

INTERNATIONAL CONFERENCE:**CORVINUS, BUDAPEST, November, 2010.****Transition to what? Reflections on the status of Capitalism as an ideology****David Harvey, Newcastle University****Preamble:**

I can scarcely imagine the experience of our honoured celebrity – Professor Csaba Csaki – on the occasion of his 70th birthday. Born in the midst of world war, and occupation of his country by one of the more vicious dictatorships the world has known. Raised, educated and then practicing under a centrally-planned communist regime, with (I presume) honest and civilised intent, if not always implementation (why should they be different?) until he was almost 50. Then, the wonderful and distressing transition from (largely external) communist dictatorship to an independent democracy, with all its trails and tribulations, quickly followed by preparation for and accession to the European Community. As I heard it said in neighbouring Poland, more like substituting external dictatorship from Moscow with another from Brussels, at least as far as agricultural and rural development policies are concerned. Csaba's experience is, of course, the experience of all of his age in the New Member States, but is more. Csaba has also become a world-leading figure in Agricultural Economics, well respected in our major international institutions and a past president of the IAAE, and vice-president and Fellow of the EAAE. He is the principal author of the World Bank's current rural development strategy ("Reaching the Rural Poor"). During the economic transition period of the 1990s, Csaba led the World Bank's analytical work on agricultural policies and food and agriculture sectors in Central and Eastern Europe. In the late 1990s and early 2000s, he was the leading agricultural and rural policy advisor at the global level for the World Bank. He is one of the world's leading experts on agricultural policy, development, and economic transition in Central and Eastern Europe, and also a Trustee of IFPRI. What, then, can any of his colleagues say that he does not already know, and has probably written about?

Abstract

The collapse of the Berlin Wall and the re-engagement of previously centrally planned economies, including Hungary, with the practices of liberal democracy and more or less governed markets seemed to have rendered obsolete serious consideration of capitalism as containing within it its own seeds of destruction. Then, the world suffered the inevitable end to a long boom – a bust, apparently triggered, if not actually caused by the greedy excesses of the purest of capitalists – the finance market 'masters of the universe' and their bankers. What price capitalism now? This paper addresses this question. It offers an alternative perspective on the metaphysics of economics, which now seems to be pertinent to the apparent difficulties with the capitalist system, notwithstanding its obvious successes.

Key words: economic theory, metaphysics, nature of markets, capitalism, governance, socio-economic evolution

Introduction

In 1848, Karl Marx and Frederick Engels published their Communist Manifesto. In it, they appear to be prescient about the fears many have today of the fact, phenomenon and processes of capitalist globalisation. *“The discovery of America prepared the way for mighty industry and its creation of a truly global market. The latter greatly expanded trade, navigation, and communication by land. These developments, in turn, caused further expansion of industry. The growth of industry, trade, navigation and railroads also went hand in hand with the rise of the bourgeoisie and capital which pushed into the background the old social classes of the Middle Ages. .. Chased around the globe by its burning desire for ever-expanding markets for its products, the bourgeoisie has no choice but to settle everywhere; cultivate everywhere; establish connections everywhere. .. Rapidly improving the instruments of production, the bourgeoisie utilises the incessantly easing modes of communication to pull all nations into civilisation – even the most barbarian ones. .. In a nutshell, it creates the world in its own image.”*¹

This account of capitalism still resonates strongly with the frequent indictments of globalisation and the apparent hegemony of western ideals, if not ideologies, in favour of free markets, individual freedoms and property ownership, and the pursuit of wealth (and hedonism). In the words of the *Economist*, *“The destruction of the Iron Curtain on November 9th 1989 is still the most remarkable political event of most people’s lifetimes: it set free millions of individuals and it brought to an end a global conflict that threatened nuclear annihilation. For liberals in the West, it still stands as a reminder both of what has been won since and what is still worth fighting for. ... For Western liberals, even ones who believe in open markets as unreservedly as this paper, that means facing up to some hard facts about the popularity of their creed. Western capitalism’s victory over its rotten communist rival does not ensure it an enduring franchise from voters. As Karl Marx pointed out during globalisation’s last great surge forward in the 19th century, the magic of comparative advantage can be wearing—and cruel. It leaves behind losers in concentrated clumps (a closed tyre factory, for instance), whereas the more numerous winners (everybody driving cheaper cars) are disparate. It makes the wealthy very wealthy: in a global market, you will hit a bigger jackpot than in a local one. And capitalism has always been prone to spectacular booms and busts.”*²

