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What does “too much government debt” mean in a stock-flow consistent model?

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Introduction

Government debt and deficits are topics that have occupied the minds of economists, commentators, journalists, television news readers and other commentators. It would be impossible to read everything that has been said and written on these topics, or even that written since the global financial crisis. In the popular literature the bulk of the commentary seems to be concern about the size of either the debt or the deficits that “create” the debt. Among the bulk of this material there is a range of concern from mild to hysterical. There is also no shortage of mainstream economists willing to put the concerns into more formal language. The purpose of yet another article on this topic is that there seems to be little by way of a clear exposition of how debt and deficits arise and why they may well be benign. The difference is that here the discussion is explicitly put into the framework of a stock-flow consistent model. This paper critically evaluates the proposition that government debt and deficits are harmful to the economy in the way suggested by mainstream authors such as Reinhart and Rogoff (2009 and 2010). To address the proposition that there will be undesirable consequences as a result of increases in government debt the paper will:

- critically examine the view that too much government debt has the consequences suggested in mainstream analysis, and
- ask what exactly could be meant by too high a level of debt and the market response to that.

It must be stressed that all the discussion here relates to independent economies with sovereignty over their fiscal and monetary systems.

The conventional view

Brad deLong in his criticism of “unfunded tax cuts” which imply deficit increases says:

“Unfunded tax cuts are, in the long run, bad juju. We cannot make policy on the expectation that the U.S. will always be able to borrow at negative real interest rates. And we should make policy aiming for a low debt-to-GDP ratio, because emergencies will arise in which we will want to boost federal spending quickly and substantially to attain important national purposes” (2013).

¹ Thanks to Tony Aspromourgos, Richard Denniss and John King for comments on an earlier version of this paper. The usual disclaimers apply.

In so much discussion people do not feel the need to actually spell out why something might be “bad juju”, and why a higher debt-to-GDP ratio might mean it is harder for governments to do something later and why there should be a balanced budget in the long run. The International Monetary Fund (IMF) has referred to “the need to reduce debt ratios and to address pressures from entitlement spending means that very few countries have long-term fiscal space” (2012) and this clearly reflects the view that too much government debt is bad.

In testimony to the US House of Representatives Committee on the Budget, former Federal Reserve Chair, Ben Bernanke said “the current trajectory of federal debt threatens to crowd out private capital formation and thus reduce productivity growth” (2012). The supposed burden of government debt is usually some variation of the thesis that large debt increases interest rates. To quote Ben Bernanke again:

“Increasing levels of government debt relative to the size of the economy can lead to higher interest rates, which inhibit capital formation and productivity growth – and might even put the current economic recovery at risk” (2010).

He did go on to say that:

“Neither experience nor economic theory clearly indicates the threshold at which government debt begins to endanger prosperity and economic stability.”

The reason why there is a threshold beyond which the “dangers” are evident is not clear. It seems not to occur to many people that such a threshold may well not exist or not in any simple way. Bernanke and others often feel no need to provide more explicit detail. The proposition has been repeated so often that it is now taken to be self-evident. Reinhart and Rogoff (2009) (R&R) did apparently find such a threshold at 90 per cent of GDP but that result was found to be the result of some spreadsheet-errors as revealed by Herndon, Ash and Pollin (2013) which we discuss further below.

A new twist in the threshold notion is introduced with the view that higher debt ratios increase the risk that countries are approaching their thresholds which makes further fiscal activism more dangerous than it would otherwise have been. So even if countries are not concerned about present debt ratios they should want to make room for future contingencies. Hence the problems posed by *The Economist* which says:

“If any of these worries [about the world economic outlook] causes a downturn the world will be in a rotten position to do much about it. Rarely have so many large economies been so ill-equipped to manage a recession, whatever its provenance, as our ‘wriggle-room’ ranking makes clear (see [article](#)). Rich countries’ average debt-to-GDP ratio has risen by about 50% since 2007. In Britain and Spain debt has more than doubled. Nobody knows where the ceiling is, but governments that want to splurge will have to win over jumpy electorates as well as nervous creditors. Countries with only tenuous access to bond markets, as in the euro zone’s periphery, may be unable to launch a big fiscal stimulus” (2015).

An OECD publication has put its concerns in the following terms, which introduces crowding out mechanisms:

“As the volume of government bond issuance fails to abate, doubts have emerged about the ability of the market to absorb this large amount of new paper” (Blommestein et al, 2010 p.15).

“This elevated supply of government debt also poses a challenge for corporates’ ability to tap the debt markets. ... potential crowding out by the public sector might increase the required rate of return to such a point that investments will be delayed. This would dampen overall growth and slow the speed of fiscal consolidation” (Blommestein et al, 2010 p. 21)

This is a clearer exposition than many and hints at the more formal expositions which can be found elsewhere. For example, some years ago James Tobin wanted “to make concrete the vague forebodings about runaway government debt” (1986). His argument can be summed up in the following:

1. government debt is growing as a share of GDP,
2. interest rates increase to equilibrate the demand for government debt with the increased supply, and
3. the capital output ratio is a declining function of the interest rate,
4. per capita income is a function of the capital labour ratio.

With this it is easy to show that the capital stock to GDP ratio gradually declines and the economy becomes poorer, at least relative to the baseline case. That was the substance of the argument and it served a useful service by turning the “vague” into a formal argument that can be better examined.²

The IMF has performed some modelling that purports to show when and how increased government borrowing crowds out other interest sensitive spending (Ostry et al, 2015). The IMF results are actually quite benign and show that for most countries there is ample scope for example to increase spending on infrastructure with benefits for economic growth in subsequent periods. But the importance of this paper is that it sets out the full mathematical argument behind debt concerns using a representative agent that also happens to have an independent government. The latter’s problem is “to maximise the agent’s utility”. Of course, neoclassical economics has to have some constraint against which the agent is assumed to maximise some sort of utility function. So the constraint is written as private consumption, government services, the public and private capital stocks at any time depend on initial capital endowments plus the labour input. The government then maximises the agent’s utility. Despite having both an agent and a government there are no net deficits/surpluses between the two and the significance of this will be highlighted below. Somehow there are bonds in the system but new bond issues are not needed because changes in the capital stock (private or public) are made out of current production (equation 2.2, p. 21). Indeed, equation 2.2 says consumption plus investment (the sum of all left hand items) just exhausts national income (RHS items). Why bonds are included in the formal analysis is not clear. Normally we expect bond issues (or some sort of net financial issue) to come about as a result of government deficits but there is no way our representative agent can have a deficit or surplus in any meaningful sense.

² Other authors have since used similar models though without necessarily citing Tobin.

The accompanying text makes it clear that the creation of debt is poorly understood in the first place. For example, in discussing a “debt shock” in a section of the paper with that title the paper says “the increase [in public debt] is exogenous in the sense that it does not correspond to higher public investment or provision of the public good, but rather results from some extraneous event, such as the fallout from a financial crisis” (p. 10). This is a good example of how most analyses seem to just assume that the agent has an exogenous increase in some asset which gives rise to attempts to get back to some more optimum ratio of that asset relative to all other assets. But at least we are grateful that this particular treatment put everything “out there” in an explicit way.

Of course there can be no such thing as an exogenous appearance of new debt in the sense that government debt can only arise in two ways. First, debt can come into existence if it is created and used in exchange for some claim on the private sector. But in the IMF case there is no net new financial assets created and this is clearly not what the IMF has in mind. Second, there may be an increase in net debt as a result of a government deficit. That deficit may well have arisen out of the bailing out of failed financial institutions during the global financial crisis. In the first case there is no net increase in financial debt so there is nothing to put into the IMF’s equations. In the second case there was presumably a large grant element in the bailing out of the banks which would be treated as an outlay; a government expenditure item. Government may well engage in subsequent borrowing in order to fund the outlay but either way there is an initial increase in government spending which involves an increase in the net payments balance of the rest of the economy.

The attempt by the IMF to put government into a representative agent model does throw up some funny elements. But it does at least illustrate the severe limitation of representative agents as a metaphor for the whole economy. Joe Stiglitz has been campaigning for an overthrow of the macroeconomics that is based on first principles and uses the representative agent to derive those principles (2014). He points out that representative agent models:

“...couldn't embrace information asymmetries: with a representative agent, these could only arise if the individual suffered from acute schizophrenia, which would in turn be hard to reconcile with their assumptions of all-knowing rationality'. Moreover it is hard to have a robust financial sector in representative agent models: who is lending to whom? Since all risk is borne by the same (representative) agent, financial structure can't matter. Not surprisingly, banks then play no role. With the financial sector at the centre of this, and many other crises, it is no wonder that these models had little to say—either before or after the crisis” (Stiglitz, 2014 p. 5).

Representative agents also fulfil another role. It also needs to be stressed that models assume the representative agent who has a finite budget and maximises intertemporal utility against that constraint. Without the maximisation-against-constraint the problem of modelling the individual's behaviour is mathematically intractable. A major problem for theorists is that some entities in a modern economy do not have budget constraints in practice. Stiglitz's comment about the role of the financial structure is a case in point. Take for example the textbook description of a bank. By the stroke of a pen the bank creates new loans which are in turn spent and reappear as bank deposits elsewhere in the banking system. The fact that they reappear as bank deposits is interesting in showing how elastic are the relevant “budget constraints”.

Problems with the conventional view

Despite the various views on deficits and debt there remain some major empirical anomalies. Countries such as the US and Japan have very high debt to income ratios but seem to be enjoying historically low interest rates and no other obvious side effects of high debt. The influential work of R&R claimed to have empirical evidence that high debt ratios were indeed associated with less satisfactory economic performance especially when debt to GDP ratios exceeded 90 per cent. The influence of R&R is apparent in the 22,800 results using a search in Google Scholar and 298,000 results in a regular Google search.³ However, the R&R results were subsequently found to reflect data errors (Herndon, Ash and Pollin, 2013) and with corrected data the results disappear. Australia should have been interested because there were five years of data missing for Australia in the R&R database, 1946 to 1950 inclusive. Over that particular period economic growth averaged a relatively high 3.8 per cent despite demobilisation after the war. At the same time our debt to GDP ratio was over 90 per cent. R&R did not examine unemployment in Australia but it is worth pointing out that the ABS yearbooks from around the time show unemployment was under two percent at the June 1947 census (ABS, 1951). According to official data unemployment was just 0.4 of one per cent in the year 1950 (Reserve Bank of Australia, 1997).

The failure of the instincts of many economists and others to be reflected in the empirical record should cause us to reflect on the theoretical underpinnings of propositions such as high debt ratios are necessarily bad. Many economists build models in which the volume of loanable funds is fixed or at least fixed in the sense that it is a function of just one variable – the interest rate. Hence attempts by the government to finance a deficit are inevitably frustrated by higher interest rates. A popular textbook by William J. Baumol and Alan S. Blinder (2008) which looks at the role of government deficits explicitly draws a demand and supply curve in loanable funds with the expected slopes. So too does the public finance textbook by Joseph Stiglitz (2000). A government deficit which increases public sector borrowing then shifts the demand curve to the right and so increases the equilibrium interest rate. However the problem with that is that the supply and demand curves are not necessarily independent. Moreover, an increase in the deficit has many other ramifications with implications for many other variables in a fully specified model. Notice the discussion goes from noting the increase in debt (as a share of GDP) on its own and then inserting that into a model of the loanable funds market to determine interest rates and then putting the new interest rates into the growth model via the impact on investment. The assumption is that we can use the increased debt as datum in the model without having to worry about any other factors that might have given rise to the increase in debt. As it turns out this is a rather strong assumption.

Note too in the discussion here all debt is treated equally or, what amounts to much the same thing, it is assumed government and other debt are close substitutes. In that way the analyst is able to model loanable funds as a market in a homogeneous item. That will also suit our purposes below since accounting for different types of debt would unnecessarily complicate the story.

In a modern economy with an independent monetary system a government that wishes to engage in deficit spending can simply spend. It does not first have to raise the funds in the open market. Deficit spending automatically increases government debt since the government

³ Search performed 18 August 2015.

spends by creating government liabilities, be they bank notes or interest bearing securities. Now consider an increase in government spending matched by an equal increase in the government deficit and noting that the increase in the government deficit implies an increase in government debt on issue. Keynes taught us that the effect of the additional government spending is to increase the level of unplanned savings in the first instance as new sales are met out of inventories. Subsequently, as entrepreneurs undertake more production the level of income increases until the amount that people save out of the higher income matches the increased government spending/deficit. But of course savings is the act of accumulating financial assets which can be regarded as an increase in the demand for loanable funds. Picturing that in a loanable funds diagram implies that at the initial interest rate the increase in the demand for loanable funds is exactly matched by an increase in the supply of loanable funds. So as the demand for loans schedule shifts to the right so does the supply schedule by an equal amount. This argument can be formalised in the following section.

Interpreting the conventional view in a stock-flow consistent model

To re-cap a bit, in the argument cited earlier Tobin begins with the appearance of a deficit which means that more government debt has to be absorbed by a private sector that is otherwise unchanged. Just how the appearance of a government deficit and additional debt take place when everything else is unchanged is not explained. However, here we attempt to examine what else would change to generate a larger deficit and how all that would fit into a stock-flow consistent analysis of the debt issue. In developing their analysis Godley and Lavoie (2007) remind us, every transaction comes from somewhere and goes somewhere. The appearance of a deficit in the budget sector will in fact fundamentally change things as we see in Table 1 which shows what happens when government spending increases and is funded by the issue of government bonds represented by ΔB .⁴ In this simple model there is only one financial asset, bonds, which may be assumed to pay interest, but we could equally call it money in a one financial asset economy. That asset is also a means of payment.

Table 1

| | Rest of the economy | Government sector | Σ |
|----------------|----------------------------|--------------------------|----------|
| Income | ΔG | $-\Delta G$ | 0 |
| Balance | $-\Delta B$ | ΔB | 0 |
| Σ | 0 | 0 | 0 |

Note that government spending is the purchase of goods and services from the private sector or the making of transfer payments. In a full account there should be a column representing the central bank but the present column headed “Government sector” can be taken as representing a combination of both the government sector and the central bank. An increase in government spending that occurs without a similar increase in taxation is shown as the outflow $-\Delta G$ in the government sector column. For the rest of the economy ΔG is a receipt which is shown with a positive sign in the income row. In the meantime in the row labelled

⁴ Normally spending and the issue of government bonds would involve separate transactions but here we simplify and assume the rest of the economy accepts payment in government bonds to keep things simple.

“balance” ΔB is shown with a positive sign in the government sector column because it represents a source of funding. However, it appears with a negative sign in the rest of the economy because it is a use of funds on the part of the people who hold the additional income in the form of government bonds.

All the non-zero quantities in the table must be equal to each other to preserve the stock-flow consistencies that always apply. This is an extremely simple account so far but already we can now appreciate what it is missing in some of the economic models that purport to show the adverse consequences of deficits and debt. When government spending increases, that spending is received as additional income. Corresponding to that flow is a stock adjustment through which the government issues more bonds and more bonds are taken up by the rest of the economy. The latter point is critical. The recipients of the additional government spending accept the additional bonds and so increase their holdings of financial assets, at least in the first instance.

Of course what that means is that the “budget constraint” of the rest of the economy has increased by exactly the same amount as the increase in government spending which is equal to the increase in the government deficit. For people who wish to think in terms of the demand and supply of loanable funds the government’s issue of additional bonds can be thought of as a rightward shift in the demand for loanable funds. However, the additional income in the rest of the economy and the simultaneous acquisition of funds on the part of the rest of the economy can be thought of as a rightward movement in the supply of loanable funds. The rightward shift is the same in both schedules which means that the supply and demand remain equal at the same interest rate and of course must have been equal to begin with. In other words, the budget constraint in the private sector automatically adjusts to the increase in the government deficit.

It could instead be suggested that the loanable funds model is illegitimate since it suggests that the demand for and supply of loanable funds can be different magnitudes when the market is in disequilibrium. Over any accounting period expenditure has to be equal to income and, as a consequence in a simple model investment must be equal to savings.⁵ However, investment involves the net issue of financial debt or, what amounts to the same thing, the running down of financial assets on the part of entities making the investment, or a combination of the two. In the meantime savings involves the acquisition of financial assets, the repayment of debt or some combination of the two. Ordinary national accounting and an analysis like that in Table 1 make it clear that savings-equal-investment identities also imply the demand and supply of loanable funds must be equal. Godley and Lavoie (2007) make it clear that this is no more than the implication of Walras’s law. The fact that people did not understand this implication was a big source of frustration to Keynes as I argued some years ago now (Richardson, 1986). It is also clear from Skidelsky’s (1992) biography of Keynes where Skidelsky describes the debates about definitions of ex ante and ex post relationships and Keynes’s frustrations with people putting the view that an increase in savings was needed to finance new expenditures.

Of course Table 1 does not necessarily show the end point. Upon receipt of the government expenditure people may well spend the additional income and there may be an open-ended range of possible outcomes, especially in a fully specified model with a production sector, a banking sector, foreign sector and so on. Some of those adjustments may well involve further

⁵ In a more complicated model the sum of “injections” must be equal to the sum of “leakages”.

spending and the generation of additional tax revenues and so forth. Table 2 shows the impact of additional consumption spending induced by the initial budget deficit. Potential changes in tax are not modelled.

Table 2

| | Rest of the economy | Government sector | Σ |
|----------------------------|------------------------------------|--------------------------|----------|
| Income and spending | $\Delta G + \Delta Y_c - \Delta C$ | $-\Delta G$ | 0 |
| Balance | $-\Delta B$ | ΔB | 0 |
| Σ | 0 | 0 | 0 |

Table 2 now includes the additional consumption spending ΔC which must also appear as an additional income item ΔY_c to indicate the additional income as a result of the induced consumption spending.⁶ ΔG in the “rest of the economy” column indicates the income generated by the original increase in government spending. With this simple extension the stock-flow consistency rules still dictate that any government deficit must be matched by an equal surplus in the rest of the economy. That holds true no matter how much the simple model here is extended. Note too that in the extended model it remains the case that the demand for and supply of government bonds remains equal. And it can be confirmed that no matter how complex we build the matrices like Tables 1 and 2 the demand for and supply of bonds remains equal. Moreover, when the government issues a large range of liabilities then the value of the supply of new liabilities exactly matches the value of the demand for new liabilities, although there may well be some composition mismatches which could give rise to further trading in the financial markets and could also produce price changes that cannot be accommodated in simple matrices like Table 2.

For our immediate purposes the important thing to notice is that a deficit in the government sector necessarily involves an equal surplus in the rest of the economy. Yet in the usual discussion, as in the Tobin model, there is no mechanism via which the appearance of a government budget deficit can create an equal surplus in the rest of the economy; nor can the increase in government spending appear as an increase in income elsewhere in the economy. Rather income in the Tobin model is expressed as a function of capital per head so income is constrained to be given by the primary determinants; the technology, the factor endowment and the price incentives facing factors of production. In that model it is impossible for income to vary except when the primary determinants vary. The model effectively rules out any role for demand. The same is true of the IMF model outlined earlier and that is why the IMF assume an exogenous increase in government debt.

In each case the model builders unwittingly start off by assuming a model in which the non-government sector cannot have a surplus and so logically, the stock-flow consistency requirement in macroeconomics means government deficits cannot occur.

We can diverge for a moment to note that the increase in savings brought about by the increase in the deficit reminds one of the Ricardian equivalence proposition⁷ but of course the

⁶ A more complete model would separate the household and the production sector but these extensions will not be necessary here.

⁷ The modern discussion goes back to Barro (1974). The Ricardian equivalence proposition in its extreme form states that the effects of government deficits are equivalent to financing the expenditures with tax increases.

mechanism is entirely different and has entirely different implications. The Ricardian equivalence result is obtained on the assumption that income is unchanged and that people will attempt to save more to finance the increase in taxes that will be eventually required to finance the repayment of the debt.

We mentioned earlier that in general when the government is in deficit the supply of new government liabilities will be exactly matched by the demand for new liabilities. This result is important. The traditional macroeconomic textbook explains how savings automatically matches investment or in a more general model the sum of leakages (into savings, taxation and imports) must be equal to the sum of injections (investment, government spending and exports). This is the flow equilibrium. What is less often made clear is that the leakage and injection flows involve an acquisition of financial assets and the issuing of financial liabilities and stock consistency ensures that the two are identically equal. We noted earlier that we could think in terms of a demand and supply of loanable funds in which both move rightward by the same amount with the implication that there need be no change to the interest rates ruling in the economy. But it must be stressed that the loanable funds diagram shows traditionally shaped demand and supply curves which assume an equilibrium point but also assume that there can be disequilibria at all other points on the diagram. That of course is stock flow inconsistent in the sense that demand and supply must always be equal in this particular 'market'.

The equal rightward shift in the demand for and supply of loanable funds means there is nothing for the "price" to do and there is nothing in the nature of savings and investment to even get the "price" to move. Adjustments take place in other ways in response to imbalances between planned and actual savings and planned and actual investment. That of course is how the textbook Keynesian mechanism works. Those changes will tend to be in volume adjustments, but in principle it might involve just increases in the prices of investment goods in the short term.

The important point is there is no price mechanism that can conceivably do the job of equilibrating planned and intended magnitudes of savings and investment. Even if one could posit feedback mechanisms from interest rates through to savings and investment intentions it is illogical, or stock-flow inconsistent, to suggest an ordinary market mechanism would achieve the equality between the two. The savings = investment mechanisms also ensure that in every period there is an equality between the new liabilities of investors and the new financial assets of savers. If the supply and demand for savings is to mean anything then it must reflect the issuing of liabilities and the acquisition of financial assets. As can be verified, those two are always equal as a result of the same mechanisms and logic that keeps investment and savings equal. That was true in the simple logic of Table 1 before any adjustments took place as well as in Table 2 where consumption was allowed to increase following the increase in income.

Godley and Lavoie (2007) put the equality of demand and supply of financial assets/liabilities down to the implications of stock flow consistency, and citing Walrus' law of markets, the equality of demand and supply of financial assets is merely a redundant equation implied by all the others. But it is precisely the demand and supply of financial assets that the critics of government deficits and debt concentrate on and assume some loanable funds mechanism would be at work.

The problem is that many economists insist that there is a market in savings that acts like any other market. But if actual quantities are always equal then there is nothing, no mechanism that can get a price adjustment going. In a normal market if there is to be a price adjustment it will involve a deliberate act on the part of at least one buyer or seller. For example, a seller may notice that sales are not strong enough and so will set a lower price. In principle an auctioneer may take on the job of equalising supply and demand. But who is there who acts in a similar way on imbalances between the supply and demand for savings? Clearly there is no such mechanism and the analogy between savings and other markets breaks down.

If there is anything in the loanable funds thesis it must mean that at least one person believes they hold too much debt and want to reduce it. We now turn to examine what that might possibly mean.

Too much government debt?

Here we ask what it means to say that there is too much government debt and what that can mean in reality and how people who think they hold too much debt could attempt to reduce their holdings of debt. One possible meaning is that people begin to feel that at the present constellation of interest rates they no longer wish to hold the same proportion of government debt to other financial assets. If that is the case then people would sell government debt and use the proceeds to purchase private debt and, in doing so, tilt the relative price of government debt against private debt. But one certainly gets the impression that we are not just talking about a bit of market imbalance and some shuffling of portfolio assets between different types of debt/financial assets.⁸

Realignment of the relative prices/yields on financial assets is just a normal adjustment that occurs all the time. This does not seem to be what is being said by the government-debt-is-too-high proposition. Among other things it is asserted that government debt will crowd out private debt so that the interest cost on the latter will also rise. The implication is that increases in government debt reduce the demand for all debt. If all asset prices are falling together then we must be talking about too much debt all round and we can trace out the consequences of that. Indeed, the simplest way of thinking about that is to assume the government and private debtors issue identical securities.⁹

If debt holders think their holdings of debt/assets are too high, perhaps relative to their income, they may well try to reduce their debt holdings. Now if some feel they want to reduce their debt to income ratio, or just reduce debt in absolute terms there is really only one way of doing that – they have to exchange part of their financial wealth for either consumption or the accumulation of durable assets (as distinct from financial assets).

Now we ask what happens when people try to reduce their holdings of financial assets. Generally all consumer spending is treated as consumption even if it relates to purchases of goods that are long lasting. Generally also the only way someone can reduce their wealth is to begin spending more than they earn. In that way they de-accumulate assets and move to a lower financial asset to income ratio. However, if we all did that on average then spending

⁸ Bohn (2010) points out that there is evidence that the gap between corporate AAA debt and government debt is negatively related to the debt to GDP ratio.

⁹ People who talk as if government debt might crowd out private debt clearly have in mind securities issued by both but which are very close substitutes.

would increase relative to income and, in the case of the government sector, taxable transactions would increase relative to government spending with the consequence that the government deficit would decline. In turn that would mean a reduction in the issue of government debt. However, consider the case where government receipts and spending are unchanged, or the equivalent example where there is no government and ask what happens then as people try to run down their financial assets. Clearly not all desires to reduce outstanding debt can be achieved in this case. In the absence of people actually burning their debt it is impossible for them to collectively dispose of their income by spending more than their income yet that is what is required if people are to take collective actions that involve getting rid of debt.

We could here go through the motions of setting the argument out in a stock flow consistent matrix like Tables 1 and 2. However, this case seems sufficiently simple that the verbal treatment should suffice.

Debt must be repaid?

There is a view that debt must be repaid. According to Allan Meltzer (2012) for example, transfer payments to individuals, what he calls “fairness benefits”, are provided using debt that must be repaid by taxpayers in the future “debt... shifts costs from present to future taxpayers” (p. 60).¹⁰ He complains about people who want to fund benefits “by the issuance of debt to be paid by later generations” (p. 10).

“Either the United States voluntarily adopts fiscal discipline or eventually it will face a crisis with rising interest rates and a falling currency. The crisis solution will impose large costs on holders of dollar denominated debt, but it will force policy adjustment. If a voluntary solution is unlikely, the mystery is when the crisis will occur” (2008).

Meltzer here expresses a common view that debt eventually has to be repaid. Most of the time it is just rolled over when it matures although of course governments retain the option to not roll over the debt. The view that debt has to be repaid also harks back to the household analogy. People who plan to retire often make plans to first pay off their debts. But it is certainly not the case that private corporations or governments have plans to retire in the near future. The representative agent may be an appropriate metaphor for the individual but certainly not for perpetual entities such as corporations and governments.

Nevertheless there is now a view that governments face an intertemporal budget constraint. Clearly the government’s intertemporal budget constraint is analogous to the similar constraint imputed to individuals and, through such a device, many important insights into intertemporal decision-making have been generated. Using the same type of thinking the UK Office for Budget Responsibility (2011) puts it that all debt must sooner or later be repaid. It comments:

¹⁰ This quote also illustrates something in common with some earlier quotations. Meltzer is concerned about “fairness benefits”, deLong tax cuts, the IMF “entitlement spending”, *The Economist* refers to government “splurge” and so on. Things like government spending seem to particularly encourage some people to complain about government debt which makes one wonder whether government deficits and debt are the real underlying concern. In this context the author likes to tell anyone who will listen that lots of people are hurt or die due to a lack of health spending, poor social services and other things that governments could fix. The author is unaware of anyone who has been hurt by a government bond.

“Most definitions of fiscal sustainability are built on the concept of solvency – the ability of the government to meet its future obligations. In formal terms the government’s ‘inter-temporal budget constraint’ requires it to raise enough revenue in future to cover all its non-interest spending and also to service and eventually pay off its outstanding debt over an infinite time horizon.”

In this way the government is assumed to face a budget constraint in which the present value of all future surpluses/deficits must sum to zero. Apart from making maximisation problems tractable there is no logical reason why we need think that governments need face such a constraint and indeed governments can issue liabilities without a promise to repay them. Base money is the obvious example. All we can think of to justify thinking in terms of a long run zero budget constraint is that many academic economists need some sort of constraint when thinking in principle about how governments try to attain some optimum spending program. To assist the mathematics it is assumed government faces some constraints against which it can maximise some other variable such as an intertemporal welfare function.

By contrast many of the results of thinking in stock-flow consistent models can be open ended at least in the sense that they do not achieve neat equilibria. So it seems likely that the government budget is not a constraint at all but an open-ended concept. Private equities have no maturity date and, in principle there is no reason why bonds need have maturity dates. Since 1751 the UK government (then the British government) has issued perpetual bonds known as Consols although these are now a very small part of the outstanding UK government debt. But there seems no logical reason why all debt might not be in perpetual bonds and the practice of rolling over bonds as they mature means that, for analytical purposes we might as well treat government debt as perpetual.

Reflections and conclusions

Geoff Harcourt makes that point that the dominant approach to economic modelling gives centre stage to the individual decision-maker attempting to maximise life-time utility as the driving force of the economic machine. Other actors and institutions are “subject to her [the decision-maker’s] whims and desires, especially within a competitive environment” and the use of representative agent models “meant the rejection of any role for the fallacy of composition, a vital strand of the economics of Keynes” (2010, pp. 3, 4 and 6). That thought could be taken further since arguably the fallacy of composition as it applies to savings/investment questions is but a particular example of the consequences of failing to keep within the constraints of stock-flow consistency. The idea that if we each save more national saving will increase is stock-flow inconsistent. Indeed, it could be argued that the savings/investment question is merely flow inconsistent; still logically incorrect but in just one dimension. Questions about government debt for example have to be not only flow consistent but stock consistent as well. The issue of too much government debt is a case in point. Godley and Lavoie (2007) have reminded us not only of the importance of stock flow consistency but also shown that we can gain an important understanding of the macroeconomy by following the implications of stock-flow consistency.

Another important point to be made is that ensuring stock-flow consistency need not involve complicated and detailed matrices that attempt to describe the economy as a whole. The discussion here was able to show the weakness in the government-debt-is-bad thesis in just a

two sector model featuring only the government and non-government sectors. We only need a two-by-two matrix to show how the emergence of government debt involves a process that must be taken into account in modelling if the end result is to be realistic. We are used to having logical constraints to guide our thinking but macroeconomics in particular has to deal with the constraints and implications of basic accounting.

Some economists have been motivated by the natural sciences but they forget that the progress in the natural sciences has developed in the context of a knowledge of the constraints that nature obeys. Nature and any theories about nature have to obey the laws of thermodynamics. Likewise economic phenomena and propositions in economics should obey stock-flow consistency constraints. This paper has tried to show that indeed, many propositions about economic phenomenon fail to obey the stock-flow consistency constraint. That definitely applies to the crude proposition that too much government debt will cause problems such as high interest rates and low investment. It is easy to be thrown off track when analysts fail to take stock-flow consistency into account – just like the mistake people used to make in failing to watch out for the fallacy of composition associated with savings decisions.

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Divine belief in Economics at the beginning of the 21st century¹

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Drinking the strength of life
from men doomed to die,
spitting the crimson blood
on all the lands of gods;
black becomes the sun
in summers to follow,
weather spells disaster –
Need you know more?

With this stanza, I begin my story of the divine belief in Economics at the beginning of the 21st century, when this faith was practised and reached the height of its glory. The stanza originates from the Norse poem *Völuspá*,² meaning prophecy of the Völva, which tells the tale of ancient gods, who at the beginning of the 21st century had long since perished. The verses were originally written in the Norse language approximately eighteen hundred years ago, while the present translation is from the beginning of the 21st century and thus about eight hundred years old. Despite the large gap in time between the first writing of these verses and the translation, it is still as if the stanza prophetically heralds the coming of events, which began in the days when the translation was made.

The Völva speaking in the poem is a mysterious entity with the ability to speak prophetically about distant pasts and futures. In this manner, one might understand the Völva as an entity located outside of time, telling us of things to come and things long since passed.³ In her prophecy, the Völva predicts the end of the Norse gods in the violent calamities of Ragnarök, but the prophecy can also be considered as mirroring the crises, which increased throughout the 21st century. For this purpose, in particular the final lines in the stanza above, show prophetic clarity. The disastrous climate changes that truly came into effect in the second half of the 21st century are mirrored here, and we are sarcastically reminded that extensive knowledge did not serve as sufficient motivation to take the actions necessary to avert subsequent disasters.

Thus many centuries later, it is not easy to give an in-depth explanation as to why countries and governments did so little to avert these self-inflicted disasters, whose nature was known with some certainty and whose arrival was doubted by few. However, there can be no doubt that the divine belief in Economics with its strong anchoring in central authorities and close alliance with society's elite was of great importance to maintaining the status quo, thus preventing the necessary transitions. Based on this relationship, I find it relevant to direct my

¹ Published in Danish in the Journal, *Kritik*, Volume 48, Issue 214, August 2015

² Sørensen & Steinsland. "Vølvens Spådom". Høst og Søn 2001. Translated to English, for the purpose of this article, by Daniel Olesen.

³ This interpretation comes from Sørensen & Steinsland 2001.

searchlight at the divine belief in Economics in the 21st century to highlight certain characteristics of this faith. Hopefully, such an investigation can improve our understanding of the tragic downfall of a civilisation.

It has now been about seven hundred years since the gods of Economics were supplanted by other systems of belief and cosmologies. Just as the Norse faith was combatting and gradually supplanted by the cosmology of the Christian faith around year 1000, the second half of the 21st century was also an era of old and new cosmologies battling for the right to preach the common faith. Belief in the gods of Economics was until this age very strong and held the foremost position in the national administrations and political thinking. State administrations were flooded by *economists*, a form of priests, skalds and sages, considered to possess unique powers related to interpreting the past, understanding the present, and foretelling the future. The policies of the nations were shaped according to their directions. Unfortunately, these directions were characterised by whims lacking a deeper understanding of the real issues of the age.

Due to extensive wars and calamitous natural phenomena, which increased in occurrence in the second half of the 21st century and presumably is the reason for the loss of many important sources in understanding divine belief in Economics, the following is a mosaic with many gaps; the number of missing pieces is most likely much greater than the number of sources I do possess. Despite the loss of many sources related to the divine belief in Economics, there is still a quite significant amount of material informing us of this system of beliefs. Based on this material, the divine belief in Economics appears to be a highly advanced, diverse complex of myths, and it is thus beyond the scope of the present work to describe the entirety of this complex. Instead, I will attempt to make selective incisions and highlight certain aspects that appear to be of particular importance in relation to understanding the gods of Economics and the times during which they were worshipped.

First, it should be noted that what we today refer to collectively as economic mythology in fact covers a number of different denominations, of which the most important are: *classical*, *Marxist*, *institutional*, *Keynesian*, *neoclassical*, and *ecological Economics*. Central to my investigations is the neoclassical denomination,⁴ which around the year 2000 held the greatest dominance; in part thanks to a political doctrine known as neoliberalism, derived from this denomination.

Whether every denomination mentioned here can truly be called a religious denomination is doubtful, however, since the status of religion is highly dependent on being anchored in institutions as well as proclamation practices. The reason why the neoclassical denomination had the status of religion must be found in an extensive proclamation practice, anchored in academic environments, partisan circles, central authorities, media, and general speech combined with a strong affinity for worshipping the divine. Thanks to this, economic sages were able to conjure up strong, religious “truths” despite the extremely underdeveloped epistemological apparatus of neoclassical Economics.

Regardless of the clear epistemological weaknesses contained in the economic mythology, this denomination was widespread throughout the world and was practised alongside the great monotheistic world religions. In some ways, it can be maintained that divine belief in Economics was the most widespread of the world religions around the year 2000. It was

⁴ In the following, divine belief in Economics is synonymous with neoclassical divine belief.

widely practised by nearly every public administration across the world, regardless of other religions also practised in the various countries.

However, the worldview presented by the natural sciences also held a strong position around the year 2000, and this epistemology had conquered many spheres of influence formerly belonging to religion. Economic mythology deftly took advantage of this by choosing a form of proclamation that was in the guise of the natural sciences. Economic mythology was thus based on an extensive, mathematical foundation. This gave the mythology strong powers of persuasion equal to those of the natural sciences, and its computational models often held status as *Völvas* with the same powers of prediction as the natural sciences⁵. In the twilight years of the mythology, however, it became more and more obvious that its acolytes made use of dubious, mathematical descriptions lacking durable theorems.⁶

Historical observations

Desiring brevity, I have in this presentation chosen to keep my scope limited to the region that still to this day encompasses the Nordic countries. I will therefore initially outline latent tensions between environmental realities and economic myths characterising the societies of this region eight hundred years ago.

Around the year 2000, the Nordic region was still highly affluent and well organised. Compared to many other regions, the Nordic countries were also characterised by relatively high levels of equality, trust and welfare, although all of the above was in decline, in part due to financial crises and the neoliberal doctrine. Related to this, it is worth mentioning that the Nordic region was among those that resisted neoliberalism the longest, along with the increasing inequality, distrust, and instability caused in part by the divine belief in Economics. This resistance was due to a particular Nordic tradition of distributing the wealth of society, though it eventually fell to the neoliberal dismantling of the welfare state.

Coinciding with how the divine belief in Economics strengthened its position of power, there was a rise in the number of increasingly alarming reports on the environmental state of the planet, originating from the natural sciences. Climate changes were deservedly the most often mentioned threat, but it was merely one out of a growing number of crises. Similarly, the swift expansion of humanity, increasing streams of refugees, the systematic eradication of other species, and ever-reducing amounts of clean water were all well documented issues. It was characteristic of many of these crises that one way or another, they were the by-product of the economic activities of human societies. The ways in which people produced, traded, consumed, transported, and built across the globe were thus on a swift collision course with the environmental boundaries of the planet. It is therefore not controversial to claim that with the knowledge possessed then as well as now, there were strong arguments in favour of radically transforming the economic activities of these societies to respect the environmental boundaries of the planet.⁷

⁵ It is interesting to note that these models often had names with religious undertones, such as ADAM (Judaism), HEIMDALL (Norse mythology), and HERMES (Greek mythology).

⁶ Among the first to make this point was the Finnish econometrist Juselius, who assisted in uncovering fundamental issues in the neoclassic models. For examples, see "Using Econometrics for Assessing Economic Models", *Economics* 2009.

⁷ The idea of planetary boundaries was probably first proposed by Rockström et al. in "A safe operating space for humanity", *Nature* 2009.

There is a number of reasons why this did not happen to a sufficient degree, of which the influence of the divine belief in Economics is merely one. However, it is useful to highlight how this religion helped reinforce certain positions of power resistant to change; how its occult faith in Growth demanded a resistance against radical, environmental efforts and democratic control of multinational corporations, who in turn possessed the necessary resources to buy influence in parliamentary democracy.

Unfortunately, it was not evident to the general public at the time that the multinational corporations were able to drain the nations of social, environmental, and economic resources at such an extensive scale. The populations were greatly manipulated by neoliberal sermons that the multinational corporations were in service to Growth, creating jobs, and that all had to bring sacrifices to the altars of Growth and Market; the dispossessed needed to be further dispossessed, minimum wage needed further lowering, everyone had to work longer hours, democracies had to relinquish their autonomy, and the environment had to be sacrificed. This way, religious belief was used as a tool for political propaganda.⁸

It is a lesson well known from studying the downfall of civilisations that priesthoods and affluent elites often join forces to protect the status quo of society⁹. There are several historical examples of this, which mirror trends that one could observe in the Nordic welfare societies around the year 2000, displaying an elite that completely ignored and underestimated the warning signs heralding the end of society. Additionally, the hypothesis concerning the close, temporal proximity between the heyday and the fall of a civilisation should also be mentioned; in many ways, this hypothesis is confirmed by the history of the Nordic welfare societies post year 2000.

Proclamation and divine belief

What we today acknowledge to be irrefutable fact was still unclear and controversial at the start of the 21st century, while matters that today are shrouded in doubt and mystery were then considered unquestionably true. By the former, I mean the multitude of environmental and social crises, which at the time had yet to manifest themselves fully; by the latter, I mean the mythical characters of the divine belief in Economics. However difficult it may be for us, we must try to understand that the society of that age truly believed in *Market* and *Growth* as eternal gods. In connection to this, it is worth mentioning that gods have a habit of losing their power over time. Around the year 2000, the Norse gods had long since passed into legend and become harmless. The same fate has fallen upon the gods of economic mythology, and we can only speculate, which of the gods of our era will be considered a mere fancy in a thousand years.

If you wish to try to understand how the gods of Economics became real, imagine yourself as a Viking and envision the journey across the sea during a thunderstorm with lightning and thunder tearing the sky apart. It is not difficult to imagine that for the Viking, having so often made sacrifices to Thor and heard tales of him, the god of thunder suddenly becomes real. Similarly, imagine the stockbroker a thousand years later being seized by the belief in Market when key numbers suddenly rocketed towards the sky or plummeted towards the ground, showering the few in wealth and the many in misery.

