

sanity, humanity and science

# post-autistic economics review

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## Seven Theses for a Theory of Realist Economics\*

### Part I: Theses One to Four

(Part II: Theses Five to Seven will appear in the next issue)

Jacques Sapir<sup>1</sup> (L'École des Hautes Études en Sciences Sociales, Paris)

The issue of realism has been central to the PAE movement from its beginning. As I have previously stated in this journal and elsewhere, for me realism is not the opposition between a "factual" world and a "theoretical" one, between reality and abstraction. Instead for me realism is both a methodological stance and the definition of a theoretical research program.

Realism however can give rise to different interpretations. Uskali Mäki has made an important distinction between world realism and truth realism.<sup>2</sup> This distinction nevertheless raises the issue of what we understand as being the "real world", and there is here a kind of fast-lane to positivism.

I agree with Tony Lawson's distinction between events and processes.<sup>3</sup> A process, a notion central to the works of Marx and Keynes,<sup>4</sup> is understood here not as a sequence of events but as "...the genesis, reproduction and decline of some structural mechanism or thing, the formation, reformation and decay of some entity in time".<sup>5</sup> This realism is completely different from empirical realism, which takes for granted the notion that any human agent can have a direct, non-mediated access to reality.

'Realism' as I use the word is both procedural and subjectivist. Subjectivism does not mean that human subjectivity is the only possible reality, a fallacy commonly found in some post-modern

authors, but that subjective views of reality, as far as they shape human decisions, are part of reality. Realism will then define methodological constraints for economists. That does not mean that economics must have a specific methodology, which is the position of mainstream economists defending Friedman's instrumentalism, but rather that the methodological requirements for social science can have distinct applications for economics, with specific methodological rules for conducting enquiries or for story-telling.<sup>6</sup> Elsewhere I have described what such applications in the methodology of economics could be.<sup>7</sup> Realist economics does not bear kindly theoretical tinkering or *ad-hoc* arguments. There are, as I have explained before in this journal, limits to pluralism.<sup>8</sup>

A coherent research program needs to be developed for a realist economics. To this end I offer the following seven theoretical theses.

**Thesis 1: The central issue in economics is the co-ordination of decisions and interactions generated by decentralised, heterogeneous and interdependent agents whose decision-making abilities are constrained by limited cognitive capacities.**

In the real world, in the theoretical sense of this word, decision-making is done in a decentralised way. Not to acknowledge this fact is to reduce human agents to the status of mere parts of a giant machine, the issue then being who is the power behind such a machine, God Almighty, the market auctioneer (pace Walras), the Party general secretary or the mainstream economist himself.

But human agents are not only decentralised, they also are heterogeneous. Not to acknowledge heterogeneity, as when one assumes identical decision-making patterns and initial positions or a single commonly shared rationality principle, transforms the community of human agents' into a world of clones. If this were really the case there would be no sense in talking about decentralisation even in a politically free society.

The decentralisation principle is then largely grounded on the refutation of the possibility of a single rationality principle which could be shared by all agents, everywhere, always and under every possible condition. Daniel Kahneman and his colleagues, the late Amos Tversky especially but also Richard Thaler, Paul Slovic and Sarah Lichtenstein to name just a few, have made this refutation.<sup>9</sup> The reluctance of mainstream economists to acknowledge these scientific results - a paradoxical position for a group professing fondness for the Popperian legacy - betrays their unwillingness to accept true decentralisation, whatever they may say about possible different initial human and material resources allocations to individuals. Heterogeneity is a necessary concept for understanding decentralisation. Ultimately heterogeneity means not just that situations can be different and thus also the social positions from where decisions are made. This is heterogeneity in its descriptive sense. In a more analytical sense heterogeneity derives from the fact that patterns of decision-making, models of rationality - here to be understood as the simple fact of having a reason for doing something - are different. Heterogeneity is not exogenous to the decision-making process, something that a dedicated policy could eradicate, but instead something at the very heart of this process.

The interdependency of decentralised and heterogeneous agents must be understood. The standard economics theoretical tradition emphasises the Robinson Crusoe metaphor, negating the interdependency issue, and envisions the social process from the point of view of a completely isolated individual. Against this tradition, realist economists conscientiously put the issue of possible unintentional effects of individual decisions on other agents at the very centre of economic activity and as part of social life. Here they reclaim both Hayek's legacy, at least the one coming from *The Constitution of Liberty*,<sup>10</sup> and the Durkheimian one with its concept of *social density*.<sup>11</sup> This last, that the web of intentional and unintentional relations and the perceptions related to them is the real place where decisions are made, was developed by Emile Durkheim in his seminal work on the social impact of the division of labour.<sup>12</sup>

To jointly acknowledge decentralisation and interdependency implies a switch from the allocation paradigm to the co-ordination one. Co-ordination can be achieved through intentional processes (networks and hierarchies) as well as through unintentional ones (markets). But whatever the process one thinks fits best at a given time and for a given problem, decentralisation is the central issue.

Anti-realism as a methodological strategy supported by mainstream economists does not stop with rejection of heterogeneity and/or interdependency. Perfect information, as in the initial Walrasian model or as in the rational expectations theory, is part of such a strategy. Refutation of the perfect information assumption can be epistemic. Simon and de Groot have shown that even if a perfect information structure could exist, our cognitive capacities preclude us from computing in a time short enough for this structure to be of actual use for our decision-making process.<sup>13</sup> But refuting the perfect information assumption can also be ontological. Perfect information could be an unreachable goal because the real world is too complex to be understood - the classical Hayekian understanding of uncertainty - or because our own attempts to gather more information are generating endogenous modifications of the information structure (Stiglitz, Akerlof). Uncertainty is then not an exogenous addition but is endogenously generated. This understanding of uncertainty puts the asymmetrical information school on the right side of the methodological realism border when compared to the information search school (Stigler).

One has to add that if we agree with the fact that there can not be a single and common rationality principle then the rational expectations theory is devoid of any logical basis. Whatever the reason for endogenous uncertainty, this assumption is another defining characteristic of mainstream or non-realist economics. It is so as to deny uncertainty that neo-classical economics pretends to give to profit and price a natural law dimension.<sup>14</sup>

A common attribute of varieties of non-realist economics, whether because they refuse to acknowledge heterogeneity or interdependency or endogenous uncertainty, is their denial of the relevance of time and money. Realist economics, on the other hand, stresses time and money relevance. Time is relevant as a causal factor,<sup>15</sup> something which was understood quite early by Gunnar Myrdal who pointed to the relevance of the ex-ante / ex-post divide in the perceptions of economic agents,<sup>16</sup> and by the classical institutionalist school with its first mover / second mover paradigm.<sup>17</sup> Time is also relevant, as a delay between decision and effects or between a demand and a supply response, as clearly understood by Mordecai Ezeckiel a long time ago.<sup>18</sup>

Money is a necessary institution for co-ordination. It generates the illusion of homogeneity that agents need to make complex decisions on the basis of their limited cognitive capabilities and because, by allowing for the separation between income formation and income utilisation, money makes possible a better use of time.

**Thesis 2: If money is a necessity in an uncertain world, money also introduces a specific form of uncertainty, casting doubts on the market's ability to efficiently process information.**

In a world devoid of uncertainty money would not matter. But money gives to every agent in an uncertain world the ability to shelter himself in liquidity. Liquidity in turn allows every agent to defect from the long and continuous chain of interdependencies generated by the division of labour. This very possibility of defection introduces a new strategic uncertainty which is at the heart of economic decision-making in money-based economic systems. Actually there is a deep interaction between uncertainty and the flight to liquidity, which in turn generates this strategic uncertainty. This was perfectly described years ago by G.L.S. Shackle:

"When knowledge seems especially elusive, we desire money rather than specialised, vulnerable assets. We sell the assets, their prices fall and it becomes no longer worthwhile

to produce them, no longer worthwhile to invest, to give employment. Had Keynes attended to Cantillon, he could have freed himself from the proposition that an employer will always offer a wage equal to marginal product of value of his body of employed people. For since he must employ people first and sell their product later, he cannot know for sure what their marginal product is going to be".<sup>19</sup>

Hyman Minsky has shown how financial innovation, as burgeoned during the second half of the XXth century, could be deeply destabilising.<sup>20</sup> From Marx to Keynes, realist economists have analysed how the flight to liquidity should put crisis - not equilibrium - at the centre of economic thinking. Crisis is the permanent horizon of a capitalist economy because either liquidity is too much in demand or is not wanted at all. The specific uncertainty generated by liquidity pushes economic systems toward under-investment and under-employment. This uncertainty can not be managed by economic computation and can be called radical uncertainty.

