it would be difficult to insist on it as a global platform which is suitable to all possible cultures or societies.

The first part of the book (volume I), therefore, is dealing with this aspect of what we have provocatively called the betrayal. It is about the way in which modern economics has created a false agenda which has become the main element in the public discourse about economic and social organisation. Naturally, in addition to the actual promise associated with the social effectiveness of competitive markets, there are other reasons why the organisational principles of modern economics have had such an appeal. The first is the claim according to which competitive markets constitute a natural order. If we just let nature take its course, society will always benefit from it. Given that individuals are all rational (in a particular manner), they will be able to co-ordinate their desires without the need for an authoritarian intervention. They will achieve this through their natural drive to specialise, trade and compete. The second, as we said

this time, this would be, paradoxically, the *capitalist calculation debate*. There is also an element of it in what is known as *Ordoliberalism*.

before, is the association of competitive markets with growth or the accumulation of material wellbeing. What, of course, is interesting in this context is to ask the question of whether growth is part of the promise of economics' paradigmatic core or is it some form of a distraction after realising—as many economists have—that the pursuit of competition will not bring the promised social benefits. To put it differently, is growth the Eldorado which replaces the Promised Land? The third issue is the liberal connection that seems to bind modern economics and the idea of natural order, with some notions of liberalism and, in particular, with civic society. We are referring here to the association of competitive decentralisation with a natural order that promises freedom and justice on top of expediency.

Consequently, this part of the book comprises four chapters in which we are trying to deal with each one of the main issues. In Chap. 1, we examine in some general and meta-historical terms the appeal and meaning of natural order either as an ideal or as a conception of reality. In early stages, the notion of natural order was more about harmony and tranquillity associated not only with the compatibility of human actions but also with the union of humanity with what is essentially good. As such, natural order is an ideal predicated on particular human behaviour, which may not be characteristic of human nature. In some sense, harmony and order will be achieved when humans overcame their nature. It is thus an order that must be pursued rather than a depiction of reality.

With the Enlightenment, the idea of a natural order, or a self-regulating system, as a reality became closer. Newtonian physics unfolded the beauty of God's creation by suggesting that the world of matter, the beauty of which we constantly observe, is nothing but a self-regulating order held together by the concept of equilibrium. This led to the belief that the same could also be true of the world of humans. However, unlike the particles of the material world, humans have opinions, reflect on outcomes and can even change their behaviour. Therefore, the only way to create a social self-regulating harmony would be through the endogenisation of these opinions, or, more generally speaking, ethics. As the latter takes longer to be formed or changed than the immediate economic interactions, we propose a distinction between 'synchronic' and 'diachronic' orders. The former is the immediate compatibility of economic