⁸ A phenomenon also known from the societies of the Viking Age according to Sørensen & Steinsland.

⁹ For examples, see Diamond, "Collapse. How Societies Choose to Fail or Succeed". Viking Penguin 2005.

Looking at documents from that age, we find that in particular the economic priesthood, partisan factions, and certain news media preached the divine belief in Economics and constantly referred to the blessings of Growth and the all-knowing providence of Market. These preachings had a great effect on the language and perception of reality as related to everyday life. Thus, you could often hear politicians speak of how Growth would soon return and bring its blessings to all, or that it was best to leave responsibility for the Economy in the hands of Market.

Around the year 2000, the divine belief in Economics was still conquering new lands. This was done by the skalds, politicians, and multinational corporations, who expanded their sphere of influence by constantly letting the gods Market and Price subjugate new territories. In this manner, rivers, forests, mountains, animals, plants, and people were given a price denoting their market value, through which they could be subject to the market mechanism, the ever-valid 'natural law' of Economics.

Mirror images

The purpose of this investigation is to examine the beginning of this millennium, now in its twilight years, in order to interpret the economic belief and missionary practices prevalent at the time. In aid of this, I have chosen an older system of faith, the Norse one, practised in the Nordic region during the Viking Age. Neither Norse nor economic beliefs are today living organisms of faith, but remnants of their many phenomenological appearances can be found in various works of writing. My primary source for the Norse mythology is the poem *Völuspá*, which we have preserved in various translations¹⁰. Due to its charismatic gods and strong themes of downfall, this mythology is a bountiful parallel to the divine belief in Economics as well as the era in which this belief was practised.

It is generally acknowledged that the *Völuspá* is based on oral traditions and it was not put into writing (in different versions) until around the year 1000. We should therefore view the surviving, written versions of the *Völuspá* as crystallisations of oral storytelling traditions, believed to have been kept alive by the skalds of that age. The written versions originate from an era where the Norse culture was receding and the Christian world religion was advancing. There have thus been many speculations as to how much the written versions of the poem are affected by and adapted to a Christian worldview. The intent of this investigation is not to contribute further to these speculations, however. Instead, focus is directed at how the poem, as we have it in its written form, can be used as an analytical mirror held up against the cosmological understanding belonging to economic mythology as we know it.

¹⁰ For transparency's sake, it should be noted that the following description of *Völuspá* is widely based on the translation and interpretation made by Sørensen & Steinsland, published in 2001.

Völuspá

The *Völuspá* is a grandiose cosmology, stretching from the earliest distant times of genesis until the last days of the gods during Ragnarök.¹¹ The storyteller is the Völva, able to gaze deeper into both past and present than even the all-father Odin, *the ancient one*. Using a classic device from narratology,¹² the prophecy can be divided into three phases¹³: chaos, order, and downfall. However, it is important to note that the phases overlap and that a phase of decline before the downfall and clear indications of resurrection following the downfall can be added to the model for the sake of further precision.

The Völva tells us that the world is born out of the void, Ginnungagap, a potential of chaotic, primordial forces. Different creatures emerge from Ginnungagap. Ymir the Jötunn is the first, and then follow the gods Odin and his brothers, who create order in chaos and shape the world known as Midgard. The gods also name all things and summon time by counting the years as they pass.

Already in the earliest phase of this creation the seed of destruction is planted. Odin and Ymir each sire a race, the Æsir and the Jötnar, who are constantly engaged in conflicts. Simplified, one might say that the original, primordial chaos is manifest in the Jötnar, while the Æsir is the opposing force, attempting to maintain order and stability. Among the Jötnar are counted the Midgard Serpent and the wolf Fenrir, who during Ragnarök assist in the downfall of the gods, but in turn succumb to the power of the gods in this all-consuming battle.

A central element in the creation of the gods is the world tree Yggdrasil, which represents stability and life force. Below the roots of the ash Yggdrasil flows a sacred source, nourishing the world tree. The three Norns live by this source, participating in the act of creation by weaving the fates of gods and mankind. The three Norns represent the three manifestations of time: past, present, and future. During the golden age of the gods, Yggdrasil is strong and green, but it is later discovered that the tree suffers more than what is known to humanity. Several creatures are sapping its strength, and the tree is rotting,¹⁴ which forewarns the impending destruction of the world.

When Ragnarök approaches, many bad omens appear. Forces of chaos, long kept in chains, break loose. Yggdrasil quakes, and moral decline becomes rampant throughout the world of Men. Finally, war can no longer be avoided, and the wild hordes of the Jötnar, including the wolf Fenrir and the Midgard Serpent, charge forward; from the East they are led by Loki, Odin's treacherous foster brother, and from the South by Surt, a Jötunn from the realm of fire. In this final battle, all the gods perish alongside their powerful enemies among the Jötnar. The wolf Fenrir kills Odin but is slain in turn by Vidar; Thor kills the Midgard Serpent but dies from the wounds inflicted by the worm upon him. As Æsir and Jötnar die, the world ends. The sun turns black and sinks into the sea while Midgard burns. Thus, Ragnarök ends in moral collapse, natural disasters, and war.

¹¹ According to Sørensen & Steinsland, Ragnarök means “the fate of higher powers” or “the downfall of higher powers”.

¹² Narratology is among others shaped by writers such as Greimas and Todorov.

¹³ This device is not from Sørensen & Steinsland, but my own attempt towards an analytical model. Whether this device has been used before in sources unknown to me, I cannot say.

¹⁴ This description comes from the poem “Grimnismál” in Lembek & Stavnem's translation and interpretation of Snorri Sturluson's “Edda”. Gyldendal 2013.

After Ragnarök, however, the world is resurrected and restored to vitality while freed from the disorder and chaos of the Jötnar. Many of the old gods, though Odin and Thor are not among them, are also resurrected; similarly, humanity is also restored to life in this new world. One of Odin's sons chooses the new world tree, and the “new” gods take up residence upon Odin's former grounds. The continued line of the gods shall live in the wide halls of the windy sky, while Men will live in peace and harmony at Gimlé, which offers shelter against the fire.

With these words and short of breath I conclude my presentation of the *Völuspá* to make room for a reflective description of economic mythology.

Gods and people of economic mythology

As a system of collective beliefs, economic mythology is polytheistic akin to its Norse counterpart, meaning it is populated with several gods. Unlike its Norse counterpart, however, economic mythology does not contain a central story that clearly progresses into several phases. Therefore, I will not begin with a narrative mirroring but instead begin by describing some of the most important gods of the economic mythology.

The first god I wish to discuss is *Market*. Market is the god eternally creating structure, keeping the primordial forces *Supply* and *Demand* in check. This way, Market resembles the gods creating order in the Norse world. However, Market cannot control the market forces without a helper. This is where the god *Price* becomes important. Practically speaking, Price maintains the balance between Supply and Demand, thereby ensuring the equilibrium of the *Economy*. Through the market mechanism, which describes an eternal interaction between Supply and Demand, Market can be considered the creator of the Economy, the legendary world of the economic gods.

There is also a number of other important gods in the economic mythology besides Market and Price. Without a doubt, the god *Growth* is chief among these. Growth is the deity overseeing wealth, happiness and prosperity. The more sacrifices upon the altar of Growth, the greater wealth and happiness shall flow into the society of mankind.

In particular, natural resources, time, and democratic rights were sacrificed to Growth around the year 2000. Goods such as clean drinking water, biodiversity, and picturesque landscapes were all sacrificed on the altar of Growth. Similarly, people had to contribute an ever-increasing amount of work hours to Market, and the various countries had to yield certain democratic rights to make room for multinational corporations with the capacity to be of service to Growth.

Same as with Market, Growth also has its helpers: *Productivity* and *Competition*. Productivity is a kind of fertility god, who is able to constantly create bigger yields with less effort, while Competition is the god of war, strengthening the countries in their economic wars against each other.

But no mythology is without forces of darkness, and in economic mythology, these are called Recession and Unemployment, representing disorder, chaos, and impoverishment. One might be tempted to consider these as the counterparts of the wolf Fenrir and the Midgard Serpent in economic mythology. Recession is the archenemy of Growth, while Unemployment is the eternal woe plaguing Market. Unlike Norse mythology, there is no tale in economic

mythology of how these opposing forces will confront each other and perish in Ragnarök. It is implied that Growth and Market will be victorious as long as we remember to make our sacrifices.

It is not certain who the supreme deity among the economic gods was. This was often dependent on the specific context in which this faith was practised. In state administrations, Growth reigned undisputed while for some political parties and independent temples, Market was most likely the supreme divine authority. If one takes a more general look at the era, however, there is a clear tendency for Growth to be considered standing tallest. Nearly every economic sage, politician, businessman, and journalist bowed before Growth in service to its every whim, regardless of how strong or weak their faith in Market.

As in Norse mythology, there is a human being in the economic mythology. This person is called *Homo Economicus* and is an important element in the market mechanisms. Unlike the Norse example, the economic man is omniscient, yet has but one thing in sight, the god Price, and one objective, to optimise his own utility.

Circles and lines

Whereas Norse mythology contains a progressive story, economic mythology is completely devoid of history. In every case, it is the same story of Price creating and maintaining the balance of the market, which is repeated ad infinitum. In spite of this, the two mythologies share certain dynamics. For instance, both can be viewed from a linear and a circular perspective. If you view *Völuspá* as a series of events from creation to Ragnarök, you will find a linear story. If you choose to incorporate the part concerning resurrection, you find the possibility of a cyclical cosmology, where the *Völuspá* merely describes one rotation in the eternal circle of birth and death¹⁵.

This circular theme can also be found in economic mythology, where a constant cyclical exchange between households and businesses results in steady growth, continuing indefinitely and only disrupted by temporary business cycles surrounding a steadily increasing growth trend. These upwards and downwards economic trends can be seen as cyclical and understood as the rotation inherent in economic mythology between crises and affluence, birth and death¹⁶. Thus we find in both Norse and economic mythology an interesting reciprocity between linear progress and cyclical repetition, where it becomes nearly impossible to imagine linear progression without cyclical repetition and reverse.

Besides these basic dynamics, Norse and economic mythology have a deterministic understanding of the world in common. However, while Norse determinism is characterised by dream-like visions, economic mythology presents a kind of hyper-determinism, where the market forces are always forced into balance. This way, there is never an actual confrontation between the primordial forces and Market. Market is always superior and brooks no resistance. This is clearly the opposite of Norse mythology, escatological in nature, meaning it moves towards an end of days where forces of order and chaos eradicate each other. In this

¹⁵ Finally, you can also view the different phases of the prophecy as concurrently existing aspects of human life and life in society. I will not pursue this interpretation further here, however, since it has no obvious counterpart in economic mythology.

¹⁶ This theme is also found in Schumpeter's hypothesis regarding creative destruction.

manner, economic mythology is a myth of eternity, always suppressing chaos, disorder, and unpredictability.¹⁷

Times of upheaval

As mentioned, the times surrounding the year 2000 were times of upheaval; human destruction of the planet's vital systems and the threat of future climate change became widely acknowledged. This is also reflected in economic mythology, which during this age became forked into new, conflicting directions. A contradiction arose inside the mythology where certain higher deities were considered forces of darkness by a smaller group of heretic skalds and their supporters. This was the case in particular with the god Growth, who was portrayed as a false idol to be rejected. Growth became a decisive point of contention, making heretic skalds denounce their fealty to this god.¹⁸

Due to the schism between those who worshipped and those who denounced Growth, two new myths arose: *Green Growth* and *Degrowth*.¹⁹ Both arose in response to the emerging environmental and social crises of that age. Green Growth was the myth presented by the ruling priesthood on how the economic growth engine could continue in a greened version with the gods Growth and Market as supreme authorities, while Degrowth was proposed by the heretic skalds and included an extensive, radical transformation of the economic cosmology.

A central point of opposition between these two myths is that the same gods and worlds appear as good and evil forces, respectively. Here, I am in particular referring to Growth but also to the very world of the mythology, the Economy. In Green Growth, these are both benign while Degrowth portray the former as evil and the latter as an organism out of balance with its surroundings, which requires it to be transformed and limited.

Both Green Growth and Degrowth are myths of transformation, in which the Economy is transformed. In Green Growth, transformation happens due to the intervention of heroes. The most important heroes in connection to this are: *the Government*,²⁰ *the Investor*, *the Entrepreneur* and *the Innovator*. The government acts by helping Price send the right market signals to make environmentally damaging behaviour costly while environmentally friendly behaviour is rewarded. The investor acts by sending financial capital to the greenest areas of the Economy, while the entrepreneur and the innovator create new green products, which are surrendered to Market and thereby supplying Growth with vitality.

An important demigod, who has a central role in the traditional divine belief in Economics, also appears in Green Growth. This demigod is *Technology*; a demigod because it has its origin in mankind, but possesses divine powers. Technology is generally believed to be able

¹⁷ It is important to highlight that this is primarily in reference to neoclassical mythology, which unlike e.g. Keynesianism did not acknowledge unpredictability.

¹⁸ It is important to note that many of these heretic skalds still considered Market to be a central and important deity.

¹⁹ The following interpretation of these two myths is the continued development of ideas proposed by Urhammer & Røpke in "Macroeconomic narratives in a world of crises: an analysis of stories about solving the system crisis", *Ecological Economics* 2014.

²⁰ The fact that the government is shown as one of the heroes indicates that Green Growth is not a purely neoliberal myth. According to neoliberalism, it was irrefutably damaging if the state interfered in the affairs of the market.

to solve all unsolved problems in the future. In this manner, technology has a reassuring presence and ensures that people need not be worried about the future.

Whether Degrowth can be considered a coherent myth is doubtful; it is simply too complicated and lacking in structure. Yet it is still useful to consider it a form of collective myth with many mythological elements, however, characterised in part by its lack of heroes. On the other hand, it has many villains and dark forces that in time proved to be as dangerous as predicted by the myth. Here, I am particularly thinking of the multinational villains, the financial shadow lands, and gods such as Growth and Competition.

While Degrowth largely defines itself as a myth in opposition to the reigning economic mythology, it also contains a wealth of constructive, political proposals; these are difficult to gather into a simple, coherent myth, however. Examples of such proposals are localisation as a response to deregulation and globalisation, fewer work hours, and a guaranteed basic income to prevent poverty, inequality, and stress, and finally certain measures to wrest control over wealth and happiness from Growth by measuring these as circumstances determined by a larger range of social and environmental conditions.

Akin to the Norse vision of Gimlé, the golden land where mankind shall live in peace after Ragnarök, Degrowth also contains the vision of a harmonious life after growth, where humanity has reached a balance between itself and the habitats of all living things. The path to this harmonious existence is through enacting a large number of political proposals, of which the aforementioned are merely a few.

Lastly, it should also be noted that a form of agnosticism towards Growth found a foothold in the economic mythology around the year 2000. Its primary belief was that Growth was a deity of no importance and whose fate was of no concern. Instead, people should devote themselves to questions concerning righteous life in society and the state of nature, letting Growth perish from a lack of attention; this was based on the belief that a god or false idol no longer being worshipped or denounced would cease to be either a god or false idol.

Final thoughts

Over the years, much has been written about the 21st century and its climate changes, social crises, and devastating wars. These works have tried to explain the conditions of society, which were the reason why highly developed societies did not react and adapt in time. Some of these works have also included the divine belief in Economics as part of their explanations. However, as far as I am aware, nobody has made a comparison between the divine belief in Economics and Norse mythology. This has been my attempt, and an important insight of this effort is the difference between the fundamental acceptance of the downfall in Norse mythology and the complete lack of this in economic mythology. In this manner, the *Völuspá* can be used as a commentary on a younger faith's lacking ability to understand its own age and the terrible calamities approaching.

If one lets the Völva be a voice whose prophecy apply to the future of the world more generally, her predictions are not merely relevant to the men and gods of the Norse world, but also to the societies and divine worship of future ages. From this perspective, the Völva has the power to explain the terrible crises of the 21st century along with the demise of the gods of Economics.

That the gods of Economics were gradually swallowed up by twilight is because they, similarly to the Norse gods, lost their connection to the surrounding world, which was swiftly changing. Blinded by their withdrawal from the world, the worshippers of Economics overlooked the actual problems of society and devoted themselves to worshipping dying gods. The economic preachers, the ruling political parties, and the elite of society were thus guilty of ignoring the advancing moral, social, and natural disasters, which might have been avoided by paying attention to the prophecy of the Völva.

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The double discipline of neoclassical economics: when the map both hides and reveals the territory

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Since the Industrial Revolution, capitalism has created unprecedented riches and allowed for massive social betterment, the emergence of a large global middle-class, and the consolidation of pluralistic democracy (McCloskey, 2015a). These achievements were, and still are, marred by slavery (yesterday: American Confederacy, colonized regions, today: underground migrant economy, segments of the official economy), cultural and social struggles, resource-driven imperialism, and widespread ecosystem degradation. Capitalism also feeds and feeds off of organized crime, white-collar crime, and criminal regimes; yet so-called democratic governments have been unable and unwilling to break this collusion between capitalism and crime, and the drift toward corporatocracy and plutocracy. Neoclassical economics serves as the official worldview of this hegemonic system: it fuels mainstream business practices, academe, think tanks and media (*Economist*, *Financial Times*) and Western-dominated international organizations (World Bank, WTO, IMF). It is a very big tent but its core assumptions, debated as they are within the profession, constitute a Foucaultian *truth regime*, a chosen discourse that generates reality. As a modernist discourse, it cloaks itself into modernist speak, that is to say science (Weir, 2008).

Therefore, this paper analyzes the dual power play at work here: within the profession, as hegemonic economists guard the orthodoxy against its critics, and within society, as neoclassical thought constructs intellectual and cultural “reality” to serve the hegemonic classes, groups, and practices. First we briefly discuss how the genealogy of power for dominant economics operates, a social dynamic that Foucault scholar Clare O’Farrell defines as “the grounds of the true and the false [...] distinguished via mechanisms of power” (O’Farrell, 2015). Then we examine five key neoclassical tenets – doctrinal orthodoxy, infinite growth, methodological individualism, utility maximization and actors’ rationality – in light of power formation, which unmasks their mobilization for neoliberal purposes.

Neoclassical economics: genealogy of power and the ideas of domination

Disciplinary self-critique illuminates the normative orientation of social sciences. For instance, University of Florida political scientist Ido Oren shows the mobilization of American political science and its intellectual transformation on behalf of American foreign policy and states: “[T]he self-image of American political science is paradoxically that of a detached science attached to particular ideas” (Oren, 2003, 1). In his detailed consideration of the relationship between expertise, politics, and democracy, the political scientist David M. Ricci further sheds light on this social production of knowledge:

“[P]ractitioners tend to expound notions they believe theory colleagues will accept, and they are reluctant to suggest ideas they assume will be less attractive, for one reason or another, to the discipline as a whole. As a result, the end-product of knowledge generated by political science and passed

down over the years, is shaped by institutional pressures that strongly affect both the kind of assertions that are advanced within the profession and the sort of ideas that are accorded the status of certified truth there” (Ricci, 1984, 3-4).

Likewise, seemingly detached economics is also “attached to particular ideas” because it results from professional, organizational, and societal expectations and power distribution. Critics point out that its claims to neutrality and objectivity are part of its cloaking strategy of domination; and describe it “as social technology, a technology of power” where “the perceived order in the world is an epiphenomenon of power” (Finlayson, Lyson, Pleasant *et alii*, 2005, 519). They skewer its central theory of the invisible hand, which supposedly “aggregates individual decisions into socially optimal outcomes”:

“[C]ontrary to claims of value neutrality, neoclassical economics functions as a master social narrative, or a technology of power, that concentrates power by transferring socio-economic decision-making from multiple sites to the centralized nodes of global economic and political institutions. This transfer occurs through the domination of the discursive space. The ‘invisible hand’ is power” (Ib., 515-16).

For instance, the noted Harvard economist N. Gregory Mankiw (the author of a widely used introductory economics textbook) casts society’s choice as a non-negotiable dichotomy, a drastic trade-off between equality and efficiency (Mankiw, 2001, 26) and reduces it to “the interpersonal comparability of social utility” (Ib., 28). Accordingly, he lauds the large compensations given to actors, athletes, and executives as earned rewards for their social contribution, and asserts that their self-concern “advance[s] the public good” (Mankiw, 2014a). But the dissenting economist Paul Krugman injects the larger context to critique such fragmented reasoning. He points out that such allocation of wealth depends on much larger policy and political choices, and not just on individual merits and social utility. Mankiw ignores the growing “inequality of opportunity” and the steady degradation of public goods (such as public education and cultural capital) and policies (tax regime) in the United States since the 1980s Reagan revolution, which facilitates such growing discrepancy in earning power. Krugman also takes on Mankiw for misrepresenting what economic fairness really is, reminding him that it does not mean authoritarianism or sameness of conditions (Krugman, 2013a). Krugman reminds Mankiw of the need to think historically in terms of the evolution of class, power, and privilege: “We were middle-class once, and young [...] We are a much more unequal society now, and as a consequence arguably one with a lot less intergenerational mobility too [...] We are not the society we once were” (Krugman, 2013b).

Mankiw’s a-historical, decontextualized defense of the merits and privileges of the One Percent reveals a key mechanism of intellectual power: the framing of issues. The Australian economist Herb Thompson explains: “[N]eoclassical economists, as traditional intellectuals, cultivate the social production of ignorance, and propagate it to their students, in the struggle for ideas. This is done through narrow pedagogy, delineation of research parameters, and by constraining the production and presentation of non-neoclassical knowledge” (Thompson, 1997, 304-05). Given such connection between neoclassical views on economic power and elite interests, it comes as no surprise that Mankiw wants to “repeal the corporate income tax entirely,” lower personal taxes, and replace them with consumption taxes (Mankiw, 2014b), which most economist and tax experts recognize as socially regressive. Following the same logic, he rejects Thomas Piketty’s thesis regarding the growing role of inherited wealth in the

social construction of inequality and contends that vast inherited wealth “is not a problem” (2014c).

Mankiw illustrates the fact that neoclassical economics is a *double discipline* – intellectual construct *and* system of control, reward, and punishment – that underlies our economic practices. The genealogy of power here is the combination of an elite intellectual discipline and the social disciplining of the dominated. For instance, as he praises the One Percent’s immense wealth, Mankiw rejects the notion of a living wage for workers at the bottom of the social hierarchy. In 2001, some Harvard students sided with janitors in their struggle for a raise of their minimum wage. Predictably, Mankiw came down against the hapless janitors (social discipline) in the name of scientific, objective, impersonal mechanisms (intellectual discipline): “We can’t ignore law of supply and demand,” and called their fight for survival and dignity a “utopian social reform” (Mankiw, 2001). This example of Social Darwinism justified by science – one among many – suggests that power (social discipline), as much as or more than science (intellectual discipline), accounts for many of the dominant traits of elite economics: its specific ontology (what is human nature?), psychology (what motivates economic agents?), sociology (what are the right relations among citizens and between citizens and authority?), ethics (what is good and bad?) and cosmology (what is the relationship between human society and the earth?). Or to be more exact, neoclassical economics dexterously weaves sound science, politicized science, and service to power, while claiming to be detached, objective, benevolent, and universal.

As Mankiw’s scientific and social positioning demonstrates, elite economics is carefully engineered to 1) promote growth under assumptions of ecosystem infinity, 2) maximize return on capital and the social reproduction of capital, 3) curb intellectual and social dissent, 4) hide the roots of unfair economic power and, 5) facilitate propaganda. In *German Ideology* (1845-1849), Karl Marx and Friedrich Engels observe that

“The ideas of the ruling class are in every epoch the ruling ideas, i.e. the class which is the ruling material force of society, is at the same time its ruling intellectual force. The class which has the means of material production at its disposal, has control at the same time over the means of mental production, so that thereby, generally speaking, the ideas of those who lack the means of mental production are subject to it. The ruling ideas are nothing more than the ideal expression of the dominant material relationships, the dominant material relationships grasped as ideas; hence of the relationships which make the one class the ruling one, therefore, the ideas of its dominance. The individuals composing the ruling class possess among other things consciousness, and therefore think. Insofar, therefore, as they rule as a class and determine the extent and compass of an epoch, it is self-evident that they do this in its whole range, hence among other things rule also as thinkers, as producers of ideas, and regulate the production and distribution of the ideas of their age: thus their ideas are the ruling ideas of the epoch” (Marx and Engels, 1845-1849).

Therefore, neoclassical economics may also be called “elite economics.” This political sociology of knowledge indicates that, like all social sciences, elite economics is both science and politics. It is a *positive* science based on observations and experiments, one that effectively draws principles and regularities – “economic laws” – and possesses some predictive value. It is also a *normative* science based on scientists’ individual, methodological, and professional bias, since it is embedded within power relations both inside academe –

economics in relation to itself and other social sciences – and society – economics with respect to socio-economic practices and the political practices that uphold them. Thus the economist Deirdre McCloskey invites economists to not confuse their map and the territory:

“All the human sciences share the problem. An economist examining the business world is not like a physicist examining the physical world, he is more like a critic examining the art world [...] The prediction of the future and the explanation of the past are symmetrical in a simple physical system. They are not in a human system, because the observer is part of the system. That he looks backward does not change the past; but that he looks forward does change the future [...] Like other scientists, economists make their world to human specifications. [...] Economics is not about the economy but about what human beings can say about the economy” (McCloskey, 1988, 645, 654).

As the following examination of five of its key tenets show, elite economics contributes simultaneously to science, to false consciousness, and to shaping the future according to its preferences.

Maligning disciplinary pluralism: willful misunderstanding and straw man arguments as exclusionary strategy

Doctrinal rigidity among – many – economists and maligning of more ethical, viable business models – notably Corporate Social Responsibility (CSR) – serve a dual purpose: to protect hierarchy within economics as a profession, and to discredit alternative economic practices that demonstrate that “another world is possible,” to use the slogan of the World Social Forum.

Dominant economists present their “basic principles of economics” (Lieberman and Hall, 2005, 13-14) as established and infallible. Take for instance E. Roy Weintraub, Duke University economics professor and noted expert of mathematical economics and the history of the discipline. In *The Concise Encyclopedia of Economics*, he offers a stern defense of the scientific character of neo-classicism and pre-emptively impugns all dissenting views. He deems neoclassical tenets non-negotiable as his discipline constitutes an objective and exhaustive rendition of reality:

“[W]hat is taught to students, what is mainstream economics today, is neoclassical economics. [...] Its fundamental assumptions are not open to discussion in that they define the shared understandings of those who call themselves neoclassical economists, or economists without an adjective. Those fundamental assumptions include the following: 1. People have rational preferences among outcomes. 2. Individuals maximize utility and firms maximize profits. 3. People act independently on the basis of full and relevant information” (2007).

UCLA economist Jack Hirshleifer also proposes a sinuous defense of *economic imperialism*, i.e., the growing penetration and influence of economics in other social sciences:

“In dealing with economics as an expansive imperialist discipline [...] a geographical metaphor may be illuminating. Our heartland is an intellectual territory carved off by two narrowing conceptions: (1) of *man* as rational, self-interested decisionmaker, and (2) of *social interaction* as typified by market exchange. *There is only one social science*. [Emphasis in original] Thus economics really does constitute the universal grammar of social science [...] Economists could then modestly claim that the hypothesis of rational self-interested man, though admittedly inaccurate, has proved to have great explanatory power *in the areas where we apply it*. [Emphasis in original] The history of imperialistic economics illustrate that the model of economic man has indeed been productive, but only to a point” (Hirshleifer, 1985, 53-54).

But his modesty quickly gives way to hegemonic reassertion of “narrowing conceptions” to annex all intellectual territories:

“While rich in data, on the theoretical level psychology remains a confusing clamor of competing categories; there is no integrating theoretical structure. I will be so bold as to predict that such a structure, when achieved, will be fundamentally economic [...] in nature. That is, it will show how mental patterns have evolved as optimizing solutions subject to the constraints of scarcity and competition” (ib., 61-62).

Indeed, when one is equipped only with hammers, all issues look like nails. In his famous 1970 article that denigrates corporate social responsibility, Milton Friedman offers a Pollyanneseque view of freedom: “In an ideal free market [...] all cooperation is voluntary, all parties to such cooperation benefit or they need not participate.” Next he misrepresents “social responsibility of business in a free-enterprise system” as “preaching pure and unadulterated socialism,” as “the most explicitly collectivist doctrine” that reveals “a suicidal impulse” on the part of its advocates. To undermine “social responsibility,” he attacks the very notion of “business responsibility” – but in the same breadth champions the idea that business “responsibility is to increase its profits.” He then establishes the responsibility of corporate managers to maximize return on investment for the real proprietors of the company, the stock holders. In effect, any “executive is an agent serving the interests of his principal” but Friedman overlooks the countless examples and abundant literature on the “principal-agent dilemma,” whereby appointed agents emancipate themselves from principals’ control and pursue their own objectives. Exaggerations and intellectual dishonesty pervade Milton’s analyses, which to this day remain a key reference for neoliberal economists. Corporate misgovernance, executive overcompensation disconnected from financial results, countless forms of abuse, “casino capitalism,” “mad money” (Strange, 1997, 1998), insulation from liability under neoliberal economics, and “suicide economy” make a mockery of such idealized views (Korten, 2015, 19-40).

Milton Friedman asserts that CSR implies the “view that the pursuit of profits is wicked and immoral,” when in fact CSR defends *legitimate* profits while castigating profit-gauging and antisocial practices in the name of profits. In 2005, the (libertarian) magazine *Reason* organized a spirited debate between Friedman, T.J. Rodgers (CEO, Cypress Semiconductor) and John Mackey (CEO and founder, Whole Foods). In yet another display of confident ignorance, Friedman stated that his brand of neoliberalism is essentially similar to Mackey’s social responsibility approach, while Rodgers incoherently denounced Mackey’s social responsibility as worthy of both Ralph Nader *and* Karl Marx. Rodgers conflated CSR and

totalitarianism by lumping together “the philosophies of collectivism and altruism that have caused so much human misery” (*Reason*, 2005). Even CSR practitioners can get confused: as John Mackey describes his Whole Foods business practices in his book *Conscious Capitalism*, it is easy to recognize them as variations of CSR, yet he adamantly rejects this label and makes grandiose claims of total originality and superiority (Mackey and Sisodia, 2013). Conversely, Yvon Chouinard (founder and CEO, Patagonia) proposes a coherent green economy, because he is able to critique consumerism (Chouinard, 2012, 26-27) and the very logic of capitalism (ib., 33-36).

Some critiques of CSR are justified. For instance, tensions and contradictions do exist among the 3 Ps (the triple bottom line of profit, people, and planet), between 1st, 2nd and 3rd generation rights that inspire CSR (liberty, equality, and fraternity are hard to reconcile in practice) and among stakeholders. And CSR is often used for greenwashing and corporate PR. But economic conservatives construct an alternative mental universe to better slander it. For mainstream capitalists, if any activity is legal, it is moral, even if social costs are huge, as in the case with tobacco, alcohol, weapons, economic exploitation but they blame CSR for imposing murderous costs to business (say, labeling for GMOs and real food ingredients). So-called free marketers (Milton Friedman, Ayn Rand, Center for the Defense of Free Enterprise, CATO Institute, Hudson Institute, Hoover Institution, Foundation for Research on Economics and the Environment etc.) allege against facts and reason that CSR is hostile to freedom, private property, and owners’ rights, that it is a Trojan horse for socialism and statism, and that it is anti-democratic (it assigns social-political responsibilities to private companies, thereby robbing elected government of its rightful duties). Technoptimists trust entirely in science rather than in voluntary self-restraint (a core trait of CSR), for instance with bioengineering (GMOs) or geoengineering. Science renegades and deniers, whom Naomi Oreskes and Erik Conway aptly call *Merchants of Doubt* (2010), pervert science to serve corporate ends (e.g. the Heartland Institute), and claim that CSR and environmentalists politicize false risks for a power grab. And developing world advocates grandly claim that environmentalism and CSR are forms of northern imperialism meant to hamstring southern development (Berstein, 2010; Driessen, 2003), or to criminally deny southern countries access to vital technologies (Driessen, 2003).

Such narrow, aggressive views of private property, business authority and accountability serve the power structure in multiple ways. If companies are accountable only to their shareholders and only strive to maximize profit, as Friedman claims, the power game remains circumscribed within elite circles and power remains organized hierarchically: CEOs deal with board members, board members with rich investors, investment banks, pension funds, magnates, etc. In effect, it promotes an antidemocratic, anticommunity conception of individual freedom and private property. It also offers an aggressive justification of first-generation rights theory (private property *against* state and public encroachment) and summarily dismisses second-generation rights theory (right *to* work, *to* unionize, *to* receive fair treatment at work) and third-generation rights theory (e.g., environmental interest). In addition, a narrow shareholders theory provides the intellectual and moral justification for greed (re-labeled “profit maximization”) and excuses dumping negative externalities on society. This “private power and private benefits with public liabilities” is abundantly illustrated by environmental degradation and social breakdowns (e.g., the 2008 financial and real estate crisis) that must be mopped up by public authority and public money. Therefore, if another version of win-win business is conceptually possible and pragmatically robust, it undermines the power infrastructure of mainstream capitalism and its intellectual edifice.

The economics profession has structured incentives to reward conformity with this dominant credo and punish dissenters. As E. Roy Weintraub candidly explains, academic departments and tenure committees enforce intellectual conformity: “The status of non-classical economists in the economics departments in English-speaking universities is similar to that of flat-earthers in geography departments: it is safer to voice such opinions after one has tenure, if at all” (“Neoclassical Economics,” 2007). Theoretical pluralism, a key requirement across social sciences, is synonymous with professional suicide in economics departments. For instance, starting in 2006-2007, heterodox economists in the department of economics at the University of Manitoba felt ostracized and victimized by their orthodox colleagues. In September 2015, the situation was so degraded that they took steps toward creating two separate and distinct departments, and the Canadian Association of University Teachers (CAUT) threatened to censure the University of Manitoba for failing to resolve this bitter crisis (Cabel, 2015). In January 2015, a special CAUT report on this conflict noted the difficult position of heterodox economists in the profession in general, and quoted:

“Jeff Schmidt, a physicist and editor of *Physics Today* [who] published the book *Disciplined Minds*. In it, he argues that the word “discipline,” in reference to knowledge workers has two meanings: first, a particular way of viewing the world and of practicing the profession that distinguishes it from other professions; and second, a distinct way of compelling adherence to an orthodoxy within the profession by way of inducements and sanctions” (CAUT, 2015, 13).

In its findings, the CAUT report observed repeated instances of injustice, intimidation, manipulation, violation of academic freedom, disrespect against heterodox economists and labor specialists by the department of economics at the University of Manitoba as well as a power grab by their mainstream colleagues (CAUT, 2015, 32-34). A similar conflict erupted in the economics department at the University of Notre-Dame (Indiana) from the late 1990s until 2010, which also led to the marginalization of heterodox economists.

The “free market of ideas” richly rewards those who support hegemonic structures: economic prizes, public appearances, media visibility, lucrative consultancy jobs, etc. In addition, American political economist Robert Wade connects neoclassicism’s intellectual “biases in favor of self-adjusting system and American hegemony,” “against attention to inequalities of income and power,” and against alternative economic models, with the current *patronage system* that benefits neoclassical economists over competing schools of thought (Wade, 2009, 106). Addressing this monoculture of/in orthodox economics, Wade explains that “[t]he neoclassical world view protects not only the underlying assumption about human nature and the virtues of self-adjusting market but also the rightness of U.S. leadership of the ‘free world’.” He also describes economics as a “colonized discipline” that now faces decolonization through “invasion by contiguous fields,” such as psychology, sociology, history and political science. Chief among them is behavioral economics that demonstrate “how people often choose in conditions of confusion, myopia and herd-following” (Ib., 116), a point we will discuss further down.

Critics of neoclassical economics use the concept of consilience to argue that in some of its fundamental assumptions, this discipline is an outlier among social sciences. Consilience is the convergence of evidence across a variety of approaches and addresses the need for intellectual consistency, for broad concordance of findings across connected sciences and disciplines. When different yet connected disciplines reach compatible conclusions by

following their own scientific methods of inquiry and criteria for evidence, this is a strong indication that their independent-yet-compatible findings are correct, and also that their own disciplinary methods of inquiry are correct. For instance, Darwin's theory of evolution is independently confirmed by many scientific disciplines such as geology, genetics, biology, comparative anatomy, paleontology, etc. As such, consilience is a safeguard against the fragmentation of knowledge and disciplinary autism. Historians and legal experts have long recognized the need for multiple independent sources in their field: "Testis unus, testis nullus," or "One witness, no witness." Thus social sciences must withstand the test of consilience, and identify and address where a particular discipline structurally departs from what biologist Edward O. Wilson calls *the unity of knowledge* (Wilson, 1999). However, for a group of European economists, the axiomatic truth of orthodox economics

"...stands in stark contrast to a broad set of regularities in human behavior discovered both in psychology and what is called behavioral and experimental economics. The cornerstones of many models in finance and macroeconomics are rather maintained *despite* all the contradictory evidence discovered in empirical research. Much of this literature shows that human subjects act in a way that bears no resemblance to the rational expectations paradigm and also have problems discovering 'rational expectations equilibria' in repeated experimental settings" (Colander *et alii*, 7-8).

Economics as cornucopian fantasy: endless abundance, human mastery, and God's hand

Karl Marx recognized that bourgeois capitalism served a revolutionary role by promoting historical modernization away from feudalism and toward industrial society, but in the process became a more sophisticated form of domination. Similarly, the neoclassical tradition served a positive historical role but today fails to recognize its own contradictions and to grasp the emerging "eco-awareness" (Scharmer and Kaufer, 2013) form of modernity. In *The Bridge at the End of the World* (2008), James G. Speth ponders this tension between economics-as-benevolent science and economics-as-service-to-power, which he calls the "Great Collision":

"For all the material blessings economic progress has provided, for all the diseases and destitution avoided, for all the glories that shine in the best of our civilization, the costs to the natural world, the costs to the glories of nature, have been huge and must be counted in the balance as tragic loss" (Speth, 2008, 1).

Tellingly, environmental economics itself eschews core issues of sociopolitical organization, notably unequal power formation, capture of regulatory power by moneyed interest, deep capture – cooptation of culture and minds – by hegemonic forces, the cosmic interdependence between the human and non-human worlds, and the need for a new systemic synthesis between anthro- and biocentrism. Its rational-instrumental and Positivist paradigms can't fathom ecosystem and cosmic dynamics nor the *relative, transient status of homo sapiens on earth*. Among the traditional forms of capital generally recognized by economists – human-social, institutional, built, and natural – dominant economists select an often decontextualized, unmoored version of human agency – one *homo economicus* who is substantially detached from its social and natural milieu. In their *social cosmology*, it is an *article of faith* that independent human agency allows human society to dominate and shape their natural environment at will. Environmental economists generally believe in the possibility

of systematic substitution of human capital for natural capital (Hartwick rule updated by Robert Solow). In addition, as resources dwindle or become more expensive, as climate deteriorates, as biodiversity erodes, taxation (Pigouvian taxes), price formation and value determination (contingent valuation, ecovaluation, choice modeling), private property regimes (Hernando de Soto, Coase theorem about the “3Ds” of private property) and prosperity itself (environmental Kuznets curve) will address man-made problems. They rightly point to the astounding upward trends since the Industrial Revolution – more production, more resource extraction, better standards of living for widening numbers – to argue that the future will be essentially an extension of the past, only better, stronger, higher, and faster. Wilfred Beckerman is a case in point:

“[T]he main reason why we will never run out of any resource or even suffer seriously from any sudden reduction in its supply is that whenever demand for any particular material begins to run up against supply limitations, a wide variety of economic forces are set in motion to remedy the situation... [E]conomic growth is in no danger of coming to an end because of resource constraints” (Beckerman, 2002, 13-14).

This raises several objections. One, there is not “away” in the “throw-away economy”: everything is connected to everything else; and natural sinks are not infinite. Two, Beckerman’s is very much a first-world view: in the current system, the global center (dominant regions, countries, classes, groups, and gender) prospers in good part thanks to *la dependencia* of the global periphery. Three, the market works better for rival and exclusive goods through the private property regime, but fails at protecting public access good and non-rival goods, notably the ecosystem, which sustain life in all forms. And four, French political environmentalist Hervé Kempf notices a paradigmatic paradox: since they believe that economic growth is past, present, and future, since they believe “in the infinite return of the same,” mainstream economic experts behave like believers in fixed traditional societies (2013, 5). Yet history shows that nothing is eternal in human affairs, and that economic systems must change to survive. This is especially true because demographics (population pressure) is a multiplier of environmental change: I=PAT.