Here we are facing the first paradox of money. As an institution money pretends to solve the heterogeneity problem by setting monetary prices as a common norm for decision-making, something which makes the deepening of the division of labour possible. However by doing so money generates the radical uncertainty which constrains the expansion of the division of labour.

A second paradox of money is that as an institution it would seem to unify time through interest rates and its function as a reserve of value. But money, through its liquidity function, contributes greatly to making the future even more uncertain.

The twin paradoxes of money stress the fact that if monetary prices are a necessary fiction, from the realist economics point of view, they nonetheless are a fiction. That was precisely what Max Weber tried to show when explaining that monetary prices are necessary in a decentralised economy but are not the result of demand and supply equilibrium - as pretends capitalist spontaneous collective thinking. Monetary prices actually reflect the balance of power between social or individual forces and interests.<sup>21</sup> Keynes, in one of his first works, wrote something very similar. He explained that inflation and deflation translated into the monetary world social conflicts opposing large, structured social groups.<sup>22</sup>

However if monetary prices are a necessary fiction they also are an uncompleted one.<sup>23</sup> They are unable to carry the whole range of information needed for decision-making. Because we need information which can not be conveyed through monetary prices and which belong then to different information spaces, our decisions are situated and embedded in multidimensional worlds. One consequence is that the transitivity of individual preferences is broken in a systematic way.<sup>24</sup> Then the Allais' Paradox holds true,<sup>25</sup> and we can forget the subjective expected utility theory and every device invented by mainstream economics to transform the static Walrasian world into a dynamic one and to cope with uncertainty (even in a Bayesian form). A second consequence, as demonstrated by Grossman and Stiglitz, is that in such a situation, where prices do not convey all needed information, competitive markets are not informational efficient.<sup>26</sup>

### **Thesis 3: Time and money are at the very heart of the interchange between the individual and collective levels.**

Time matters, inter-alia, because of the time constraint: the more we wait before making a decision the more we lose even if our decision is the perfect one. However the time constraint has not the same meaning for individuals and groups. Our decision tempo is largely shaped by our more or less deep insertion into collective groups, from the family to the enterprise, including social and political organisations. In turn, the way collective groups are institutionalised shapes also their impact on our individual use of time and our sensibility to the time constraint.

The power that money gives, particularly as liquidity, is not used in a vacuum of representations. Kahneman and his colleagues have demonstrated that our individual preferences are shaped, or more precisely "framed" by collective contexts.<sup>27</sup> But the way I use my liquidity power could affect decisively some collective groups to which I belong, even if I have no idea of this fact. A bank-run, even if induced by misguided collective representations, is a movement of thousands of individuals who try to protect their savings but, by doing so, usually destroy most of the economic context supporting collective groups (enterprises) from where their income is generated.

Any attempt to seriously make time and money relevant, from a theoretical point of view, amounts to repudiating methodological individualism. But because time and money relevance comes from interdependency and from social density, we also have to repudiate the idea of a single dominating collective context. If realist economics embraces methodological holism it is a non-deterministic holism.

**Thesis 4: Any attempt to negate the theoretical status of time and money leads to non-scientific assumptions and transforms the economist himself into a producer of ideology.**

Being serious about time and money places economics in the very middle of the social sciences. If statistical regularities and stabilities are to be found, they are not the products of intemporal laws but of social systems of institutions. The stability of these systems is itself a local and temporary phenomenon. On the other hand if one wants to ground economics on laws similar to ones found in natural sciences, in physics or mechanics, one has to negate time and money relevance. Such a strategy is logically coherent if and only if one negates either decentralisation or interdependency. Both are radical retreats from realism.

Here we have one of the most fanciful paradoxes of mainstream economics. To reject realism for axiomatics, mainstream thinkers have to invoke ergodicity.<sup>28</sup> But to pretend that economic processes could be in any sense a kind of ergodic process, one has to demonstrate that they are subject to a determination which is non-human (thereby violating the initial assumption of decentralised decision-making) and non-social. Obviously the standard theory of individual preferences and its conclusion, the closed and universal model of rationality, fit nicely here.

Traditional assumptions about individual preferences (transitivity, continuity, reflexivity, independence and time monotony) are then just not ad-hoc assumptions but the logical core for any instrumentalist methodology grounded on preference utilitarianism.<sup>29</sup> They provide the stable, non-social, reference point needed to pretend that observable local economic stabilities are like the exposed tips of yet unknown "natural" laws of economics.

It happens to be the case, however, that all these axioms can be tested and when they are they are invalidated.<sup>30</sup> Facing such results most mainstream thinkers pretend they are irrelevant. They dismiss the very idea of confronting an economic theory with real life experiments.<sup>31</sup> By doing so they fail to understand that they can claim legitimacy for the axiomatic approach if and only if they can find empirical grounds for their ergodic assumption. What psychology has done is no less than to destroy the only substantial argument for ergodicity, that is the universality and stability of the neoclassical model of rationality.

The willingness to integrate into economic theory the findings of applied psychology versus the refusal to do so is the true borderline between economics as a scientific activity and economics as production of ideology. The defence of axiomatism clearly no longer belongs to any kind of scientific approach to economic phenomenon but instead is a form of religious thinking.

In contrast to the we-do-not-want-to-know approach, George Akerlof has succeeded in integrating recent psychology results to a theory of inflation, which is clearly Keynesian.<sup>32</sup> Akerlof's writings are living proof that Kahneman and Tversky works can be solid ground for Keynesian assumptions,

particularly when it comes to money and time.<sup>33</sup>

## Notes

\* This paper is a translation and adaptation of one that appeared in the French journal *Alternatives Économiques* (n° 57, 2003, hors série, pp. 54-56, see also [www.alternatives-economiques.fr](http://www.alternatives-economiques.fr)) and is published here with authorisation of the journal's editorial board. The initial aim was to review assumptions developed in an earlier book, *Les trous noirs de la science économique* (Albin Michel, Paris, 2000) and to specify some details that could be of use for the PAE readership.

This book was published in the very middle of the battle following the French students appeal for more realism in the teaching of economics (spring 2000) and sold quickly, being re-printed twice before its forthcoming pocket edition, September 2003. This coincidental publishing was a pure stroke of luck. The book was written between 1995 and 1998 when I was teaching at the *Vyshaya Shkola Ekonomiki* (Higher School in Economics - Moscow). From lectures delivered in Moscow I wrote first a basic book for Russian students (*K Ekonomicheskoy teorii neodnorodnykh sistem - opyt issledovaniya decentralizovannoy ekonomiki* - Economic theory of heterogeneous systems; an essay on decentralised economies) which was published by Vyshaya Shkola Ekonomiki Press, Moscow, in 2001. At the same time I re-focused and expanded part of its content to write *Les trous noirs*, this time not as a basic book but as a critical essay on mainstream economics. This second book is not then the translation of the Russian one, although they are closely related.

I have adapted and developed here the arguments of the *Alternatives Économiques* paper for the sake of an English language readership not necessarily aware of debates currently raging in Paris.

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## Part II: Theses Five to Seven will appear in the next issue.

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## Special Request

*The Crisis in Economics: the post-autistic economics movement: the first 600 days* was published in May. It consists of material taken from the first 12 issues of this journal. **You are encouraged to review and/or rate, hopefully with 5 stars, this book on any of the various online bookshops that offer this opportunity.** Your doing so will help spread the PAE message. Links to the relevant web pages for reviewing and/or rating *The Crisis in Economics* for various online bookshops are as follows.