Neo-classical economics limits itself to a silo or fragmentary approach. It theorizes the use and value of natural resources – land, water, energy, etc. – but does not rise to ecosystem thinking, the Big Picture, earth itself. Fritjof Capra and Pier Luigi Luisi argue that neoclassical economics is a 19th-early to mid-20th century-type of science, a science of the parts (and a flawed one, at that) whereas contemporary science “has shown repeatedly that all natural phenomena are ultimately interconnected, and that their essential properties, in fact, derive from their relationships to other things” (Capra and Luisi, 2014, 2). Inspired by the “secular and material orientation” and “the manipulative mentality of the Industrial Age,” modern economics tried to devise a Positivist social physics by using a universal mathematical language but its mathematical models “are defined on the basis of assumptions that often make the models quite unrealistic” (Ib., 47-49). Its core illusion, the belief in infinite growth, “is the result of a clash between linear, reductionist thinking and the nonlinear patterns in our biosphere – the ecological networks and cycles that constitute the web of life” (Ib., 56) when in fact economics should “ground the understanding of social phenomena in a unified conception of life and consciousness” (Ib., 297).

Mainstream economics posits the boundlessness of nature as a theoretical and practical absolute and justifies – nay, glorifies – our current system of limitless extraction,

production, and consumption. Its proponents consider economic growth as indefinite and open-ended, natural resources as indefinitely fungible, and nature as an exogenous, given, stable factor. Or to be more precise, they believe in a series of infinities: of resources, energy, natural sinks, substitutability of forms of capital, human ingenuity, profit and growth (Simon, 2015). With dire consequences. The ecological economist Eric Zencey explains: “When an economy is not rooted in resilient systems, market forces are far from being impersonal, noncoercive, and automatic” (Zencey, 2012, xv). Therefore, “[i]n a finite world, free markets built on infinite-planet assumptions are just the other road to serfdom [...] In the world that we have made, it’s not planning but the absence of planning that is the road to serfdom” (ib., 18, 31).

Mainstream economists point to increasing technological progress as the key factor behind this *ad perpetuam* growth. The famed neoclassical economist Julian Simon presented human intelligence as “the ultimate resource” (Simon, 1983; 1998) and won his famed bet against Paul Ehlich, the neo-Malthusian demographer who, it is true, has a troubling record of making brash statements and failed predictions (Sabin, 2013). But ecological modernization rests on several discredited predicates. First, sciences and technologies enjoy a transcendent, apolitical status in our societies and always work for the betterment of all and nature – this ignores the abundant literature on the structural implications of the technostructure (“Big Science”) in terms of unequal access, exclusion, scientific divide, etc. Second, technologies are key to the realization of the environmental Kuznets Curve – but the EKC works for some limited type of environmental degradation (visible and immediate effect) and is largely disproven on the global scale. Third, the dematerialization of the economy is a structural trend – but energy descent, and material decoupling and delinking are not happening at the aggregate level despite the diffusion of backstop technologies, as both the Jevons paradox and the Khazzoom-Brookes postulate (“rebound effect”) demonstrate. Ecological modernization ignores the run-away consumption that reverses technological gains. And fourth, path dependency (the closing of alternate options due to past choices and sunk costs) and the ratchet effect (making it impossible to go back to earlier alternatives) close many doors to technology-based reformism. Experts identify two broad types of ecological modernization: weak (focus on technological solutions, widely compatible with environmental economics and the sociopolitical status quo) and strong (technological changes plus social, cultural, and political reformism) (Jänicke, 2008; Mol, Sonnenfeld et Spaargaren, 2009 ; Mol et Sonnenfeld, 2014). Clearly, capitalism needs more than Big Science to reform itself, especially given its ability to penetrate and co-opt culture, as demonstrated by its association with conservative Christianity. Therefore, only the strong ecological modernization and a substantial cultural and normative transformation may help address capitalism’s crisis of sustainability.

The same fantasies of human centeredness (anthropocentrism) and self-importance (egocentrism) that drive neoclassical economics also inspire conservative American Christianity. The same holds true for other regions and religious expressions, but it is especially clear in the case of conservative American Christianity, and bears vast consequences for both the U.S. and the world. Their theoretical convergence also makes for political alliance. Princeton University historian Kevin Kruse retraces the invention of a version of Christian America by corporate America, which still predominates today. In the 1930s, “big business needed rebranding” (2015b), and the National Association of Manufacturers sought to “rehabilitate a public image that had been destroyed in the crash and defamed by the New Deal” (2015a, 3). As Roosevelt casted his reformist policies as *Social Gospel* – Christian charity applied to the common good – , a coalition of reactionary businessmen and clergymen

“advanced a new blend of conservative religion, economics and politics [...] aptly anointed ‘Christian libertarianism’” (2015a, 7). Kruse details the evolution of American public religion, from personal and ceremonial deism intended for a harmonious civic life (the Founding Fathers’ intention) to a witches’ brew of intolerant piety, aggressive patriotism (American exceptionalism), and corporate apologetics. Eisenhower and Reagan, in particular, played a key role in this theocratic drift of American politics in the name of fighting godless communism and defending (an idealized version of) liberty. This version of Christian America goes well beyond the traditional civil religion “where the nation’s institutions and its destiny take on an indeterminate, quasi-sacred quality” (Green, 2015, 2). A deep yet supple deism was part of the Founders’ worldview; religiosity has remained part of the American national character and rhetoric, and this ubiquitous force was meant to unite. Christian libertarianism however was devised for economic, political, and cultural warfare by reactionary special interests against moderates, progressives, and government reformism. And true to form, in a move common to ideologies of power, it also sought to hide its historically-determined and questionable origins by presenting itself as natural, original, and transcendent. Kruse reveals these hidden foundations, the genealogy of power for Christian libertarianism:

“The rites of our public religion originated not in a spiritual crisis, but rather in the political and economic turmoil of the Great depression. The story of business leaders enrolling clergymen in their war against the New Deal is one that has been largely obscured by the very ideology that resulted from it” (2015a, 292).

Both neoclassical economics and conservative Christianity believe that capitalism results from higher authoritative laws – rather than messy fights among competing social forces and mind capture – and is by essence a force for good. Here, Kruse illuminates another key commonality: their concern for the common good emphasizes “the values of individualism” as both rest “on the fundamental belief that an individual rises or falls on his or her own merit alone” (2015b). Species-centric and self-centric economics and religion also converge in materialism, which in religious matters is the so-called prosperity theology. Mega church pastor Joel Osteen preaches thus, with his trademark carnivorous smile:

“But God wants us to constantly be increasing, to be rising to new heights. He wants to increase you in His wisdom and help you to make better decisions. God wants to increase you financially, by giving you promotions, fresh ideas, and creativity. [...] To experience this immeasurable favor, you must rid yourself of that small-minded thinking and start expecting God’s blessings, start anticipating promotion and supernatural increase” (Osteen, 2005, 5-6).

Railing against such materialism posing as spirituality, Robert Bellah (1927-2013), one of the most distinguished sociologists of religion in the United States, reflected in 2004 on “the future of religion” in the U.S.:

“The way ‘spirituality’ is often used suggests that we exist solely as a collection of individuals, not as members of a religious community, and that religious life is merely a private journey. It is the religious expression of the ideology of free-market economics and of the radical ‘disencumbered’ individualism that idolizes the choice-making individual as the prime reality in the world” (Bellah, 2004).

Harvey Cox (1927-), one of the most prominent contemporary American theologians, also observes the conjunction of a “comprehensive market theology” and a “total market” that absorbs all manifestations of human life: the human mind and body, the numinous, family life, the arts, unstructured time, etc. (Cox, 1999). After his World War II exile in the United States, Swiss cultural theorist Denis de Rougemont observed that in the U.S. the Christian religion is meant to make life sweeter and easier, while in Europe it retains its sterner, old-world preoccupation with preparing us to die. Prosperity theology may be seen as an extreme in this quintessentially American focus on self-affirmation, self-betterment, and self-promotion. Therefore, many tenets of the Gospel of Wealth are highly compatible with neoclassical economics: humans have rightful dominion over Creation and are entitled to infinite material abundance, physical and mental abundance are inseparable, personal empowerment is key to success, wealth is a sign of right thinking/right worshipping, prosperity is governed by laws that God (or economic science) revealed to humanity, following such laws will guarantee prosperity, success is measured by living “without limits” and by home and big items ownership, etc. In the Gospel of Wealth, a traditional Calvinist sense of personal election converges with the belief in the excellence of capitalism and in American exceptionalism.

This conflation of muscular Christianity, nationalism, and capitalism is nothing new in the Anglosphere. The English political economist, famed free trader and polyglot John Bowring (1792-1872) was the fourth governor of Hong Kong (1854-1859) and a noted colonial administrator. He famously stated: “Jesus Christ is Free Trade and Free Trade is Jesus Christ” (Bowring, 2014, 19; Johnson, 2012, 2) – and he was a liberal-radical in his age! John Quincy Adams, sixth president of the United States, echoed such views: “The moral obligation of commercial intercourse between nations is founded exclusively upon the Christian precept to love your neighbor as yourself” (Johnson, 2). Oceans apart, but the same ideology: both men made these strikingly parallel statements in 1841 as justification of the Opium Wars (1839-1860) that started the dismemberment of China by Western imperialists.

For its defenders of yesterday and today, Christian libertarianism promotes individual rights, freedom of conscience and action, and insures the greater good through emphasis on individual agency. For its critics, it is another step in the secularization and cooptation of religion by Mammon and expresses a very American sense of narcissistic entitlement. The Gospel of Wealth and neo-classical economics laud materialism, consumption, and conspicuous consumption; both reject social liberalism and government reformism. Both explain capitalism in terms of superior forces (religious for Christianity, universal laws for economics), rather than messy, subjective human contingency and bitter power struggles, and believe that human agency must serve the system – not challenge it. Both cultivate fantastical notions: belief in an individual, separate, and sovereign self; concurrent celebration of narcissism and entitlement; an aversion to critical history and politics (since God’s infinite good will and objective market rules determine winners and losers); and a bizarre estrangement from the natural world (since God and objective market mechanisms promise prosperity everlasting). Indeed, as countless critics observe, our current environmental crisis is also a moral-spiritual crisis, a crisis of meaning (Warner, 2004).

Methodological individualism: social atomism as prerequisite for elite domination

All conceptions of society, politics, and economics rest on conceptions of human nature, of people’s rights and duties, and on the founding social compact, both in its horizontal dimension (citizens interacting among themselves) and its vertical dimension (relation

between citizens and authority). In this respect, neoclassical views reflect a particular Western bias that emerged in the 18th-century (Adam Smith's baker's self-interest) and solidified in the 19th: that of the isolated, rational, utility-maximizing actor. Today, economic conservatives and libertarians are animated by an anti-community understanding of individual freedom. Milton Friedman opens up his classic *Capitalism and Freedom*, a key reference for modern free-marketers, with a fiery declaration of radical individualism: "To the free man, the country is the collection of individuals who compose it, not something over and above them" (Friedman, 1971, 1-2). In his equally famous anti-Corporate Social Responsibility article published in 1970, he doubled-down: "Society is a collection of individuals and of the various groups they voluntary form." (Friedman, 1970). In 1987, Margaret Thatcher also famously contented that "There is no such thing [as society]! There are individual men and women and there are families and no government can do anything except through people and people look to themselves first" (Thatcher, 1987). In fact, for Friedman, individuals are Robinson Crusoe (Friedman, 1971, 13, 165-66).

Economic libertarians celebrate such contentions as common-sense calls for personal responsibility and freedom; opponents bemoan them as wicked selfishness. The expression *homo economicus* is attributed to John Stuart Mill who clearly stated that political economy does not address

"...the whole of man's nature as modified by the social state, nor the whole conduct of man in society. It is concerned with him solely as a being who desires to possess wealth, and who is capable of judging the comparative efficacy of means for obtaining that end" (Mill, 1874, Essay 5, paragraphs 38, 48).

What John Stuart Mill proposed as a deliberately fragmentary definition or a working framework became, in part under the influence of rational choice theory, neoclassical orthodoxy. Neoclassical views of humans as *homo economicus* describe only one aspect of social agents' behavior and sell the part for the whole. Veblen famously ridiculed this conception of social beings:

"The hedonistic conception of man is that of a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift about the area, but leave him intact. He has neither antecedent nor consequent. He is an isolated, definitive human datum, in stable equilibrium [...] self poised in elemental space" (Camic and Hodgson, 2011, 153).

Cost-and-benefits analysis is methodologically true in a very broad sense but economic calculus bears countless exceptions, is context-dependent and is anthropologically and philosophically lacking, not to mention socially and environmentally destructive. While it is true that in a market economy most economic decisions are made in a decentralized fashion and are widely distributed among large numbers of individuals, companies, and groups, economic agents are not disembodied entities floating in the ether; and methodological and practical individualism – loneliness – carry high cost in our mass societies. Paradoxically, many orthodox economists celebrate methodological individualism yet underline the importance of social capital – social connections and networks, voluntary associations, trust in neighbors, associates, partners, adherence to common social expectations and behaviors, respect for

the law and social norms of business – as a foundational element of an open, rule-based market. The American sociologist Robert Putnam confirms these findings:

“For a variety of reasons, life is easier in a community blessed with a substantial stock of social capital. In the first place, networks of civic engagement foster sturdy norms of generalized reciprocity and encourage the emergence of social trust. Such networks facilitate coordination and communication, amplify reputations, and thus allow dilemmas of collective action to be resolved. When economic and political negotiation is embedded in dense networks of social interaction, incentives for opportunism are reduced. At the same time, networks of civic engagement embody past success at collaboration, which can serve as a cultural template for future collaboration. Finally, dense networks of interaction probably broaden the participants’ sense of self, developing the ‘I’ into the ‘we’, or (in the language of rational-choice theorists) enhancing the participants’ ‘taste’ for collective benefits” (Putnam, 1995, 67).

The French sociologist Émile Durkheim showed the role that *anomie* – a term he coined to describe the erosion of social links and of one’s sense of belonging – plays in individuals’ anguish and self-destructiveness. In his noted *Bowling Alone* (2001), Robert Putnam shows how from the 1950s to the 2002, Americans have become increasingly disconnected from family, friends, neighbors and collective structures. And social activists and community organizers stress the high cost of individualism, from the erosion of the family unit to individual pathologies (addictions, suicides, teen pregnancies, etc.) and all manners of deviant social behavior.

Free marketers also pay insufficient attention to societal scales and to the paradox of collective action: “rational” behavior at the micro level create sub-optimal results at the aggregate level. In this respect, road traffic is an apt metaphor for the market: if people were motivated by utility maximization and rationality in complex situations, roads would be much safer. It makes individual sense to leave the office around 5 o’clock every night, but this aggregate behavior creates traffic jam, stress, and accidents. Anarchic and anti-social impulses in a highly complex and fluid environment (the road, the market) that are not channeled by regulatory powers put individuals on a collision course with others. In the absence of monitoring or coordinating mechanisms (police on the road, regulatory authorities in market), individual agents pursuing their own interest based on incomplete information may individually advance but on a social level they create “sub-optimal outcomes” or “disamenities,” to use economics newspeak. Rationality and utility-maximization, already debatable concepts at the individual level, become even shakier at the aggregate level.

With its exaggerated emphasis on decontextualized individual agency, neoclassical economics also ignores a key finding of feminist scholarship, that of *intersectionality*, the combination of various forms of inequality and domination that hinders agency for some groups and individuals. For instance, women are exposed to specific biological, legal-societal, and cultural constraints that create specific challenges to the full realization of their potential. Neo-classical theories defend a legal-formalistic conception of individual freedom (free floating, foot-loose economic decision-makers) in order to obliterate historical-sociological realities (individuals are embedded in situations and communities and seldom function as *homo economicus*) that stand in the way of capitalistic accumulation. Theories regarding atomistic agents moving freely across market opportunities are invalidated by multiple

frictions (“stickiness”) within markets, by power formations that freeze the advantage of some agents over others, by rent-seeking, by regulatory capture (control of regulatory mechanisms by vested interests), etc. Whereas capital and corporations move freely and fast across vast distances and borders, people and small businesses are embedded in real families, communities, and situations; they have a different relation with time and space. In other words, there is a natural “stickiness” (resistance) of groups and individuals to the logic of capitalistic accumulation, to hyper-mobile markets, while symbolic, dematerialized capital roams around. It is no accident that the neo-classical views of footloose, hyper-rational agents describe best the financial sector, which has proven to be the most socially destructive part of neoliberalism. If these theories are incorrect, why are they defended?

A first explanation touches on reflexivity: defining reality is bending and shaping it. The Boston University feminist economist Julie A. Nelson proposes a nuanced explanation for what she calls the “simplistic view of economics,” “the cookie-cutter content of the most popular K-12 teaching materials, standardized test, university introductory and intermediate microeconomic and macroeconomic theory textbooks and graduate “core” theory courses.” She explains that framing economic relations as “a free standing, fundamentally private, mechanical and ethics-free sphere,” as impersonal and purely technical, “stack[s] the deck in favor of individualism and selfishness” (Nelson, 2012). If the hegemonic culture describes individuals as selfish and exploitative, it feeds our fears of survival, encourages self-protection and isolation, and substitutes for organic social connections in the form of materialistic consumption. This self-fulfilling prophesy confirms the concept of positive feedback loop, which is central to systemic analysis: the energy a system sends out comes back to reinforce the dynamics of the system. In this instance, intellectual-cultural *preferences* (energy) in favor of economic libertarianism emanate from economists (originating sub-system) and come back as *facts* to reinforce the general system in the direction of the original message. Sociology and psychology have long established the importance of socialization and internalization of collective messages in the definition of self.

In *Cultural Violence* (1990), Johan Galtung (a key creator of the field on conflict resolution) illuminates a second function of methodical individualism for the hegemonic classes:

“A violent structure leaves mark not only on the human body but also on the mind and the spirit. The next four terms can be seen as parts of exploitation or as reinforcing components in the structure. They function by impeding consciousness formation and mobilization, two conditions for effective struggle against exploitation. *Penetration*, implanting the topdog inside the underdog so to speak, combined with *segmentation*, giving the underdog only a very partial view of what goes on, will do the first job. And *marginalization*, keeping the underdog on the outside, combined with *fragmentation*, keeping the underdogs away from each other, will do the second job” (Galtung, 1990, 294).

Thus individualism is the organizing principle that underlies elite’s policies of penetration, segmentation, marginalization and fragmentation. Ayn Rand on the far-Right and Garrett Harding on the Green Left show this connection between radical individualism and Social Darwinism. Rand provides the potent brew of self-aggrandizement, narcissism, Nietzscheism (the entrepreneur as transcendent hero) and Social Darwinism needed by the libertarian right to assert its hegemony. She systematically reduces altruism to a vice and elevates selfishness and will to power as paramount virtues and conditions for individual freedom

(Rand, 2015). Harding, despite his “tragedy of the commons” fame and environmental credentials, is vindictive toward the weak, the poor, and the immigrants. He advocates a lifeboat philosophy where the powerful ought to reject and punish the poor and vulnerable in order to save the environment (Harding, 1974a, 1974b, 1991, 2001).

For labor and consumer markets to be “optimally competitive” and “frictionless,” corporations need an atomized society and will do their utmost to make reality conform to the neoclassical paradigm. This is why the labor market and the marketing machine have a vested interest in isolated and selectively desocialized individuals. Community bonds, family solidarity, local communities, churches, voluntary groups and the whole web of civil society ties are essentially *res extra commercium* – things outside the commercial realm. They provide their members with non-monetarized common goods such as strong civic culture, solidarity, a sense of belonging and identity that are detached from consumption. Therefore they must be brought into the merchant sphere by both the intellectual and social disciplines. The marketing machine does not like fully-informed citizens and organic communities: it needs to increase isolation, envy, and competition where they already exist, and introduce them when they do not. This is precisely the role played by mass individualism and materialism.

Utility maximization: materialism as doctrinal prerequisite for social isolation and deep capture

Rational choice theory provides the psychological foundations for neoclassical economics. In the conclusion to his 1992 Nobel Prize address, the Chicago school economist Gary S. Becker emphatically states that

“...no approach of comparable generality had yet been developed that offers serious competition to rational choice theory. [...] The rational choice model provides the most promising basis presently available for a unified approach to the analysis of the social world by scholars from the social sciences” (Becker, 1996).

Rational choice theory broadly posits individual calculations of costs and benefits and agents rationality: *how* agents come to their decision, not *what* decision they make. The University of North Carolina economist Irvin B. Tucker interprets “consumer choice theory” with reference to the standard canon (total utility, marginal utility, diminishing marginal utility, consumer equilibrium income effect and substitution effect) without mentioning any holes in the doctrine (Tucker, 1997, 145-59). In another classic college textbook, the neoclassical economists Marc Lieberman and Robert E. Hall seem to offer a more realistic view of reality but, constrained by the Procrustean requirements of doctrinal orthodoxy, they wiggle their way out of the conundrum, and reassert the article of faith that individuals seek to *maximize* their utility: “Another feature of preferences that virtually all of us share is this: We generally feel that *more is better*” (Tucker, 1997, 106). Experience belies such black-and-white contentions. In fact, individuals seek to optimize – not maximize – utility by juggling divergent preferences and forces in situations of imperfect and fragmented information, as Joseph Stiglitz demonstrated – and his work in this field was distinguished by the Nobel Prize in economics.

One observes a triple slide in this materialistic economism: social facts are reduced to their economic dimensions, economic activities to profit maximization, and individual behavior to consumerist materialism. The expression “consumer sovereignty” was coined by the British economist William H. Hutt (1899-1988) in his 1936 *Economists and the Public*. It posits that

consumers rather than producers are the primary and ultimate authority of what economic services and products benefit them most. In essence, consumers' preferences shape the production of goods and services. It has become a central tenant of mainstream economists and the Austrian school economist J. Patrick Gunning even deems it central to Ludwig von Mises' theories (Gunning, 2009, 4). Such affirmation of the free primacy of individual choice feeds the corporate bottom line for it is a battering ram against social forms and forces that impede unbridled consumption and profit maximization. Forces of resistance to capital accumulation that must be shrunk or eliminated include: individual autonomy, community life, social justice, personal and social spaces for non-profit activities, and environmental stewardship.

Under the current system, utility maximization overwhelmingly equates with materialistic satisfaction. This tenet serves capitalistic accumulation by reducing human being to consumers. It describes some, but not all of us, and applies perfectly to neurotic individuals, addicted shoppers, and psychopathic corporate actors. Orthodox economists recognize that individuals are caught between utility maximization and the law of diminishing marginal utility (Tucker, 1997, 108-09), which expresses the diminishing pleasure that consumers experience as they acquire more stuff. Psychologically they experienced this law of diminishing (emotional) return as compulsion, rote repetition, boredom, emptiness, anxiety. The "paradox of hedonism" (pleasure or happiness can be attained only indirectly), the Easterlin paradox (there is no automatic or proportional correlation between increased possessions and increased happiness), happiness economics, the Gross National Happiness (GNH) Index, the Green and Happiness Index (GHI), the Social Progress Index (SPI) may provide alternative economic frameworks to neoclassical utilitarianism. And philosophy, spirituality, morality and faith may provide alternative views of human nature and objectives.

Well-adjusted and principled individuals know that materialism cripples our emotional and spiritual lives: more is often less. As they sense contradictions within their model, many neoclassical economists concede that behavioral economics "point out that some human behavior is not consistent with *any* type of maximization" because "they incorporate notions about people's *actual thinking process*." Despite this remarkable admission, they also insist that "the standard economic models work so much better" and dismiss behavioral economics as merely "an extra limb that extends the theory's reach to some anomalous behavior" (Lieberman and Hall, 2005, 122-23). Reality pokes enough holes in "these assumptions economists make" (Schlefer, 2012) that specialists concede countless exceptions, exemptions, and exclusions to their core beliefs, while still protecting said assumptions as fundamentally valid – an example of cognitive dissonance within members of a scientific community. Gary S. Becker provides a case in point in his 1992 Nobel prize address with his departure from the core *homo economicus* postulate, yet he immediately negates his nuances by applying his brand of economic logic to countless non-economic topics such as law, crime, or family: "[T]he economic approach I refer to does not assume that individuals and motivated solely by selfishness or gain. It is a method of analysis, not an assumption about particular motivations. [...] Behavior is motivated by a much richer set of values and preferences" (Becker, 1992). In other words, all sorts of motives move actors in various spheres of social activities, yet the economic rationale as understood by neoclassicism still holds across the board!

The ultimate form of alienation, of loss of connection with self and community, is loss of personal awareness and the capture of mental, emotional, and psychological agency by market forces. This *deep capture* leads to the self being estranged from self, and internalizes

the manufactured reality concocted by marketing, television *programming*, and corporate media. Rather than informed participation and cost-benefit analysis, a false consciousness often prevails in individuals' economic behavior. As the economist Victor Lebow famously stated as early as 1955,

“Our enormously productive economy demands that we make consumption our way of life, that we convert the buying and use of goods into rituals, that we seek our spiritual satisfaction and our ego satisfaction in consumption. The measure of social status, of social acceptance, or prestige, is now found in our consumptive patterns. The very meaning and significance of our lives today is expressed in consumptive terms. [...] These commodities and services must be offered to the consumer with a special urgency. We require not only ‘forced draft’ consumption, but ‘expensive’ consumption as well. We need things consumed, burned up, worn out, replaced and discarded at an ever-increasing pace. We need to have people eat, drink, dress, ride, live with ever more complicated and, therefore, constantly more expensive consumption” (Lebow, 1955).

These alarming trends have grotesquely sped up, hardened, and metastasized since the 1950s, aided by orthodox economics as it refuses the notion of limits to growth, to consumption, and to ecosystems and natural resources.

Rationality, bounded or not: hiding the messy dynamics of human behavior

Rationality in the service of utility-maximization, key tenets of neoclassical thought, is a convoluted way of saying that people like what they like and want as much of it as they can get. Here, Galtung's critique regarding elite strategies for penetration, segmentation, marginalization and fragmentation of the dominated, is most enlightening. The social purpose of putting the onus of decision-making on *supposedly competent autonomous individuals* is to hide the collective mechanisms – outright lying, hidden persuasion, manipulation, multiple forms of censorship and framing – deployed to “manufacture consent” (Herman and Chomsky, 1968) to this economic system and this system of power relations. It is to make this strange social order seem natural and self-evident – since we are born selfish and are natural-born consumers – and sell it as the best possible – nay, the only world – for individuals. It is meant to discourage critical thinking regarding social structures and alternative modes of social organizing: why run against nature when individuals are competent? It is meant to hijack democracy: why object if individuals know what's best for them? And finally, it is meant to hide the alarming importance of psychopaths for this business world.

In fact, decision-making in economic – and other – matters incorporates a range of heterogeneous motivations mixing reason, cognitive-emotional flaws, neuro-biological forces, individual *Weltanschauungen*, social conditioning, habits and gregarious influence, cost-and-benefit utilitarianism, misinformation, miscalculation and bias, amnesia, as well as moral, ethical and altruistic aspirations, animal spirits, and antisocial, even psychopathic, tendencies. This is why Alexander Hamilton quipped that “People are not reasonable, they are capable of reason”. In 1936, John Maynard Keynes famously wrote:

“Even apart from the instability due to speculation, there is the instability due to the characteristic of human nature that a large proportion of our positive activities depend on spontaneous optimism rather than mathematical expectations, whether moral or hedonistic or economic. Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as the result of animal spirits – a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities” (Keynes, 1936, 161-62).

Alan Greenspan himself, despite being chair of the U.S. federal reserve from 1987 to 2006 and a chief actor of financial neoliberalism, has to admit the failure of economic science in the wake of the 2008 crisis which “represented an existential crisis for economic forecasting” (Greenspan, 2013, 88). He asks with some Angst: “Why was virtually every economist and policy-maker of note so blind to the coming calamity? How did so many experts, including me, fail to see it approaching?” (Ib., 89) His answer: Keynes’ animal spirits, for people are predictably irrational.

The American sociologist and economist Thorstein Veblen (1857-1929) is credited for coining the term “neoclassical economics” in 1900. Alfred Marshall (1842-1924), Carl Menger (1840-1921), Léon Walras (1834-1910), and William Stanley Jevons (1835-82), the founders of neoclassicism were his contemporaries. Veblen disagreed with the neoclassical theories that emerged around him and his alternative vision of economics, which over time developed as institutional economics, shares with other heterodox and innovative schools of economics (notably evolutionary economics and behavioral economics) the belief that economics is embedded in history, psychology and ethics, anthropology and sociology, biology and neurosciences. These theories rejects the neoclassical view of human nature, which posits that individuals are rational (i.e., fully informed... except when they're not, when their rationality is 'bounded') utility maximizers who approach market transactions fully informed from a cost-benefit perspective. Individuals are perceived as manifesting stable preferences across time, settings and cultures. With respect to such views of human motivations, three dissenting economists rightly point out that “[h]ow preferences are formed or whether they correspond to biology or physical reality is considered to be outside the scope of economics” (Ayres, van den Bergh and Gowdy, undated, 3).

For another group of economists preoccupied by the “systemic failure of academic economics,” the mainstream discipline “reduces economics to the study of optimal decisions in well-specified choice problems. Such research generally loses track of the inherent dynamics of economic systems and the instability that accompany its complex dynamics.” (Colander *et alii*, 3). Indeed, why should we believe that individuals are guided by rationality and well-understood self-interest in complex economic decisions, when all around us social behavior provides a wealth of contrary evidence? If cost-benefit analysis and rational choice inspired humans in their everyday conduct, all drivers would be prudent, courteous, and safe, save for weather problems and freak accidents. And as individuals would be better informed before marrying, marital unhappiness and divorce rates would dramatically plummet. Beyond easy sarcasm, the fact that masses of people make their most important decisions – driving, crossing the street, marrying, etc. – with stunning incompetence shows the limits of cost-benefit analysis.

In *Protestant Ethics and the Spirit of Capitalism* (1905) Max Weber showed the connection between positive psychological-cultural traits (creativity, sense of duty, deferment of gratification, self-discipline) and capitalistic entrepreneurship. That is the positive side of capitalism, yet its shadow also looms large. Gary Becker applied neo-classical theories of choice to criminal choices, and *Freakaconomics* did the same for drug dealers (Levitt and Dubner, 2009). Many neo-classical economists are similarly interested in street-level gangsters but demurely look away as capitalism is largely shaped by sociopathic individuals. In fact, the pathological personality often operates mainstream and disproportionately contributes to capitalistic growth *and* societal toxicity. The *Society for the Scientific Study of Psychopathy* (SSSP) defines it thus:

“Although psychopathy is a risk factor for physical aggression, it is by no means synonymous with it. In contrast to individuals with psychotic disorders, most psychopaths are in touch with reality and seemingly rational. Psychopathic individuals are found at elevated rates in prisons and jails, but can be found in community settings as well” (SSSP, 2015).

Power (financial, political, social, or religious) *attracts* and *rewards* countless sociopaths. Indeed, the SSSP’s clinical definition of psychopathy – “dishonesty, manipulateness, and reckless risk-taking” – describes many business and corporate leaders. In *Driven to Lead: Good, Bad, and Misguided Leadership* (2010), Paul R. Lawrence, an authority in the field of organizational behavior, argues that “Leadership is not simply an external effect on other people; it’s what is actually happening inside the brain” (driventolead.com). With a firm grounding in evolutionary biology, Lawrence posits the existence of four fundamental human drives: to acquire resources and offspring, to bond, to comprehend, and finally to defend ourselves, our loved ones, and our property. The conflicts and compromise among these urges – Freud’s *Trieben*, or vital impulses – form a complex tangle of motives. Acquiring and defending inspire self-interest and are common to territorial animals, whereas complex bonding and comprehending define the human species, and inspire self-restraint and good will. In power-hungry leaders such positive drives are severely deficient.

Likewise, in *Snakes in Suits: When Psychopaths Go to Work* (2006), industrial psychologist Paul Babiak and criminal psychologist Robert D. Hare (the creator of the Psychopathy Checklist Revised, or PCL-R, used worldwide by researchers, clinicians, and law enforcement personnel) provide ample evidence of the *banality of evil* among corporate leaders. As demonstrated by the chronic pandemic of white-collar crime, especially in the United States, these predators thrive in such open, fast-paced, and under-regulated environments with their heady mixtures of high risk, immense financial and ego rewards, and socially-rewarded domination over others. The sick ego loves to worship itself through power, so their marauding is enabled by today’s culture of neoliberalism that celebrates solipsistic, predatory, and self-aggrandizing individualism. Their misdeeds are also facilitated by dodgy politicians, many of them fellow psychopaths who *admire* their corporate counterparts, and many others seduced, cowed, or corrupted by money and neoliberal economics. Psychopathic “characteristics and traits [...] conflict with the generally accepted norms and laws of society” (Babiak and Hare, 2006, x), but not with how corporations operate under the Washington Consensus and Wall Street’s hegemony. In fact, many corporations and industries (notably FI.RE, or finance and real estate) are the natural milieu and *institutional extension* of modern psychopaths:

“Egocentricity, callousness, and insensitivity suddenly became acceptable trade-offs in order to get the talents and skills needed to survive in an accelerated, dispassionate business world [...] [L]ack of specific knowledge about what constitutes psychopathic manipulation and deceit among business people [is] the corporate con’s key to success” (Babiak and Hare 2006, xi-xiii).

The “ring of power” can be summarized as follows: twisted yet highly functional individuals channel their will for domination into exploitative capitalism and are richly rewarded and honored. Elite economics provides the false consciousness, the veil of illusion needed to simultaneously hide, deny, justify and glorify this charade. In the U.S., cunning masters of the economic game consolidate their power through corporatocracy, regulatory capture, deep capture, and by what Mike Lofgren (2014) calls “the deep state,” the subsurface complicity among Democrats, Republicans, and public agencies on behalf of the military-industrial-espionage-security-corporate complex. Given its hyper-rationality, its lack of social and national allegiance, its obsession with maximum accumulation, its imperialistic ambitions against other social spheres (individual and community autonomy, regulatory independence), the financial sphere embodies the neoclassical fantasy of *homo economicus*. This is why progressives such as Jim Hightower, Ralph Nader, and Robert Reich demand that American companies pledge allegiance to the United States, in order to moor them in a real community.

Hiding cultural violence: methodological and linguistic obfuscation of power relations

Key economic institutions and practices (market, trade, entrepreneurship, investment, innovation, risk-taking, money, credit mechanisms, etc.) precede capitalism by millennia but have been *rationalized* by neoliberalism, which dresses up its particular choices as science. For instance, Paul Hawken reminds us that “[o]ne of the reasons we like the term “market economy” is because we picture the market square with farmers and craftspeople” (Hawken, 2010, 86). In this example, the dominant discourse manipulates our natural yearning for close and protective communities (Ferdinand Tonnies’s *Gemeinschaft*) while promoting anonymity and competition (*Gessellschaft*). While fostering status anxiety, retail therapy, and conspicuous consumption, it proposes an alternative verbal and mental reality that serves to dissimulate the economy of domination – and we use “economy” here in the dual sense of the term.

In his canonic *History of Economic Analysis* (1954), Joseph Schumpeter denounced as “Ricardian vice” (what he considered) David Ricardo’s habit of oversimplifying his economic hypotheses to bolster his assumptions, of devising abstract model building with a few basic variables that bothered little with empirics (Schumpeter, 1954). In a similar vein, the economist Erik S. Reinert speaks of the “sterile formalism” of Darwinian economics where “the models had become more real than reality itself” (Reinert, 2013, 58, 63). For critics, such abstractions are further dis-embodied by the mathematical formulations at the core of mainstream economics, which they castigate as formal, autistic, and disconnected from flesh-and-blood reality. E. Roy Weintraub provides an authoritative consideration of *How Economics Became a Mathematical Science* and acknowledges that since “economics is intertwined with mathematics in the twentieth century, in order to understand the history of economics we need to understand the history of mathematics.” In fact, “economics has been shaped by economists’ ideas about the nature and purpose and function and meaning of mathematics” (Weintraub, 2007, 2). This trend draws fire from a sub-set of mainstream economist and from dissenting experts. For instance, Nobel Prize laureate Wassily Leontief

analyzed the contents of the *American Economic Review* and contrasted the proliferation of mathematical models with the paucity of application and results:

“The connection between mathematical models of finance markets (expressed for instance by the Black-Scholes equation) and the anti-social and anti-economic behavior of financial markets raises core epistemological questions for economics. Yet it satisfies one key fantasy of capital accumulation, that of a frictionless market, a market where transaction costs are nil, where economic transactions unfold without the usual fuss and costs associated with real-world, social exchange or ‘trans-actions’” (Daly and Cobb, 1989, 32).

Ronald H. Coase (Nobel Prize in economics in 1991) also provides a sinuous defense of economics’ methodological imperialism. First he acknowledges the narrowing of its method:

“This impression is reinforced if we have regard to the articles which appear in most of the economic journals, which, to an increasingly great extent, tend to deal with highly formal technical questions of economic analysis, usually treated mathematically. The general impression one derives, particularly from the journals, is of a subject narrowing, rather than extending, the range of its interest” (Coase, 1978, 204).

Then he tries to wiggle his way out this conundrum:

“[T]here are, at present, two tendencies in operation in economics which seem to be inconsistent but which, in fact, are not. The first consists of an enlargement of the scope of economists’ interests so far as the subject matter is concerned. The second is a narrowing of professional interest to more formal, technical, commonly mathematical analysis. It may say less, or leave much unsaid, about the economic system, but, because of its generality, the analysis becomes applicable to all social systems” (Ib., 207).

What is left “unsaid” in such formal models that concentrate on technical issues in highly technical terms is an enormous chunk of sociopolitical reality, messy power struggles, the clash of economic ideas, and the position of economics as a social science embedded in political and historical practices. As the economist McCloskey argues, “Words, ideas, rhetoric make for a ‘humanomics’, an economics with full humans let back in” (2015b). McCloskey is considered a conservative University-of-Chicago style economist, and describes herself as a “Christian libertarian” (www.deirdremcclosekey.com), but she does take exception with formal, a-contextual theorizing:

“The average economist, especially the average young American economist, is ignorant of what happened yesterday in the economy. In a recent survey of American graduate students in economics [...] only 3 per cent said that knowing something about actual economies was important for success as an economist. But the economists [...] are going to continue resisting historical facts and historical argument until they recognize that they themselves are historians, tellers of stories. The anti-empirical character of economics, shielded from criticism by a naively empiricist philosophy of inquiry, is startling to outsiders [...] Economists have for a century or so been

enchanted by mathematical physics. Some decades ago they cast off their identities as worldly philosophers and economic historians, donning the garb of social physicists, tough and masculine and quantitative [...] They adopt a philosophy of inquiry that they think goes along with being physicists” (McCloskey, 1988, 643).

McCloskey also connects elite economists’ professional orientation with the incentive system provided by the power structures: “They follow the course of honors in physics, from big government grants to the Nobel prize” (Ib., 643). Her mention of economics as a “tough and masculine” exercise reveals the role played by American masculinity in this discipline. Indeed, neoclassical economics is deeply steeped in the American national experience, character, and mythology. A-historical economics very much reflects American mainstream culture with its historical amnesia and reflexive glorification of its uniqueness. The U.S. celebrates its history-as-change but sees itself largely immune from history-as-tragedy. Or to be more exact, because of American exceptionalism, tragedy remains an exception, an anomaly in the long arc of American progress, while it is the norm for “the rest of them out there.” A sense of tragedy is not in the American character, winning optimism is. Awareness of limits and respect for measure are not in the American character, boundless energy and materialistic celebration are. A sense of individualism, narcissism, competitiveness and acquisitiveness also inspires American personhood. Therefore, moral progress through cumulative and infinite material growth – America’s self-evident destiny – also inspires neoclassical economics. America is elected by history, by God, and by its own fundamental goodness; therefore it alone has discovered the Big Secret for human happiness, individualistic democracy and its own brand of capitalism and economics. Elite economics also serves American global interest through the intellectual diffusion and practical imposition of Reaganomics and neoliberalism.

Therefore, as James Galbraith explains, the discipline needs to clarify the relationship between empirics and theorizing, contextualize mathematics, and reset the boundaries of observation:

“Empirical work should be privileged. Real science does not protect bad theory by concentrating on matters that cannot be observed. It is, rather, a process of interaction between conjecture and evidence [...] Mathematics should mainly clarify the implications of simple constructs, not obscure simple ideas behind complex formulae [...] A focus on social structures and the data that record them requires new empirical methods [...] The study of dispersions, of inequalities, is intrinsic to the study of power. Neoclassical economics with its bias in favor of the sample survey, the Gini coefficient, and the assumption of normality in the distribution of errors has, to a degree, neglected the mathematical and statistics of dispersion measures [...] Likewise the study of social structures cannot be done wholly with parametric techniques held hostage to the dogma of hypothesis and test...” (Galbraith, 2008, 497-98).

Economics then suffers from mathematical autism and “physics envy,” as even conservative sources acknowledge (*Bloomberg*, 2006; *Economist*, 2011; see also Clarke and Primo, 2014 for a summary). Yet such strict methodological choices are no accident: they serve to dissimulate the construction of the truth regime through control of professional discourse. British International Political Economy (IPE) scholar Nicola Phillips observes that in the United

States the discipline has moved away from the pluralism and intents advocated by its founder, Susan Strange, and toward “the contraction and demeaning of pluralism [and] a sharp methodological homogenisation” (Phillips, 2009, 85). She sees “a fairly small handful” of IPE professional journals act as gate-keepers of the field, with contributions disproportionately authored by men (86%) from hegemonic universities (29% from just 11 U.S. universities) (Ib., 86). The twelve IPE journals that dominate the profession – where faculty want to publish for tenure, promotion, and other organizational rewards – are from the U.S. and far from being generalist outlets as claimed, work “within the liberal paradigm,” and the vast majority of IPE articles they publish use quantitative methods (Ib., 87). They opt for micro-issues, for a “narrow empirical focus on a small handful of advanced industrialized countries,” for strategically important regions for the United States (notably, East Asian economies) and in these regions for issues related to finance, trade, competition, regulation and such, rather than for “questions of global development, migration, poverty, labor standard, environment and climate change, and so on.” Of course, such choices come at the detriment of big picture issues, integrative thinking, and critical perspectives (Ib. 91-93).

Among the approaches thus excluded from the orthodox IPE discourse are Marxism, constructivism and ideational paradigms, feminism, “post-structuralism and other critical, non- and post-positivist approaches” (Ib., 88). Therefore Phillips contrasts the openness and eclecticism of the British school of IPE with the narrow approach defended by the dominant IPE community in the United States, and sees IPE’s intellectual landscape better reflected in a wide range of social science journals, rather than in the reference disciplinary journals. The vigorous debate launched in the IPE profession by Benjamin Cohen’s book *International Political Economy: An Intellectual History* (2008) and the flurry of scholarship that ensued (Maliniak and Tierney, 2009; *Review of International Political Economy*, 2009) reveal this closing of the American IPE mind.

The notion of “negative externalities,” a key concept for environmental economics, provides a clear illustration of such intellectual obfuscation. Negative externalities are the detrimental social and environmental consequences of economic transactions that are not mediated by market-based instruments and in particular, not expressed in the price-formation system. They are excluded from official accounting at the aggregate level with the GDP, which considers accidents, pollution, crime and countless social ills as productive as long as they generate business and value-creation. They are also ignored at the micro-economic level through companies’ conventional accounting systems. Milton Friedman called them “neighboring effect” or the negative impact of economic activities on their close surroundings – but today we know that they are global, systemic, and often self-sustaining. They represent an effort on the part of environmental economics as a discipline to account for market disamenities and sub-optimal outcomes in an economic system that they deem otherwise self-regulating, self-improving, self-correcting and optimized – the Pareto equilibrium.

In fact, externalities are “external” only in the language of conventional economics and conventional politics, for those who benefit from them. They are external to the system of economic power and its intellectual representations, to the hierarchy that produces the dominant discourse and practices. They are gains (“positive externalities”) for hegemonic classes, groups, and countries, and often a condition of their prosperity, and are externalized by power practices and conventional accounting, which are power relations embedded in law and accepted business practices. But they are indeed negative for those groups (subaltern classes and groups, dominated regions, etc.) at the periphery of power formation. “Negative externalities” is econ-speak to avoid the much more damaging concept of “structural

contradictions,” and serves to hide the fact that negative externalities trickle down the power ladder while the lion’s share of positive externalities moves up the power ladder. One example is how first-world corporations, consumers, and societies transform developing countries and poorly regulated countries with weaker civil societies, into pollution havens by exporting their polluting activities and dumping their industrial waste.

The notion of “lawful economic activity” provides yet another example of this cloaking strategy. Free-marketers argue that capitalism is essentially benevolent since it operates within the law, the highest authority in democratic nations and organized societies. Yet the integrity of the law is increasingly corroded by regulatory capture; and the law’s social purpose – to serve the common good by allocating rights and responsibility and organizing accountability fairly – is systematically highjacked by economic forces. The powerful make the laws and break them with impunity; they institute one set of laws for the best and another set of laws for the rest. They set a public law for the dominated and a private law for themselves, a *privus lex*, a privilege. Examples of this corruption of law and democracy include banks that are too big to fail, the shielding of individual criminal executives from penal responsibility, and the mobilization of public resources for corporate welfare and bailouts of misbehaving finance institutions.

Together, regulatory capture and deep capture show that individual freedom in economic matters is often manipulated by power structures. This is why orthodox economics, as facilitator of unequal power relations, *must* postulate the *essential* freedom and responsibility of all economic agents, big and small: it needs to hide the reality that *practical* freedom is an unequally distributed common good. In Marxist terms, elite economics postulates formal, bourgeois freedom in order to dissimulate and deny the crisis of effective social freedom. In our *Animal Farm*, the pigs – the agents that structure, co-opt, and articulate economic power for their own benefit – are more equal than other animals.

Being partly scientific, neoclassical economics has not yet exhausted all its positive contributions; but it has shown its true colors and its limits as a systematic and systemic ideology. As a *comprehensive* tool for organizing socio-economic relations, it lingers on as an increasingly obsolete technology blocking the way toward a new environmental and social paradigm. Yesterday, prior to the rise of global environmental awareness, Daniel Bell could focus solely on “the cultural contradictions of capitalism” (Bell, 1976) without reference to its ecosystem limits. But today Marxist analyst David Harvey identifies seventeen of them (Harvey, 2014) and the neoliberal avatar faces its ultimate structural contradiction: the limits to earth’s carrying capacity, the degradation of ecosystems, the over-use of natural resources, and climate change. Capitalism harbors an immense capacity for both further deterioration *and* dramatic self-improvement. Its critics have many times predicted its *future* demise, when in fact vast regions *already* suffer from economic exploitation, and social dislocation aggravated by resource attrition and climate change. Tomorrow is already here, has been here since the dawn of capitalism, and it looks very different when viewed from the core or the periphery, for instance the Horn of Africa, where climate change is contributing to chaos (Parenti, 2011).

This explains elite economics’ role. With many of its scientific claims battered by the earth itself and its historical purpose increasingly questioned, its social function is increasingly to 1) organize mass individualism on behalf of power structures, 2) help hide and “outsource” negative externalities and, 3) provide the veil of illusion needed to soldier on. Take for instance, the profession’s herd-like celebration of Enron (micro-economics wrong at the unit

level) and its inability to predict the 2008 systemic collapse (macro-economics wrong at the system level). In other words, before they are economists, neoclassical economists are humans; and before they are globalists they are Americans – or largely reflect a chosen version of the American experience. This discipline needs to free itself from exploitative power structures in order to help commerce recover its true ecology (Hawken, 2010) and its relations with good and evil (Sedlacek, 2011). Let all neoclassical economists meditate these admirable truths from Adam Smith's *Theory of Moral Sentiments* (1759), whose opening lines posit human sympathy as fundamental to all societies:

“How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it. Of this kind is pity or compassion, the emotion which we feel for the misery of others, when we either see it, or are made to conceive it in a very lively manner. That we often derive sorrow from the sorrow of others, is a matter of fact too obvious to require any instances to prove it; for this sentiment, like all the other original passions of human nature, is by no means confined to the virtuous and humane, though they perhaps may feel it with the most exquisite sensibility. The greatest ruffian, the most hardened violator of the laws of society, is not altogether without it” (Smith, 1759, ch. I).

Then as a moralist Adam Smith explains how greed and reverence for it corrupt this fundamental human drive of sympathy. “The corruption of our moral sentiments,” he says, “is occasioned by this disposition to admire the rich and the great, and to despise or neglect persons of poor and mean condition”:

“This disposition to admire, and almost to worship, the rich and the powerful, and to despise, or, at least, to neglect persons of poor and mean condition, though necessary both to establish and to maintain the distinction of ranks and the order of society, is, at the same time, the great and most universal cause of the corruption of our moral sentiments. That wealth and greatness are often regarded with the respect and admiration which are due only to wisdom and virtue; and that the contempt, of which vice and folly are the only proper objects, is often most unjustly bestowed upon poverty and weakness, has been the complaint of moralists in all ages” (Smith, 1759, ch. III).

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Two worlds of minimum wage and a new research agenda¹

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Abstract

Under the conditions of advanced capitalism minimum wage is the statutory lowest boundary for remuneration that is directly relevant for a small group of people who are not protected by the other components of the system. In developmental context, however, firms do not exactly comply with minimum wage but it may still act like a lighthouse (beacon) positively affecting all wages across both formal and informal sectors even without being effectively enforced. Consequently, vast majority of population may be influenced by minimum wage dynamics. Therefore while under the conditions of advanced capitalism the name and nature of minimum wage coincide, in developmental context this is no longer the case. Although its name remains the same its nature is different: it is neither minimum nor wage but a signal that may become the reference price for the fair value of labor across entire economy. This suggest that minimum wage and people's sense of fairness may be linked. The research has been overlooking these peculiarities and analyzing minimum wage in developmental context on the basis of assumptions derived from the conditions of advanced capitalism. This approach makes us overlook interesting dynamics triggered by minimum wage across "developing" countries. I propose a new approach to minimum wage that would recognize its different nature in developmental context and would scrutinize its role in legitimation dynamics and its relationship with social cost of labor. This approach would open new avenues for research and prevent us from asking wrong questions.

JEL Codes B2, E2, H1, I3, P1

Keywords Minimum wage, accumulation and legitimation dilemma, developing countries, social cost of labor

Introduction

Do we know enough about minimum wage? This question may sound absurd given the huge literature on this subject accumulated over more than a century enabling meta-studies (Card & Krueger, 1995; Doucouliagos & Stanley, 2009; Belman & Wolfson, 2014) and even inspiring meta-meta studies (Schimdt, 2013). But still the answer is simple: No, probably we don't! And to understand why we should recall a nice observation made by Karl Marx a long time ago:

"Name of a thing is entirely external to its nature. I know nothing of a man if I merely know his name is Jacob" (Marx, 1867[1992]:195).

I argue in this paper that a substantial part of minimum wage research, by taking the name of this "thing" literally and thereby confusing the name of the thing with its nature, has developed on the basis of an implicit assumption, namely, the assumption that minimum wage is a

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component of an institutional landscape which reflects characteristics of advanced capitalism as it is imagined to exist in “Western” countries. The implication is that within this conceptualization minimum wage appears quite literally as the lowest legally possible wage which is directly relevant only for a small group of marginalized people and thus its significance results not from its wider societal impact but from its capacity to provide a test ground for opposing economic theories about the nature of labor “market” (Leonard 2000, Kaufman 2010). Practical end results have been the colonization of minimum wage research by mainstream economics and its use as an academic battlefield for competing theories that attack each other almost as if they fight a war of attrition in which only numbers rather than creativity count. Hence is the authority of meta-studies in this field.

In fact one can easily find oneself constrained by this dull programme even as one tries to object to it if one solely scrutinizes the empirical reality of “advanced” capitalism. Thus the only heretical strand within minimum wage research that objects to the confinement of the programme to the employment effect, that is the institutional economics perspective, also, due to its de facto subscription to the same “advanced capitalism” idea, fails to enrich our understanding as much as it could do.

In this paper, first I show that minimum wage exists in two different worlds: advanced capitalism and developing economies, and argue that examining the latter on the basis of assumptions derived from the former would pave the way for complete ignorance of implications of minimum wage in terms of fairness and justice and would make employment effects the main focus with the result that rich dynamics created by minimum wage across “developing” countries would remain unexplored. And second, by drawing on O’Connor’s conceptualization of accumulation & legitimation dilemma (1973) and the idea of social cost of labor introduced by Webbs (1912, Kaufman 2009), I outline a working hypothesis and modestly propose a new agenda which requires “renaming” minimum wage in accordance with the dynamics created by the juxtaposition of politics and economy so as to comprehend its distinctive features in “developing” countries. And within this framework I argue that there are at least three paths through which minimum wage research may advance further: first, identifying the conditions under which minimum wage acts like lighthouse (i.e. beacon) affecting all wages without being enforced by an authority and revealing the link between this dissemination dynamic and the social cost of labor, second, scrutinizing the role of minimum wage in containment of industrial conflict at the micro level, and finally, comprehending legitimation dynamics triggered by minimum wage and its link with accumulation process and the implications of this relationship for politics.

In the following pages, first I examine minimum wage under the conditions of advanced capitalism and explain why the research under these conditions has been mostly confined to the scrutiny of employment effects. In this exercise I also briefly outline institutional economics approach as the only alternative perspective and the idea of social cost of labor. The second section is reserved for outlining the general characteristics of developmental context that distinguish it from advanced capitalism and showing the failure of neo-classic economics to predict the impact of minimum wage in this environment. In the third part I outline the accumulation and legitimation dilemma of capitalist states and explain the relevance of this for studying minimum wage in developmental context. In the fourth section a working hypothesis is developed by combining the insights provided by social cost of labor and accumulation and legitimation dilemma. This exercise is completed by pointing out three possible themes for further research.

“Name of the thing”: minimum wage under the conditions of advanced capitalism

In order to see why minimum wage research has developed within narrow limits of (mainstream) economics and been almost completely obsessed with the unemployment effect, it is essential to explore what this name “normally” implies when its meaning is derived from the idealized environment of advanced capitalist countries.²

In this environment it is taken for granted that the minimum wage is nothing but the wage that is minimum, more explicitly, the minimum amount of money that must be paid for a specific duration of work. And of course the most crucial element is the “must” part, that is, the mandatory-ness of this minimum-ness, and this mandatory-ness is based on the assumption that compliance only implies strict implementation and this can only be assured by an external authority that effectively enforces minimum wage in such a way that failure to comply with this enforcement has legal consequences that are sufficiently deterring.

On top of this initial conditioning about what minimum wage and complying with minimum wage can possibly mean, comes a second layer of assumptions that specify people targeted by minimum wage. These are individuals who are not, at least not effectively, represented by trade unions or not covered by collective agreements and at the same time lack education and sufficiently marketable skills that would endow them with a reasonable level of bargaining power. A minimum wage should help them.

But given that this picture is imagined within the context of advanced capitalism, one should assume that there are some social policy provisions (ranging from generous unemployment benefits and active labor market policies in some European countries to tough means-tested assistance of various sorts across the US) that would to some extent facilitate these people to resist accepting unfavorable conditions for commodification of their labor. However, if/when they are employed or need to find a job, given that they lack bargaining power, there is nothing that would prevent employers from exploiting them if there is no statutory lower boundary for remuneration. Here comes the minimum wage that is effectively enforced by government (which may be local, regional or national) as an instrument to help these vulnerable workers by setting a lowest level of pay.

According to this picture, minimum wage exists as a part of comprehensive institutional landscape which includes at least one of the following components: collective bargaining mechanisms and collective non-state actors that prevent employers from unilaterally dictating the value relation between wage and effort, education system and/or comprehensive vocational training opportunities that enable people to acquire skills that allow them to enjoy some level of individual bargaining power, some sort of formal social policy that alleviates immediate commodification of labor, and finally a sufficient amount of state capacity to regulate and monitor employment dynamics and enforce wage limits. Thus if someone is not covered by collective bargaining, has no marketable skills due to lack of education, and cannot be helped (anymore or sufficiently) by various social policy provisions or active labor market policies, then a minimum wage can protect him/her from straight forward exploitation.³

² I think despite all the differences across “advanced” capitalist countries, one can still draw a common picture, as I try here, for heuristic purposes. I think varieties of capitalism literature, despite the very useful insights it has produced, focuses too much on differences so as to overlook similarities across “advanced capitalisms”.

³ One should not forget the integrated nature of this entire composition for those systems that contain all components. In order to prevent vulnerable people from remaining permanently within a social policy net rather than participating in the “labor” market, usually benefits and minimum wage are indexed to each other in such a way that the latter remains higher than the former. Similarly, collective bargaining too

There are also two important though implicit corollaries: firstly, those people whom the minimum wage helps are imagined to have not much agency, expected to accept very low wages due to their almost non-existent bargaining power unless there are purely technical reasons (so called “frictions” of labor market such as transportation costs) that prevent them from performing the job, while firms and employers retain their capacity to act (thus considered as agents) and may always choose from a set of alternatives that in the worst case scenario contains the exit (from the market) option. Secondly, if minimum wage is not effectively enforced by an authority, then it would de facto cease to exist, thus the minimum wage that practically exists is the one that is enforced. Consequently, if the minimum wage “really” exists, then at least in theory compliance would be the norm and non-compliance the exception. Thus it is the general implications of the former case rather than those of the latter that would deserve scrutiny.⁴

This picture coincides (and perhaps used to coincide more) with the reality of advanced capitalism where trade unions and collective bargaining have pushed up wages (more on this below) and where there are comprehensive social policies and/or laws (health insurance, unemployment benefits, housing subsidies, labor law) that generate legitimacy and stability (Koch, 2005; Freeman, 1996).

One may argue that if we view minimum wage within this institutional structure we must concede that it would have a complementary role which is relevant only for a marginal group of people⁵ who are not covered by other components of the system. Under these conditions – and let’s borrow the terminology introduced by Marx once again – the term “minimum wage” would have something to do with its nature: it would merely be the wage that is the minimum without any political repercussions or wider societal impact. If this is the case, then it is not difficult to see why minimum wage research would focus on employment effects, given that under these circumstances minimum wage would have the sole purpose of helping those people who are at the bottom of the income distribution and do not have much chance of climbing up. The implication is that if the goal is to help these people, and given that no other component of the system can do that, the only way of helping them would be to ensure that they help themselves, that is, they are employed and earn a reasonable wage.

If we arrive at this point in our reasoning, then the following questions appear: as we try to make sure by using minimum wage that these vulnerable people earn a reasonable wage do we undermine their chance of finding employment? To what extent or under which conditions is there a trade-off between employment and reasonable wage? The implications of these questions are clear: employment effects of minimum wage must be carefully scrutinized to find out whether there is a way of dictating a lowest wage limit without increasing unemployment and/or decreasing employment. Of course at the same time various designs such as differentiation of minimum wage across regions, sectors or age groups and/or

would be (if not being directly incorporated into the mechanisms of determining minimum wage) at least indirectly linked to minimum wage in the sense that any increase in minimum wage would be gained without a “fight” by those who are covered by collective agreements. The result is that changing the minimum wage level radically would imply a lot of other changes in the entire system, and thus it would not be surprising to see that such changes would not happen very frequently.

⁴ There are also those who acknowledge that non-compliance rather than compliance might be the norm, or more correctly, official enforcement might not be very strict and that this leads to evasion (see Basu et al, 2010). However, this approach fails to realize two things: compliance might be with the change in minimum wage rather than with its exact level, and, there may be sophisticated mechanisms that compel firms to comply with minimum wage in this sense even without official enforcement.

⁵ They may be marginal in terms of their numbers or they may be marginal in terms of their power to influence political processes or both.

determination of minimum wage by governments, wage councils, tripartite commissions, or benign experts, should be carefully compared and analyzed so that as we determine the lowest wage we do not hurt those people that we try to help.

Indeed, this has been the focus of minimum wage research for decades. The result is the opposition between two arguments. On the one hand there is the claim that minimum wage distorts the equilibrium between labor supply and demand by imposing a higher wage than the market clearance value. This is expected to decrease employment. Thus, minimum wage in the middle and long-term cannot help the vulnerable workers (for example Stigler 1946, Brown et al, 1982; Mahoney & Nunez, 2003; Kuhn, 2004). And there is the monopsony argument⁶: if an employer has significant control over labor, minimum wage, by bringing the remuneration closer to the marginal product and increasing the output, may increase employment (for example Lester, 1946; Card & Krueger, 1995; Dolado et al, 1996; Boal & Ransom, 1997; Manning, 2004). Minimum wage studies have been mainly confined to this debate between unemployment versus monopsony effects. Although this is not a paper about the findings of existing minimum research, it is still important to mention two things about this programme. Firstly, it is somewhat surprising to see that huge effort has been devoted to minimum wage research given that it is in fact directly relevant, as mentioned above, only for a small group of people in advanced capitalist countries, for example around 5 percent of population in the US (Leonard, 2000:118) and around 7.5 % in France (Husson et al, 2012:3). The reason behind this peculiarity is the fact that minimum wage offers an empirical test ground for examining the validity of prominent claims of neo-classical economics, thus, the fight is essentially about something else than minimum wage itself; the extent to which neo-classical claims match with reality (Leonard, 2000; Kaufman, 2010). Secondly, despite numerous studies investigating the unemployment effect of minimum wage, there has been so far no indisputable, unambiguous and generalizable finding that shows that minimum wage increases unemployment or reduces employment (for an overview see Schimdt, 2013). Actually some prominent meta studies show that the effect is quite close to zero (Card & Krueger, 1995; Doucouliagos & Stanley, 2009). In other words, confidence in neo-classical economics regarding its ability to capture the reality of an economy seems to have failed at least in the case of minimum wage.

To do justice to minimum wage research, however, it is important to acknowledge that there is also a third and more sophisticated strand in the literature that has been quite prominent in the early 20th century but then pushed to the margins of debate, that is, the “institutional economics approach”. Drawing on a formidable tradition emanating from Thorstein Veblen, Walton Hamilton, John R. Commons, Wesley Mitchell (Rutherford, 2001; Kaufman, 2007), this perspective, does not conceptualize minimum wage as an artificial interference with the dynamics of ‘free’ market as neo-classic economics does, instead it considers the market itself not as a fragile thing that appears naturally in its perfect form when there is no intervention but as an institutional structure which is constructed and sustained by elaborate rules and mechanisms. Thus, minimum wage appears as one of the possible instruments that can be used in construction of labor market, and its merits should be judged in accordance with the extent to which it serves the societal goals that are deemed valuable. Against this background, institutional economics approach reminds us of at least one important thing that is intimately related to minimum wage but has been overlooked due to the exclusive focus on employment effects: the social cost of labor.

⁶ The term “monopsony” has been first used by Joan Robinson in her book titled *Economics of Imperfect Competition* (1933)

As Webbs has observed more than a century ago (Webbs, 1912), labor like all other production factors has a replacement cost, and if the remuneration falls below this cost, the difference between cost and price, unlike any other production factor, would be covered by society, and thus there will be a “social cost of labor” imposed by the firm on society. In less abstract terms this means that if a firm pays someone insufficiently so that he cannot even cover his basic expenses properly such as food, accommodation, leisure, and health that are indispensable for being able to work in the first place then these needs would be covered by those who are connected to this person by emotional ties. Thus, the firm would be practically stealing from these third persons as it simultaneously exploits the worker because under such circumstances these people would be partly covering the production costs of the firm by directly paying for one of the production factors. Such firms are not producers of surplus value but essentially inefficient entities that have a parasitic relationship with society. The institutional approach argues that minimum wage may, by making wages at least equal to replacement cost of labor, ensures that no firm can enjoy such parasitic existence at the expense of society, and thus minimum wage facilitates proper functioning of economy.

This is a valuable insight which is, as I argue below, crucial in comprehending minimum wage dynamics in developing countries. However, it is important to note that despite such insights it produces for minimum wage research, the institutional economics perspective itself has developed as response to the problems of advanced capitalism (Kaufman, 2010). This of course does not rule out its usefulness outside this context but should warn us about the way in which it is hitherto operationalized. In practice (and at least so far) institutional economics approach despite its objection to the dominant paradigm in minimum wage research that solely focuses on employment effects shares the same premise, namely, that it conceptualizes minimum wage under the conditions of advanced capitalism. Thus this approach is more about finding out which institutions in the institutional landscape of advanced capitalism can perform the functions that minimum wage fulfils rather than the variety of functions minimum wage can perform in the absence of these other institutions, for example in the developmental context. This is clearly articulated by Kaufman, arguably the most prominent proponent of the institutional economics approach to minimum wage:

“...minimum wage is likely to become less useful and attractive as the degree of unionization increases and as a country’s social welfare program expands in breadth and depth (as in many European countries) ... even in lightly regulated neo-liberal labor markets a legislated minimum wage could be a second-best solution to one or more of [these] other approaches” (Kaufman, 2010:448-49).

Therefore the only heretical strand in minimum wage research that objects to the confinement of the programme to the employment effect, that is, institutional economics perspective, also, due to its de facto subscription to the same “advanced capitalism” idea, fails to enrich our understanding as much as it could do.

“Nature of the thing”: (neither) minimum (nor) wage in developmental context

Now let's outline (an idealized) institutional landscape of “developing” countries, and contemplate the position and implications of minimum wage in such a setting⁷.

Usually in the “developmental context” political economy contains all institutions that one would have in advanced capitalist countries but the resemblance would mostly be at the level of names. The nature of these institutions would be quite different. Let's outline these differences. Firstly, there is almost always some sort of organized industrial relations component that consists of interest representation organizations and collective bargaining. However, the coverage is extremely small and confined only to quite privileged segments of the labor market such as public servants,⁸ workers at public enterprises and some workers in large private firms that usually have some sort of international connection. Secondly, there is always an organized education system but those educational tracks such as tertiary level or even short vocational training opportunities that would enable one to acquire marketable skills that increase bargaining power would remain quite inaccessible for the vast majority of people. And finally there are social policy provisions but usually only at a very rudimentary level (such as pensions and health insurance) and serve once again only a small part of population that includes groups like public servants, employees of public enterprises and those who perform managerial jobs or high-skill tasks in the private sector. It is also important to realize that usually in the developmental context the monitoring capacity of the state is quite low. Thus labor market regulations may look elaborate on paper but in practice they remain unenforced.

If we “add” minimum wage into this picture, what kind of function should we expect it to perform: would it be once again helping a small marginalized group of people that are not helped by the other components of the system? Obviously this would not be the case because now those unprivileged people constitutes the majority and the institutional landscape outlined above is relevant for a small minority. Moreover the capacity of the state to monitor the compliance with regulations is rather low. Thus one can assume that under such conditions minimum wage too would remain unenforced (Saget, 2001:237). What should we expect then?

The key that would help us to answer this question is informal economy, that is, all sorts of commercial, industrial or entrepreneurial activities that are performed or undertaken without official records, registration or contracts. In the developmental context the majority of people are employed in the informal economy and it is this fact that we should take into account as we try to figure out the implications of minimum wage. Before elaborating on these implications it is important to clarify a couple of things. Firstly, the informal economy exists also in advanced capitalist countries but its relative magnitude is quite different in developmental context. It is not unusual to have more than 80 percent of working population to be employed in informal economy in some developing countries (Kocer & Hayter, 2011:32). Secondly, formal/informal divide does not imply a binary differentiation. The best way to think about this divide within the realm of employment relations is to imagine it as a continuum

⁷ Needless to say that descriptions associated with generalizations like “developing countries” would be quite misleading if they are used to comprehend the specificities of any particular country, but as a heuristic device such generalizations would help us to identify the way in which minimum wage performs quite different roles once it is imagined outside the conditions of advanced capitalism.

⁸ Possibly without the right to strike.

starting from full registration of workers and their salaries and exercise of collective bargaining to complete absence of any kind of contract or registration and thus no officially recognized collective interest representation. In between these two extremes one might have situations where part of the workers' salary is registered, only part of the workforce is registered, and various combinations of such arrangements. Finally and most crucially, the formal and informal economy are functionally connected. This can happen in at least two ways. One way is that a firm by making different (in)formality arrangements for different parts of its workforce might functionally connect these various forms of (in)formality for itself so as to make them jointly generate a beneficial position for the firm.⁹ The other possible functional connection is generated by subcontract relations¹⁰ that help formal firms to reduce their labor costs. An entirely formal firm may outsource some of its production to a partly formal firm which in turn re-outsources part of the production to another and perhaps entirely informal entity (Kocer & Fransen, 2009: 243). The final point in such a sequence may be single female workers making production in their own homes, and thereby blurring the distinction between self-employment and being employed¹¹. Actually in the "developmental context" one might think of the formal and informal economy as components that are integrated through a large grey zone which is always in flux. Pure formality, pure informality and this grey "in-between" zone together create a single production field that can be cultivated in different ways to reduce costs and increase profitability.

Now, before dealing with the question of implications of minimum wage, let's once again outline the main contours of our generic "developmental context" by adding informal economy as a crucial component: the state has a low capacity to enforce its own regulations and cannot effectively monitor employment relations, collective bargaining together with education system and rudimentary social policy provisions serve only a small part of the population that is employed in formal economy while the majority remains uncovered by this institutional landscape and makes its living from informal economy but these two segments are functionally connected. Now our task is to imagine what happens if we "add" minimum wage into this setting.

Neo-classical economics would have the following argument which is known as Welch-Gramlich-Mincer model (Welch, 1974; Mincer, 1976; Gramlich et al, 1976): let's assume that minimum wage is at least partially enforced in small formal economy but remains entirely unenforced in large informal economy. Under these conditions once minimum wage is dictated formal firms would lay-off some of their workers due to increasing labor costs and these workers would seek new jobs in informal economy and thereby increase the number of job seekers there. Consequently, firms operating in informal economy would have higher bargaining power *vis-à-vis* workers and would offer less remuneration not only to those who are seeking jobs but possibly also to their existing workforce. The overall result would be that minimum wage would not only increase unemployment and reduce the relative size of formal economy but would also trigger a dynamic which would decrease the wages in informal

⁹ For example, keeping some workers entirely unregistered so as to reduce labor costs while retaining a formal appearance by offering official contracts to a small segment of the workforce might be the best strategy for being connected to international production chains because in this way it would be possible to remain as an accountable legal entity that can sign deals while keeping costs as low as possible.

¹⁰ Usually there are three reasons for subcontracting: first, a firm may supply sub-contracts to other firms in order to make use of technology or know-how, second it may do so occasionally when the production orders overwhelms its capacity, and finally subcontracts may be offered in order to reduce labor costs.

¹¹ Thus a production chain emerges that cuts through various forms and grades of (in)formality that may start from a large and "respectable" formal firm and end up in home production units at slums of big cities.

economy. Thus, it would actually hurt those people it tries to help while hindering structural transformation of entire economy from less to more formal existence.

This hypothesis may sound intuitive to those minds that are conditioned to reason in neo-classical way but it seems like there are complex dynamics initiated by minimum wage in developmental context that cannot be captured by the simplistic logic of Welch-Gramlich-Mincer model. There is empirical evidence hinting that in an environment characterized by the absence of comprehensive collective bargaining, rudimentary social policies, limited educational opportunities and large informal economy, increasing minimum wage seems to act like a lighthouse (beacon) and generate an upward push for the price of labor across the entire economy including the informal sector where it is not officially enforced (Lemos, 2009; Freije, 2007; Maloney & Nunez, 2004; Lustig & McLeod, 2001: 65). There can be wages below the minimum wage (in the informal sector) and there are certainly wages above it (both in formal and informal sectors) but it seems possible that minimum wage may positively influence all wages regardless of the official enforcement (Koçer, 2009). Therefore minimum wage seems to be capable of acting as the reference price for labor throughout the entire labor market affecting a large part of the population.¹² It is argued that “though probably not enforced by law, the minimum wage appears to be an important benchmark for ‘fair’ remuneration” (Maloney & Nunez, 2004:120).

Let’s clarify what is interesting about this. Firstly, what is surprising is that these findings suggest that increasing minimum wage in the developmental context may also raise wages in the informal economy despite the fact that it is not enforced there.¹³ This compels us to recognize that complying with minimum wage may mean something else in the developmental context than what it is under the conditions of advanced capitalism. Secondly, it is interesting to see that the concept of “fairness” enters into the equation. It seems like people’s notion of fair remuneration, regardless of their weak bargaining position, is a factor that may influence wage dynamics; and, minimum wage, it seems, is a factor that may influence people’s notion of fair remuneration. Of course under such circumstances one may

¹² It is important to stress that this lighthouse effect does not always emerge. As I mention in the following pages, to figure out the exact circumstances that generate the lighthouse effect of minimum wage in developing countries should be a crucial item in minimum wage research.

¹³ Of course, this is the opposite of neo-classical expectation. But there is also a neo-classical explanation for the lighthouse effect inspired by Carruth & Oswald (1981). According to this view it is the capital that moves to the informal sector rather than labor, and thus, due to the resulting increase in demand for labor, the wages rise there (Lustig & McLeod 2001: 65). There is a comparable argument which is based on the idea that after an increase in the minimum wage, unskilled labor flows from the informal to the formal sector leading to a similar outcome (Boeri et al 2011). There are three reasons that should make us cautious about such explanations. Firstly, these explanations typically ignore the complex nature of the link between formal and informal sectors. Instead they assume that there is a binary differentiation between these two realms (and they also assume a strict separation between self-employment and dependent employment). However, in developing countries firms are either already functionally connected to the informal sector via subcontract relations or they are placed somewhere in between pure formality and pure informality at a rigid point that assures their legal visibility (similarly the difference between self-employment and dependent employment blurs as one follows the subcontract relations deep into the informal sector). Firms cannot move away from their position easily without seriously compromising their business connections (see Koçer & Fransen 2009). Secondly, usually it is not the case that the minimum wage is really “binding” and thus strictly enforced in the formal sector. Here too firms can find ways to ignore the minimum wage without ‘escaping’ into the informal sector due to low monitoring and enforcement capacity of the state. So the compliance with the minimum wage occurs both in the formal and informal sectors without effective enforcement, implying that there are other forces that compel firms either to comply with or to take into account the minimum wage. Finally, such explanations overlook the socially embedded nature of the labour market that renders “purely” economic arguments invalid and requires us to attribute to the sense of justice a crucial role in employment dynamics (see Kelly 1997).

also expect people's sense of fair remuneration to influence minimum wage in some way. This means that it is essential to develop an approach to comprehend minimum wage in the developmental context that takes this fairness dimension into account.

Before attempting to sketch such framework, let's be clear about the name and the nature of the thing that we are dealing with. The name is still minimum wage. But once we envisage it within "developmental context" its nature seems to be different from what it is in the environment of advanced capitalism. There the name and nature of the thing coincide: the minimum wage is the lowest possible wage. However in developmental context minimum wage is not *the* minimum wage since we know that there are wages below it. It is also clear that minimum wage is relevant for a large part of the population because it seems possible that it acts like a lighthouse and may positively influence all wages both in formal and informal economy. Moreover complying with the minimum wage refers to different things under the conditions of advanced capitalism and those in the developmental context. In the former compliance implies the adoption of the exact level of new minimum wage but in the latter compliance seems to mean that firms would increase their wages (to a level whose determinants are yet to be determined, as I argue below) when there is an increase in minimum wage. Thus compliance is essentially with the change rather than with the exact level. In short the name of the thing that we are looking at may be minimum wage but by examining its nature we see that in developmental context it is not the lowest possible wage, it is actually a signal rather than wage and it is definitely not something which is only marginally important. Thus its nature tells us that minimum wage in the developmental context is something different from what it is in advanced capitalist countries. Given these differences, one should ask whether it is adequate to think of minimum wage in the developmental context merely as a policy instrument that might be altered at will without properly understanding its exact meaning and function.

Existing research seems to have overlooked this question and remains purely technical, essentially pursuing an agenda that is quite similar to that of minimum wage inquiries in advanced capitalist countries. Consequently the focus has been, not surprisingly, the employment (or unemployment) effects of minimum wage and the only additional item in the agenda is the question of whether or not minimum wage might be used for poverty reduction (see for example Comolla & Mello, 2011; Saget, 2001; Lustig & Mcleod, 1997; Jones, 1997).

I argue that this technical approach to minimum wage which considers it as an instrument to be judged in accordance with its effect on unemployment and poverty while ignoring its meaning for people in terms of fairness and justice is inadequate. To be sure, increasing employment and reducing poverty are important but they are essentially middle and long term goals that can be discerned at the macroscopic level. However, for people what matters is what happens in the present time; their expectations about fairness must be satisfied here and now. If an institution has an unintended function of somewhat responding to these concerns, then it would be imprudent to think that one could treat this institution as if it were a technical instrument. However when minimum wage research in developmental context pursues an agenda derived from the conditions of advanced capitalism focusing entirely on unemployment and poverty reduction effects this is exactly what happens. Because then the implicit assumption derived from the conditions of advanced capitalism about minimum wage recipients, namely considering them as people without much agency who are in need of help, would be too apply to the developmental context. This would lead to seeing the majority of people in developing countries as impotent objects rather than individuals, ignoring their expectations about fairness and justice. This is not a sentimental note for respecting people

but an analytical argument for taking people's expectations seriously. In recent years the Arab Spring has shown once again the consequences of not doing so. Ignoring the agency of people in "poverty" and treating them as masses with predictable reactions while attributing enormous capacity to policy makers as if they could "play with" institutions such as minimum wage at will without properly understanding their exact meaning and function is probably dangerous.

Against this background I argue that there are two worlds of minimum wage: those of advanced capitalism and developmental context. Examining the latter on the basis of assumptions derived from the former would pave the way for complete ignorance of elusive dynamics created by minimum wage across "developing" countries. The minimum wage research so far has not fully acknowledged this either theoretically or empirically. Therefore one needs to develop a new theoretical framework and set a research agenda in order to scrutinize and comprehend minimum wage in developmental context.

Accumulation and its legitimation

As mentioned above, institutional economics proposes to examine the minimum wage in accordance with the function it performs within the entire institutional landscape in which it operates. This is a valuable insight but so far it has been used to speculate about which other institutions can perform the functions currently assumed by a minimum wage rather than which kind of functions a minimum wage can perform when institutions that are comprehensive in advanced capitalism become exclusive in developmental context. Given that it is in the latter situation that we are interested, it is essential to develop a theoretical framework that would help us capture possible functions performed by minimum wage under the conditions peculiar to developmental context.

I suggest using James O'Connor's *The Fiscal Crisis of the State* (1973). O'Connor argues that in any capitalist economy the state must undertake two potentially contradictory tasks. On the one hand it must ensure the accumulation of capital in the hands of a small group so that they can continue their entrepreneurial activities and create surplus value. On the other hand this process must be legitimized in the eyes of those who cannot accumulate wealth, that is, the vast majority of society. If the existing economic order while enabling accumulation of capital cannot prevent accumulation of resentment triggered by this process, then the entire system would be volatile and unsustainable. Therefore in any capitalist society accumulation must be accompanied by legitimation. The accumulation task is simple but not necessarily easy. The legitimation task is neither simple nor easy. While the former always means the transfer of a large part of economic surplus value to an existing or emerging class of capitalists, the latter requires cultivation and preservation of the silent approval of the majority for this uneven distribution of wealth. This legitimation process may be based on promotion of societal goals invoking various common values such as patriotism or may be ensured through propaganda that endows hegemonic status to the idea that the existing accumulation regime is inevitable, or may be substituted by the coercive powers of the state. But sooner or later legitimation process must involve at least incremental improvements in the material conditions of those who cannot accumulate wealth (Gramsci, 1971). In the last analysis these people should be convinced that the existing political and economic order works or may potentially work in some way also for their advantage. Therefore although it is imperative for any capitalist state to ensure the continuity of accumulation process, it is equally crucial to

cultivate and sustain the acquiescence of those people who cannot accumulate wealth. Hence is the accumulation and legitimation dilemma.

In advanced capitalist countries the legitimation task is performed by a complex network of institutions. Social policy provisions, so long as they are comprehensive, constitute a crucial component of legitimation function. Similarly the education system too, especially if it has at least some free tracks, would contribute to the legitimation task. Collective bargaining has a special role within the performance of legitimation function: since bargaining is usually conducted by non-state actors it is them who would bear the brunt of societal reaction first if they fail to deliver reasonable conditions for their affiliates. Thus, collective bargaining may be seen as the delegation of legitimation task from the state to social partners, and it also, at least to some extent, separates economic demands from political ones, and thereby prevents immediate politization of economic grievances (Dahrendorf, 1959; Kerr et al, 1960). One may also add free press and regular elections to the list of legitimation mechanisms which generate legitimacy for the system by hinting that it may be criticized openly and improved from within. Various consumption opportunities that enable people to buy expensive commodities such as house or car through bank credits also generate legitimacy for the entire political-economic order. In short, under the conditions of advanced capitalism, any given individual or group is “covered” by several and at least partly overlapping layers of legitimation mechanisms which cultivate and sustain their tacit approval for the continuation of the system and the accumulation regime associated with it. Given that it is difficult to paralyze all these layers simultaneously, advanced capitalist countries usually remain stable. In this picture, however, minimum wage plays only a marginal role because, as mentioned above, it directly affects only a small group of people, and even this small group may still be “covered” by other and more subtle legitimation mechanisms. Therefore it would probably be absurd to think that minimum wage might have crucial role in ensuring the stability of political system and economic order in advanced capitalist countries.