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## Capabilities: From Spinoza to Sen and Beyond\*

### Part II: A Spinoza-Sen Economics Research Program

Jorge Buzaglo (formerly University of Gothenburg, presently in search of funding and affiliation)

[“Part I: Spinoza’s Theory of Capabilities” appeared in the last issue](#)

### *The Ethics* and present-day science

The psychophysical identity theory in Spinoza’s *The Ethics* is particularly well adapted for the analysis of the body/mind problem in the framework of present day natural sciences. In particular, evolutionary theory finds its natural foundation in the notion of immanent causation inherent to Substance (God or Nature) — that which has itself as its own cause and is not produced by anything external. Particular entities are modifications or *modes* of the Substance, produced by one another in an infinite chain of causation. According to Henry Atlan (1998, p. 215), “[w]ith such a notion of immanent causality, Evolution can be seen as the unfolding of a dynamic system, or a process of complexification and self-organization of matter, produced as the necessary outcome of the laws of physics and chemistry. In this process, new species come into existence one after the other as effects of mutations and stabilizing conditions working as their efficient causes, whereas their particular organizations are particular instances of the whole process.” The omniform complexity of the texture of matter/extension corresponds to the omniform complexity of the thought dimension of the Substance. To the chain of causes in the material domain corresponds an equivalent chain of causes under the attribute of thought.<sup>1</sup> It is important to remark the absence in this conception of interaction between matter and thought; both have their own, equivalent causal structures, as they are two (different) faces of the (same) coin. In his *Ethics* Spinoza writes:

[A] *mental decision and a bodily appetite, or determined state, are simultaneous, or rather are one and the same thing, which we call decision, when it is regarded under and explained through the attribute of thought, and a conditioned state, when it is regarded under the attribute of extension, and deduced from the laws of motion and*



rest (3.2, Note).

Or, as emphatically stated in 3.2: *Body cannot determine mind to think, neither can mind determine body to motion or rest or any state different from these, if such there be.*

However, the idea that the decisions of the mind determine the actions of the body is deeply rooted in our intuitive (unreflective) view of our actions. This is due, thinks Spinoza, to the fact that, in general, we are aware of our desires and intentions, but unaware of the causes that motivate these desires and intentions (2.35, Note; 3.2, Note).<sup>2</sup> The belief is so entrenched that it is merely at the bidding of the mind that the body performs its actions, says Spinoza (3.2, Note), that only experimental proof may eventually induce us to change our minds.

Now, it seems that neuroscience can today supply the conditions for an experimental proof of immanent causation, and convincingly reject the hypothesis of mental causation of bodily action. As reported by Atlan (1998), Libet (1985) consistently found that a conscious decision to act corresponds to an electrical brain event which occurs 200 to 300 milliseconds *after* the beginning of action. This experimentally reproducible fact, consistent with the above “monist” model, falsifies the conventional idea of mind-determined bodily action. The action of the body is triggered by some neuronal unconscious stimuli. That is, a physical impulse determines a bodily movement. Accompanying that action there is a conscious observation with an understanding of the action. The conscious observation accompanies the action, but it is not its cause. The psychic decision and the neural impulse are identically equivalent, each within their own domain of existence/description.<sup>3</sup> This fact has of course important consequences for our understanding of *homo oeconomicus*, and for what can be accepted as meaningful explanation in economic theory.

### **Economic theory after *The Ethics***

The effects of the above insights on conventional economic theorising are, I think, devastating. The utility maximizing individuals of conventional theory are isolated minds commanding bodily actions. *Homo oeconomicus* is a mind with a particular preference system and a perceived resource constraint commanding a body to perform specific actions (purchases and sales) in a marketplace. This mind is conscious of its own actions, and ignorant of the causes by which it is conditioned. This idea of “rational choice” simply reflects ignorance of any cause for the agent’s actions.

That is, the *homo oeconomicus* model of conventional microeconomics does not specify how the preferences of the mind have been themselves determined, and even less how the mind determines the body to perform its “optimal” decisions in the market. Microeconomics is totally silent on how and where this interaction could take place. The model of man propounded by microeconomics simply eludes the problem of interaction. The man of microeconomics should more accurately be named *homunculus oeconomicus*. In cognitive science, the *homunculus* is an implausible little man inhabiting the brain and embodying an uncaused will making choices and commanding the body to execute them.<sup>4</sup>

The canonical model of body/mind dualism is still that of Descartes in *Traité des Passions de l’Ame* (1.50). In Descartes, the will, located in the pineal gland, receives signals and sends impulses — by means of the bodily humours (*esprits animaux*) — to other parts of the body.<sup>5</sup> But, as Spinoza argues (Part 5, Preface) it is not possible to have non-physical entities acting on material objects (*deus ex machina*) as an acceptable form of rational explanation. Should an interactive mechanism ever get specified, it would absorb the non-physical antecedent into the physical consequent.<sup>6</sup>

In *The Ethics*, individual entities are, as described in the previous section, causally interconnected in an unlimited web of modifications (*modes*) of the uncaused Substance (*causa sui*). The ideas of the mind are causally connected to other ideas, as bodies in space are causally interrelated. Yet this does not exclude autonomy and responsibility. On the contrary, individual entities endeavor to exist according to their own individual nature (3.6):

*Everything, in so far as it is in itself, endeavors to persist in its own being.*

For Spinoza (3.7), the actual essence of a thing is nothing else but this endeavor to persist in its own being (*conatus*). The mind endeavors to persist in its being, and is conscious of it (3.9). An implication of *conatus*, as formulated in the *Theologico-Political Treatise*, is that

[...] *no man's mind can possibly lie wholly at the disposition of another, for no one can willingly transfer his natural right of free reason and judgment, or be compelled to do so... All these questions fall within a man's natural right, which he cannot abdicate even with consent.* (Spinoza 1951, p. 257, quoted from Ellerman 1992, pp.144-5)

The freedom of the mind is, for Spinoza, inalienable, for it cannot renounce, even if compelled to, its own nature.<sup>7</sup> *Conatus* (a thing endeavoring to persist in its own being) belongs to the essence of human being, and this essence is common to all human beings. An important consequence is that slavery, even voluntary, is inherently invalid. The same logic, applied to the modern employment contract, makes it also inherently invalid and universal self-employment or economic democracy the only “post-socialist” alternative to present day wage-slavery.<sup>8</sup> Spinoza (1958, Chapter VI, par. 12) also propounds that land — the principal source of status, power and wealth in feudal society — be the public ownership of the commonwealth, and hired to its citizens. An up-to-date radical Enlightenment reform would then imply public ownership of capital, to be hired to the producers (“labour hires capital,” instead of the other way round) — along with abolition of the employment contract.

Now - What would it look like, an economic science that is consistent with the ontological scheme of *The Ethics*? As I see it, in the first place *Homunculus oeconomicus* should be exorcized. The fiction of invisible homunculi with particular (arbitrary) idiosyncrasies performing their autistic optimizing calculus, and thereby shaping the economic (extended) space, should be abandoned.<sup>9</sup> Instead of the homunculus, we should introduce the notion of an (intersubjective) economic mental space. In my view, the most fruitful concept for representing the causal web of interconnected thoughts is the notion of *field*. Individual thoughts (perceptions, deliberations, feelings, volitions, etc.) are not arbitrary or contingent, but belong to structured sets.<sup>10</sup> Consumption choices, for instance, change characteristically over socioeconomic classes. They show also observable patterns over space. Being subjected to causal processes, individual preferences also show definite patterns of change over time — although accepting this obvious fact is anathema for conventional economics. Another obvious fact is that individual choices are influenced by persuasion (advertising, etc.), which so contributes to shaping the field of preferences. Collective opinion, as reflected for instance in regulating bodies and other social institutions, also shapes the economic mind-space. Similar analysis of causal chains should be applied to the subjective dimension, or economic psychology, of production and other spheres of economic activity. All these aspects should also be embedded in the characteristic mentality or spirit of the time (and place), or dominant ideology, which influences the configuration of the whole economic mind-set. Our Spinoza-Sen objective for economic and social development being not consumption or output, but enlarged human capabilities, it would also be necessary to confront the additional difficulty of tracing the effects of consumption and production activities on mental capabilities. Certain types of consumption (and production) contribute to enlarging capabilities more than others; some have negative effects; some have only transitory effects, other more durable; etcetera.