What about the legitimation (of accumulation) in developmental context and the role of minimum wage in this? The institutional landscape that performs the legitimation task in advanced capitalist countries through multi-layered and overlapping mechanisms has a very exclusive coverage in developmental context. As mentioned above, usually all components of the system exist (such as collective bargaining, educations system, social policy) but only a small minority benefits from them. Moreover, it is not unusual to see that some more subtle legitimation mechanisms such as freedom of expression, or regular and free elections may suffer from infringements and limitations or they may simply not exist, thus they would not be very effective in cultivating the idea that the system can be improved without radical transformations. However, as mentioned above, unlike in advanced capitalist countries, in the developmental context minimum wage affects a very large part of population, and it may act like a lighthouse and become the reference price for the value of labor in entire economy even without being practically enforced. I argue that understanding minimum wage properly with these qualities in developmental context is only possible if one comprehends it as a crucial legitimation mechanism which occupies a central place in cultivating and sustaining the approval of people for the continuation of existing accumulation regime and corresponding political-economic order.

However, before outlining a working hypotheses on the basis of this idea some more justification would be appropriate. Because given that there is little research on minimum wage in developmental context one might “legitimately” ask where this claim about the

“legitimacy” function of minimum wage comes from.¹⁴ Actually, there is some empirical evidence that not only encourages us to think along these lines but it also illuminates other peculiar dimensions of minimum wage in developmental context. The evidence is from Turkey.

In Turkey during the last two decades of 20th century when the country was more of a developing country with a large informal economy than it is today, a minimum wage had been used effectively for legitimation purposes to the extent that increases in national minimum wage were perfectly coupled with elections, hinting all governments’ awareness of the crucial importance of this instrument for electoral success (Koçer & Visser 2009). The reason could be found by examining the employment relations at micro level. In Turkey too, the minimum wage was (and still is) influencing wage developments across the entire economy including informal sector, and this lighthouse effect was redirecting employee’s feeling of injustice created at work regarding remuneration from immediate employers to governments. In other words, as long as employers responded to minimum wage increases by raising their wages (not necessarily to the same level), the blame for injustice has been directed at least partly towards governments who were (and still are), determining the minimum wage despite the tripartite appearance of the wage committee (Kocer 2009). One may see that as blame for injustice, through minimum wage is redirected from immediate employer to government, it would also reduce the conflict potential at shop floor level while politicizing economic grievances. It is important to see that in this way by connecting the economic sphere with that of politics, the minimum wage does the exact opposite of what collective bargaining does in advanced capitalist countries by separating economic grievances from political expectations. This may be another distinguishing feature of minimum wage in the developmental context that deserves scrutiny.

Obviously, coming from only two studies this is not conclusive evidence but only an encouragement for making further scrutiny about minimum wage in developmental context on the basis of the legitimation function it fulfils. My goal here is to develop a working hypothesis on this basis and point out possible directions for research.

A new agenda

The basic goal of a new research agenda should be to explain why and under which circumstances minimum wage positively influences all wages across both in formal and informal sectors, and the consequences of this dissemination dynamic. I argue that one might craft a working hypothesis for this purpose by combining the idea of social cost of labor with the legitimation function that might be performed by minimum wage.

As mentioned above, when remuneration does not even cover the replacement costs of labor, then these costs must be covered by the society. They become “social cost of labor”, allowing firms to enjoy a parasitic existence. In practice this means that when a worker is not receiving a sufficient amount of wage, then his friends and family pay for his accommodation, nutrition,

¹⁴ A recent study by Bhoran et al (2015) on minimum wage in Sub-Saharan Africa seems to lend support to the perspective that I develop here. The authors, besides showing that there is no discernable negative impact of minimum wage on unemployment and acknowledging that there may be lighthouse effects, argue that ‘minimum wage policy is particularly aggressive in the covered sectors in Sub-Saharan Africa’ (Bhoran et al, 2015:3). As I show in the following pages this finding may be generated by the legitimation function performed by minimum wage in the absence of more complex set of legitimation mechanisms.

health and leisure costs. In developmental context, with usually very low wages one can safely assume that many firms impose such costs on the immediate circle of their workers, probably, forcing these people to live on the limits of their capabilities. This situation however creates an uneasy condition for firms: they may directly engage only with their workers but they also have indirect relationship with the immediate social circle surrounding these workers. Workers' acquiescence is possible as long as acquiescence of this immediate circle is ensured, and these peoples' judgment about the fairness of wages is of crucial significance. This implies that the labor market is monitored closely by a large group of concerned individuals who cover part of production costs, and there should be a limit beyond which these costs can no longer be borne by them.

One might argue that those who determine minimum wage would recognize this limit point and, by increasing minimum wage, send a signal across the labor market hinting that the existing situation is not fair anymore and the resulting social cost of labor can no longer be taken for granted. One may expect such an increase in minimum wage to lead all concerned people to re-evaluate their obligations towards workers to whom they are connected with emotional ties. They, not only the workers, would expect a similar increase to occur in their own surroundings too. In other words, change in minimum wage would undermine the legitimacy of work conditions and raise expectations. Consequently some speculations about the magnitude of a fair increase would start to disseminate across sectors, regions and firms which are intimately connected, due to the integrated nature of formal and informal sectors. Firms failing to respond to these expectations would risk losing their workers, because as fairness is redefined the replacement costs would no longer be borne by society. The advantage of following the suit on the other hand is that this may redirect workers' blame for injustice from immediate employers to decision makers about minimum wage and reduce the conflict potential in the workplace.

This is a hypothesis rather than a theory, and it triggers, as it should, a lot of questions that need to be examined through empirical inquiry. Here is a list consisting of three broad themes/questions for further research.

- 1) *Under which specific conditions of developmental context does minimum wage function as a lighthouse and affects all wages positively. What is the role of the social cost of labor in this process of dissemination? How do the actual wage changes occur across sectors, firms and regions after an increase in the minimum wage is determined? Is there any role played by different magnitudes of social cost of labor in this process? Actually, one could identify three dimensions of the social cost of labor, each of which might be of some relevance: its actual magnitude, the extensiveness of the network of people that bears it, and the basis of legitimacy that makes these networks of people pay this cost. The legitimacy dimension requires careful thinking. What would define the limit point here? Obviously studying this legitimacy dimension would require grasping the culture of responsibility prevailing in a country/region/locality, and this calls for the help of anthropology and other disciplines.*
- 2) *Does minimum wage in developmental context function somewhat like collective bargaining in advanced capitalist countries by at least partly removing the wage conflict from workplace as workers re-direct their blame for injustice from employers to those who determine the minimum wage? Although it is not possible to rule out quantitative approach, to answer this question properly it would most probably be*

necessary to conduct interviews with employers and workers in different firms operating in informal and formal (or both) sectors. Such a study would need to take into account firm size, sector, and surrounding economic conditions as well as the nature of unofficial worker collectivities existing at shop floor.

- 3) *What is the role of minimum wage in management of accumulation and legitimation dilemma and what are the implications of this for political processes?* The idea that a minimum wage might be exporting the conflict created within employment relations into the realm of politics by redirecting the blame for injustice from employers to those who make minimum wage decisions (assumed to be the government in the last analysis) requires us to ask this question. In its relatively simple empirical form such an inquiry would require examining the way in which minimum wage decisions interact with economic growth, public resentment, electoral process and government composition. However, in order to probe deeper into all possible complexities in politics in the developmental context it would be imperative to realize or at least assume (and analytical tools to capture) that in all political systems even if they are not “textbook democracies” there is some sort of “process” through which people give their consent for the continuation of the system. In this regard when/where such processes are elusive it may be only possible to observe them when they fail. This requires studying periods preceding the moments of legitimacy crises (such as massive protests, violent clashes etc...) in order to see to what extent or whether rigidity of minimum wage has played any role in triggering such crises.

Conclusion

In this article I have shown that minimum wage exists in two different worlds: those of advanced capitalism and developmental context.

In the former it is the statutory lowest boundary for remuneration that is directly relevant for a small group of people who are not protected by the other components of the system such as collective bargaining, various social policies, and vocational training and education opportunities. For people belonging to this small group finding employment sooner or later becomes mandatory but their low bargaining power makes them susceptible to exploitation. Minimum wage aims to protect them but as it tries to do that it may also reduce their chance of finding employment. This dilemma may justify focusing on the employment effects of minimum wage.

As to the latter, however, describing minimum wage is not easy. In the developmental context although firms do not comply with it exactly, minimum wage is still capable of acting like a lighthouse positively affecting all wages across both formal and informal sectors, and this happens despite the fact that usually there is no authority that would enforce it effectively. Consequently, unlike in advanced capitalist countries, the majority of population is directly influenced by minimum wage dynamics.

Therefore while under the conditions of advanced capitalism the name and nature of minimum wage coincide, in the developmental context characterized by the absence of collective bargaining, rudimentary social policies, and limited education opportunities this is no longer the case. Although its name remains the same the nature of minimum wage is different: it is neither a minimum nor a wage but a signal that may become the reference price

for the value of labor across entire economy. This suggests that minimum wage and people's sense of fair remuneration are somewhat linked.

However, the research has been overlooking these peculiarities and analyzing minimum wage in developmental context purely technically by focusing on employment and poverty reduction effects. This approach ignores elusive connections between minimum wage and people's sense of fairness and justice.

I propose a new approach to minimum wage that would recognize its different nature in developmental context and would scrutinize its role in legitimation dynamics and its relationship with social cost of labor. This approach opens at least three avenues for research: first, identifying wage dissemination dynamics triggered by minimum wage and the role of social cost of labor in these dynamics, second, scrutinizing the role of minimum wage in containment of conflict at shopfloor, and finally, comprehending the legitimation function performed by minimum wage and its relationship with different accumulation regimes and political processes.

I argue that this new agenda would enable us to capture interesting insights triggered by a minimum wage in "developing" countries and prevent us from using a conceptual framework which is derived from the conditions of advanced capitalism and quite often makes us ask wrong questions.

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The IMF and Troika's Greek bailout programs: an East Asian view

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Abstract

This paper examines the current financial and economic crisis in Greece from a perspective of the East Asian Financial Crisis. The paper traces some of the distinctive features of the ongoing economic crisis in Greece, comparing them with those of the financial crisis in East Asia in late 1990s. This comparative analysis of the two crises shows that the aggravation in the Greek economic situation is primarily due to the IMF and the Troika's misguided bailout conditionality, just as the IMF's failed bailout programs in East Asia severely damaged many East Asian economies, 17-18 years ago. Drawing upon this observation, the paper proposes a series of common reform agendas. These include (1) a need of reversing myopic financial liberalization and premature relegation of fiscal and monetary authorities to a supranational entity, (2) a need of extending the US Chapter 11 bankruptcy provision to sovereign states at regional and international arena, (3) a need of creating an effective international lender of last resort, and (4) a need of overhauling the existing austerity-oriented bailout conditionality in favor of inclusive development-oriented strategies.

JEL O23, O52, O53, O57

Keyword Greek debt crisis, East Asian financial crisis, IMF, Troika, bailout conditionality, austerity

1. Introduction

For many East Asian economists, the current financial and economic crisis in Greece is like dreaming a never-ending nightmare over again. This is because the IMF and Troika (European Commission, European Central Bank, and the IMF)'s policy response to the current Greek financial crisis is not at all different from what the IMF had done to Thailand, Indonesia, and South Korea during and after a similar financial crisis in late 1990s. Just as the current financial crisis in Greece originated from foreign capital outflows that were directly associated with a global spread of the US subprime mortgage-led financial crisis in 2008-09, foreign private portfolio investors' drastic withdrawal of their investment from East Asian countries resulted in a series of domino crises in currency markets in the late 1990s. At that time, the IMF under heavy political pressures from the US Treasury department played an exactly same role in East Asia, as that of the IMF and Troika in Greece nowadays. The IMF and the US Treasury imposed strict bailout conditionalities and a series of austerity-oriented policy measures in the name of "saving" Asian economies, just as Troika nowadays has been imposing the same conditionality to Greece in the name of "helping" Greece. Did they really save East Asian economies back in the late 1990s? The answer is no. Are they really helping Greece today then? Unfortunately, the answer is no. In the name of saving an economy, the IMF and Troika are actually creating a humanitarian crisis on a massive scale in Greece now, just as the IMF and the US Treasury did in East Asia.

The goal of this paper is to examine the origin and process of the ongoing economic crisis in Greece from a comparative perspective, paying close attention to the detrimental effect of the IMF and Troika's austerity policies in Greece. The observation in this paper strongly suggests

that (1) drastic capital outflows from a country in the absence of regional and/or international regulatory arrangements are the most destabilizing factor that created a financial crisis in both Greece and East Asia, and (2) the IMF and Troika's austerity-oriented bailout conditionality has exacerbated the problem of a vicious cycle of economic contraction and increasing sovereign debt burden in Greece. Drawing upon this observation, the paper proposes a series of reform agendas at both regional and international level. These agendas include (1) a need of reversing myopic financial liberalization policy and the premature transfer of fiscal and monetary authorities to a supranational entity, (2) a need of extending the US Chapter 11 bankruptcy provision to sovereign states, (3) a need of creating an effective regional and international lender of last resort, and (4) a need of completely overhauling the existing austerity-oriented bailout conditionality in favor of economic growth and development.

2. The origin and process of the current financial and economic crisis in Greece

Let us first recall what has happened in Greece for the last five to six years and identify some of the distinctive stages in the process of financial and economic crisis. The first and initial stage of the financial crisis in Greece dates back to late 2009, when the then newly elected Panhellenic Socialist Movement (PASOK) government released the information that the former conservative governments intentionally concealed the true magnitude of public debts. As part of the Eurozone membership requirements, all Eurozone member countries including Greece were required to meet a series of "convergence criteria". These criteria include the individual member government maintaining not more than 3% of fiscal deficits and 60% of public debts (European Commission 2015). The PASOK government found that the former conservative government had not accurately recorded the true liability structure and in some cases intentionally covered up the actual size of fiscal deficits and debts, using some mean financial tactics.

Under normal circumstances, this revelation could have ended up as a minor financial happening. The time when this news was reported, however, was not in any sense a normal financial circumstance. The year of 2009 was just one year after the collapse of the American investment bank, Lehman Brothers. The flourishing of unregulated subprime mortgage lending in the US housing market, together with massive over-the-counter transactions of opaque private-labelled mortgaged- and asset-backed securities throughout the world instantaneously brought down the entire banking system in both the U.S. and core economies in the Eurozone. Under these circumstances, the revelation that the Greek government had actually accumulated more foreign debts than initially thought inevitably jolted the core Eurozone financial markets. The banks and non-bank financial companies in core Eurozone economies instantaneously froze their lending to Greece and many other peripheral economies in the Eurozone. The Greek stock price index fell and borrowing cost on the Greek government bonds rapidly rose to an intolerable level, as a result. Three major American crediting agencies (Fitch, S&P's and Moody's) lowered their credit ratings of the Greek government bonds, amplifying portfolio investors' concerns for credit and default risks even further. Simply put, a series of chain events like these were the immediate causes of the original financial crisis in Greece (BBC, 2011).

Of course, the problem did not end there. The second stage of the Greek financial crisis resurfaced one year after the Greek government agreed to accept the first three-year standby loan agreement with the IMF. As part of this bailout agreement, the Greek government had started implementing pension cuts and tax reforms. The government also announced a

preliminary privatization program in early 2010, defying massive domestic resistance and protests against the austerity measure. In return, the European creditors had released the first two tranches (15bn euro each) out of the initially proposed total bailout funds. In late May of 2011, however, the Greek government declared that the government might not be able to achieve its fiscal target of 3% of surplus, citing adverse economic fallout and contraction of tax revenues. American credit rating agency Moody's downgraded the Greek bonds from B1 to Caa1 (which is effectively "junk" status) and the ten-year government bond interest rates sharply rose to 16.25%. European finance ministers hurriedly pressed the Greek government to fasten its efforts to impose "structural reforms" to gain credibility and confidence from foreign creditors, threatening to terminate releasing additional tranche of the initial bailout fund to Greece (IMF, 2011).

As the Eurozone financial market abruptly swelled into another instability, however, European finance ministers needed to overturn their hardline position and attempted to expedite Greek debt restructuring negotiations. As this negotiation was stalled and frequently suspended due to disagreement among creditors, European finance ministers came up with an idea of providing 8.7bn euro of emergent funds to bridge the shortfall in the Greek government debt repayment. They also agreed to provide another three-year extended standby bailout fund to Greece by 2014, totaling 109bn euro (37bn euro in each tranche) on top of the remaining tranches of the first bailout fund (IMF, 2012a). Unfortunately, all of these measures turned out to be too late and too timid. Even though it seemed to help in stabilizing Southern European sovereign bond markets (notably, in Spain, Portugal, and Italy) temporarily, they failed to address the fundamental debt sustainability problem in Greece and debt repayment concerns that foreign creditors had. Of course, the end of the second plot in this Greek tragic drama has its own Greek characteristics. By the time when the Greek parliament was required to approve this second bailout conditionality, the Greek Prime Minister Papandreou announced that he would rather hold a general referendum, asking whether ordinary Greek people would be willing to accept the harsher second bailout conditionality. As this plan was announced, the European financial markets plunged again. Angela Merkel (Prime Minister of Germany) and Nicholas Sarkozy (then President of France) pressed George Papandreou to resign from the post, citing that Papandreou's "defiant" move endangered the hard-earned consensus among creditors. After having two to three days of tumultuous political clamor, the publicly elected Greek prime minister was impeached by the second majority party members, members of the New Democracy (ND) party, in the Greek parliament. After expelling George Papandreou, the ND party and some opposition leaders in the PASOK agreed to hold a general election. And in the following two elections held in May and June 2012, the ND ultimately formed an allied government with a majority parliamentary seat. This allied government elected Antonis Samaras as its new prime minister and it pledged to thoroughly implement the agreed second bailout conditionality.

The last and concurrent stage of the Greek drama is coincided with an electoral victory of Syriza, the Coalition of the Radical Left in the January election this year of 2015. After experiencing failed austerity-oriented bailout conditionality, the Greek voters wanted to change the course. They wanted to say "no more austerity" and "enough is enough". In the general election, the majority of the Greek citizen voted for Syriza, which has actively campaigned for renegotiation with the Troika. The Syriza gained 36.34% of the total ballots and occupied 149 parliamentary seats, shrinking the second leading ND party's parliamentary seats to only 76. The Syriza formed an allied government with Independent Greeks (ANEL). One of the main campaign agenda and Syriza's party programs was that the Greece's new government could renegotiate the bailout terms so that the Greek economy and people would

have some breathing spaces. They claimed that they would be able to gain much more concession from Eurozone creditor countries by even leveraging Greece's "exit" from the Eurozone. The new Prime Minister, Alexis Tsipras nominated Yanis Varoufakis as finance minister to renew the negotiation with German counterparty. The overall negotiation process between Greece and the Troika was tumultuous, sometimes involving multiple suspensions of negotiation schedules, personal blaming, and of course overreacted responses from Eurozone financial markets. At one point, Alexis Tsipras called for a referendum, asking whether Greek citizens would be willing to accept another round of bailout conditionality. He also replaced the prime minister to refresh the air over the negotiation table. The Syriza government introduced bank closings and capital controls to prevent chaotic capital outflows by domestic citizens. After majority of Greek citizens voted "No" to harsh bailout conditionality in the referendum, however, Alexis Tsipras shockingly overturned the course and hurriedly signed on the third bailout terms without receiving much concession from German finance minister, a chief negotiator from creditor countries. The prime minister, Alexis Tsipras survived in another referendum held in September, but the Greek economic crisis is continuing.

3. The role of the IMF and Troika in the current crisis in Greece

During the entire process of the Greek financial and economic crisis, what kinds of role did the IMF and Troika play? Did the IMF and European creditors early detect the potential source of problems in Greece and advise a preventative measure? No, not at all. Instead, the IMF and Troika have simply exacerbated the initial financial problem.

In the IMF's country report (known as Article IV consultation) issued in both January and December of 2007, IMF economists highly praised the Greek government's financial market liberalization policy and optimistically projected a sustained economic growth in Greece. They argued that the Greek economy had grown remarkably thanks to sustained inflows of private foreign capital to the country and corresponding growth of household and corporate credit. They also praised the Greek government's efforts to enhance the competitiveness of domestic banking and financial industry by following Eurozone-wide financial sector liberalization policies (IMF 2007a; IMF 2007b).

The IMF's extremely fragrant attitude toward the Greek economy, however, was drastically changed and completely reversed during the first half of 2009. All of sudden, the IMF report began to warn that the Greek economy might enter recession as foreign financial capital flew out of the country. Even though the Greece did not have any direct exposure to toxic mortgage-backed securities, the report observed, banks' balance sheet would quickly deteriorate, posing serious downside risks to Greek economy, as foreign private lending dried up (IMF, 2009).

When the Greek government ultimately reached a deal with the IMF in May of 2010, the IMF imposed a series of bailout conditionality (IMF, 2010a; IMF, 2010b), which exacerbated initial financial troubles in Greece. In the face of rapid foreign capital outflows, the Greek government should have adopted a strong capital control measure as a way to insulate systemic damages potentially done by this myopic capital outflow. At that time, foreign private creditors drastically reversed their portfolio decision and competitively withdrew their prior investment from Greece, not because they came to realize that the Greek government mismanaged its foreign liability structure *per se*, but mainly because they feared that they

might lose their lent money if they had not done so. Thus, the only sensible way to prevent this panicky herd behavior in this situation was to introduce temporal capital control measures and to create an orderly debt repayment mechanism, in which both creditors and debtor meet together to renegotiate the maturity and the terms of repayment. If this negotiation potentially involves too many private parties, the IMF or ECB could have played a role as a leading negotiator on behalf of multiple private creditors.

It seemed also necessary for the Greek government to adopt a series of countercyclical fiscal and monetary policies as a way to alleviate socioeconomic pain caused by financial crisis and real economic recession. The Greek government should increase its revenues if it wants to repay previously incurred debts, and the only sensible way to achieve this means is to help the private sector economy grow substantially in a sustainable way. This requires that the Greek government adopt countercyclical fiscal and monetary policies to forge rapid economic recovery. When it comes to actual policy measures, this means that the Greek government should have incurred more deficits and more debts temporarily in the form of the government-sponsored work project, infrastructure building and renovation, and increases in its social and educational spending, to complement a substantial reduction and deficiency in private aggregate demand.

The Troika's bailout conditionality contained exactly opposite measures to this basic economic principle. The imposed standby agreement mandated the Greek government to achieve fiscal surpluses during the culminated period of the financial crisis and completely failed to address how to set up and manage orderly debt repayment mechanism over a long period of time (cf. IMF, 2010c; IMF, 2010d). Notwithstanding these repeated failures, however, the IMF and Troika have attempted to impose the same nonsensical austerity-oriented bailout conditionality over again. They have never thought about the apparent fact that austerity measures that they have imposed on Greece are the very same barriers that make it impossible for the Greek government to repay its debts. As the Greek chief negotiator, Yanis Varoufakis once reflected, Wolfgang Schauble, the German finance minister and many other ministers from creditor countries did not listen to whatever the economically sensible debt relief and debt repayment plan that Greek finance minister has proposed in vain (Varoufakis et al 2013). They put their unfounded Christian moral and ethical belief far ahead of any sensible economic solution (Varoufakis, 2015). For this reason, they are responsible for the current ongoing humanitarian crisis in Greece.

Under the ND party-led, pro-Troika allied government that has thoroughly implemented the second bailout conditionality, the Greek economic situation has deteriorated seriously. The government has successively cut the pension payment to the retirees and salaries for public employees by 25% during the last 5 years. They also drastically reduced educational and social spending, including the long-lasting government subsidies for food and nutrition supports for elementary school students. Under Troika's close monitoring, the government also has come up with a series of expedite privatization plans for public utility enterprises such as water, electricity, and onshore gas and oil drilling companies (IMF, 2012b; IMF, 2013; IMF, 2014). The end outcome of this austerity is simply a prolonged recession and debt deflation. As we can see from the following series of charts that capture the Greece's GDP growth rates and industrial production activities, the Greek economy has been pushed into a serious economic contraction, whose level is unseen in any advanced capitalist market economy since the Great Depression in the 1930s (see Figures 1 and 2 at end of article).

According to the IMF and Troika's rosy economic forecast, the Greek economy will soon quickly recover, once the Greek government committed itself to cutting its expenditures. However, the Greek government has not only missed Troika's yearly fiscal targets multiple times, but also has incurred an increasingly high public debt burden measured by the government debt to GDP ratio. This is not because the pro-Troika government in Greece has cheated the Troika repeatedly, but precisely because the government has thoroughly implemented what the Troika imposed onto Greece. Under the circumstances of serious economic downturn, private aggregate demand (both household consumption and corporate investment) fall. In the absence of the government's countercyclical policy measures, the economy must fall into a deeper downward spiral. The Troika's harsh austerity-oriented bailout conditionality simply has reinforced this downward spiral, making it almost impossible for the Greek economy to achieve any meaningful debt repayment through economic recovery. The end outcome is a massive humanitarian crisis, a combination of prolonged real economic recession, rising unemployment rate, accompanied by an unabated debt payment burden (see Figures 3 and 5 at end of article).

4. Revisiting the East Asian financial crisis in the late 1990s

Unfortunately, this manmade humanitarian crisis is not historically unprecedented. Many East Asian economies in the late 1990s had undergone a similar tragic experience. In the late 1990s, some East Asian countries experienced a region-wide currency market turmoil, which ultimately brought down governments of Thailand, Indonesia, the Philippines, and South Korea to the IMF bailout negotiation table.

The immediate cause of the currency market crisis was a heavy devaluation pressure associated with drastic capital outflows. Foreign investors (banks, institutional and individual portfolio investors) were initially attracted to these countries, partly because of a strong economic performance during booming years and partly because of low interest rate environments in most advanced capitalist economies at that time. Foreign investors' Asian portfolio investment in turn was made possible, because most East Asian governments had successively opened their domestic financial markets since late 1980s onward.

During the heyday of finance-led globalization, monetary policy makers in advanced economies and in international financial institutions popularized the idea that opening domestic financial markets to foreign investors would offer a chance for developing countries to finance their domestic investment and economic growth. Foreign investors, in turn, could earn higher rates of return that were not available in their home countries by purchasing various financial assets issued in developing countries. In this way, financial market liberalization and the government's *laissez faire* approach to financial markets in developing countries was praised to be conducive to economic growth in these countries (McKinnon, 1973; Shaw, 1973; Camdessus, 1997; IEO, 2005).

Under the influence of this orthodox doctrine, most Asian governments and monetary authorities competitively adopted a series of financial liberalization measures, allowing foreign investors to purchase financial assets and real estate property freely, in addition to holding majority ownership stakes in financial firms in this region. In some cases, governments in South East Asia went a step further to set up tax-free non-bank financial companies and facilities to attract more foreign private investment. The Thai government's Bangkok International Banking Facilities (BIBFs) and Indonesian government's Labuan International

Offshore Banking Center are a good example. Monetary authorities in this region also changed their securities law, lifting restrictions on the type of financial instruments that domestic financial institutions could sell and on the volume and type of foreign exchange transactions (Azis, 2006, 180-188; Dekle and Pradhan, 1997, 4-8, 11; Johnston et al 1997; Chang et al, 1998, 737-39).

One immediate consequence of this financial market liberalization was a substantial increase in capital inflows to the Asian region and a resultant real exchange rate appreciation and asset price bubble. The total magnitude of portfolio investment drastically rose to an unprecedentedly high level between 1993 and 1997, and most of this portfolio investment flowed into asset markets, creating both equity and a real estate bubble. According to a series of BIS reports that track the volume of international capital flows *ex post*, a total \$378.1 billion foreign capital flowed to all parts of East Asia (even excluding Singapore and Hong Kong) by the end of 1997 (BIS 1997-1999). The flipside of the coin is that recipient domestic entities in the Asian region continuously incur foreign liabilities. Banks and non-bank financial companies competitively increased the volume of consumer credit and corporate lending, recycling their borrowed money from abroad. According to the same compiled data, private sector (banks and non-bank financial companies)'s foreign liabilities occupied more than 80 percent of the total foreign debt by the end of 1997, compared to less than 20 percent of public debt.

Of course, there was an additional complicating factor specific to the Asian region. That was a massive increase in the volume of yen "carry trade". Since the burst of its own real estate bubble in the early 1990s, the Japanese central bank had maintained near-zero interest rate policy in the hope of reviving depressed domestic economy. This low interest rate in Japan in turn attracted massive foreign equity flows that invested in booming Asian property markets after borrowing cheap money from the Japanese financial sector. This short-term portfolio investment generated bubble in both equity and real estate markets, which ultimately burst during the onset of the currency crisis. In this process, there was virtually no common regulatory arrangement in which either individual government or regional financial institutions manage the magnitude and the direction of short-term capital flows and this unsustainable dynamic continued through the onset of the financial crisis. As foreign banks and creditors began to worry about the region's debt sustainability, they drastically reversed their lending decisions and began cutting their loans as competitively as they did when they lent. Now, foreign short-term capital began to flow out of Asian countries, leading to successive currency devaluation and crises in the region.

In the face of rapid capital outflows, monetary authorities in this region had to abandon their quasi-fixed exchange rate regime and allowed their currencies to fall freely. As the value of Thai baht, Indonesian rupiah, Malaysian ringgit, and Korean won fell almost simultaneously, however, foreign liability situations deteriorate further. This is because Thai and Indonesian banks and non-bank financial companies borrowed short-term foreign capitals in the form of loans that were denominated in foreign currencies (i.e., in US dollars term and/or Japanese Yen term). This means that indebted East Asian countries needed to pay back these foreign loans, not in terms of their own currencies, but in terms of US dollars. Thus, drastic and competitive foreign capital outflows that led to currency devaluation also meant that private banks and corporations in these countries could not find any other solutions but to declare corporate bankruptcy.

Governments in Asian countries ultimately resorted to the IMF's bailout programs, after failing to defend their currencies for months. In exchange for receiving emergency financial assistance under the standby loan agreement, Asian governments had to accept highly stringent conditionality that was, in substance, the same as what Troika has imposed on Greece nowadays (IMF, 1999a; IMF, 1999b; IMF, 2000; IMF, 2002). As in the case of Greece, the IMF's East Asian bailout programs failed to stabilize the currency market turmoil in the region. Instead of providing a framework for an orderly debt resolution mechanism, the IMF's imposition of austerity-oriented policy measures worsened the situation, ultimately spreading the initial currency crisis into real economic recession.

The IMF has claimed that increasing interest rates as part of conditionality was the only way to stabilize the currency market and to prevent further depreciation of regional currencies (Lane et al, 1999, 35-37; IMF, 1999c; IMF, 2000b, 3-4). However, there was no empirical evidence that supported the stable correlation (not to mention, causality) between interest rates and exchange rates, especially during the currency crisis period (IEO, 2003, 35). The most effective alternative way to prevent further declines in currencies due to capital outflows is for the Asian government and private creditors to devise a coherent and speedy mechanism to reach an agreement on how to repay the debts orderly under the government guarantee. Once agreed, foreign creditors would no longer have an incentive to cut their credit line competitively, which triggered the initial currency market turmoil in the first place. In this process, the Asian governments in the region might have needed to collaborate to introduce regional capital control measures to stabilize the currency turmoil temporarily.

The IMF also claimed that maintaining fiscal surpluses in the government budget, which was the second part of the bailout conditionality, was necessary in restoring the credibility of the government. In response to heavy criticisms of this costly measure, the IMF economists even argued that mandating to achieve fiscal surplus in East Asia did not contribute to a sharp private sector contraction after the crisis (Lane et al, 1999, 28-29). However, the Asian financial crisis was unrelated to public sector deficits, thus there was no need at all to reign in the government's fiscal position in the name of restoring foreign investors' confidence. Admittedly, the Asian governments experienced a sharp but temporal increase in fiscal deficits. But it was not the cause, but a result of the currency crisis, just as the Greek government's current debt sustainability problem is not the cause, but the result of the post-financial crisis adjustment. Thus, the government should expand, rather than reduce, its economic functions to complement the drastic reduction in private sector investment and to pull the economies out of recessions. Otherwise, the economy would fall into a deeper recessionary spiral, as it actually happened in both East Asia then and Greece nowadays. Indeed, unlike the IMF's *ex-post* excuse, the relaxation of this rigid requirement for maintaining fiscal balance on the part of the IMF and the implementation of expansionary fiscal policies on the part of the government in varying degrees since late 1998 – the exact opposite fiscal policy stance from what the IMF preached – explains much of the rapid economic recovery in both Malaysia and Korea since early 1999.¹

Last but not the least, the IMF's blind emphasis on "corporate governance reform" was one of the most destabilizing factors in the crisis in Asia. The IMF economists repeatedly claimed that the structural weakness in the Asian banking sector and "cronyism" in corporate

¹ This relaxation of the IMF bailout conditionality was made possible, partly because of Malaysia's unilateral introduction of capital control measures and partly because of the leadership change in the IMF. For empirical tests of the effectiveness of capital controls in Malaysia and other countries, see Edison and Reinhart (2000), Ariyoshi et al (2000) and Government of Malaysia (1999).

governance were the root causes of the financial crisis in East Asia, and thus that any reform measure should target this fundamental governance problem (Lane et al, 1999, 2-3; Lane et al, 1999, 9-10; Lane et al, 1999, 18-19; IMF, 2000b, 6). However, this diagnosis was highly dubious from the beginning, and it became increasingly clear that the currency crisis was largely driven by self-fulfilling expectations on the part of foreign investors. The magnitude and the direction of foreign capital flows were largely exogenous to Asian economies and the deterioration of Asian banking and financial balance sheets was a direct consequence of the redirection of short-term capital flows. Thus, various indicators of structural weakness that the IMF economists enumerated were not the cause, but the result of the currency market turmoil. Even if this claim of “Asian cronyism” were to be correct, it does not follow that the IMF and any other international lenders should mandate the governance reform *a priori*. Instead, the IMF should have provided a debt resolution mechanism that addresses how to repay foreign debts as the foremost important priority at the culmination of a currency crisis. Prioritizing governance reform is like putting a cart ahead of horses, which was nonsensical from any sound economic reasoning.

In this way, the IMF bailout program in East Asia completely failed to contain the regional currency crisis from getting serious. The IMF bailout program not only contributed to making economic situations even worse by amplifying the initial turmoil in currency markets into a full-blown banking crisis and a far more severe post-crisis economic recession, but also destabilized the political and socioeconomic stability in the Asian region. By confusing the priority of resolving the immediate debt repayment problem with long-term “structural reform agenda”, the IMF policy triggered a series of bank runs that transformed the initial currency shock into a real economic crisis. Ultimately, the IMF’s failed bailout programs in East Asia transformed the initial Asian currency crisis into a series of sovereign debt crises in other parts of the world, in the form of sovereign debt crises in Russia and Brazil in 1999, and Argentina in 2001. In this sense, the Asian financial crisis was also a complete failure of the IMF and the predominant form of international financial arrangements (Blustein 2003).

5. Policy lessons for sovereign financial stability and reforming the global financial system

It is irony and tragic to see that the same old institution and doctrine are playing exactly the same role in the current international financial arena: the IMF and Troika are preaching and imposing a series of misguided policies based upon an outdated model in a disguised form. It is particularly striking to see that the IMF is playing the same role in Greece, even after it publicly apologized for its failed bailout programs in East Asia and for its blind advocacy of unfounded benefits of financial liberalization. It is even more striking to recognize that the IMF once published highly unorthodox papers on the benefit of capital control measures during the culminated period of the financial crisis in recent years (Ostry et al, 2010; Ostry et al, 2011). Betraying its own modest proposals, the IMF has behaved in exactly the same way in Greece as it once did in East Asia, repeating the same mistakes over again.

One set of important policy lessons that we can learn from these experiences is to recognize the grave danger of financial liberalization policies and of a premature relegation of sovereign autonomy to a supranational entity. As long as individual governments cannot control the speed, magnitude, and direction of short-term capital flows, any financial market liberalization should not be adopted. As long as the existing global financial system persistently fails to provide symmetric provision of long-term financial resources for growth and development, and

thus as long as the global financial system lacks an effective international lender of last resort function, any decision to transfer domestic monetary and fiscal authority to a supranational entity should be cautiously adopted or even avoided.

As an alternative, international financial institutions should expand special drawing rights (SDR) to its member states regardless of their country size and respective contribution, and should actually play a role as an effective international lender of last resort. The World Bank (if it should exist) or regional development banks in turn should increase the volume of their low cost long-term loans to developing countries, so that the governments in these countries can safely rely on them to increase their public investment in infrastructure and educational systems. In the context of Eurozone, this means that the member countries should agree upon the need of creating a common fiscal authority and a regional development fund, both of which are aiming at mitigating and reducing uneven regional economic development among the member countries in the medium and long run.

In the face of an urgent need of currency and financial crisis management, international financial institutions should coordinate an orderly debt restructuring management, in which both creditors and borrowers voluntarily agreed to such measures as debt rollover as well as debt swap (Cf. Stiglitz and Guzman, 2015). The IMF and Troika should allow an individual government to adopt emergent policy measures including capital controls to prevent devastating runs on the country. If the country ultimately requested the bailout fund, the IMF and Troika's conditionality should include developmental policies and criteria, rather than sticking to the prevailing austerity-oriented policy prescription. Under this new institutional framework,

- The Troika should set up a formal monitoring and enforcement mechanism in order to stop an unnecessary run on the country and to prevent free riders among foreign investors during the early stage of financial crisis;
- The Troika should coordinate and target to expand domestic and regional aggregate demand by helping the country and the region adopt coordinated expansionary fiscal and monetary policies.
- The Troika's financial program should also allow the government to provide an unlimited and unconditional provision of domestic liquidity for the monetary authority to prevent a sharp freeze in the domestic interbank market from causing a complete breakdown of the financial system;
- Post-crisis financial sector restructuring may be inevitable to clean up bad loans and to create a more sound financial system. During the culmination of a financial crisis, however, it is necessary for the government to temporarily ease or suspend the international capital adequacy rules in order to prevent banks from drastically cutting much needed corporate and household credit;
- The individual government can set up separate financial facilities through recapitalized financial institutions under the government's conservatorship to help ease credit constraints placed on solvent non-financial corporations and households, and international financial institutions and regional central banks should support this effort;
- The last but not the least, the crisis-stricken country or entity should be given rights to take full advantage of an internationally extended Chapter 11 bankruptcy protection mechanism that would enable them to shield and protect themselves from panicky creditors' herd behaviors. As in the area of trade and industrial policy, the individual government should have sufficient "policy space" for adopting different financial

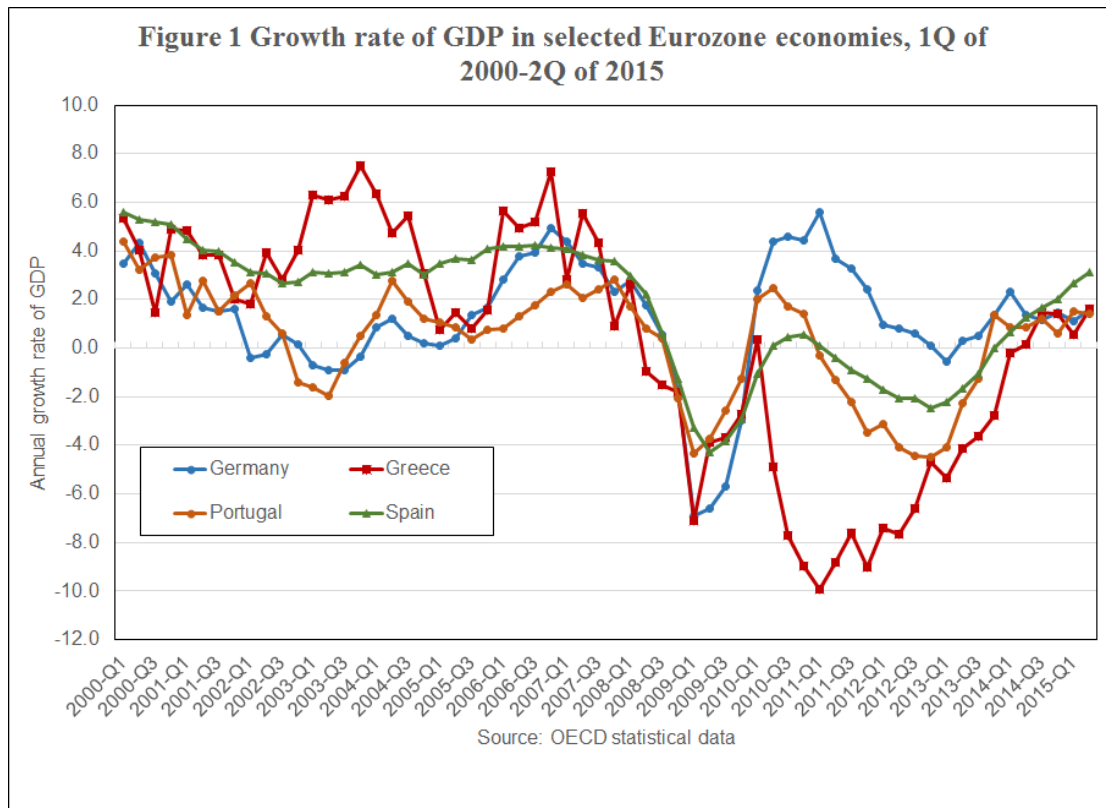
regimes and measures for managing short-term capital flows. This requires a fundamental change in our notion of capital controls, which should be understood as a legitimate component in a series of “macro-prudential” preemptive measures.

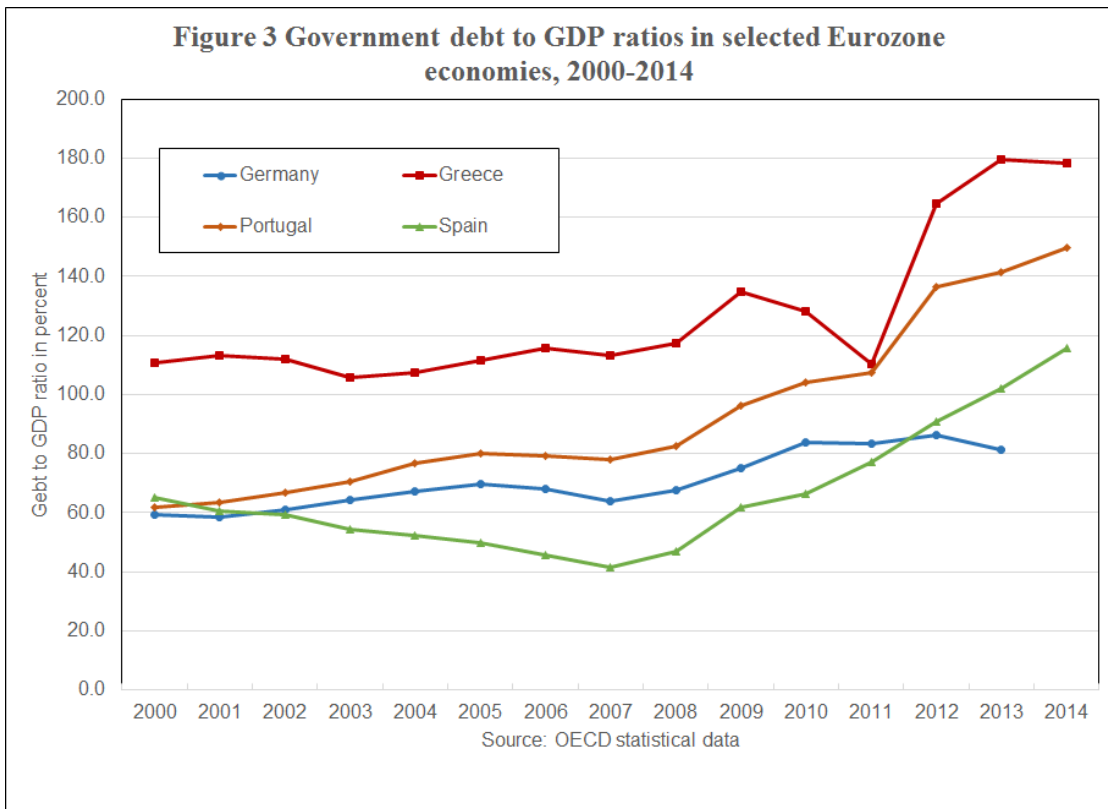
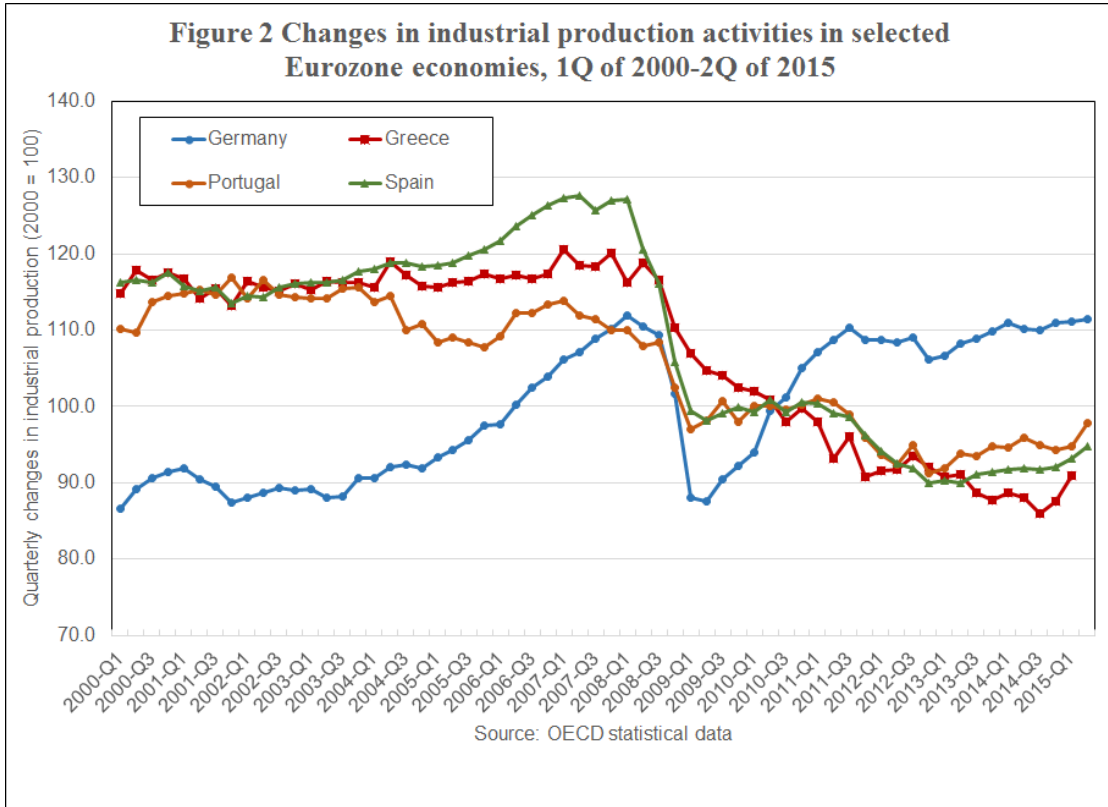
6. Concluding remarks

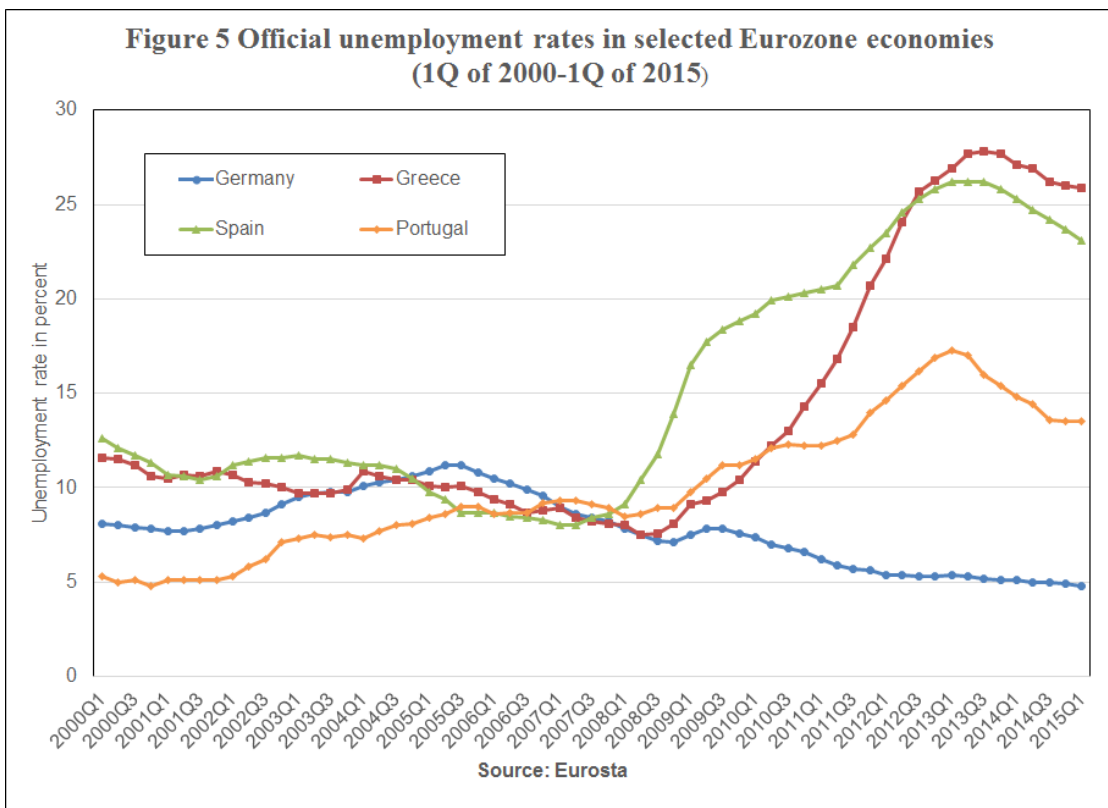
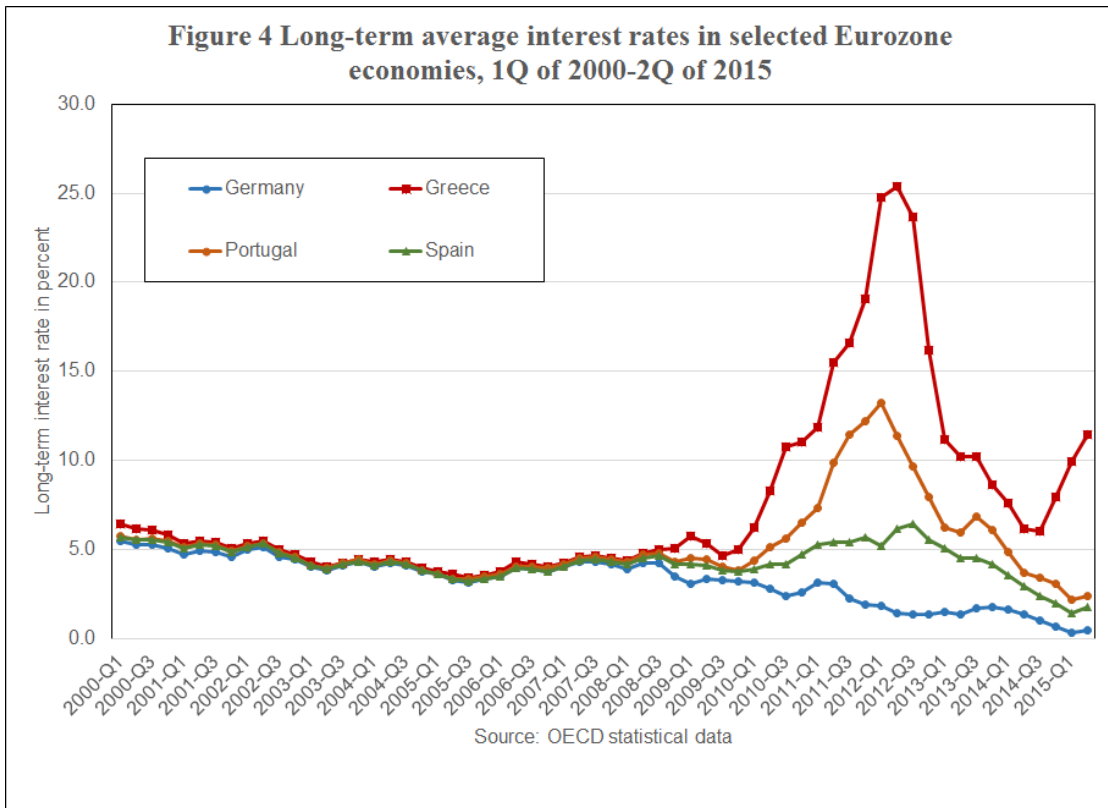
One of the main goals of this article is to examine the current Greek financial and economic crisis from a perspective of the East Asian financial crisis in the late 1990s. This comparative analysis of the two financial crises strongly suggests that the myopic and premature liberalization of domestic capital accounts in the absence of proper fiscal and monetary sovereignty is the common cause of financial crises in both regions, and the IMF and Troika’s misguided bailout conditionality exacerbated economic situations even further.

One important lesson that we should learn is that we do not have any adequate sovereign debt resolution mechanism at either regional or international level. In the absence of this effective sovereign debt management arrangement, we may continue to see repeating currency and banking crises associated with drastic capital flows. The East Asian financial crisis in the late 1990s and the current ongoing humanitarian crisis in Greece have clearly shown how fundamental flaws inherent in the prevailing global financial system and the lack of decisive will for policy reform can seriously harm societies.

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Globalisation and sticky prices: “con” or conundrum?

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Abstract

With reference to a case study which illustrates the existence of segmented markets and international price discrimination, this paper develops a theoretical model of comparative advantage in which domestic prices may be sticky. We show, when domestic prices do not converge to world prices, the effects of international trade upon domestic welfare are ambiguous. In particular, for a nation with no absolute advantage, specialising in comparatively advantageous production will reduce welfare where prices are sticky. This finding contrasts with the general view that pursuit of comparative advantage will always increase welfare.

JEL Codes A1 General Economics; C6 Mathematical Methods and Programming; F1 Trade

1. Introduction: cons and pros

Comparative advantage is a cornerstone of globalisation theory. It theorises that, where two countries trade, they will both be better off if they specialise in producing the products that they make comparatively better (Ricardo, 1817; Dornbusch *et al.*, 1977; Shiozawa, 2007). The merits of globalisation are seen by some economists as incontestable (Harford, 2007) and have been confirmed in terms of aggregate economic growth (Dreher, 2006). As summarised by Samuelson and Nordhaus (2010: 442), “the theory of comparative advantage is one of the deepest truths in all of economics”. Bernhofen and Brown (2005: 208) similarly claim “The one point on which most economists will agree is that opening up to international trade will increase a country’s economic welfare”. See Arkolakis *et al.* (2012) for a recent review of theory and some limited empirical results.

Notwithstanding, it is clear that trade between economies may be more complicated than trade within an economy. For example, some argue that the benefits of globalisation are illusory or at least limited to those who wield economic power (Canterbery, 2001; Dong-Hyeon *et al.*, 2012; McClintock, 1996; Samuelson, 2004). This raises the issue of asymmetric free trade where the benefits of trade are particularly clouded in developing economies: “instead of workers moving from low productivity jobs to high productivity jobs, [supposedly] the ‘promise’ of liberalization, workers move from low productivity jobs to unemployment” (Stiglitz 2002: 4). Even in developed economies, the effects of trade liberalisation may not be entirely benign; for example, Melitz and Trefler (2012) claim jobs in the USA have been lost as a result of import substitution.

Globalisation may also lead to environmental damage; in this connexion, Brander and Taylor (1997: 549) claim “international trade may provide lower steady-state utility than autarky, and the overall welfare consequences of free trade may well be negative”. Fujiwara (2012) also warns that increasing international trade can lead to welfare losses because of pollution.

Our contention is that, even where free trade occurs symmetrically, the benefits from free trade are ambiguous as one of the implicit assumptions of the model is often not realised: the assumption that domestic prices adjust to world prices. In practice, domestic prices may not be free to adjust quickly to converge with world prices. As Ricci (2006: 52) outlines, “trade theory usually ignores the existence of short-run market rigidities”.

Previous analyses of international trade have used different assumptions. Some writers refer to monopolistic competition (Melitz and Trefler, 2012; Neary, 2009: 225); others assume oligopoly (Neary, 2009: 241). Arkolakis *et al.* (2012) consider perfect competition and monopolistic competition. In the following, we determine mathematically the consequences on welfare if this assumption is not realised. Our model is a conventional, two-economy, two-good model, except that we do not assume that domestic prices adjust to world prices. Rather, we assume that prices are either “sticky”, or that market segmentation and price discrimination occurs. This assumption may significantly change the conclusion of conventional globalisation theory: to wit, rather than trade improving welfare, our model suggests that globalisation could harm a domestic economy.

The remainder of the paper is as follows. In section two we discuss the evidence of sticky domestic prices in an international context. Our mathematical model is specified in section three, where we also discuss the implications of the analysis; section four concludes the paper.

2. Sticky prices: consumers, contradictions and costs

2.1 Motivating case study

In 2002, Levi Strauss, a multinational clothing manufacturer and retailer, closed its last two factories in Scotland, claiming that “production costs in Scotland were up to 60% higher than elsewhere in Europe” (BBC News 22 March 2002).¹ The company had “done its sums” (*ibid.*) and concluded that the UK plants were uneconomic. However, any savings that the domestic (UK) consumer might have expected to make from the anticipated cost reductions were not realised. The local price of this clothing did not decline. Indeed, later that same year, Tesco, a major UK supermarket, lost a legal battle to parallel-import Levi jeans sourced from Mexico, Canada and the United States. By importing the jeans and reselling to the domestic market, Tesco would have been able to reduce the retail price to the UK consumer by nearly 50% (*Telegraph* 1 August 2002). However, the European Court of Justice (ECJ) ruled that retailers required trademark holders’ permission to import goods in this way.

Since the Tesco court case, Levi Strauss has continued to take legal action to maintain segmented markets for its products. In 2011 it secured an injunction against the online retailer Papikian’s use of its trademark and applied to prohibit Papikian from importing Levi jeans into Europe (Krongold Law, 2011). The USA judge ruled that the latter issue was a matter for the ECJ, but as Calboli (2012) has pointed out, the ECJ has adopted an increasingly narrow interpretation of “consent” over the last ten years, further strengthening the protection for trade-mark holders. Thus, globalised manufacturers are able to take advantage of international labour markets to reduce costs, while retailers are constrained from taking advantage of international goods markets to reduce prices. In other words, UK (and

¹ This was part of Levi Straus’ policy of shifting away from internal production towards outsourcing: the last of its American factories were closed in 2003, its Canadian factories in 2004.

European) consumers are forced to pay a premium above the world price. This case study highlights that, while the costs of globalisation to UK workers are evident in terms of reduced job security, the benefits of globalisation are, at the very least, questionable.

2.2 Generally sticky prices

The lack of instant adjustment of “sticky prices” in response to a change in supply or demand has frequently been observed in economics (Álvarez *et al.*, 2006; Faia and Monacelli, 2008; Ricci, 2006). An explicit expression of this conundrum is made by Lipsey and Swedenborg (2007: 20), who claim “international differences in national price levels and prices of individual products are striking and have persisted over long periods, despite the presumed equalizing influence of international trade and despite the liberalization of trade and reduction of transport costs that have occurred.” Such differences in international prices exist even within the European Union, despite the supposed Single Market: “between 65% of firms (Spain) and 92% (Germany) use price discrimination ... About half of firms charge different prices depending on the country [in which] the good is sold” (Dhyne *et al.*, 2009: 67).

Despite general consensus within economic theory, the assumption that domestic prices will converge to world prices can be granted only limited empirical support. In the UK, there is much anecdotal evidence of prices failing to adjust fully to world prices (see, for example, *Telegraph* 22 June 2009, *Guardian* 13 April 2012, *Daily Mail* 31 May 2012).

There are many reasons why the price of a good may differ between two countries, such as:

- tax-rates may be higher in one country than another (Jones, 1987; Melitz and Trefler, 2012: 103).
- imports tend to lower prices (Melitz and Trefler, 2012: 97); therefore import barriers – artificially constraining supply – may prevent domestic prices falling to world prices.
- a government may subsidise exports (Neary, 2009; Trela *et al.* 1987).
- exchange-rates between currencies may be held at an artificial level by government so as to promote a current account surplus.
- random changes in exchange-rates may have long-term effects on prices where adjustment is slow (Frankel, 1984).

The above reasons apply in any market structure, including perfect competition. If a firm has monopoly power (monopoly or monopolistic competition or oligopoly), there are more reasons why prices may differ between countries:

- a firm may carry out “dumping”, i.e. selling below cost price in a foreign country to gain future profits (Neary, 2009).
- a firm with market power could set different prices in different countries, depending on demand elasticity.

3. The mathematical model: confidence and commodities

In what follows, we develop a mathematical model for a two-country, two-commodity world. We show that, gains from trade do not follow where prices are sticky. We begin by considering a closed economy and the level of consumption therein. This analysis is expanded to an open economy model where nations pursue comparative advantage. National

welfare is compared to the closed economy model. Where prices are sticky, the open economy may have lower welfare.

3.1 The closed economy case

Consider a two-good economy, country 1, with goods q and s . The quantities *per capita* produced in one period of time are q_1 and s_1 respectively. The goods are perishable, thus the level of consumption in the absence of trade is also q_1 and s_1 . The maximum *per capita* level of q_1 which may be produced is a_1 and the maximum level of s_1 is b_1 . The production frontier is linear, hence we may write:

$$q_1 = a_1 - \frac{a_1}{b_1} s_1$$

Suppose the numeraire is the *per capita* production in one time period. The budget constraint is $p_1 q_1 + r_1 s_1 = 1$. Hence the prices of good q and good s are $p_1 = \frac{1}{a_1}$ and $r_1 = \frac{1}{b_1}$ respectively. The budget constraint is equivalent to the production possibility frontier in this case. The objective is to maximise utility $u = A q_1^\alpha s_1^\beta$ subject to the budget constraint:

$$\max F(q_1, s_1, \lambda) = A q_1^\alpha s_1^\beta - \lambda \left(\frac{q_1}{a_1} + \frac{s_1}{b_1} - 1 \right).$$

The solutions to this problem are:

$$q_1^* = \frac{\alpha a_1}{\alpha + \beta} \quad \text{and} \quad s_1^* = \frac{\beta b_1}{\alpha + \beta}.$$

3.2 The open economy case – price discrimination

Consider a two-country model in which economy 1 has a comparative advantage in good q ; i.e. $\frac{a_1}{b_1} > \frac{a_2}{b_2}$. Therefore economy 1 specialises in good q : a_1 units of q are produced, q_1 for local consumption and $(a_1 - q_1)$ for export. In each market, the price charged is the greatest the market will bear. Because of “sticky prices”, the domestic price in neither economy will adjust to the world price.

The price of q in the local economy (as before) is $p_1 = \frac{1}{a_1}$ and the price in the foreign economy is $p_2 = \frac{1}{a_2}$. The price of good s in the local economy is $r_1 = \frac{1}{b_1}$. The value of exports is $p_2(a_1 - q_1)$ and the cost of domestic consumption is $p_1 q_1 + r_1 s_1$. Hence the budget constraint is:

$$p_1 q_1 + r_1 s_1 = p_1 q_1 + p_2(a_1 - q_1) \Leftrightarrow \frac{s_1}{b_1} = \frac{a_1}{a_2} - \frac{q_1}{a_2}.$$

Therefore we have the constrained maximisation:

$$\max F(q_1, s_1, \lambda) = A q_1^\alpha s_1^\beta - \lambda \left(\frac{q_1}{a_2} + \frac{s_1}{b_1} - \frac{a_1}{a_2} \right).$$

which implies:

$$q_1^* = \frac{\alpha a_1}{\alpha + \beta} \text{ and } s_1^* = \frac{a_1}{a_2} \frac{\beta b_1}{\alpha + \beta}.$$

Comparing this result to the case of the closed economy, we see that economy 1 consumes the same amount of good q as before, but it will consume less of good s unless $a_1 > a_2$, which is to say that it enjoys an absolute advantage in producing good q . In the situation where economy 1 enjoys a comparative, but not absolute advantage in good q , the consumption of good s declines and the utility of economy 1 must decrease.

Hence, where an economy enjoys a comparative, but not an absolute advantage in production, the gains from trade will result only where local prices are allowed to adjust to world prices. In the presence of “sticky prices”, international trade may result in a decline in a country’s welfare if it does not have an absolute advantage in either good. This confounds the standard result from comparative advantage: “small countries have the most to gain from international trade” (Samuelson and Nordhaus, 2010: 437) as small countries, lacking the potential for economies of scale, may be at an absolute disadvantage in production of tradable goods.

4. Conclusion

Based on an indicative case study, we suggest that the theory of trade suggested by comparative advantage does not lead unambiguously to increases in domestic utility. An implicit assumption of the standard model of international trade is that domestic prices of tradable goods will adjust to world prices. However, there is a deal of evidence that this assumption is not supported by real world practice. Where, through asymmetries of market power or for some other reason, world prices do not feed through to the domestic economy, our analysis shows the supposed benefits of trade may not be realised. Indeed, the pursuit of comparative advantage may leave the domestic economy worse off. In practice, domestic governments must address the issues of “sticky prices” and price discrimination as a part of their overall approach to international trade.

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Putting an end to the aggregate function of production... forever?

Review of Jesus Felipe and John McCombie's book: *The Aggregate Production Function and the Measurement of Technical Change: Not Even Wrong* (2013) Cheltenham, UK and Massachusetts, USA: Edward Elgar Publishing. 400 pages. ISBN: 978-1-84064-255-1.

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Abstract

Since the publication of a famous article by Solow in 1957 in which he seems to give empirical evidence to the aggregate production function, different respected neoclassical authors have shared their doubts about the results obtained.

For some it is nothing but a tautology, for others it is simply the result of an accounting identity – the two criticisms sometimes overlapping. As a matter of fact, both are right. In their book, *The Aggregate Production Function and the Measurement of Technical Change: Not Even Wrong*, Felipe and McCombie give a detailed account of these criticisms. They show – using both (elementary) mathematics and econometrics – why the “empirical results” obtained based on the alleged existence of an aggregate production function are absolutely misleading.

In this article we provide an overview of their main arguments – which are very simple and clear, contrary to the obscure “Cambridge controversies” –, with the hope to convince everyone to definitively abandon the aggregated production functions, both in theory and practice.

The aggregate production function plays a central role in macroeconomics. It is very often identified with the work of Cobb-Douglas and Robert Solow's model of growth. In the recent debate about “[mathiness](#)”, Paul Romer opposes “science” and “politics”. He gives the example of Robert Solow:

“...*who was engaged in science* when he developed his mathematical theory of growth... [and] mapped the word “capital” onto a variable in his mathematical equations, and onto both data from national income accounts and objects like machines or structures that someone could observe directly.”

and of Joan Robinson:

“...*who was engaged in academic politics* when she waged her campaign against capital and the aggregated production function” (Romer P. 2015, our emphasis)².

The aggregate production function, and Solow's model, is also the point of departure of the *Real Business Cycle* model and its siblings, the *DSGE* models ([Prescott](#), 1988). The same can be said about Thomas Piketty's *The Capital of the 21st century*.

For a sensible person, it is obvious that quantities of different kind of goods cannot be aggregated in a quantity of “a good” – even imaginary. If asked, no economist would say that

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² Commenting Romer, even the very clever Robert Waldmann [approve the choice](#) of Solow's model as an example of science as it “fits the data surprisingly well” (Waldman, 2015)

it is possible to describe all of society's possible combinations of productions and inputs with one function – regardless of the number of its variables. Why, then, does the community of economists accept the idea that a country's economy can be “described”, or characterized, by a function of two variables (“labour” and “capital”)? Well, because for some mysterious reason, “it works” – at least in some important instances. In fact, it is only since 1957, when Solow published an article where a Cobb-Douglas function gave a “remarkable fit” with US GDP data, that the aggregated production function became very popular – not theoretically founded, but empirically true. As [Solow once remarked](#) to Franklin Fisher:

“Had Douglas found labor's share to be 25 per cent and capital's 75 per cent instead of the other way around, we would not now be discussing aggregate production functions” (Fisher, 1971, p 307).

Facts rather than theory or, simply, common sense.

But common sense was not completely lost, even among neoclassical economists, as a few raised their voices – including those of Henry Phelps Brown, Franklin Fisher, Herbert Simon and even, in a way, of Paul Samuelson³ – to point out that behind Solow's “miraculous adjustment” there is a statistical test of an accounting identity (which is by definition always true). Although prestigious, these voices went unheard.

Those criticisms were totally justified. Even Solow, who first tried to answer them, didn't really insist much. Perhaps because, as he noticed in his [Nobel lecture](#), following the results obtained in his 1957 article, “a small industry”, which “stimulated hundreds of theoretical and empirical articles”, has established itself around the aggregate production function, which has “very quickly found its way into textbooks and in the fund of common knowledge of the profession” (Solow, 1987a).

This “industry” has gained such a predominant role that nearly no one wants to see it fall down under the pressure of those criticisms. The various flaws related to the problem of aggregation or the relevance of the production function are hence totally ignored by the academic world – teaching included.

Luckily, everybody hasn't given up. First Anwar Shaikh showed how the “remarkable fit” of an aggregate Cobb Douglas function, whose variables are measured in value, can be explained by the accounting identity relating its variables, provided that the factors of production shares are (almost) constant – a “stylized fact” is largely accepted (Shaikh, 1974). What was presented as a *consequence* of the theory – the fact that the factors shares are constant – is actually coming from the data. This invalidates the empirical tests of the production function, as they are simply tests of an accounting identity. But, above all, there is the work of Jesus Felipe and John McCombie who have shown how the combination of an accounting identity – inevitable as aggregates are not measured in quantity but in value terms – and a few “stylized facts” suffice to reproduce, or explain, the supposedly “miraculous” results of Solow but also of Cobb, Douglas and many others – without any need of a fictitious production function. Felipe and McCombie have published, on their own or together, more than 30 articles on this

³ In his tribute to Douglas after his death, he raises some criticism about “across-industry fitting” which have not received “the attention it deserves”. He even says that “on examination, I find that results tend to follow purely as a cross-sectional *tautology* based on the *residual* computation of the non-wage share” (Samuelson, 1979, emphasis in the original). For more details, [see](#) Felipe and Adams (2005).

question, where they have mobilized the most recent econometric techniques and built several simulations which support their views.

All their results are recalled in their book, published in 2013's last quarter, *The Aggregate Production Function and the Measurement of Technical Change: Not Even Wrong* (Edward Elgar). This book is so rich in content that it should, at least, be present in libraries of all economics departments around the world. Its exhaustive nature, the recollection of the debates around the aggregate production function, the review and thorough refutation of all the objections which might be made to the explanation offered, show that we are in the presence of a seminal work – although, at times, a little tough to read. This is why we will restrain our review to the essential point of the book, the relation between the production function and the accounting identity.

The “divine surprise” of the Cobb-Douglas adjustment

Felipe and McCombie remember how Cobb and Douglas had the idea, in 1928, to adjust a function of the form $F(K, L) = AL^\alpha K^\beta$ to the data on the GDP of the United States between 1899 and 1922.

To their great satisfaction, they found estimates of α and β whose sum is little different from 1, with the values concerning the share of income going to labor and capital quite close to those actually observed. One of the main criticisms made at Cobb and Douglas by their contemporaries is the role almost absent of technical progress in their function. Douglas was, actually, aware of it since he had opted for the study of inter-industries data (not including any temporal dimension), which avoids this problem. He then obtains far better results, without however managing to really convince the profession, which had not completely lost its common sense – how can it be accepted that the industries of a country, in all their diversity, can be described (correctly) by a function of (only) two variables?

In reality it took thirty years for the aggregate production function to be accepted by a large majority of economists. [Robert Solow's article](#) “Technical Change and the Aggregate Production Function”, published in 1957, seems to have much contributed to ease the judgments on this point. In this article, Solow, who knows well the (unsolvable) problems posed by the aggregation, adopts a very prudent attitude, as he begins by remarking that:

“...it takes something more than the usual ‘willing suspension of disbelief’ to talk seriously of the aggregate production function” (Solow, 1957, p. 312).

As the title of the article points out, his purpose is to try to isolate and then measure the effect of technical progress, identified by the letter A in the Cobb-Douglas function. Unlike them, Solow considers that this effect is not constant and proposes a method to measure it. This allows him to isolate and “eliminate” it, so as to keep only what in the product is given by the single combination of labor and capital “factors”. He then obtains, despite “the amount of *a priori doctoring* which the raw data had undergone”, a “fit remarkably tight”, with a correlation coefficient higher than 0.99 (Solow, 1957, p 317). In addition, the estimates of the elasticities α and β are very close to the shares of labor and capital in the product observed values.

Is this too good to be true?

The doubts

Very few questioned Solow's "surprising" results. Warren Hogan was, seemingly, the first to remark that in Solow's data, the shares of labor and capital are almost constant – 0.344 for the capital, the rest for labour, with a variation coefficient of 0.05 (Hogan, 1958). Taking that into account, it stems from the way in which Solow "eliminates" the effects of the term A within the aggregated production function that the term remaining in L and K is necessarily of the form $L^a K^{1-a}$, where a is the observed share of labor (and $1 - a$ the capital's one). According to Hogan, we are therefore in the presence of a tautology: the result obtained is present in the hypothesis.⁴

Almost at the same time, Henry Phelps Brown published an article where he suggested that Cobb and Douglas good fitting may be the result of "a mere statistical artifice" (Phelps Brown, 1957). He observes that it is not the "technical" relation between *quantities* $Q = AL^\alpha K^\beta$ – that is, a production function – that is tested but the relation, $V = cL^\alpha J^\beta$, between *values* which are related by the accounting identity:

$$V \equiv wL + rJ,$$

where w and r are, respectively, the wage and the capital rate of return, and V and J , respectively, the value of product and capital.

Six years later, Herbert Simon and Ferdinand Levy gave a more precise content to Phelps Brown criticism (Simon and Levy, 1963). In "A Note on the Cobb-Douglas function", they showed how the accounting identity can explain the data's "remarkable fit" by a Cobb-Douglas function, provided that the wage and the rate of return are constant across industries or over time. The fact that – like Phelps Brown – Simon and Levy use the relation between *values*, and not quantities, plays a central role in their demonstration.⁵

Simon thought these criticisms serious enough to mention them in his [Nobel Memorial Lecture](#). He recalls that "the empirical results" related to the aggregate production functions "do not allow to draw a conclusion on the relative plausibility" of different theories that are at the origin of these functions (Simon, 1978). A year after the lecture, he published [an article](#), "On Parsimonious Explanations of Production Relations", where he "examines three sets of macroscopic facts which can be used to test the classical theory of production". He concludes that:

"...none of them provides support to the classical theory. The adequacy to the data of the Cobb-Douglas and CES functions is misleading – *the data in*

⁴ In his reply to Hogan, Solow concedes that he should have "warned the reader explicitly that the method would automatically produce a perfect Cobb-Douglas function fit if the observed shares were constant" (Solow, 1958). But he argues that, as shares "wiggles", his reasoning is a "good tautology", not the "bad one" suggested by Hogan (Felipe and McCombie, pp. 167-168).

⁵ Taking the logarithm of the ratio of $V_0 = AL_0^\alpha J_0^\beta$ and $V_1 = AL_1^\alpha J_1^\beta$ and using the approximation:

$\ln(x/y) \approx x/y - 1$, provided that x and y are not too much different, we obtain the approximation:

$V_1/V_0 - 1 \approx \alpha(L_1/L_0) + \beta(J_1/J_0) - \alpha - \beta$. Multiplying both sides by V_0 and rearranging, we get:

$V_1 \approx (\alpha V_0/L_0)L_1 + (\beta V_0/J_0)J_1 + V_0(1 - \alpha - \beta)$. This look like the accounting identity $V \equiv wL + rJ$ with the constant term equal to 0. Somebody testing data verifying this identity will believe that he have "proved" the marginal distribution theory ($\alpha + \beta = 1$, $\alpha = wL_0/V_0$, $\beta = rJ_0/V_0$). Note that the relations are not exact because of the log approximation and because w and r generally vary across data.

fact reflect accounting identity between the value of the inputs and outputs”
 (Simon, 1979, our emphasis).

In their book, Felipe and McCombie confirm Simon’s conclusion with a “simple simulation exercise”. They construct an “artificial data set of 25 observations”, assuming that the shares of wages “vary as if drawn from a normal distribution with a standard error of 2%, which is plausible when compared with actual values of labour’s shares”. They obtain a “very good fit” with the Cobb-Douglas function, notwithstanding the fact that data are generated by the accounting identity (Felipe and McCombie, p 57).

The mystery (finally) resolved

Hogan, Phelps Brown, Levy and Simon felt that that behind the “remarkable fits” obtained with the Cobb-Douglas function (at least in some important cases), there is simply a trick. Each of them advanced a plausible explanation. In an article [entitled](#) “Laws of production and laws of algebra : the Humbug Production Function”, published in 1974 in *The Review of Economics and Statistics*, Anwar Shaikh goes further and shows that the:

“...puzzling results of the empirical results is (...) the mathematical consequence of constant [factors] shares (...) and not to some mysterious law of production” (Shaikh A., 1974, p 116).

The proof is so simple that it is astonishing that nobody found it before. Shaikh begins by taking the derivative of the two members of the accounting identity, $V \equiv wL + rJ$, assuming that all the variables may vary in time or in the space, depending on the type of study done. Dividing by V and doing some elementary manipulations, the following linear relation between growth rates (marked by the symbol \wedge) would appear:

$$\hat{V} \equiv a\hat{w} + (1 - a)\hat{r} + a\hat{L} + (1 - a)\hat{J},$$

where a is the labour share, wL/V , of the product (therefore $1 - a$ is the capital part, rJ/V)⁶. If, in addition, we accept the “stylized fact” according to which the shares of labour and capital are constant (in time or space, depending on the case), we can show by a simple calculation that the accounting identity (1) implies the identity:

$$V \equiv BL^a J^{1-a}.$$

The identity (2) looks incredibly like the Cobb-Douglas relation! It may be, therefore, that the one who performs (foolishly...) a regression of the V on the L and J willing to test a causal relationship gets a “perfect” adjustment (with a R^2 equal to 1) – after “extracting”, as Solow does, the effect of the “residual” B . The only condition is the constancy of a . The formula (2),

⁶ Dividing by V the derivative of the accounting identity: $V' \equiv w'L + wL' + r'J + rJ'$, it comes:

$$\frac{V'}{V} \equiv \frac{w'L}{V} + \frac{wL'}{V} + \frac{r'J}{V} + \frac{rJ'}{V}.$$

Noting \hat{x} the rate of growth x'/x of the variable x and observing that:

$$\frac{w'L}{V} = \frac{wV'L}{wV} = \frac{wLw'}{Vw} = a\hat{w},$$

$$\frac{wL'}{V} = \frac{wL'L}{VL} = \frac{wL'L}{V L} = a\hat{L}, \text{ etc., the identity (1) follows.}$$

which may be obtained by any first year student in economics, therefore explains the “puzzle” of the “remarkable fit” obtained by Solow and others with an aggregate production function.

More generally, it allows us to understand why statistical adjustments with a Cobb-Douglas function can sometime lead to astonishing results and other times to mediocre ones. It mainly depends on the constancy of a and of the variability of $B (= a^{-\alpha}(1-a)^{-(1-\alpha)}w^{\alpha}r^{1-\alpha})$ – that is, of wage and profit rates.⁷

This brings us to the question of the “total factor productivity”, so prevalent in empirical studies.

On “total factor productivity”

Solow’s 1957 article’s title is *Technical Change and the Aggregate Production Function*. Its goal was to distinguish, in the growth rate, what is relative to the “factors” themselves and what is relative to the “residual” – particularly, technical change.