I am afraid that, to many, the above research program would look rather quixotic. However, what as a whole and at first sight can look like an overly ambitious project, might give some interesting results already at the initial stage of description, conceptualization, formalization, and organization of data. Indeed, the task is greatly facilitated by the wealth of extant results from empirical research in different disciplines (marketing, experimental and industrial/economic psychology, etc.). However imperfect and limited, this change of perspective, from the constricted perspective of the homunculus towards the extensive causal network of the economic mind-space, would imply a decisive movement, within the discipline of economics, in the direction of what one philosopher of science called the “great transformation,” in the evolution from the ego-centered image towards a unified, scientific view of human being.<sup>11</sup>

Let us now leave the mental dimension, and briefly refer to the “extended” dimension of our

“psychoeconomic” identity, that is, the external world of observable economic relationships. With the sorilege of the homunculus gone, big chunks of masonry — or even all of it — risk falling from the baroque façade of economics. The underlying classical structures, closely related to social philosophy and ethics, will appear in all their august beauty. The parts of economic theory inhabited by the homunculi and affected of Cartesian interactionism/dualism will lose much of their enchanting power. A case in point is the Arrow-Debreu model of general equilibrium, the central piece of conventional economic theory and the archetype of interaction between atomistic, self-caused minds, and passive bodies (consumers, factor owners, firms, etc.) acting in the markets. This means also that most of microeconomics should follow the same fate, for it is today conventionally conceived as variations on different aspects — and in teaching, a piecemeal construction — of the general equilibrium model. Along with microeconomics should also go most of macroeconomics, since most of conventional macroeconomics has today abandoned the Keynesian paradigm, to become a kind of aggregated, policy-oriented — and often interest-group — microeconomics.

The view of the economy as a causally structured, directly observable system of relationships existing in time has deep roots and lively ramifications in economic theory. One of the oldest sources of this view is the *Tableau Économique* of François Quesnay (published in 1766). For Quesnay, the chief question for investigation was what causes the wealth of the nation, and how this wealth circulates between “*la classe productive, la classe des propriétaires & la classe stérile.*” The *Tableau* is the first sophisticated analysis of the flow of value through the economy and among social classes. This focus on value creation *and* distribution was characteristic of the classical economists, including Marx, and could be seen as the permanent characteristic of a wide strand of economics that flourishes still today. This wide current includes nowadays post- and neo- Keynesian (Kaleckian) economics, Sraffian and neo-Ricardian economics, input-output economics, and (non-interactionist) post- and neo-Marxian economics.<sup>12</sup> But what from the Spinoza-Sen perspective is still lacking in all these theoretical approaches is how output and distribution relate to capabilities. These theories focus on the growth and distribution of output and incomes, but not on how they influence the growth and distribution of human capabilities. These theories describe production and distribution/exploitation in the system where “the accumulation of capital is God and the prophets.” We should also analyse systems operating towards expanding human capabilities.

## Notes

\* I would like to thank Edward Fullbrook for his suggestions during the work on this essay and the Wenner-Gren Foundation whose grant facilitated this study at an early stage.

1. This implies that to all forms and levels of organization of matter correspond different forms and levels of organization of thought. The psychophysical identity, says Spinoza (2.13, Note), is ... *entirely general, applying not more to men than to other individual things, all of which, though in different degrees, are animated.* This type of theory has been named, in different contexts, monism, panpsychism, or hylozoism.

2. Or, in the words of a brain scientist and philosopher (Flanagan 1996, p. 56): “We typically have no accurate and ongoing personal access to proximate causal antecedents of conscious acts of thought and choice, and this can produce a ‘user illusion’ that unmoved volitions precede and guide acts.”

3. Or, in other words (Feigl, 1967, p. 79), “... the states of direct experience which conscious human beings “live through,” and those which we confidently ascribe to some of the higher animals, are identical with certain (presumably configurational) aspects of the neural processes in those organisms.” Or also (ibid., p. 149): “... the configurational (Gestalt) features of immediate experience are isomorphic with certain global features of our brain processes. Hence, strange as it may sound at first, it is possible that by doing introspective-phenomenological description of immediate experience, we are in effect ... doing a bit of ... brain physiology.” This type of insight led Bertrand Russell (1959, p. 25) to maintain that “... the brain consists of thoughts.” In the intricate language of quantum mechanics, psychophysical identity is described as follows (Lockwood 1990, p. 191): “An n-dimensional phenomenal quality [mental] space is to be identified ... with an n-dimensional space of observable attributes, each point of which is associated with some n-tuple of eigenvalues of the spectra corresponding to the shared eigenstates (eigenvectors) of a set of n compatible brain observables.” A particular (and in my view, restrictive) version of psychophysical identity theory, popular among scientists (“physicalism”), simply affirms that “there is no mind: the mind is the brain” — there are no psychological facts that are incapable of being reduced to physical facts (see e.g. Humphrey 2002).

4. See e.g. Dennett (1991).
5. Descartes' *esprits animaux* became famous among economists as the unfathomable "animal spirits" of the investors in Keynes.
6. "I think we know for sure that neuroscience is not going to find any place for metaphysical freedom of the will, since that would involve neuroscientific vindication of the hypothesis that there is a faculty that initiates thought and action without itself having causal antecedents" (Flanagan 1996, p. 58).
7. See Flanagan (2002, Chapter 4) for a recent discussion of the compatibility of free human agency and moral accountability with universal causation (no Cartesian free will).
8. See Ellerman (1992). Chapter 9 of this book contains an enlightening intellectual history of this argument in the protracted struggle against slavery.
9. "The image of a decision maker that makes choices by consulting a preexisting preference order appears increasingly implausible. The alternative image is of a decision maker ... who constructs preferences in the context and in the format required by a particular situation." (Kahneman, 2000, p. xvi).
10. Kurt Lewin (1936) represents a seminal exponent of this approach. Unfortunately, it does not seem to have produced as many followers as it deserves. Another, more recent, possible structuring principle is the set theoretic dialectical psychology of William Hoffman (1999). Kahneman and Tversky (2000) document a wealth of experimental research showing the implausibility of the homunculus, and pointing to the (intersubjective) rationality of causal structures/processes.
11. "What happens in this "great transformation" is the replacing of most (or all) concepts of the solipsistic (egocentric) perspective as well as the manifest [dualistic/Cartesian] image (still suffused with subjectivistic features) by a completely intersubjective account. This has been seen, but expressed far too obscurely, even by the existentialists (e.g., Martin Buber), when they speak of the shift from the "I-Thou perspective" to the "It perspective" of impersonal, objective cognition." (Feigl 1967, p. 155.)
12. Kurz and Salvadori (1995) is a concise survey of these schools. Other related schools are, for instance, the *école de la régulation*, evolutionary economics, (progressive) institutionalism, Latin American structuralism, and the SAM (social accounting matrix) approach.

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## **Ethics And Economic Actors**

Charles K. Wilber (University of Notre Dame, USA)

### **Introduction**

Economics and ethics are interrelated because both economists (theorists and policy advisers) and economic actors (sellers, consumers, workers, investors) hold ethical values that help shape their behavior. In the first case economists must try to understand how their own values affect both economic theory and policy. In the second case this means economic analysis must broaden its conception of human behavior.

In a previous article in this journal I dealt with the first issue. In this article I will focus on the importance of the second issue-- economic theory, with its myopic focus on self-interest, obscures the fact that preferences are formed not only by material self-interest but also by ethical values, and that market economies require that ethical behavior for efficient functioning.

### **Values of Economic Actors**

It is important to recognize that though Adam Smith claimed that self-interest leads to the common good if there is sufficient competition; he also, and more importantly, claimed that this is true only if most people in society have internalized a general moral law as a guide for their behavior.<sup>1</sup> This means that the efficiency claims that economists make for a competitive market system require that economic actors pursue their self-interest only in "fair" ways. Smith believed most people, most of the time, did act within the guidelines of an internalized moral law and that those who didn't could be dealt with by the police power of the state.

One result of this recognition must be the acknowledgment that a better conception of human behavior is needed. Thus, I argue that (1) people act on the basis of embodied moral values as well as from self-interest and (2) the economy needs that ethical behavior to be efficient.

Hausman and McPherson recount an experiment in which wallets containing cash and identification were left in the streets of New York. Nearly half were returned to their owners intact, despite the trouble and expense of doing so to their discoverers.<sup>2</sup> It could be argued that altruistic motives-- modeled as the concern for another's utility as an element within one's own utility function-- ultimately are an extension of self-interested behavior. Such an argument is substantially weakened in this case because the discovered wallets belonged to persons unknown to the finders. Hence, the personal satisfaction and pleasure stemming from the wallets' return ought to be significantly diminished, as altruistic sympathies are usually weaker with a lack of personal familiarity. The effort expended and the apparently unselfish behavior demonstrated by those who returned the lost goods

may, as Hausman and McPherson assert, more likely reflect a commitment to societal norms than a reflection of egoistic desires.