This distinction can be shown easily with homogenous functions of degree 1 – as the Cobb-Douglas function. For instance, taking the logarithmic derivative of both members of the relation “in quantities”:

$$Q = AL^{\alpha}K^{1-\alpha},$$

gives:

$$\hat{Q} = \hat{\varepsilon} + \alpha\hat{L} + (1-\alpha)\hat{K}, \quad \text{with } \hat{\varepsilon} = A'/A.$$

The growth rate of Q is given by the sum of the factors growth rate, $\alpha\hat{L} + (1-\alpha)\hat{K}$, and of the term $\hat{\varepsilon}$ which represents the other factors which influence the growth of the product – essentially, the technical progress. This “residual” influence on growth is thus given by:

$$\hat{\varepsilon} = \hat{Q} - \alpha\hat{L} - (1-\alpha)\hat{K}.$$

If we proceed in the same way with the function in value terms, $V = BL^{\alpha}J^{1-\alpha}$, we obtain the equivalent in value of $\hat{\varepsilon}$, the so-called “total factor productivity” rate of growth:

$$\widehat{TFG} = \hat{V} - \alpha\hat{L} - (1-\alpha)\hat{J}.$$

Although the formulae (5) and (6) are very similar, they may lead to drastically different results. Felipe and McCombie give an example where they use hypothetical data to calculate the growth of total factor productivity for an industry which consist of ten firms, with *the same* Cobb-Douglas function and *the same rate* of technical progress of 0.5% per annum – then, it is possible to talk about the rate of technical progress being 0.5% per annum *in the industry* (Felipe and McCombie, p. 107). They value each individual firm’s product and constant price capital stock assuming the mark-up: wL for labour, $wL/3$ for capital, the product playing the role of *numéraire* (see note 2). Industry values are obtained by adding individual firms’ values.

⁷ The greater variability in time than in space of w and r – and then of B – explains why Douglas found better results with the inter-industrial data than with the chronological series.

The rate of total factor productivity growth obtained by using the aggregated value data came to 1.48% per annum – almost three times the “real” or “technical” rate. The reason for the notable difference between these growth’s rates is, obviously, due to the choice of prices – here, the mark-up rule – used to compute the aggregated output and “factors”.

This is an illustration of why, as Felipe and McCombie explain,

“...what the neoclassical theory called ‘total factor productivity’ is, *tautologically*, a function of wages and profit rates” (p. 209, the authors’ emphasis).

More generally:

“...as far as there is no underlying production function, it is not possible to calculate separately the contribution to the growth of technical progress (growth of TFP) and the growth of each factor” (ibid).⁸

It is then not a surprise if Felipe and McCombie explain at the end of the two chapters (5 and 6) of their book dedicated to the total factor productivity that:

“...in our opinion, the concepts of TFP and the aggregate production function serve more to obfuscate than to illuminate the important problem ‘why growth rates differ’” (p 209).

A comment on Solow’ attitude

Robert Solow is one of the most open minded neoclassical economists⁹. We have noticed that from the beginning he was very cautious about the existence of aggregated production functions (“the ‘willing suspension of disbelief’ to talk seriously of the aggregate production function”).

In his [Nobel Memorial Lecture](#), he expressed reservations on the use that may be made of the total factor productivity, a subproduct of his model:

“these total-factor-productivity calculations require not only that market prices can serve as a rough and ready approximation of marginal products, but that aggregation does not hopelessly distort these relationships. (...) So I would be happy if you were to accept that the results I have been quoting point to a qualitative truth and give perhaps some guide to orders of magnitude. To ask for much more than that is to ask for trouble” (Solow, 1987a).

He more or less accepted Hogan’s critique, even if he tried to escape from it by playing with the world “tautology”. He didn’t publicly answered to Phelps Brown, Simon and Fisher papers – even he had private discussions with them.

⁸ Felipe and McCombie show the relationship between the accounting identity and the *Constant Elasticity of Substitution* and the *translog* production functions, which can sometimes better fit the data than the Cobb-Douglas function – all depends of the variability of factors’ shares, wages and profits (pp. 84-89).

⁹ He is among the very few mainstream economists who clearly state that [the “representative agent” is a non sensical assumption](#).

By contrast, he didn't like at all Shaikh's criticism – even if it was not fundamentally different from Simon and Fisher's ones. His riposte was brief and along the lines of his reply to Hogan – confusing –, but also unfair. Confusing, when he argues that the intention of his 1957 paper was to “yield an exact Cobb-Douglas and tuck everything else into the shift factor” (Solow, 1974), while in the 1957 paper he expressly stated his intention to “reconstruct the (underlying) aggregate production function”. [In his reply](#) to Solow¹⁰, Shaikh asks then:

“If, as Solow now claims, he knew all along that the underlying production function would be a Cobb-Douglas, then why bother “reconstructing” it? Why the surprise at the tightness of fit and the “inescapable impression of curvature”? Why does Solow need regression analysis to ‘confirm the visual impression of diminishing returns’¹¹ (Shaikh, 1980).

Along the same line, we, in turn, could ask: why, in his Nobel lecture, Solow reminds that before his “surprising results”, he was “very skeptical about this device [the introduction of some technological flexibility]” (Solow, 1987)?

But that's not all: Solow added bad faith to confusion. To give a proof that his approach is not tautological, he estimated the relation $V = AL^\alpha J^{1-\alpha}$ using Shaikh's data but *arbitrarily assuming* that the “residual” $A(t)$ is approximated by an exponential function (or equivalently, that its logarithm, $\ln A(t)$, is a linear function of t). He obtained a very bad fitting ($R^2 = 0,0052!$) and thought that he had delivered *le coup de grâce* to Shaikh, ignoring – or feigning to ignore – the fact that the latter chose deliberately a fictional data set which draws (ironically) the word HUMBBUG (assuming only approximate constancy of factor shares). The values of $A(t)$ corresponding to this set oscillate rather than grow smoothly (as it is shown [in the figure 2 of Shaikh's paper](#)). In his reply to Solow, Shaikh proposed another proxy of $A(t)$, which allowed him to deduce from his HUMBBUG data set a Cobb-Douglas function that “remarkably fitted” the data ($R^2 = 0,82$ and “realistic” factor shares) – as in Solow's 1957 paper.

In turn, Felipe and McCombie take Solow at its words and “test” the Cobb-Douglas production function using Solow's own data but they *assume a linear trend* for $\ln A(t)$ – as he has done with Shaikh HUMBBUG example. They ascertain that the results of the regressions “differs markedly from factor shares and, indeed, the coefficient of the capital term is not significant”. They wonder:

“...whether Solow's 1957 paper would have had such a dramatic impact if these regressions had also been reported” Felipe and McCombie, 2013, p 172).

Solow's didn't reply. Indeed, thirteen years later – after winning the “Nobel Prize” – he tried again to answer Shaikh with a different method, which consists of examining the model at the micro (“technical”) level (Solow, 1987b). But as Felipe and McCombie reminds us:

¹⁰ In fact, Shaikh was not allowed to reply to Solow in the same review and could only publish its response 4 years later, in the “postscript” of a book chapter – with a (very) limited diffusion.

¹¹ The “curvature” and the “impression of diminishing returns” concern figures where the relation $Q = A F(L, K)$ is expressed in the form $q/A = f(k)$, where $q = Q/L$, $k = K/L$ and $f(\cdot) = F(\cdot, 1)$ (remember that F is homogeneous of degree 1).

“It is possible for Shaikh’s critique not to apply at the engineering production functions, but still be applicable to the use of value data” (Felipe and McCombie, 2013, p 181).

It is quite fascinating to see how a person as intelligent as Solow tried, in vain, to fight against the “laws of algebra”: Shaikh’s argument is exclusively based on two algebraic relations, the identity relation and the constancy of factors shares.

Solow’s name is closely linked with the so-called “neo classical growth model”, with the aggregated production function and the marginal distribution theory. Maybe, it is impossible for him to admit that behind all that there is banal identity account – even if he agrees that the results of the model “point at most to a qualitative truth”.

Conclusion

Since their introduction, aggregation and production functions problems have been at the heart of particularly heated discussions. Sometimes, though, the debates got lost in secondary details, as with the questions of the “reswitching” and the “reverse capital deepening”, that are, in fact, missing the point, as [Franklin Fisher rightly notes](#) in an article entitled “The Aggregated Productive Function – a Pervasive, but Unpersuasive, Fairytale”:

“The Sraffians consider the existence of reswitching and reverse capital deepening to be a decisive criticism of neoclassical theory. They believe that this was the deciding factor in the Cambridge debates over capital theory. But that view fails to realize the following. Reswitching and reverse capital deepening only appear paradoxical if one supposes that aggregates should behave the way intuition suggests they should behave – the way that factors of production and outputs behave at the micro level. *But the non-existence of aggregate production functions means that such intuition simply does not apply.* No further consequence can be read from its failure” (Fisher, 2005, our emphasis).”

The defense of the existence of aggregated production functions is exclusively based on empirical grounds – no sensible person can (or at least should) accept its existence on a theoretical one. In their book, Felipe and McCombie examine some of the models, often given as examples in textbooks, which are supposed to “confirm” empirically the existence of an aggregate production. They prove, in each case, that the observed fit can be explained by the accounting identity and the factors’ shares, wages and profits variability. They therefore solve definitively the mystery of the (empirical) aggregated production function that had puzzled – or should had puzzled... – economists for near a century. By the way, it provides the means to demolish anyone who pretends to prove, “on empirical grounds”, the existence of an aggregated production function – or who assume its existence to “prove” some “result” or “theorem”.¹²

¹² In the last chapter of their book, Felipe and McCombie answer to the objections made by a handful of macroeconomists who still try to defend the existence of aggregated production functions, often by a circular reasoning – they first accept their existence and then see a “proof” of that in the data’s good fitting.

Despite all that, aggregate production functions continue to populate textbooks as well as theoretical and applied works. In fact, it has been a long time since the issue of the aggregation of goods and functions has stopped being on the agenda. It has virtually disappeared from the university. Two reasons can explain such an attitude from those who do not cease yet to state their commitment to rigorous analyzes.

The first reason is ideological. It is reassuring to be able to affirm that the (delicate) issue of income distribution has been solved in such a simple – and effective for the society – way by the retribution to each according to their marginal productivity, provided that the markets are “competitive”. The other reason is of a practical nature: the “industry” which is built around the aggregate production function is so important that questioning it would be catastrophic for those who benefit from it, while making it thrive.

We hope that Felipe and McCombie’s book will help to change this situation. It will, at least, provide to those questioning the aggregate production function – and the underlying theory of the distribution – all the answers they seek, both on the theoretical and practical levels. It is why this book is so important, in particular for students and researchers in economics.

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Paul Mason's *PostCapitalism*

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This is an article review of Paul Mason, *PostCapitalism. A Guide to Our Future*.¹ The book is a complicated one, containing discussions of quite intricate theoretical matters, such as the Russian economist Kondratieff's theory of long waves in capitalist development. However, in this review, I will concentrate only on what I take to be the central thesis of the book. I will try to state this thesis and the main arguments for it as clearly as I can, and also to add one or two extra considerations of my own – particularly as regards the political consequences of this view. The central thesis of the book is that because of new technologies (the internet and associated developments), capitalism is in decline and is likely to be replaced within a few decades by an entirely new socio-economic system – PostCapitalism. As Paul Mason himself says (p. xiii):

“...the technologies we've created are not compatible with capitalism ... Once capitalism can no longer adapt to technological change, PostCapitalism becomes necessary... *That, in short, is the argument of this book: that capitalism is a complex, adaptive system which has reached the limits of its capacity to adapt.*”

Now this thesis is a very surprising one. Most people have an exactly opposite view, namely that capitalism is triumphant and irresistible. According to this more usual opinion, capitalism in the last few decades has overcome its traditional enemies. Communism has collapsed in Russia and Eastern Europe, and in China has been transformed into a kind of capitalism. Even in Western Europe, traditional social democracy has been undermined, and replaced by a more unbridled form of capitalism. It would seem then that capitalism is here to stay, and indeed is “the only game in town”. To think anything else seems to be mere wish fulfilment on the part of the old left. Indeed Paul Mason himself says that, for some people, (p. 250): “it is easier to imagine the end of the world than to imagine a non-market ... economy.”

Still, strange and surprising views sometimes turn out to be correct, as Copernicus showed. Could it be that the successes of capitalism in the last few decades are a last flowering rather than a final triumph? In fact it is the opinion of the present reviewer that the central thesis of Paul Mason's book is indeed correct. The main argument for his view can be made explicit by stating what I will call: *The Principle underlying the Decline of Capitalism*. Once this principle is formulated it will be seen to be plausible and indeed compelling. Before coming to this, however, it is worth saying something about the current crisis of capitalism.

¹ I would like to thank Edward Fullbrook and Grazia Ietto-Gillies, who made comments on an earlier draft, which led to several revisions and improvements.

1. The current crisis of capitalism

Here and in what follows I will confine myself to capitalism in the developed world, that is Japan, the USA, and Western Europe. Now in the developed world, capitalism has been in a critical state since the collapse of Lehman Brothers in 2008. Many countries have had recessions, and even the more successful have experienced only anaemic levels of growth with high levels of unemployment. However, a defender of capitalism could argue that this by no means shows that capitalism is becoming moribund. In fact capitalism has experienced similar periods of crisis and depression in the past only to emerge reinvigorated. For example there was a difficult period of depression for capitalism in the 1930s following the Wall Street crash of 1929. Yet in 1945, capitalism revived and began to enjoy a long period of full employment with high growth rates. Indeed this Post-War boom was the longest and had the best growth rates relative to any previous period in the history of capitalism. Let us compare the collapse of Lehman Brothers in 2008 to the Wall Street crash of 1929. If history repeats itself, then from 2024 on, there might be more than 25 years of capitalist boom with high growth rates and near full employment.

However, according to Paul Mason, history is not going to repeat itself. There is a key difference between the 1930s and the present, and that is the rise of the digital economy on the basis of the internet and the associated new technologies. It is specifically the rise of the new digital economy, which is bringing about the decline of capitalism.

2. The digital economy creates difficulties for capitalism

It will be convenient for investigating this question to begin with a definition of a digital product (or good). A *digital product (or good)* is one which can be placed on a public website, and, if it is so placed, can be downloaded by any of those connected to the website. The digital economy is concerned with the production and distribution of digital goods.

Let us now survey some digital products. The outputs of any kind of research in the natural sciences, social sciences, technology, the humanities etc. are books and papers, which give the results of the research. These are all digital products nowadays. Musical scores or recordings of performances are all digital products. Photographs, films, television programmes, newspaper or magazine articles are all digital products. So are reproductions of works of art, and indeed many actual works of art. So is literature. So is software. Indeed the digital economy is very extensive. It contains the whole world of research, and more specifically of software production. It also contains all the media, literature, music, and a good deal of the visual arts.

Here then we come to the central problem, for it is very difficult, if not almost impossible, to produce digital products under capitalism. The reason for this is easy enough to see. Let us compare the production of a digital good, e.g. software, with the production of a traditional material good such as a car. Capitalist manufacturers of cars have first to design and test a new model. This model is then put into production, and the cars are sold at a price, which enables the manufacturers to recoup their costs (the original design and testing costs, the cost of the machinery, and the wages of the workers involved) and still make a profit. The problem with a digital product is that once the product has been designed, and a single example put into the public domain, then anyone can reproduce it at zero cost. Thus it becomes very difficult to sell the large number of copies, which will enable the capitalist

manufacturers to recoup their costs and make a profit. Who wants to pay for something, which, with a little know-how, can be obtained free?

Paul Mason explains this central difficulty in the following interesting passage (p. 163):

“The rise of information goods challenges marginalism at its very foundations because its basic assumption was scarcity, and information is abundant. Walras, for example, was categoric: ‘There are no products that can be multiplied without limit. All things which form part of social wealth ... exist only in limited quantities.’

Tell that to the makers of *Game of Thrones*: the pirated version of Episode 2 of its 2014 series was illegally downloaded by 1.5 million people in the first twenty-four hours.

Information goods exist in potentially unlimited quantities and, when that is the case, their true marginal production cost is zero.”

Walras was one of the founding fathers of neo-classical economics, the approach to economics, which is used by mainstream economists to justify capitalism. What this passage shows is that this justification fails for digital products, so that even right wing economists have to admit that digital products are not suited to capitalist production.

The problem of illegal downloads arises in other areas as well, such as academic publishing. Academic publishers used to produce editions of technical research books in traditional material form. These would then be sold to university libraries and students for sums, which were often well over £100 a copy. Now apparently there are pirate websites where such books can be downloaded free. The problem is complicated by the fact that such websites can be located anywhere in the world, including in countries which are hostile to the West, but want to gain knowledge of the West’s latest research for as low a cost as possible. Indeed I was told by a professor from Paris that the students he teaches now rarely go to the library because they can download all the material they need, including the latest books, from a particular foreign website. In the face of all this, one cannot help thinking that the capitalist firms, which once made such large profits by publishing academic books, are now doomed to extinction. As far as the authors of such books are concerned, they earned very low royalties anyway. So many of them would be quite happy to produce their books in digital form and place them on a public website where anyone can download them free. This strategy might indeed ensure a much wider circulation.

This raises the question of the extent to which capitalism has been damaged by the development of the digital economy so far. Generally speaking what are now digital products are updated versions of products, which were formerly distributed by some material carrier. This material carrier could be produced and distributed in traditional capitalist fashion, and so the product posed no problem for capitalism. An obvious example is recorded music. During the Post-War boom this was distributed in records, and so fortunes were made by for the Beatles and for capitalist music companies in the 1960s. The World Wide Web was invented in 1990, and the internet then developed rapidly to become a significant force by the end of the 1990s. We can date the onset of the digital economy about then. So it has been in existence for only about 15 years. The first consumer industry to be effected was music. In June 1999 the first peer-to-peer file sharing system (Napster) was created, and this in effect

allowed recorded music to be downloaded free. Naturally the lawyers got to work and Napster was closed down in 2001. However, further websites sprang up from which music could be downloaded free, and legal battles continue to this day. Despite all the activities of lawyers, more and more music, which was once purchased, is now downloaded free, and capitalist music businesses are in steady decline. An interesting view of the present situation can be had by reading an interview in the *Guardian* of 16 November 2015² with a famous musician Steve Goodman, known as Kode9. Kode9 is very much an intellectual. He was a graduate in the Department of Philosophy at the University of Warwick, UK, and took part in the secessionist movement within the department known as Cybernetic Culture Research Unit. He was a lecturer at the University of East London for almost ten years before becoming a full-time musician. His latest album entitled: *Nothing* is the result of reading about the history of zeros in mathematics, about vacuums and voids in quantum mechanics, and also chapter 10 (Project Zero) of Paul Mason's book *PostCapitalism*. What particularly impressed Kode9 was Paul Mason's claim that "when production costs are reduced to zero, this has a massive impact on the whole system." It is not surprising that this point struck Kode9 so forcefully, since, despite his fame, he earns nothing from his recorded music, and his income comes exclusively from his work as a DJ. What a difference this is from the 1960s when the sale of records made substantial sums for any well-known musician.

Books and publishing remained more or less intact for a little longer than music. However in 2007 the Kindle was launched, and in 2010 the iPad. These devices enabled books in electronic form to be read easily, and naturally the negative effects on publishers began straightaway. Steady profits used to be made on the sale of classics of literature, but these can now be downloaded free and legally since they are out of copyright. As we have seen, academic book publishing, once the most profitable sector of the industry, has been particularly hard hit. In many ways it is more convenient to read an academic paper or book on an iPad than in a paper version. This is because notes can be made on the text and these can then be transmitted electronically. It is difficult to see how all the rest of the media (films, television programmes, newspapers, etc.) can avoid going the way of music and books. As for software, it was affected even before the internet. Richard Stallman founded the free software foundation (FSF) in October 1985, and free software has become ever more common.³

What is interesting to note is that the areas of capitalism now being eroded are precisely the ones in which great capitalist fortunes were made in the 1980s and 1990s. Those two decades saw the rise of firms selling software, which made their owners millionaires or billionaires. The same decades also saw the emergence of the famous media tycoons. This suggests that it may indeed be more accurate to view this period as the last flowering of capitalism view rather than its final triumph.

So capitalism is being hit hard by the rise of the digital economy. Let us now consider whether there are any ways out for capitalism. There seem to be only two possibilities here. The first is to accept that the digital goods have to be given away free, and to finance the capitalist business by advertising. This is the model adopted by Google, but it has obvious limitations. There is a limited pool of advertising expenditure, and so a limit to the number of companies that can finance themselves in this way. In fact the transfer of advertising to the internet has

² <http://www.theguardian.com/music/2015/nov/16/kode9-nothing-album-steve-goodman-hyperdub-interview> I was given this reference by my son Mark Gillies.

³ See Sam Williams (2002) *Free as in Freedom. Richard Stallman's Crusade for Free Software*, O'Reilly; and Steven Weber (2004) *The Success of Open Source*, Harvard University Press.

hit commercial television channels. Moreover who pays for the advertising? It can only be traditional capitalist firms. Thus the new digital economy, on this model, becomes parasitic on old traditional firms. This constitutes an obvious limitation. The second approach is to get the lawyers to work, and try to enforce copyright and intellectual property. However, as we have seen, this is fraught with difficulties. If millions are already downloading free, how can draconian copyright laws be enforced? If North Korea (say) were to decide to create websites where all the products of western media companies are available for free download, what could be done about this?

So if there is little future for capitalist production of digital goods, and yet such goods are clearly much in demand, how can they be produced? This is the next question to which we must turn.

3. How can digital goods be produced? The example of Wikipedia.

If a new mode of production is really going to supersede capitalism, then it is likely that we can find examples of this way of producing already coming into existence, though perhaps not yet in fully developed form. Paul Mason draws attention to a striking example, namely Wikipedia. This is what he says (p. 128):

“Wikipedia is the best example. Founded in 2001, the collaboratively written encyclopaedia has, at the time of writing, 26 million pages and 24 million people registered to contribute and edit – with about 12,000 people regularly editing and 140,000 people vaguely taking part.

Wikipedia has 208 employees. The thousands who edit it do so for free. ... With 8.5 billion page views per month the Wikipedia site is the sixth most popular in the world – just above Amazon the most successful e-commerce company on earth. By one estimate, if it were run as a commercial site, Wikipedia’s revenue could be \$2.8 billion a year.

Yet Wikipedia makes no profit. And in doing so it makes it impossible for anybody else to make a profit in the same space.”

Paul Mason goes on to say that Wikipedia is organized (p. 129): “in a decentralized and collaborative way, utilizing neither the market nor management hierarchy.” This really is a new way of organizing production, which is at the same time much more efficient than more standard systems. Paul Mason emphasizes this by the following thought experiment (p. 129):

“... imagine if Amazon, Toyota or Boeing tried to create Wikipedia.

Without collaborative production and Open Source there would be only two ways to do so: by using either the market or the command structures of a corporation. Since there are maybe 12,000 active writers and editors of Wikipedia, you could hire that number, and maybe get away with some of them being outworkers in the sweatshop economies of the world, controlled by a better-paid managerial layer in the American sun-belt. Then you could incentivize them to write the best possible encyclopaedia on the web. You

could give them targets, bonuses, promote teamwork through quality circles, etc.

But you could not produce anything as dynamic as Wikipedia. Getting a 12,000-strong corporation to produce 26 million pages of Wikipedia would be... pointless... A 208-strong foundation would always do it better. And even if you could produce something just as good as Wikipedia, you would face a massive problem: Wikipedia itself, your major competitor, doing it all for free.”

This is a very forceful argument. Big capitalist organisations are bureaucratic and authoritarian. A hierarchy of managers, leading up to the CEO, plan what is to be done, and assign tasks to the workers. Interestingly, hitherto existing forms of socialism have also had this bureaucratic, authoritarian and hierarchical character. This is obviously true of communism, but also holds of the productive organisations of social democracy. For example, a nationalized industry, such as the former coal industry in Britain, was run by a bureaucratic hierarchy of managers. The appearance of these bureaucratic forms in both capitalism and socialism shows that they were indeed suited to production, given the then development of the productive forces and the type of good being produced. However, Paul Mason’s thought experiment shows that these bureaucratic forms are not suitable for the production of digital goods in the era of the internet. For the production of such goods, as the example of Wikipedia shows, we need a networked, collaborative group of workers who agree among themselves what is to be done and by whom, without the intervention of any managerial hierarchy or bureaucracy. The same message comes out clearly from other examples such as the free software movement.

Here then we have in embryo the PostCapitalist mode of production. However, there is one feature of the Wikipedia and free software examples, which must be removed if this type of production is to become general. Those who contribute to Wikipedia and free software projects are not paid, and so have to do this work in their spare time, while earning their livings in some other activity. It is remarkable that such numbers of skilled people are willing to do this, but the lack of pay sets a limit on the extent to which this mode of production can become general, since obviously most people have to earn their living in some way. The question then arises: if groups of workers are going to be paid to produce digital goods, who is going to pay them? Clearly no one in the private sector is going to pay them, because of the difficulty of producing digital goods under capitalism. It follows therefore that they must be paid by the state.

This leads me to a conclusion, with which Paul Mason might not perhaps agree, namely that the PostCapitalist mode of production will turn out to be a form of socialism, but one which differs from the earlier forms of bureaucratic socialism by being more egalitarian and libertarian. This type of socialism I think could be called *networked socialism*. Paul Mason writes (p. xvii): “info-capitalism has created a new agent of change in history: the educated and connected human being.” Of course the overwhelming majority of educated and connected human beings are white-collar workers. So networked socialism is based on white-collar workers in contrast to earlier forms of socialism, which were based on manual (blue-collar) workers.

Another feature of networked socialism is that it is international. In the networks, which produce Wikipedia, free software etc., there are members from all over the world. What is important is whether someone is good at doing the job. Where they happen to live is an

irrelevance. Capitalism too has gone international with the rise of the multi-national (or transnational) corporations. All this shows that the economic foundations of nationalism are being eroded.

But can the state simply take over the production of digital goods, paying the researchers, journalists, film directors, actors, artists, musicians, etc. who are needed to produce these goods? Of course it can, and the simplest proof that this is possible is that the state already pays for the production of many digital goods. In fact almost all scientific research is carried out already by workers in universities and research institutes who are paid by the state. This system has simply to be extended to other areas. The fact that the products of these workers are given away free is no problem. They are being produced for the benefit of society. So it is right that they should be freely available to anyone in society. While attempts to preserve capitalist production of digital goods involve trying to strengthen copyright laws, the socialist production of these goods involves the total abolition of these laws. Musicians, writers etc. may no longer receive royalties, but they will instead be paid salaries⁴ by the state for what they produce, just as most researchers are at present.

Altogether then the difficulties associated with trying to produce digital goods under capitalism disappear once these goods are produced under socialism. Only one problem remains. The type of socialism needed is networked socialism. However, governments, if they tolerate socialism at all, much prefer bureaucratic socialism. This is for obvious reasons. Bureaucratic socialism gives governments much more control. They appoint the top managers of the bureaucratic hierarchy and through them can have a say in what goes on in the organisation. With networked socialism things are different. The government has to pay a group of workers, assign them a task, and then leave them to get on with it without interference. Such a hands-off, libertarian approach is not very appealing to governments, as is clearly shown by the case of scientific (and other) research, which is already financed by the state. Governments have tried to re-organise research on a more managerial model using such devices as research assessment systems. The results have been very unsatisfactory. The costs of research have been increased while the results have got worse with the stifling of new ideas and other undesirable consequences.⁵

The promised principle underlying the decline of capitalism can now be formulated. It runs as follows. *It is very difficult, if not almost impossible, to produce digital goods under capitalism, but very easy to do so under socialism.*

4. Will the digital economy become the dominant branch of the economy?

We are used to think of industrial manufacturing as being the dominant branch of the economy. However, Paul Mason gives some statistics which show that this sector does not in fact employ a very high percentage of the work force – even in the industrial powerhouses of Asia. Paul Mason writes (p. 208):

⁴ Actually such salaries could easily be linked to the number of downloads of an individual's products, thereby giving a kind of substitute for royalties.

⁵ For more a more detailed account of this, see my book: Donald Gillies (2008) *How Should Research be Organised?* College Publications. Some information about the content of this book is to be found on my website: www.ucl.ac.uk/sts/gillies.

“Only in the export giants – Germany, South Korea and Japan – does the industrial workforce come close to 20 percent of the whole; for the rest of the economically advanced countries it is between 10 percent and 20 percent.

In the developing world too, only around 20 percent of the workforce is industrial.”

In many ways this is not surprising. Industrial production is now increasingly carried out by robots. A striking example is the contemporary Australian industry for extracting iron ore. For centuries, ore was extracted by miners working underground. In this Australian industry, there is not a single human miner who works underground. The world of D.H.Lawrence has disappeared. The extraction is all done by robots. Not only that, but the resultant ore is automatically loaded onto driverless trains which take it off for automatic processing and then delivery to its destination. The whole of this operation, which takes place in the remote outback, is controlled from centres in the major Australian cities by experts in the design and functioning of the various robotic and automatic systems. These experts are of course educated and connected white-collar workers.

This sort of example raises the question of whether the production of digital goods will become the dominant sector of the economy. Let us look at this from a historical point of view. With the invention of settled agriculture, humans were able to develop cities and civilisation. The economies of these states were, for thousands of years, based on agriculture. Food production was the dominant branch of the economy and usually as much as 90% of the population worked in this sector. Since food is so necessary for humans, it is doubtful whether anyone living in these agrarian states could have imagined that things might one day be different. Yet with the rise of capitalism and the industrial revolution, things did change, and it was not long before industrial manufacturing rose to become the dominant branch of the economy. The reason for this was that the industrial sector provided inputs for agriculture, such as machinery, fertilizers, etc. which increased agricultural output, while diminishing the number of people needed to produce that output. Once a nation started industrialising, it was not long before the industrial workforce greatly exceeded the agricultural workforce. It is also worth noting that capitalist relations, which had first established themselves in the manufacturing sector, quickly spread to the agricultural sector, so that capitalist farming replaced the various forms of pre-capitalist agriculture.

If now we look at the rise of the digital economy in relation to traditional capitalist industry, the parallel with the rise of capitalist industry in relation to traditional agriculture becomes immediately apparent. The digital economy produces inputs to industry such as new scientific and technological knowledge, software in general, and artificial intelligence programs in particular, and so on. These inputs increase industrial output, while diminishing the number of people needed to produce that output. Probably already in the advanced economies the percentage of workers in the digital economy exceeds the percentage in traditional industrial manufacturing. Moreover the digital sector plays the dominant and controlling role in relation to industrial manufacture. If therefore networked socialism becomes the standard mode of production in the digital sector, it will probably spread to the industrial sector as well, just as capitalist farming replaced earlier pre-capitalist modes of agricultural production.

5. Political changes in the transition to PostCapitalism

In this review I have supported Paul Mason's thesis that capitalism is declining because of the rise of the digital economy, and that we are entering a period in which capitalism will be transformed into a new mode of production: PostCapitalism. I have also suggested that PostCapitalism will be a form of socialism (networked socialism) which, however, will differ from earlier forms of socialism which have been bureaucratic in character. I will now add a few points of my own regarding possible political implications of this situation.

At the moment the overwhelming majority of the political class in the developed world are committed to preserving, and, if possible, extending capitalism. We can hardly expect this class to devote state funding to the production of digital goods by networked socialism, although this is quite a practical policy which would be easy to implement, and would, almost certainly, benefit the economy as a whole. What becomes necessary for the economy cannot, however, be long resisted by politicians, and so changes in politics are very likely. Of course when such changes will happen, and what form they will take, is impossible to predict. Political developments are always dependent on contingent circumstances, irregular, and often surprising. Still an analysis of underlying economic trends is often helpful for understanding political developments, as we can show by considering a recent surprising event in British politics, namely Jeremy Corbyn's election to the leadership of the Labour Party in September this year. Under current rules, the election of the leader is carried out by all members of the Labour Party and not just by the Labour MPs in parliament.

For readers outside Britain, I had better explain the background to this event. In Britain there are two major parties: the Conservative (or Tory) Party on the right, and the Labour Party on the left. In the 1970s and 1980s the Labour Party swung to the left, but this had disastrous consequences for its ability to win elections. Thatcher, the leader of the Conservative Party came to power in 1979, and the Conservative Party remained in power for 18 years, with the Labour Party losing election after election. It was Tony Blair who was able to alter the situation. After his election as leader of the Labour Party, he managed, despite considerable opposition, to move the Party to the right and to rebrand it as "New Labour". Under his leadership the party won the election of 1997 and the next two elections, remaining in power until 2010.

After this experience, it seemed that the old left of the Labour Party was doomed to extinction. However, there was still a very small group of Labour MPs in parliament who had remained committed to left wing policies while the Labour Party as a whole swung to the right. When there was an election for the leadership of the Labour Party this year, one of these, Jeremy Corbyn, stood as a candidate for the leadership, not because he had any real hope of winning, but merely to show that the left had not quite disappeared. Contrary to everyone's expectations, Jeremy Corbyn won by a huge margin. The votes for him exceeded those for the other 3 candidates put together. This result took everyone by surprise, including Jeremy Corbyn himself. It is not too much to say that the political commentators were dumbfounded.

During the election, Tony Blair returned to the British political arena by urging members of the Labour Party not to vote for Corbyn. Interestingly he did not argue against the policies proposed by Corbyn, or claim that these would have a negative effect on the economy and the country. His argument was that if the Labour Party elected Corbyn as its leader and swung to the left, they would become unelectable, and the result would simply be a long period of Tory rule, exactly as had happened in the 1980s. Now this argument of Tony Blair's

is certainly a powerful one. To rebut it two things have to be demonstrated. (1) It has to be shown that British society has changed in some fundamental ways from how it was in the 1980s. (2) It has then to be shown that these changes favour the left in politics. The analysis given in this review shows that both these conditions are in fact satisfied.

First there has indeed been a very big change in society since the 1980s. In the 1980s, the internet had not been invented, while nowadays the internet is ubiquitous. With the internet as the necessary infrastructure, there has been the creation and rise of the new digital economy. Secondly the rise of the digital economy has brought about a decline of capitalism, and so clearly favours the left in politics. All this shows that Tony Blair's argument, plausible though it sounds, is not in fact valid.

I will conclude with the following quotation from Machiavelli:⁶

“...we see that some princes flourish one day and come to grief the next, without appearing to have changed in character or any other way. ...I... believe that the one who adapts his policy to the times prospers, and likewise that the one whose policy clashes with the demands of the times does not... I conclude, therefore, that as fortune is changeable whereas men are obstinate in their ways, men prosper so long as fortune and policy are in accord, and when there is a clash they fail.”

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⁶ Machiavelli, *The Prince*. Translated by George Bull, Penguin Classics, 1974, pp. 131 and 133.

The long-term rate of interest as Keynes's "villain of the piece"

Review essay of "Long-term interest rates: a survey", The Council of Economic Advisers (2015)

Geoff Tily [Trades Union Congress,¹ UK]

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"Personally I have come to believe that interest – or, rather, too high a rate of interest – is the 'villain of the piece' in a more far-reaching sense than appears from the above. But to justify this belief would lead me into a longer story than would be appropriate in this place." Keynes, "Saving and Usury", *Economic Journal*, March 1932, CW XXIX, 16²

The US Council of Economic Advisers (CEA) has issued an account of the dynamics of the long-term rate of interest that typifies conventional wisdom, finding only a "decline in interest rates over the last three decades". An alternative interpretation of these dynamics is set out in two parts, the first empirical and the second from the perspective of theory and policy.

In section 1 the empirical techniques used by the CEA are contested as partial and inadequate, and an alternative presentation of these dynamics is offered that leads to very different conclusions. The long-term rate of interest has not declined in the manner suggested; instead, the dominant feature has been a severe rise in interest rates since financial liberalisation, with any subsequent decline, coinciding with the end of the bull-run at the turn of the millennium, relatively modest (and now potentially reversing).³

In section 2 an alternative account of and explanation for these movements is set out, deriving from Keynes's *General Theory* and specifically his liquidity preference theory of interest. Inherent to this interpretation is a wider argument about the scale of the distortion of Keynes's theory and policy goals, which is not fully appreciated even by the most prominent and/or sophisticated of his modern-day interpreters and followers. In the 1930s, under the impetus of his analysis, dear money came widely to be understood as the cause of the great depression. This understanding was suppressed by the post-war economics profession, even while policy operated broadly to avoid dear money. But at the start of the 1980s, dear money was again allowed to prevail, and has done so ever since – regardless of the trajectory of the rate of interest on US Treasuries (and other governments' debt). Whether wrong-footed by their predecessors or continuing in the same tradition, today economists can't even discern these movements in the underlying state of interest. Any understanding of interest is rooted in

¹ Writing in a personal capacity.

² References to Keynes's work include a title (where relevant), date and the *Collected Writings* volume and page number.

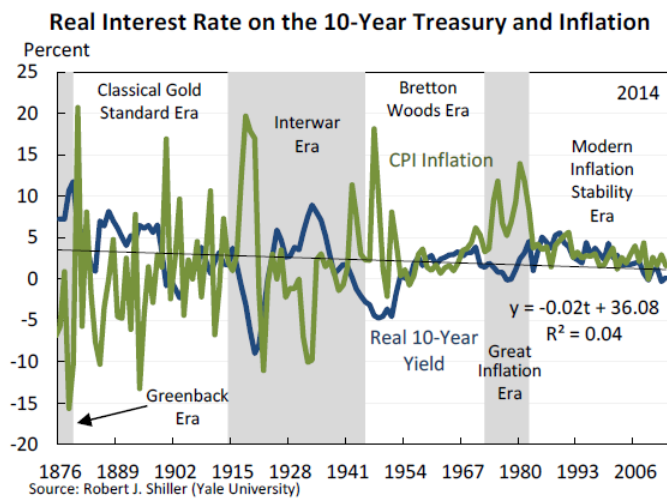
³ The charts were constructed when provisional versions of this work were published at the start of September in two parts, on the websites of Prime Economics (<http://www.primeeconomics.org/>) and the World Economic Forum (<http://www.weforum.org/>). Since then the trends observed have intensified significantly, not least with the sharp rise in interest rates on US corporate debt: the Federal Reserve website shows rates on BAA corporate debt rising from 4.5 per cent over the first four months of the year to 5.5 per cent in November 2015.

'loanable funds', which underpins macro-prudential regulatory initiatives. In the meantime Keynes's very different interpretation of the cause of the economic depression and his (profoundly optimistic and vindicated) means to its resolution remains lost to society, when it so badly needs to be found.

1. Empirics

As is common in mainstream literature, the CEA emphasis is on US *government* rates. Under normal conditions government rates underpin and hence proxy wider rates in the economy, but it can be easily established that conditions have not been "normal" for much of the period in question. The particular problem with US government rates is that US government bonds are regarded by global investors as a safe asset. (Wider claims in the paper that the US analysis generalises to the rest of the world are not well founded, drawn on the basis of a handful of advanced economies.) Second, there is undue emphasis on nominal rather than real rates, even if the authors concede that real rates are most important for economic outcomes: "The real interest rate is the rate that influences economic activity—ultimately, market participants care about the returns to their saving and investment decisions net of inflation" (p. 3). This is all the more surprising given the normal emphasis in economics on the private sector and real quantities. The critical analysis here is poorly presented, with the important features not easy to discern (shown below).