Similarly, it usually is argued that the provision of such goods as public broadcasting and church services will be hobbled by the classic free-rider problem that accompanies public goods. Many consumers of these goods do indeed fail to respond to funding appeals or shirk as the collection plate passes. This, however, does not explain the motivation of the many who do give. Are we to attribute irrationality to those who contribute to public broadcasting, for example, knowing that their gift offsets the free-loading of others? In the case of public church collections, it might be argued that the anticipated approval of fellow church-goers entices contributions and their threatened opprobrium dissuades stinginess. Masking the amount of one's gift in a closed fist or a sealed envelope are effective and relatively costless, however, and suggest that perhaps a sense of duty, obligation or gratitude might be more important in compelling contributions to church collections.

It is not only for the sake of accuracy that economists should pay attention to evidence that human actions are guided by concerns not solely egoistic, but also because there are real economic consequences to non-egoistic behavior. Robert Solow has suggested that "principles of appropriate behavior" among workers may explain why labor markets are not fully clearing. Appropriate behavior dictates that one not undercut a peer in order to get that person's position. As Albert Hirschman argues, this example of seemingly non-self-interested behavior may entail market inefficiencies and resulting costs, but most in society (with the exception of many economists) would deem the portrait of human interaction it paints as more than worth it.<sup>3</sup>

### **A Case in Point: The Supply of Blood**

An example of the problem of relying solely on self-interest is given by a comparison of the system of blood collection for medical purposes in the United States and in England. In his book, The Gift Relationship, Titmuss questions the efficiency of market relationships based on purely monetary self-interest principles.<sup>4</sup> Instead he hypothesizes that in some instances, such as blood giving, relying on internalized moral values (in this case, altruistic behavior) results in a more efficient supply and better quality of blood. Kenneth Arrow's response to Titmuss questions the extent to which altruism or other internalized moral values may be counted upon as an organizing principle yet acknowledges that there may, indeed, be a role for altruistic giving.<sup>5</sup> The following covers some of the more salient points in the debate and reflects on these issues in an attempt to clarify the role that embodied moral values may play in the economy.

Titmuss focuses on the blood supply system in Great Britain and the United States. The United States system has moved toward a commercialized market system in which suppliers of blood are paid for the service while in Great Britain the supply of blood depends on voluntary and unpaid individual blood donors. Titmuss argues that the commercialization of blood giving produces a system with many shortcomings. A few of these shortcomings are the repression of expressions of altruism, increases in the danger of unethical behavior in certain areas of medicine, worsened relationships between doctor and patient, and shifts in the supply of blood from the rich to the poor. Furthermore, the commercialized blood market is bad even in terms of nonethical criteria.

In terms of economic efficiency it is highly wasteful of blood; shortages, chronic and acute, characterize the demand-and-supply position and make illusory the concept of equilibrium. It is administratively inefficient and results in more bureaucratization and much greater administrative, accounting, and computer overheads. In terms of price per unit of blood to the patient (or consumer), it is a system which is five to fifteen times more costly than voluntary systems in Britain. And, finally, in terms of quality, commercial markets are much more likely to distribute contaminated blood; the risks for the patient of disease and death are substantially greater. It is noteworthy that since the AIDS crisis started in the United States, physicians regularly recommend that patients scheduled for non-emergency surgery donate their own blood in advance.

Arrow attempts to restate Titmuss' arguments in terms of utility theory. Thus the motivation for blood giving is reduced and reformulated in the form of a utility function. One such form is (1) the welfare of each individual will depend both on his own satisfaction and on the satisfactions obtained by others. We here have in mind a positive relation, one of altruism rather than envy. Another form is (2) the welfare of each individual depends not only on their own utility and of others but also on one's own contribution to the utilities of others. By representing altruism in this way, the incommensurability of self-interest and altruism that is crucial to Titmuss' analysis is ignored.

However, the commercialization of certain activities that historically were perceived to be within the realm of altruism results in a conceptual transformation that inhibits the expression of this altruistic behavior. Contrary to the commonly held opinion that the creation of a market increases the area of individual choice, Titmuss argues that the creation of a market may inhibit the freedom to give or not to give. If this is true then Arrow's model that treats apparent morally based behavior as a simple addition to an ordinary utility function, seriously misrepresents these issues. What is only mentioned in passing and downplayed by Arrow is that market relations may often drive out non-market relations. Material incentives might destroy rather than complement moral incentives.

The supply of blood provides a clear illustration of the problem. A person is not born with a set of ready-made values, rather the individual's values are socially constructed through being a part of a family, a church, a school and a particular society. If these groups expect and urge people to give their blood as an obligation of being members of the group that obligation becomes internalized as a moral value. Blood drives held in schools, churches, and in Red Cross facilities reinforce that sense of obligation. As commercial blood increases, the need for blood drives declines. Thus, the traditional reinforcement of that sense of obligation declines with the result that the embodied moral value atrophies. In addition, the fact that you can sell your blood for, say, \$50 devalues the donation from a priceless gift of life to one of a small monetary value. Finally, there is an information problem. As blood drives decline it is rational for an individual to assume that there is no need for donated blood. The final outcome is that a typical person must overcome imperfect information, opportunity costs, and a lack of social approbation to be able to choose to donate blood. The tremendous outpouring of blood donations after September 11 indicates the latent altruism available.

Economists often claim value neutrality in their analysis. But value neutrality cannot be achieved merely by focusing on the efficiency results of a policy recommendation derived from a theoretical model. The motivations on which the results are based are also important, that is, how we achieve these results needs to be addressed.

This problem arises because economists take preferences as given--they neither change over time nor are affected by the preferences of other individuals or society. Consequently, the process of preference formation and the nature of the preferences that people have are ignored. That the distribution of beliefs and behaviors at time  $t$  influences individual beliefs and behaviors at time  $t+1$  is, however, the single most basic finding of the voluminous research within sociology on the behavior of groups.<sup>6</sup>

Beliefs and preference structures are important because they are the basis for individual motivation. An understanding of these also gives us a notion as to what are and what will encourage the continuation of certain valued feelings. When economists look to self-interest to solve social problems they are placing a higher value on and promoting their own beliefs about what is proper motivation.

Even though neo-classical economists are seldom interested in why people behave the way they do, society usually places a high value on motivations. This is readily evident if one looks at the legal system. Consider a situation in which a person shoots and kills someone else. The end result is the same but depending on the motivation the act may be judged to be murder, justifiable homicide, or even just an accident.

In short, three conclusions can be derived from our discussion of issues raised by the Titmuss-Arrow debate. First, economic policies have a direct effect on both market outcomes and individual values. Second, economists should drop their narrow approach to human behavior and join the rest of society in giving attention to the effect that policies have upon values. How we achieve results is important. Finally, economists must recognize that the policy impact upon values exerts its own influence on future market activity. Thus, over time the type of values promoted by public action has significance even within the 'efficiency' realm of traditional economic analysis.

Economists are often reluctant to depend on ethics. Ethics are perceived to be a less stable attribute of human behavior than self-interest. As Arrow states: "I think it best on the whole that the requirements of ethical behavior be confined to those circumstances where the price system breaks down... Wholesale usage of ethical standards is apt to have undesirable consequences."<sup>7</sup>

Certainly individuals, with particular needs and abilities, motivated by self-interest do create consequences that often are benevolent. But there is also a role for ethically based behavior. In response to Adam Smith's "it is not from the benevolence of the butcher, the brewer, and the baker that we expect our dinner, but from their regard to their own interest," the reality is that more than half of the American population depend for their security and material satisfaction not upon the sale of their services, but rather on their relationships with others. There are many occasions on which reliance on the good will of others is necessary and more reliable.

### **Internalized Moral Behavior vs. Self-Interest**

I do not want to leave the impression that ethically based behavior and self-interest are necessarily mutually exclusive. Proximity to self-interest alone does not defile morality. Moral values are often necessary counterparts in a system based on self-interest. Not only is there a "vast amount of irregular and informal help given in times of need"<sup>8</sup>; there is also a consistent dependence on moral values upon which market mechanisms rely. Without a basic trust and socialized morality the system would be much more inefficient.

Peter Berger reminds us that "No society, modern or otherwise, can survive without what Durkheim called a 'collective conscience,' that is without moral values that have general authority."<sup>9</sup> Fred Hirsch reintroduced the idea of moral law into economic analysis: "truth, trust, acceptance, restraint, obligation-- these are among the social virtues grounded in religious belief which...play a central role in the functioning of an individualistic, contractual economy....The point is that conventional, mutual standards of honesty and trust are public goods that are necessary inputs for much of economic output."<sup>10</sup>

The expectation that public servants will not promote their private interests at the expense of the public interest reinforces the argument that the economy rests as importantly on moral behavior as self-interested behavior. As Hirsch wrote: "The more a market economy is subjected to state intervention and correction, the more dependent its functioning becomes on restriction of the individualistic calculus in certain spheres, as well as on certain elemental moral standards among both the controllers and the controlled. The most important of these are standards of truth, honesty, physical restraint, and respect for law."<sup>11</sup>

Attempts to rely solely on material incentives in the private sector, and more particularly in the public sector, suffer from two defects. In the first place, stationing a policeman on every corner to prevent cheating simply does not work. Regulators have a disadvantage in relevant information compared to those whose behavior they are trying to regulate. In addition, who regulates the regulators? Thus, there is no substitute for an internalized moral law that directs persons to seek their self-interest only in 'fair' ways. The second shortcoming of relying on external sanctions alone is that such reliance can further undermine the remaining aspects of an internalized moral law. The Enron case might be an example of the decline of those embodied moral values in the market place. As discussed above, by promoting solely self-interest society encourages that type of behavior rather than ethical



behavior. The argument is not that there is no role for self-interest, but rather that there is a large sphere for morally constrained behavior. To distinguish in which sphere self-interest should be used and in which sphere altruism should be promoted is very important and sends signals to society as to what we value.

## Conclusion

In conclusion, I claim that (1) self-interest alone does not adequately explain actual economic behavior because economic actors are also motivated by internalized moral values, such as trust and honesty and (2) self-interest does not lead to efficient outcomes in the absence of these moral values. The irony of mainstream economic theory is this: on the one hand it is permeated, despite repeated denials, with ethical values imported from its governing world view; on the other hand it fails to fully understand that economic actors are motivated by more than material self-interest *and need to be* if a market economy is to function efficiently.

## Endnotes

1. See Adam Smith, Theory of Moral Sentiments (London: Henry Bohn, 1861); A.W. Coats, ed., The Classical Economists and Economic Policy (London: Methuen, 1971); and Jerry Evensky, "Ethics and the Invisible Hand," Journal of Economic Perspectives, Vol. 7, No. 2 (Spring 1993), pp. 197-205..
2. Daniel M. Hausman and Michael S. McPherson, Economic Analysis and Moral Philosophy (Cambridge University Press, 1996), p. 34. It is interesting that experimental studies by psychologists indicate that people are concerned about cooperating with others and with being fair, not just preoccupied with their own self-interest. Ironically, these same studies indicate that those people attracted into economics are more self-interested and taking economics makes people even more self-interested. Thus economic theory creates a self-fulfilling prophecy. See Robert H. Frank, Thomas Gilovich, and Dennis T. Regan, 'Does Studying Economics Inhibit Cooperation,' Journal of Economic Perspectives, 7, 2 (Spring 1993), pp. 159-171.
3. Albert O. Hirschman, "Morality and the Social Sciences: a Durable Tension," in The Passions and the Interests: Political Arguments for Capitalism before Its Triumph (Princeton: Princeton University Press, 1977), pp. 304-5.
4. Richard M. Titmuss, The Gift Relationship: From Human Blood to Social Policy (London: Allen and Unwin, 1970).
5. Kenneth Arrow, "Gifts and Exchange," Philosophy and Public Affairs, I, 4 (Summer 1972), pp.343-362.
6. Steven Kelman, What Price Incentives? Economists and the Environment (Boston, MA: Auburn House Publishing Company, 1981), p. 31.
7. Kenneth Arrow, "Gifts and Exchange," p. 355.
8. Kenneth Arrow, "The Gift Relationship," p. 345.
9. Peter Berger, "In Praise of Particularity: The Concept of Mediating Structures," Review of Politics (July 1976), p. 134.
- 10 Fred Hirsch, Social Limits to Growth (Cambridge, MA: Harvard University Press, 1978), p. 141.
11. Fred Hirsch, Social Limits to Growth, pp. 128-129.

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# Confessions of a Recovering Economist\*

Jim Stanford (Economist, Canadian Auto Workers)

I am an economist. It is seventeen days since I last uttered the phrase "supply and demand." But the demon still lurks untamed, within me. Economics is an addiction. Every other addiction has a Twelve Step program, laced with tough love and blunt self-honesty. Why not a Twelve Step program for economists? God knows, we have done enough damage with our arrogant, drunken prescriptions. Here's how each and every economist can face up to their inner demons, and make their own small contribution to setting things right.

Economics is an addiction. Every other addiction has a Twelve Step program, laced with tough love and blunt self-honesty. Why not a Twelve Step program for economists? God knows, we have done enough damage with our arrogant, drunken prescriptions. Here's how each and every economist can face up to their inner demons, and make their own small contribution to setting things right.

**Step 1: Admit you have a problem.** Like they say at the AA meetings, this is half the solution. Where economists are concerned, however, it's easier said than done. Getting a substance abuser to face the facts of their addiction is nothing compared to convincing an economist that they're hooked on elegant but useless mathematical models, and authoritative but destructive policy advice. Where economists are concerned, we're talking denial with a capital 'D.'

**Step 2: Accept that all our efforts to explain the world have failed.** The 'market' is the holiest symbol in all of economics. It's magically automatic and efficient. And supply always equals demand. The whole profession of mainstream, 'neoclassical' economics is dedicated to the study of markets and how they can be perfected. The problem, however, is that in real life these idealized 'markets' don't explain much at all. Powerful non-market forces determine most of what happens in the economy - things like tradition, demographics, class, gender and race, geography, and institutions. Indeed, what we call the 'market' is itself a complex, historically constructed social institution - not some autonomous, inanimate forum. Power and position are at least as important to economics, as supply and demand.

**Step 3: Turn to our friends in other disciplines for help.** Economists get pretty snobby about the usefulness of other disciplines. After all, when's the last time you saw the chief sociologist for the Royal Bank interviewed on TV? Five years ago the Canadian Economics Association even decided to hold its annual conferences completely separate from the giant congress of other social science disciplines. This intellectual separatism harms the pursuit of knowledge, and exaggerates the predisposition of economists to a blinkered mode of thinking. A recovering economist can confess - even in public - that they might have something to learn from other disciplines. Turn to your friends, those who haven't been hypnotized by supply and demand graphs, for help in understanding the world and how it works.

**Step 4: Make a list of the situations where you are most likely to act like an economist, and avoid those situations.** Recovering alcoholics know they must avoid bars. Recovering economists must similarly avoid any meeting or social gathering where they may be asked to give authoritative views on where the economy is going, explain elegant but counter-intuitive doctrines (like why free trade is always good for everyone, everywhere), or provide personal financial advice. Even if you mean well, the damage to both yourself and to your audience could be incalculable.

**Step 5: Acknowledge that an expanding GDP will only feed your habit.** The growth rate of Gross Domestic Product is the stuff of newspaper headlines and international comparisons. Yes, it's true that having more material wealth opens the possibility of using that wealth to improve living standards in a meaningful and sustainable way. But one doesn't automatically imply the other. GDP leads to human progress only if we make sure it does. If we are concerned with how people live, and

how they interact with their environment, we must evaluate and target those things directly, rather than blithely hoping that a rising tide of GDP will lift all our boats.

Inspired by folks like Marilyn Waring, there's now a determined constituency of activists promoting alternative, more genuine measurements of our economic progress. They believe these measures will guide us to collectively adopt more balanced and genuine economic and environmental policies. They are wrong. It is power, not statistics, that determines how our economy operates - the things we produce, the way we produce them, and how the proceeds are divided. But taking on the mainstream infatuation with gross output indicators, and exposing the failure of growth to solve the real problems of the world and its peoples, is a useful way for recovering economists to start to chip away at that power.

**Step 6: Stop putting price tags on everything you see.** Economists believe the 'value' of something is its monetary price. How, then, do we understand the truly powerful passions and desires and emotions that dominate our lives? Think of how most of us felt during the SARS scare. Ask Canadians at that point which was more important - tax cuts or public health - and the choice would have been overwhelming. Ask someone who's just lost a loved one to place a dollar value on their feelings, and you'll probably get socked in the face. For the things that really determine our ability to lead a good life - family, health, community, peace - there are no price tags. Yet the business pages and the classifieds and the Sears catalogues are full of them.