Figure 2



Charts A and B offer an alternative perspective on nominal and real rates on US government and corporate borrowing background on methodology is in endnote.⁴

⁴ Interest rate data are not readily available for most countries, the US is the exception, with long-run figures available from the Federal Reserve website, supplemented with Sidney Homer's *A History of Interest Rates*. Government figures are based on Treasury 10-year bonds, corporate on BAA corporate bonds; both are adjusted with the GDP deflator, with BEA figures supplemented with historical information from Friedman's monetary history. CEA real-terms figures are based on the CPI, which seems too narrow a measure given the concern with activity across the economy as a whole. But the choice of index does not change any of the results (see e.g. n. vi). More generally, while plainly a special case, it is likely that rates on US corporate borrowing underpin rates on borrowing and therefore serve as a proxy for rates across the globe. Though "risk" premia in developing countries in particular

Chart A: US nominal interest rates, 1923-2015

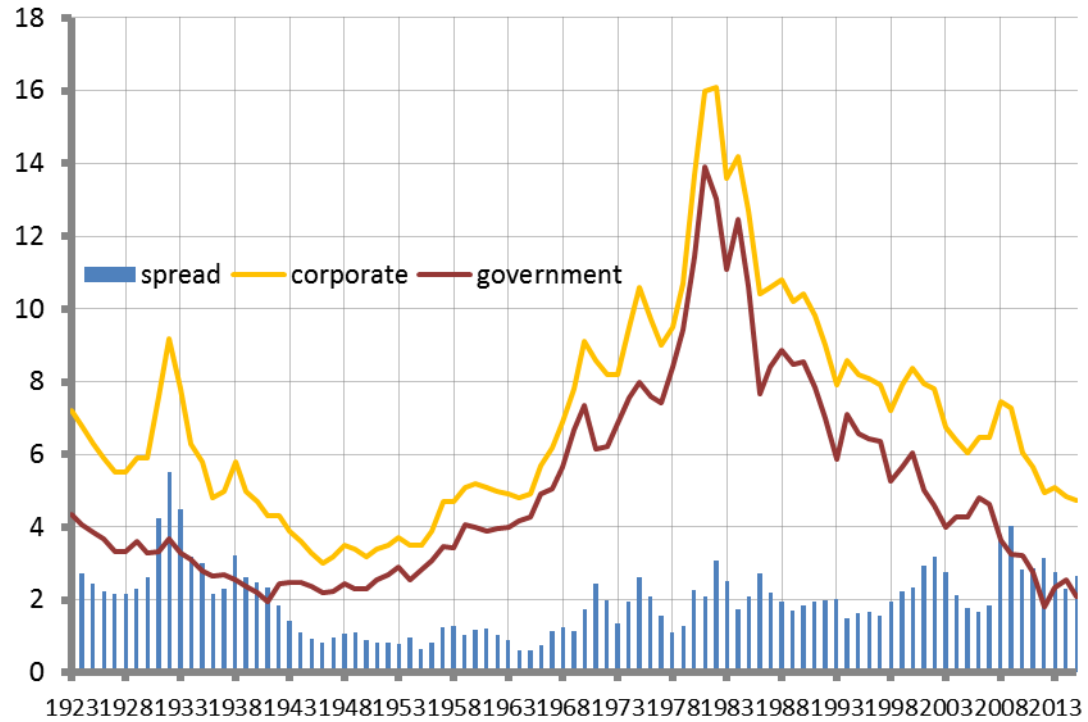
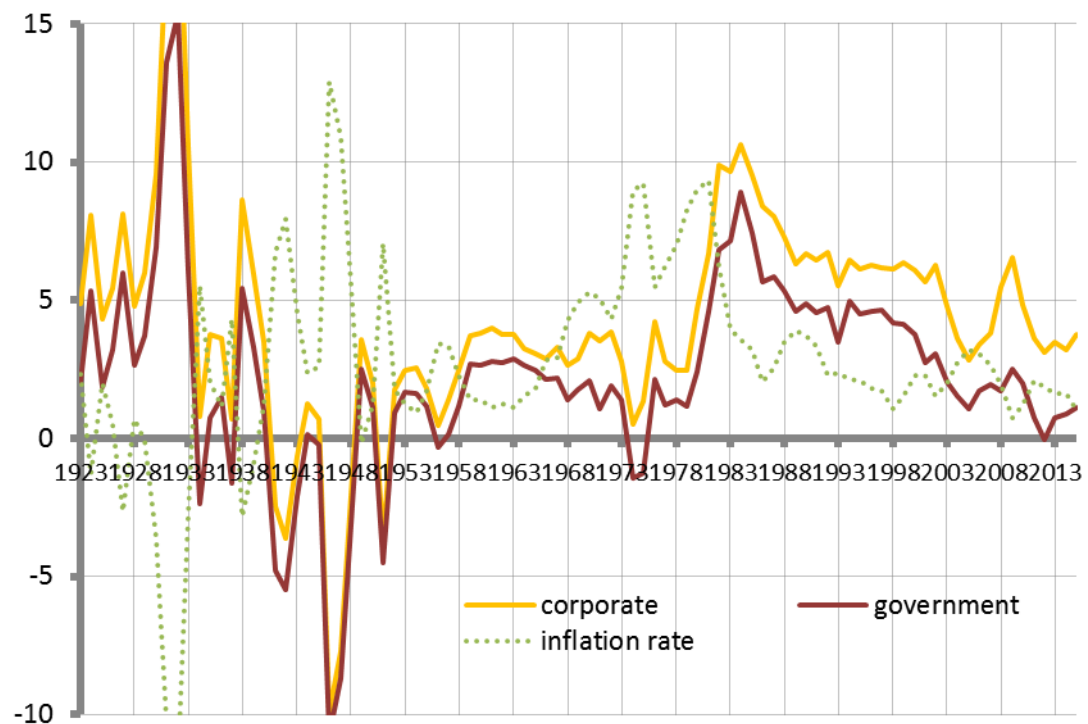


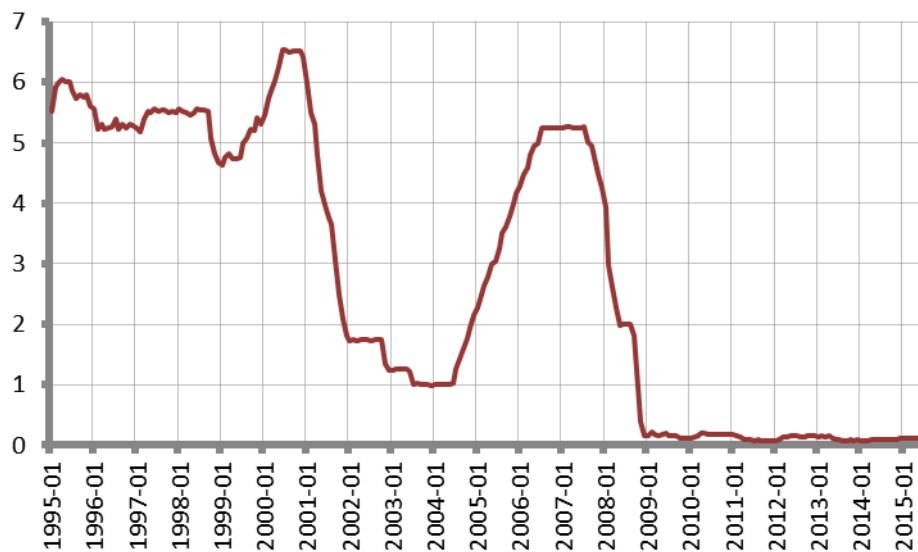
Chart B: US real interest rates, 1923-2015



may mean rates departing very significantly from the US benchmark. The 2015 figures on both charts are mid-year, given availability of GDP deflators at the time of writing.

On this basis the claimed 30-year decline is a feature only of nominal rates: real government rates have been falling for 17 years and real corporate rates for 15, though for the latter no continuous decline is evident. The relation with major economic crises should be obvious. The government rate began its material decline from 1998, in the wake of the South-East Asian crisis, Russian debt default and collapse of the hedge fund, long-term capital management. From that point on, US government bonds were a safe haven. The material decline in the corporate rate came at the end of the corporate (dot.com / new-economy) expansion of the 1990s which coincided with the turn of the millennium and the end of the long bull-run on equity markets; the rate fell to 5 per cent in 2001 from 6 per cent in 2000. From that point on, the major shifts in direction have followed policy on the federal funds rate and associated financial interventions, through with a widening spread.

Chart C: Federal funds rate



The most important feature of the dynamics of the long rate of interest is not the recent reduction, *but the long-standing and severe elevation of rates prior to that reduction*. Even now corporate rates have declined only to a level that was the upper end of the norm for the 30 years after the war. The increase in rates came at the start of the 1980s, in the wake of the Volker shock to monetary policy and full capital liberalisation. The latter a disastrously failed action, given it was ostensibly aimed at the reduction of rates. Apparently mystifying but at least recognised by policymakers at the time,⁵ high real rates were the norm until the end of the millennium and equally recognised as such.⁶ These rates were:

⁵ From the 1985 IMF *World Economic Outlook*:

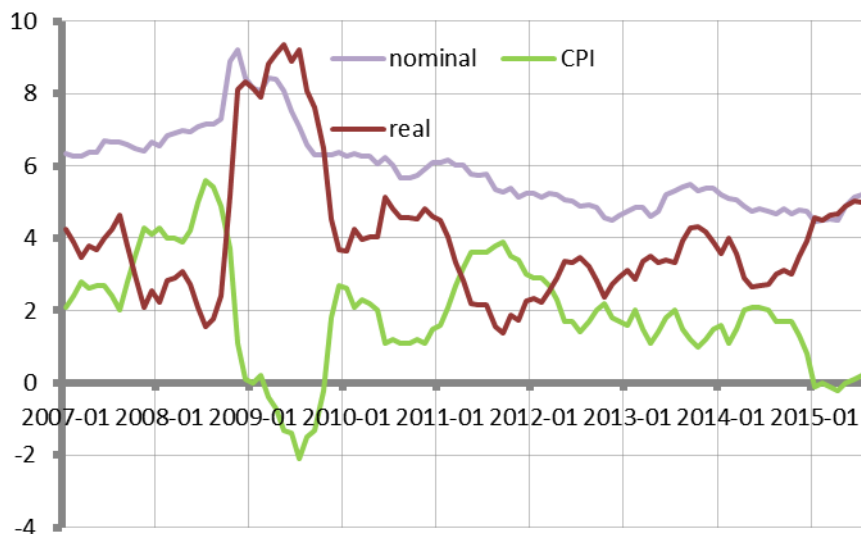
“Perhaps the most striking and puzzling feature of monetary conditions in the major industrial countries over the past several years has been the persistence of high real interest rates, on both short-term and long-term financial instruments. These high real rates, which have no historical precedent outside periods of price decline during depressions, have persisted, despite lower inflation and the continued existence of a significant margin of economic slack. The phenomenon is quite widespread. Although real interest rates have differed across the major industrial countries, on the whole there has been less divergence of these rates, especially during 1982–84, than in previous periods... These measures imply that real interest rates in the major industrial countries during the 1980s have been significantly higher than those that prevailed in the 1950s and early 1960s and even further above those of the 1970s. Real interest rates increased sharply during the period from 1980 to 1982 and then remained at relatively high levels in 1983 and 1984... The average real short-term interest rate in the major

- basically double the rates of the golden age; and
- broadly equivalent to the rates in the 1920s that preceded the great depression; the average rate over 1923-29 was 5.9 per cent and over 1980-2000 was 7.2 per cent⁷.

With the real rate regarded by the CEA as “influenc[ing] economic activity”, at face value it is hardly surprising that since 1980 the performance of the global economy has in general terms fallen well short relative to the post-World War Two period, and in terms of stability is not unlike the disastrous years of the inter-war period.

One final remark on current rates: in spite of the intensive focus on the extent of reductions in certain rates of interest, it is notable that these have not proceeded as far as they did in the aftermath of the great depression. After only four years in office, Roosevelt had reduced the nominal corporate borrowing rate by around half (chart A). In the meantime he had reflat[ed] the economy, so the average real rate over 1934 to 1937 was 2.2 *per cent*. (Then followed the imposition of a deflationary policy leading to the recession of 1938, but these actions were quickly and decisively reversed.) Over the comparable four-year period today (starting two years after the peak nominal rate of 7.4 per cent in 2008), real rates over 2010-2013 were 3.7 *per cent*. While nominal corporate rates match that achieved by 1936, the deflationary (or rather at present disinflationary) tendency has not been arrested. The CEA publish their analysis at a time when real rates have risen quite abruptly, and are at virtually a five-year high (a point normally ignored in the deflation debate).⁸

Chart D: Real corporate rate of interest



industrial countries in 1980–84 was 5.5 per cent per annum and the average real long-term interest rate was 5.8 per cent. In contrast, average real long-term interest rates for the major industrial countries during the period 1952–65 ranged from roughly 1.5 to slightly over 3 per cent per annum. The contrast is even sharper with the experiences of the late 1970s. During 1976–79, for example, the average real long-term interest rate in the major industrial countries was 0.9 per cent per annum” (pp. 123–4).

⁶ At the end of this era, an issue of the *Oxford Review of Economic Policy* on real rates confirmed: “There is a widespread impression that real interest rates have been very high since 1980 in comparison with post-Second-World-War experience. The data in [Table 11.2] confirm that this is indeed the case. Short-term real interest rates, averaging nearly 4 per cent, have been much higher and a little more stable than between 1950 and 1980. The general picture is confirmed by data on long rates as well” (Allsopp and Glynn, 1999, pp. 3-4).

⁷ Using the CPI: 5.9% and 6.4%.

⁸ Real figures are derived here using the CPI, given availability of monthly figures.

Given the recognition of the central importance of the long rate to economic outcomes, this interpretation suggests a far less benign trajectory of interest rates over the past 30 years and into the present.

2. Theory and policy

The CEA find theoretical justification for their 30-year decline (and to aid looking forward) in a host of the usual “real”, factors:

- lower long-run growth in output and productivity;
- the global saving glut (in part driven by lower productivity growth);
- shortage of safe assets, like U.S. Treasuries; and
- lower population growth.

(On a shorter horizon they emphasise post-crisis expansionary policy, low inflation and deleveraging of private debt.)

Absolutely fundamental to Keynes’s view was that the long-term rate of interest was in the gift of policymakers. This realisation dawned as he completed the drafting of his *Treatise on Money* in 1930. “The root causes of what has happened ... is to be found in the high level of the market-rate of interest” (CW VI, 377). As Ben Broadbent (2014), Deputy Governor of the Bank of England, has recognised, Keynes proposed deliberate policy action aimed at “a very great fall in the long-term rate of interest throughout the world”, including “The Bank of England and the Federal Reserve Board ... buy[ing] long-dated securities either against an expansion of Central Bank money or against the sale of short-dated securities until the short-term market is saturated” (*Treatise*, CW VI, 386).

Only two years later he had devised the theory of liquidity preference. Keynes saw that the long-term rate of interest was not a reward for saving, but the reward for parting with the liquidity of savings (or wealth) *after* the decision to save (or rather not to consume) had been made. This reward was a psychological factor, to some extent a matter of convention, and convention could be changed. Over the 1930s and especially in World War Two, he devised increasingly sophisticated debt management and monetary mechanisms that brought the whole spectrum of interest rates under the authorities’ control. The reduction in the UK rate of interest over the 1930s was a result of these deliberate actions and advice. Likewise, Roosevelt too took his cue from Keynes. Fundamentally, policy towards the monetary system was brought under public rather than private authority, under the control of democratic forces rather than “vested interests”.

Fiscal policy may also have been essential to recovery, but the new monetary environment was necessary to ensure that it endured:

“I am in favour of an admixture of public works, but my feeling is that unless you socialise the country to a degree that is unlikely, you will get to the end of the public works program, if not in one year, in two years, and therefore if you are not prepared to reduce the rate of interest and bring back private enterprise, when you get to the end of the public works program you have shot your bolt, and you are no better off” (Harris Foundation Lectures, 1931).

This statement is a very important and *categorical* refutation of those who attribute to Keynes only fiscal policy and a preference for the state over the market. (It is omitted from the published record of Keynes's work, but was recovered by Richard Kent, 2004).

With the policies successful, and recovery ensured, in 1937 he issued his fundamental warning that *dear money must be avoided "as we would hell-fire"* (Keynes, "How to avoid a slump", *The Times*, January 1937, CW XXI, 389, my emphasis). Standing the present consensus on its head, once cheap money was established he saw no further role for monetary policy in the day-to-day management of the economy (instead he envisaged turning on and off a tap of public works expenditures, when capacity was achieved). When war came, it was fought with interest rates set at 3 per cent in the UK and 2½ per cent in the US (in contrast to World War One, when the "hard-faced men" of the City and Wall St. profited from the carnage). His subsequent international initiatives at Bretton Woods and domestic plans devised in the UK Treasury were aimed at ensuring the permanent continuance of low rates into the post-war era.

The British Labour government took their cue from Keynes, but they were quickly forced to retreat after his death in April 1946. ("The forces against me, in the City and elsewhere, were very powerful and determined ... I felt I could not count on a good chance of victory. I was not well armed. So I retreated", as Hugh Dalton later put it, 1954, p. 239). Then, with the 1951 Federal Reserve Accord, the US Treasury effectively allowed financial interests to reassert their authority over interest rates offered on government bonds; economists from Chicago had already begun to call the shots.⁹

Yet for some 30 years, policymakers permitted relatively low rates to prevail.

But finally, with the Volker shock and full financial liberalisation, policies holding rates down were decisively abandoned and, unsurprisingly, rates rose. These rates were the norm for 20 years, and accompanied a severe deterioration in performance, not least crisis after crisis (Germany, Japan, Scandinavia, South-East Asia etc.) that culminated in the global financial collapse and economic recession over 2007-09.

The Council of Economic Advisers may recognise that high rates are detrimental to prosperity, but really their theoretical account has interest as a passive outcome of other macro (really, micro) factors, fundamentally, of course, productivity. For Keynes high rates were the *cause* of low output, employment and incomes, but they were far more dangerous than 'just' that. Animal spirits – more precisely, excessive expectations of income – mean that high interest is not a deterrent to borrowing. The particular problem of excess borrowing then comes through price rather than quantity, for higher rates of interest are much more difficult to repay than lower. Keynes did not say it, but the outcome is expanding debt, a debt inflation (and for sure in the environment of the great depression of the 1930s he knew it, his commentary on events makes that perfectly plain). On the basis of Keynes's theory, which emphasised *corporate* investment expansion and animal spirits, the global financial crisis

⁹ An article in the *Federal Reserve Bank of Richmond Economic Quarterly* (Hezel and Leach, 2001) contains the reminiscences of Ralph F. Leach, "Chairman of the Executive Committee of J. P. Morgan and Morgan Guaranty Trust. Before joining the Guaranty Trust Company in 1953, he was Chief of the Government Finance Section at the Board of Governors of the Federal Reserve System" (n. 1). "Leach had graduated with an A.B. degree from the University of Chicago in 1938. At that time, Chicago had two of the great economists of the twentieth century, Frank Knight and Jacob Viner. Even at the height of the recession, they and other Chicago economists had retained a belief in free markets. Leach had absorbed that belief and made use of it while at the Board to convince the governors and others of the viability of a free market in government securities" (n. 3).

really began at the end of the millennium. In the light of history, far from a “black swan”, it was entirely unsurprising.

The subsequent reduction in corporate rates followed as a reaction to the crisis, as the authorities allowed the financial system to flood itself with money. (In the UK the vast expansion of the financial sector’s balance sheet was passed over in silence, in spite of the regular, forensic official commentary on the economy.) The financial crisis of 2007-09 came as these actions could be taken no further, and the central bank and governments then took “responsibility” for monetary expansion. With quantitative easing (QE) apparently regarded as inexplicable theoretically, liquidity preference is perfectly clear cut on the operation of this process. Rates rise as a result of sharply increased liquidity preference in crisis; extending the money supply forces them back down.

With only a real theory at their disposal, the CEA’s judgements about prospects for the rate of interest depend on pure speculation about real factors going forward. On a Keynes view, the trajectory of the long rate depends on policy in the wake of the unresolved crisis of indebtedness. With deflationary forces intensifying and relentless asset inflations, it is unlikely that this process – effectively, repeated demand stimulus through massive liquidity injections – can continue indefinitely.

3. Conclusion

Devised in the wake of a comparable crisis, Keynes’s theory unsurprisingly offers a coherent and compelling (to me at least) explanation of the behaviour of the economy over the past 30 years as a result of a high long-term rate of interest. The actions of policymakers in the 1930s provide a blueprint for an alternative way forward, to reassert democratic control on the economy and the destiny of the world.

It is tragic – even shocking – that such high authorities as the CEA can proceed apparently oblivious to Keynes’s interpretation of these matters, let alone to the more obvious events of history. They are victims to a betrayal that has the most immense implications for economics and society.

The “Keynesian” economists of the 1930s, including Paul Samuelson, Alvin Hansen, Franco Modigliani, John Hicks and James Meade, are on record opposing Keynes’s approach to the rate of interest. Though in the UK it was left to Dennis Robertson¹⁰ to administer the fatal blow, only two and a half years after Keynes had died (also amounting to one of “forces” “elsewhere” that Dalton mentioned, undermining the policy of the democratically-elected Labour government). He did so unashamedly as a matter of taste “rather” than a theoretical or analytical judgement:

“Nowadays – I am still talking about high-brow opinion – things seem to have altered in two ways. The rate of interest has come to be regarded as of less importance in the causal nexus, its high *reclame* [public acclaim] of the nineteen-thirties savouring too much, to the modern taste, of an obsolescent economics of price” (Robertson, 1966 [1948], p. 188-9).

¹⁰ Robertson and Keynes worked closely together in the early days, but he came to reject and vigorously oppose Keynes’s eventual destination. Unfortunately for Keynes, after the war, he was in charge of economics at Cambridge University until he retired in 1957.

The theory that made it into the textbook and wider literature had no substantive role for the rate of interest, with liquidity preference transfigured as loanable funds (Chick and Tily, 2014). Judged on the basis of this *entirely false* account, Keynes's theory and policy has never been assessed on its own merits. Yet in spite of the crisis and various campaigns for reform of the teaching of economics, such a review continues to be rejected on the grounds that a theory rooted in mainstream analysis provides a more rigorous justification for fiscal policies to combat recession. That this position prevails beggars belief, though I should concede that even heterodox interpretations only scratch the surface of Keynes's monetary policies, and my own efforts to convince otherwise (including in this journal: Tily, 2009) have met with only limited enthusiasm.¹¹

As a result, even on the failure of the restoration of the system that Keynes understood as profoundly at odds with stability, prosperity and a just society, financial authority is virtually uncontested in a material way by either academic or political forces. The economics profession needs to wake up to the impossibly high stakes of its ongoing negligence.

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¹¹ Mainly on the part of a handful of reviewers including practicing economists and Keynes scholars, the former including interest from the Bank for International Settlements (Tily, 2012). I have been entirely unsuccessful in attracting the attention of modern-day "Keynesian" economists.

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Mass migration and border policy

Herman Daly [University of Maryland, USA]

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I heard a radio interview on the BBC with the Swedish minister of migration in which he was repeatedly asked by the interviewer, “How many immigrants should Sweden accept? What is the limit of Sweden's capacity to absorb immigrants?” The minister repeatedly deflected the question, preferring to talk instead about the European Union's lack of a coherent policy. The interviewer became insistent. Finally, the minister said that as long as the economy is growing there is no reason to limit immigration. Pointing to past periods of rapid growth of the Swedish economy, he noted the absence at those times of an immigration problem. Therefore, he concluded, the way to deal with immigration demands on Sweden is to increase its economic growth. I looked up the BBC interview online, and it was as I remembered it, except that the last point about economic growth as the solution was omitted. Maybe the migration minister, Mr Tobias Billstrom, had second thoughts about that, or maybe the BBC edited it out of the interview. Be that as it may, growth is usually considered the panacea, not only in Sweden, and not only for immigration. For those who see that aggregate growth has become uneconomic in a full world, and that a steady-state economy is both a biophysical and moral necessity, this answer is ultimately unsatisfactory – in spite of its being a generous response to a crisis situation. If immigration continues to increase, maybe the difficult question put to the minister will, in democratic Sweden, eventually be answered by Parliament, or by a referendum. Or maybe not.

In a *Washington Post* article (“The Growth that Refugees Drive” 10/2/15, p. A23), World Bank President Jim Yong Kim extended the Swedish minister's position that growth will make room for immigration by arguing that immigration will promote growth. From his family's remarkable experience as legal immigrants in the U.S., he generalized to the mass extra-legal immigration into Europe, arguing that these immigrants will contribute to growth in Europe. Minister Billstrom in Sweden will be pleased to learn from the World Bank president that not only does economic growth make room for mass immigration, but that mass immigration itself will provide the needed growth. So we have a self-reinforcing positive feedback of growth in which the many children of migrants to Sweden can grow up to be World Bank presidents like Mr. Kim. Such a bright silver lining makes the European migrant crisis seem almost benign.

The immigration problem in Europe is currently more severe than in the U.S. because many migrants, especially Syrians, are actually refugees driven from their country by war and the literal destruction of their homes and livelihoods. Where do you draw the line between refugees and economic migrants, and how many of each should Europe take? Sweden has taken a generous number, as has Germany, whose announced intention to take some 800,000 is stimulating more inflow (there are millions of potential immigrants), and causing second thoughts among Germans. Some other European countries frankly do not want the influx, feeling that they have a responsibility first to solve the problems of the unemployed and poor among their own citizens, including past immigrants. It is sometimes forgotten that the open-borders policy within the European Union is premised on enforcement of border control at the boundaries of the Union with the rest of the world. If the latter fails, so will the former.

A stationary population is part of the definition of a steady-state economy, and in the U.S., Western Europe, and Canada, population growth is almost entirely due to net immigration. So it is hard to evade the difficult and divisive issue of immigration in discussing population policy for a steady-state economy, although we do tend to avoid it precisely because it is so difficult, both ethically and politically. Without claiming to have a solution, I would at least like to stop avoiding the issue and try to face some of its underlying problems.

There are three fundamental philosophical divergences that contribute to the difficulty of immigration policy. ([Elsewhere, I have considered the political conflicts of immigration policy in the U.S.](#)) These philosophical problems do not have simple answers, and differences must be both respected and debated.

First, there are differing visions of world community. Some people think that a world without borders is the key to universal peace. Others think that it is the short road to post-national corporate feudalism in a global commons. Count me as sympathetic to the latter view, with the stipulation that the road to true global community is through the UN model of a federation of interdependent nations. The alternative to be avoided is the WTO model of integration of former nations into a single global economy by free trade, free capital mobility, and free migration, dissolving national communities rather than federating them into a global “community of communities”. In the WTO model of global economic integration, local autonomy at the national and sub-national level is replaced either by the centralized control of a world government, or by unregulated corporate feudalism in a global commons. Neither alternative is appealing. But that is how I see things. Others will rightly remind me of the dangers of nationalism, and the catastrophe of two world wars and threats of another, and will argue that anything that weakens the nation state is probably a good idea. They may be right, even if I am not convinced.

A second philosophical divide is the ethical divergence between deontologists and consequentialists, illustrated some years ago in Garrett Hardin’s agonizing parable of “lifeboat ethics”. It demonstrates a social trap. Shipwrecked passengers on an already full lifeboat face the dilemma of what to do about other survivors still in the water trying to board. Helping everyone board will overload and sink the lifeboat – everyone drowns, but no one is favored (complete justice, complete disaster). Keeping some out is unjust – survival of some at the sacrifice of others. Once we are in the trap there is no acceptable way out – a classic tragedy. The lesson of the parable is that we must by all means avoid the trap in the first place – provide more lifeboats on the ship, take fewer passengers on each cruise, and go more slowly through safer passages. That is what a steady-state economy seeks to do. The drowning of people on overloaded boats in the Mediterranean witnessed on the TV news every day underlines the tragic prescience of Hardin’s parable. The difficulty with deontology is that in its devotion to absolute rules of rightness, it is sometimes blind to foreseeable evil consequences. The difficulty with consequentialism is that it can be wrong in its prediction of consequences, especially if they are complex or far in the future. It can also be too willing to employ bad means in the service of good ends.

A third philosophical divide is the conception of people either as isolated individuals, or as persons-in-community. Are we independently defined atomistic individuals related to each other only externally? Or is our personal identity itself constituted by internal relations in community? For the individualist (most economists), external relations, largely mediated by the market, are basic. Consequently, labor mobility and free migration, along with free trade and free capital mobility, are favored policies. But these policies abstract from relations in

community, provided by families, places, nations, traditions, religious communities, language, culture – relations that largely define our identity as persons. The focus of immigration policy is usually on costs and benefits to migrants as individuals. But there are also social costs and benefits to migration. The social benefit of cultural diversity is real, but its cost in terms of disunity is also real. Two social costs are often underestimated – the cost of migration to the receiving community of absorbing the new members (both economically and culturally), and the cost to the sending community of losing mainly its younger and more capable members. For individualism the costs and benefits to the individual migrant dominate the social costs and benefits. The person-in-community view opposes excessive individualism, but courts the opposite danger of shading into identity politics by privileging membership in a particular community as the essence of one's personal identity.

While there is deep disagreement on these three philosophical issues, there is basic agreement that the rich have a duty to help the poor, and that includes poor migrants. The question remains, how best to do it – to try to help them repair their failing country of origin, or to abandon the failing country and help them immigrate into a more successful country? Those left behind in the failing country (too old, or too ill, or too needed by others to be able to leave) merit help as well as those capable of migrating. And when the young and capable flee, it is harder to rebuild a failing country. Also, the poor, homeless, or unemployed in the receiving country, who will have to compete for jobs and social services with the new immigrants, should not all be self-righteously written off by cosmopolitan elites as “nativists” or “racists” when they object to mass immigration, any more than all Muslim immigrants should be written off as probable terrorists.

Ultimately, we all must all play the hand that we are dealt by fate, and at least initially bloom where we were planted. We do not choose our parents, our generation, or our genetic inheritance any more than we chose our original nationality. However, we can change the last by migration. That, however, does not make migration the solution to the fundamental unfairness of the world. Individual or small-scale migration is not a problem. Mass migration is a different matter. It may be inevitable in a bloody revolution. But like a revolution, or a natural disaster, it reshuffles the entire deck, altering the hands previously dealt, by changing risks, wages, property values, and prices. Every relative price change in land, labor, and capital caused by mass migration entails both winners and losers throughout the whole population. Whether that will make the world more just, or simply more uncertain, with a new set of arbitrarily determined winners and losers, is a question with no clear answer.

All peoples need to think honestly and clearly about these difficult questions. A first step toward clear and honest thinking is to insist on distinguishing legal from illegal immigrants, and economic migrants from refugees. Lumping them all together as “immigrants” and then referring to any policy of border control or selectivity as “nativism” or “bigotry” is unhelpful, unfair, and unrealistic. A second step is to better distinguish winners and losers resulting from mass immigration, and to share the costs and benefits more equitably between them.

A third important step is to realize that the growth economy in the U.S. and other countries, protected by militarism, is contributing to wars over remaining resources and ecological space, and will increase the numbers of people displaced by war and by ecological destruction. The growth strategy of the “bigger pie” – more things for more people – will just lead to a larger ecological and social disaster. In the empty world of two billion people into which I was born, one could share the growth optimism of Minister Billstrom and World Bank President Kim. But in today's full world of over seven billion, it is past time to stop whistling in

the dark, and to seek a steady-state economy. Growth can no longer substitute for living within, and equitably sharing, the carrying capacity of Creation. And erasing national borders, while it has some appeal, unfortunately leads to the tragedy of open access commons, which is a bad way to share.

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Stiglitz and the “Greek morality tale”

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It is worth reflecting on the developments in Greek economic and financial affairs and the recent change in its political leadership, because what is befalling Greece is very similar to what is happening in many member countries of the IMF, including my Sudan. What happened in Greece with its democratic turning to the left aroused negative feelings from most of Europe, especially in its rich countries. One of the most interesting contributions in support of the Greek’s case came from J. Stiglitz entitled [“Greek Morality Tale”](#). In reading this valuable contribution I found myself strongly struck by its second paragraph:

“We hardly needed another test [referring to the Greek situation]. Austerity had failed repeatedly, from its early use under President Herbert Hoover, which turned the stock-market crash into the Great Depression, to the IMF programs imposed on Eastern Asia and Latin America [and also Africa] in recent decades. And yet when Greece got into trouble, it was tried again.”

If we agree with Stiglitz that austerity has been a failure through the past decades, why is it that Europe showed so much hostility when Greece decided to stand against austerity? Is Greece alone in having this experience? Certainly not. What Greece had been through and continues to suffer has been the day-to-day business and worry in a number of countries in Asia, Africa and Latin America, and without anyone caring for the plight of the many millions of people in these unfortunate member countries who have been squeezed by austerity programmes into poverty and absolute decline in their welfare. In fact the failure of the IMF austerity programmes in the countries mentioned has a lot to do with their inability to achieve sustained development and real improvement in their way of life.

I have been following the course of such austerity programmes since 1966, when Sudan first resorted to the IMF and I was a young officer in the Central Bank of Sudan. The program was imposed for three years by a minister of finance who was the first African head of the African Department in the IMF. The program was interrupted in 1968 when a another minster who loathed the IMF and its policies took office and immediately broke all the promises made in the Letter of Intent made in 1966 by the previous minister. Therefore, in March 1969 the IMF suspended the program and in May 1969 a military coup took place and which was as a result of the squeeze the IMF imposed from 1966 till mid-1968. This military government lasted for 16 years.

From experience, once a member enters into an austerity program, often it becomes difficult to disengage from it. It is like an addiction, and the cycle goes on, leading to less and interrupted development and, therefore, more inability to repay debts, etc. There are a

¹ *“I have prayed to God not to take my life until I have seen countries such as the USA and Europe resort to the IMF for financial assistance so that they could see the agonies and pains that our country had gone through since its first Stabilization Programmes imposed on Sudan in 1966!!”* Ali Abdalla Ali, In an International Conference held by the UN Quaker Society , Mohonk Resort, N.Y , June [1982](#)

number of factors which makes one feel that the austerity programs and their imposition in many member countries has a lot to do with their delayed growth and development.

- 1) The Fund's help is usually tied to a country's quota. When a member country needs help, the resort to the Fund is usually at the last minute. Needs are then usually more than financial capacity and/or other flows, so expenditures are apt to go beyond what has been agreed upon in the Letter of Intent. This usually leads to reconsideration of the program with even more conditions and the cycle goes on.
- 2) Because of the small size of the assistance given, members usually through local pressures over spend and break the limits promised. This is so because some of the higher ranking Ministers might not be aware of the necessity to abide by promises given in the Letter of Intent, especially when the member country is in some kind of a civil war.
- 3) In member countries that follow a comprehensive political system, taxes on individuals or firms are imposed and collected by law, the same as in democratic systems. The difference here is that no one is consulted in the way such taxes are disbursed, even if the defense and security budgets swallow the whole budget at the expense of education, health and other basic needs which are cardinal to the health of the nation. IMF missions cannot make any remarks about such a course of action as they will be considered as interfering in the internal affairs of the member country. But one thing the IMF is good at is advising governments to waive subsidies on fuel, bread and other necessities. When such policies produce discontent and revolt and death (as happened in Sudan in Sept, 2014), they absolve themselves by stating that it is the government that accepted such advice. It means also that their evaluation was wrong and so was their judgment and their advice.
- 4) The IMF and its missions usually prefer to deal with comprehensive political systems since they do not need to have lengthy meetings with numerous professionals. When professionals go on arguing and making things difficult for them academically, they often try to go up the ladder to the president of the country who usually has no idea about the intricate arguments involved. At other times and in a very subtle manner one finds that very knowledgeable ministers of finance are relieved from their posts if they stand firm against IMF policies.
- 5) A very important point is that in a country whose improper management is not discussed frankly, problems accumulate and more than addiction takes place. Once a country's policy makers and professionals become resigned and conditioned to the daily polite harassment by the IMF representative, all thinking about the medium and long terms objectives recedes into the background with serious implications for the country's future.
- 6) In the Sudanese experience in the period 1975-77 when the Minister of Finance had a firm and intimate relation with his counterparts in the Gulf countries, it used to be easy for him to obtain quick funding from the Gulf. And he had leverage in negotiations with the Fund missions during that period. Once the Minister left his post, some of the Gulf countries requested the Sudanese authorities to settle their affairs with the IMF before receiving funding from them. This is clear proof that not only do the Fund officials try to control the status of local finances, but also try to

make it difficult for the member to get funding from other sources by reporting the status of the member country to those potential donors. This has also been the practice with some Western banks that were told by the IMF not to provide financial facilities to a member country which is under scrutiny by its staff. Both these instances happened in the case of the Sudan. So a member country is besieged, and other potential windows are gradually closed.

- 7) That is why a Palestinian economist (the late Yousif Sayig) correctly described the IMF mission economists as technical economists and not social economists, meaning that they are indifferent to the human suffering resulting from the imposition of these programmes. In fact, Lord Thomas Balogh, Economic Advisor to United Kingdom's Prime Minister Wilson and member of Balliol College, Oxford in his 1996 book, *The Economics of Poverty* wrote:

“The economic relations of the US to South America are essentially not different from those of Britain to her African colonies. The International Monetary Fund fulfils the role of the colonial administration of forcing the rules of the game,” p.29.

Has anything changed since then?

- 8) One of the greatest weaknesses of the IMF's austerity programmes is that they tend to forget that many members of the IMF have colonial heritage. These countries are in effect periphery economies structured in accordance with an imperial policy that reflect what is needed from that specific member (e.g. Sudan became a cotton producing economy to satisfy the need of British mills in Lancashire for raw Cotton, which Britain lost as a result of the American Civil War). It therefore, does not make sense to impose the same medicine on both the centre and periphery. The periphery members, because of the distorted shape of their economies, need a different treatment than sheer austerity.
- 9) Since many of the African countries' professionals are a product of the Anglo-phone and franc-phone institutions of higher learning, they return home and take higher posts and usually become a sort of conduit for the ideas prorogated by the IMF. Therefore, such ideas are easily adopted. During the Cold War period, and even today, some professionals who argued against the IMF policies were branded as Communists, even if they had graduated from Oxford University (as happened to this writer). In other countries where those on the top do not possess the necessary intellectual capacities, austerity programmes find their way to reality *vis-à-vis* the IMF staff who are highly educated in the best universities and also well trained in the IMF. The austerity programmes are put in place with the hope that the economic difficulties will abate, but they never do.

There was a recent warning by Lagarde, the Managing Director of the IMF prior to the Tokyo annual meeting that European countries should not take to austerity programmes as a way to economic reform. This statement was a warning rather than advice. In spite of that the IMF still goes on harassing some member countries to carry on with various forms of austerity. This is because the IMF system and behavior has been like this since its beginning. It will not be easy for Lagarde to shake the system. What else would the staff of the IMF do if austerity is wiped out of existence?

- 10) Of course austerity is not the only problem with the IMF. A number of member countries had to be convinced to put their homes in order, and in some cases IMF missions needed to avoid drawing attention to the fact that some of their practices were intervention into the internal affairs of such countries. Moreover, member countries are at various levels of development, some plagued with frequent changes in governance and some living under permanent dictatorships where there is no consideration of equity and fair treatment and so on. In such complicated situations austerity may increase misery and pain as well as delay development.

From the above observations and a lot more one has the strong feeling that Greece is not alone in this unfortunate situation. Greece and its people are capable of finding their way to a better free life. They will find their own solutions because they are an old nation with a long history and heritage. But what worries me about the Greek's story are the following.

- 1) Greece after four or five years of agonies came to realize the futility of austerity, and as a result the Greek people decided to vote for the left hoping to find their dignity and freedom in such a pure democratic direction. If that direction reflects the will of the Greek's choice, why are other European nations such as Germany not accepting such a choice? Are they not favour of democracy? I was surprised to see one of the placards raised in Greece saying "We are not Merkel's Colony". In fact she indicated that she will just sit and watch what happens to the Greek people under austerity. If the West insists that poor countries should turn to democracy and human rights, how can one from our poor world understand such behavior from someone leading a rich country such as Germany? No matter what historical factors govern the German mind, such a stand looks immoral and inhuman. Is it moral to just sit and watch how the people of Greece suffer? If this is the attitude towards a sister European country, what will then be the position *vis-à-vis* our poor countries in Africa? Will not an attitude such as Germany's stiffen the attitude of the IMF and rich countries towards the poor countries of Africa and Asia in spite of the fact that the IMF has admitted that austerity can affect a member negatively? If so my simple question is who will compensate the member countries that got into the habit of resorting to the IMF for assistance and help?
- 2) Another point drawn from the Greek case is that if the poor member countries of international institutions are persistently harassed and driven to turn to countries other than Western ones to get assistance, a possibility suggested by the Greek Minister of Defence, such attempts may prove futile. Going to China or Russia is like leaving one's own ungrateful neighbor to another potential difficult master. The alternative is to look inwardly in the short run and see how much each country could do by itself before seeking a bailout. This also applies to Greece, something the Greek people have already started exploring and which is both healthy and good.
- 3) To my mind, the case of Greece should be taken as a starting point from which to look into the agonies and pains of many other countries that are undergoing austerity, whether in Europe or Africa or elsewhere. The case of Greece should be looked at in the context of all the members of the IMF. One more thing, the IMF being very financially powerful and with its word taken as sacred by many institutions, banks and countries should no longer besiege members who are able to find finance from friendly countries, given that the IMF's major policy of austerity programmes is at

present discredited by its repeated failures. Even some members of the Fund have started admitting that their advice was faulty and ill-conceived.

- 4) If there remains an element of morality in the minds and hearts of institutions and countries who are controlling and directing the international financial system, then they should sit with modesty and humility with other members of the IMF and similar institutions. Otherwise what is described in the Middle Eastern media as the “Arab Spring” will not remain an exclusive invention of some of the Arab countries.

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