**Step 7: Avoid the temptation to run regressions - even "just one."** Economics is at its addictive, hyper-positivist worst when it substitutes inscrutable statistical correlations for genuine creative thought. It's even spawned its own sub-category of statistics: 'econometrics.' Certain tenured economists spend all their research time performing computer regressions on randomly paired data sets, searching blindly for strong correlations which they then explain with a theory custom-fit to the data. Quantitative analysis, carefully applied, can play a useful role, both in understanding the world and in seeking to change it. But for a recovering economist, regressions are as dangerous as that infamous glass of wine with dinner for an alcoholic.

**Step 8: Get off your pedestal.** Economists place themselves at the top of an assumed hierarchy of knowledge. So it should be no surprise that they enforce a rigid hierarchy within their own ranks. And at the peak of that hierarchy, of course, stands one economist above all others: the legendary 'Chief.' Reporters are always trying to call me the 'Chief Economist' of the CAW. "Wrong," I tell them. "I am just the economist. There is no 'chief' economist." But often as not, the adjective still slips into their stories. It's as if they would undermine the authority of their own reportage by admitting in print that they only talked to a run-of-the-mill economist - not to the chief. Chances are, most 'Chief Economists' work just the same way I do: solo, with no little "junior" economists beaver away under their tutelage. But the adjective is invoked nonetheless, to promote an aura of gratuitous importance. Recovering economists know their inherent worth comes from inside - so they can lose the phony titles.

**Step 9: Learn from those who went before you.** Mainstream economics is arrogantly ahistorical. In most cases, capitalism is presented as a natural, eternal state of human affairs. Even the term 'capitalism' is rarely used: naming the system, after all, might imply that there are others. The preferred euphemism is 'market economy,' which implies that the economy is like some big flea market where anybody can set up a card table on Saturday mornings and sell their wares. It's just coincidence that General Electric has \$575 billion (U.S.) worth of capital assets sitting on its card table, while you and I have only our brains and our brawn to offer.

Modern economics was not actually invented until the early days of capitalism. So the very discipline is historically relative - not to mention the economies it purports to study. And the roots of neoclassical economics were always inherently ideological: to justify, in the guise of explaining, the perverse distribution of power and wealth that emerged under this new social order. Studying economic history, and the history of economics, is the best way to critique this knee-jerk

determinism, and to place the whole profession in a healthier, more contingent context. In economics, history itself is subversive.

**Step 10: Make a list of the countries and people you have harmed.** Billions of human beings, entire continents, even the planet itself - all have been devastated by the glaringly misguided dictates of economists. Even some of the most orthodox practitioners at the World Bank and the International Monetary Fund will now quietly admit that their domineering advice to developing countries in recent decades - liberalize trade, liberalize finance, downsize government, and wait for the invisible hand of the market to work its magic - was completely and devastatingly wrong. Of course, these institutions still actively perpetuate the poverty and hardship which their own false recipe books did so much to create. But large cracks are appearing in the intellectual dominance and self-confidence of orthodox economics. Cataloguing the damage is an effective and damning first step in tearing down the edifice.

**Step 11: Make amends to those countries and people.** Every Twelve Step program requires the recovering addict to humbly commit to fix up their own mess. Economists are no different. This is the time for recovering economists to step to the front of the room and make personal pledges to undo the damage that has been wrought in the name of supply and demand. Commit to studying what's wrong with markets, as opposed to how beautifully perfect they are. Work to empower rank-and-file folk, instead of dominating them with your apparent but phony expertise. Start to imagine economic ideas that could change the world, rather than invoking economic mumbo-jumbo to justify inequality and explain why it's inevitable.

**Step 12: Help other economists who come your way.** Perhaps the scariest thing about the economics profession is that it seems to be becoming more homogeneous with time, not less. Economics departments at Canadian universities, by and large, will only hire entry-level faculty who demonstrate requisite acceptance of the free-market assumptions supporting their elaborate but fragile intellectual scaffolding. At least twenty years ago there was a token radical or two in each department, around whom critical-minded students could congregate. Today even that is rare. Most progressive-thinking students flee in panic from economics after their first mind-numbing encounter.

Recovering economists of any age need help to rediscover their latent humanity and rededicate their energies to the pursuit of things that really matter. But none need our assistance and solidarity more than economics students. Most are motivated by a gut-level conviction that learning economics should allow us to do great things for people and the planet. (Needless to say, they didn't go into the field because of the snappy dress or witty humour of their professors!) Yet they are left to flounder in a curriculum that tests mathematical aptitude more than ability to think, and in which the urgent crises of the real world are made invisible. If you encounter someone like this, put your hand on their shoulder. Tell them you know how it feels. Help them find alternative sources of economic inspiration, and places where they can befriend other recovering economists-in-training. Show them they're not alone.

Don't get me wrong. Personally, I'm very happy to be an economist. I still believe that there is a material basis to most of the problems humanity faces. I think economics is the best way for me to make a contribution to human progress and social change, and I've enjoyed great personal opportunities because of my career choice. But lurking in my brain is a nagging awareness that my own success was built at least partly on the pseudo-rationalist coattails of the whole arrogant discipline - even as I espouse a twisted, and hopefully insidious, version of that pseudo-rationalism.

So collectively, my profession must come to grips with its elitist addiction. I do it every morning when I wake up, look myself in the mirror, and say out loud: "I am an economist."

\* A version of this article appears in the current edition of This Magazine [www.thismagazine.ca](http://www.thismagazine.ca). On-line help for recovering economists is provided by the Progressive Economics Forum [www.web.ca/~pef](http://www.web.ca/~pef) of which the author is a member.

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## Driving a car with no steering wheel and no road map: Neoclassical discourse and the case of India<sup>1</sup>

Matthew McCartney (SOAS, University of London)

Neoclassical economics is based, as is any school of economics on certain assumptions. It is my contention here that too often these assumptions have served to narrow its analytical perspective. In particular the analysis of economic liberalisation has been limited to accounts chronicling its implementation. Analysis is very seldom concerned with the practical impact on issues such as productivity, employment, social stability, etc. This is examined here with particular reference to India in its 'liberalising' period after 1991.

### **Economics and Assumptions**

Assumptions make life easier. In partial equilibrium analysis *ceteris paribus*<sup>2</sup> allows a researcher to turn his attention from a bewildering array of possible general equilibrium interactions and reach a commonsense conclusion. A demand curve slopes downwards; a higher price of apples will reduce the quantity consumed. There is no pressing reason to explain the endlessly complex interactions with markets for oranges, bananas, guavas, .... Assumptions in economics offer simplification; they give to a question a parsimonious structure, enabling the researcher to focus on the heart of the problem. Altering the assumptions and gauging the impact on the conclusions enables the robustness of the model to be analysed. Even in a patently unrealistic abstraction, such as the Walrasian General Equilibrium model, assumptions provide a benchmark. Once we drop the assumption of perfect information we can analyse the impact on welfare of asymmetric information in exchange; of externalities and imperfect competition in production. Properly utilised the Walrasian General Equilibrium provides us a gateway to the rich analysis of Stiglitz, Akerlof et al.<sup>3</sup>

In neoclassical economics assumptions obscure underlying economic processes. Results may be totally contingent on an assumption included for mathematical convenience. Ultimately assumptions may serve to distract the researcher from the heart of the issue.

"Theories can therefore be judged by their assumptions to some extent, if one has an intelligent taxonomy of assumptions. A theory may well draw power from 'unrealistic' assumptions if those assumptions assert, rightly, that some factors are unimportant in determining the phenomenon under investigation. But it will be hobbled if those assumptions specify the domain of the theory, and the real world phenomena are outside that domain." (Keen, 2002, p153).

### **Efficient Growth (By Assumption)**

By assumption individuals are rational and exchange is voluntary. Under perfect competition, consumption will be distributed intertemporally efficiently. Profit maximising firms will utilise these available resources and optimise investment decisions. The growth path over time reflects preferences of individual agents, hence by assumption it must be efficient.

Economic reform (comprising stabilisation and structural adjustment) is based on this assumption of efficient growth. The two components are intrinsically linked. Stabilisation ensures that growth will be sustainable, reducing inflation, government budget deficits and any trade imbalance.<sup>4</sup> Once stabilisation is achieved, the reform process (synonymous with liberalisation) is simply an accelerator.

Structural adjustment comprises all those policies that may interfere with optimising decisions by consumers and firms. Tariffs must be reduced to align domestic with world prices. Privatisation will ensure that decisions are made by rational profit maximising entrepreneurs. Removal of minimum wage legislation enables agents to make voluntary and hence mutually beneficial exchanges in the labour market. There is no question of steering the economy, simply of speeding up (deepening is the typical metaphor) or slowing down the process of transition from dirigisme to a free market.

Neoclassical analysis typically focuses nearly exclusively on the depth, pace and implementation of reforms. A typical example is the slowdown in economic growth in India after 1996. There is a broad consensus among neoclassical economists on the need for a 'Second Generation' of reforms to deepen those launched in 1991, to liberalise those areas hitherto neglected – especially the labour market and privatisation. Growth has stalled, hence the accelerator needs pressing.

### **Liberalisation, Means and Ends**

Much of the intellectual artillery for the neoclassical counter-revolution in economics was derived from close study of the experience of countries that had pursued strategies of import substitution in the post-war period.<sup>5</sup> Industry was found to be high cost, capital intensive and hence generating little employment. Far from achieving self-sufficient industrialisation, such countries continued their dependence on imports of capital goods and inputs. The counterpart of industrialisation was a general discrimination against agriculture.

This type of analysis provided important antecedents for the shift to strategies of outward orientation often as intrinsic parts of structural adjustment programmes from the 1980s onwards.<sup>6</sup>

However the widespread adoption of the neo-liberal agenda has not seen a complementary pattern of analysis. The success of 'reform' is not typically measured in terms of employment, inequality, and growth. Rather,

“The problem was that many of these policies became ends in themselves, rather than means to more equitable and sustainable growth. In doing so these policies were pushed too far, too fast, and to the exclusion of other policies that were needed.” (Stiglitz, 2002, p53).

A good example of the neoclassical evaluation of liberalisation in India is provided by Ahluwalia<sup>7</sup> (2002) and Bajpai<sup>8</sup> (2002). Ahluwalia makes the claim that,

“we consider the cumulative outcome of ten years of gradualism to assess whether the reforms have created an environment that can support 8 percent GDP growth, which is the government’s target.” (Ahluwalia, 2002, p69).

Ahluwalia retreats into a typical twofold analysis, considering first whether growth is sustainable – examining as a consequence trends in the fiscal deficit, current account deficit and foreign exchange reserves. Then cataloguing how far liberalisation has been implemented - tariff reductions, degree of integration with the world economy<sup>9</sup>, removal of price controls, deregulation.<sup>10</sup>

Bajpai (2002) follows the same track. He compiles a review of liberal policy reforms – devaluation,

current account convertibility, trade liberalisation, encouraging FDI inflows, opening the capital market to portfolio investment, permitting domestic companies access to foreign capital markets. Bajpai does not even make passing reference to the impact of these 'reforms' in any other context than the change in integration with India and the world economy. He notes, over the course of the 1990s that the weighted average tariff fell from 90 to less than 30%, foreign investment increased from 0.1 to 1% of GDP, the share of trade increased from 18 to 30% of GDP.

The underlying assumptions of voluntary exchange and rational optimising individuals mean that it must by definition be the case that the level of growth reflects individual preferences and hence maximises welfare in a free market. The successful outcome of reform and the degree of implementation of liberalisation are collapsed by a-priori assumption into the same meaning.

There is, it is assumed, no need to examine the impact of liberalisation on the productivity and level of investment, the degree of social cohesion, political and social stability, the level of spending on R+D, the diversification of exports into more dynamic industrial sectors.<sup>11</sup>

### **Liberalisation, Reform and a Roadmap**

There is no roadmap because by assumption neoclassical economics does not admit the possibility of an alternative.

Rodrik (2000) argues to the contrary that integration with the world economy cannot substitute for a development strategy. Development is increasingly viewed as synonymous with global integration and with trade and investment being used as yardsticks for evaluating government policy. In actual fact 'integration' may crowd out alternatives. Rodrik suggests globalisation should be evaluated in terms of the needs of development, not vice-versa.

It is clear, that although there exists a near consensus on the positive relationship between openness and growth,

"there is a dirty little secret in international trade analysis. The measurable costs of protectionist policies – the reductions in real income that can be attributed to tariffs and import quotas – are not all that large." (Krugman, 1995, p31).

And there is another fact often forgotten. Liberalisation and integration are not concerned solely with the removal of controls and unwinding of government intervention. They also have demanding institutional requirements. Rodrik notes that to comply with the full panoply of WTO obligations (customs, phyto and sanitary, intellectual property rights, etc.) would cost the typical LDC \$150m. The small gains from trade noted by Krugman are undoubtedly offset by the potentially enormous gains from an alternative – such as basic education for girls<sup>12</sup>.

### **Liberalisation, Implementation and Crisis**

The neo-liberal discourse has not reacted to crises by evaluating their underlying assumptions, but instead adding layers of complexity to preserve them. To the concern with the pace and depth of implementation have been added other considerations.

Liberalisation in the Southern Cone countries of Latin America in the early 1980s, saw rapid capital account liberalisation and large budget/ trade deficits. This generated huge capital inflows, consequent currency overvaluation, deindustrialisation, debt accumulation and inevitable collapse. There was no fundamental attention to assumptions in response, no puzzling that in the case of Chile at least the vast bulk of the accumulated debt was private<sup>13</sup> so could not by definition be considered a problem. The concept of *sequencing* of liberalisation emerged, specifically that a fiscal

deficit should be corrected before the capital account is liberalised. With a similar crisis in Asia in 1997, sequencing implies prudential regulation of the banking sector before capital account liberalisation.

The economic disintegration of Russia after 1989<sup>14</sup> despite a bold pursuit of liberalisation (price reform, privatisation, abandonment of planning) and rapid democratisation generated much discussion of the relative merits of *gradualism over shock therapy* and the importance of *institutions*. An evident example is that privatisation without a functioning legal system in the midst of an economic collapse, will generate compelling incentives for asset mining among managers and workers.

Analysis of liberalisation can be likened to driving a car with no steering wheel – there is only one path of reform (from dirigisme to a free market), the only item of control is the accelerator (the speed and depth of implementation), and there is of course no road map (there is no alternative). To extend the analogy (too far), even at its worst moments, when neoclassical theorising careers through red lights – in the Southern Cone countries in the 1980s, in Russia in the 1990s there is no critical evaluation of underlying assumptions, only ever more convoluted refinements to preserve them.

## Notes

1. Grateful thanks to Ashwin and Alan for invaluable comments.
2. Other things being equal.
3. See for example Stiglitz (1986).
4. Private sector induced trade deficits, representing an excess of (optimal) private sector investment over (optimal) private sector savings reflect efficient decisions of optimising consumers so do not represent a macroeconomic problem.
5. For the case of India see Bhagwati and Desai (1970), Bhagwati and Srinivasan (1975).
6. The experience of East Asia may have been wrongly interpreted as one of 'outward-orientated' free trade rather than a strategy of export promotion. The latter may imply an increase in government intervention through a mechanism such as export subsidies.
7. Finance Minister in 1991-6, the Congress Government which launched the first generation of liberalising reforms.
8. One of the famously influential American-based non-Resident Indian economists who have done so much to promote the agenda of liberalisation in India over the 1990s.
9. Exports plus imports as a share of GDP and level of Foreign Direct Investment.
10. There is momentary concern with other potential determinants of growth, infrastructure provision and education, but this does not detract from the primary thrust which is concerned not with 'an environment to support eight percent growth' but the sustainability and implementation of liberalisation.
11. See variously Athukorala and Sen (2002) Ch 7, Rodrik (1999), Fosu (1996), Barro (1991) etc for discussions of these issues and their positive role on economic growth.
12. See Sen (1999).
13. Unlike Argentina the public sector budget was in balance.
14. Under IMF tutelage in the 1990s industrial output declined by a larger share than during the whole of the Second World War.

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## PAE in the news: from *The Guardian*, 9 September 2003

### Fired Up for Battle

*An economics conference next week will highlight the rift between the subject's traditionalists and its 'post-autistic' movement. Kurt Jacobsen and Donald MacLeod report*

Next week about 200 economists from around the world will gather in Cambridge - ostensibly to celebrate the centenary of the university's economics degree, but in reality for another skirmish in a war that has split the discipline. Economists have been bitterly divided between an establishment wedded to mathematical models which dominates the journals and many university departments (including Cambridge) and opponents who label them "autistic" and out of touch with reality.

The conference, sponsored by the Cambridge Journal of Economics, has set out to open up the subject to outside influences from geography, history, law, management, philosophy, psychology and sociology, and stop it disappearing into mathematics.

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