Capitalism may have survived, so far, if not actually at the expense of communism, at least apparently in competition with it as a governing ideology. Indeed, according to common perception, capitalism has been so competitive that it threatens to take over the world. The idea and phenomenon of globalisation has at its core the global reach and coverage of financial institutions and transactions, and the associated economic power that goes with the accumulation of wealth. Since 2007 and the beginning of the credit crunch and the ensuing near global recession, capitalism also appears to many to threaten global economic stability and security, not to mention its apparent continuing threat to the planet’s ecosystem and with it our own life support system.

The countries of the Former Soviet Union have undergone and are still undergoing a triple transition (at least): from state to (governed) market systems; from agrarian to industrial

¹ As translated by Manfred Steiger, *Globalisation – a very short introduction*, Oxford, 2009, p32

² *Economist*: Nov. 5 2009, The Berlin Wall, ‘So much gained, So much to lose’ The leader goes on to remark: “Many businesspeople, too busy on their BlackBerrys to worry about nationalism or fundamentalism, might ponder Keynes’s description of a prosperous Londoner before August 1914: sipping his morning tea in bed, ordering goods from around the world over the telephone, regarding that age of globalisation as “normal, certain, and permanent, except in the direction of further improvement” and dismissing “the politics of militarism” and “racial and cultural rivalries” as mere “amusements in his daily newspaper.””

structures (especially Poland and Romania, but also elsewhere); from Communes (and communist) ideals to (European) Community ideals and ideologies. This paper focuses on the third of these transitions. It re-considers the prevailing economic paradigm which underpins the western model, and the way in which this paradigm is explained. In short, the economics which we teach, and which our leaders apparently take for granted, appears to be in a rather sad state – a conclusion apparent well before the recent credit crunch and ensuing mayhem.³ The fact of the crunch, however, makes the story easier to tell and potentially more saleable.

The essence of my argument is that we need to think of socio-economic and political systems as complex adaptive systems, embedded within other social systems and co-adapting with the planet's natural eco and climate systems. If so, then the natural theoretical and metaphysical (epistemological) apparatus we need to use is that of evolution, as explored, for example, by Dennett (1995). Amongst the avalanche of books explaining the causes of the credit crunch and the current world recession, Kaletsky (2010) provides both a longer-term perspective and also a rather more optimistic view of the future than most. More pertinent to the purpose of this paper, however, he also presumes an evolutionary theme for the analysis and discussion of economic conditions.

Marx and Engels were writing during what Kaletsky categorises as Capitalism 1.0 – the period of largely *laissez-faire* following the conclusion of the Napoleonic wars and culminating in the Great Depression of the 30s (*pace* the Great War of 1914-18). In this version, politics and economics were regarded as largely separate activities, with the interactions mostly concerned with either raising taxes to fund government (mostly military) or to protecting vested interests such as landowners or the craft guilds. Kaletsky argues that Capitalism 2.0 was spawned in the face of the Great Depression's obvious annihilation of version 1, and was characterised by common acceptance of the major role of government in guiding and stabilising otherwise potentially chaotic markets. Markets, in the 1930s, appeared more or less obviously capable of growing the seeds of their own destruction (though not quite as Marx envisaged it, except in Russia, which, ironically, had not developed a capitalist system prior to the revolution).

Kaletsky's version 3.0 appears in the 70s, as a consequence of the 'great inflation' (following the collapse of the Bretton Woods fixed exchange rate regime and the first major oil and commodity price spikes). The control of inflation forced governments to withdraw from the previous levels of intervention and gave effective power back to the markets, believed by many to be more responsive and equilibrating than (practical) governments could ever be in regulating the economy – at least given responsible monetary policy.⁴ This period was marked by market fundamentalism (arguably enshrined in the 'efficient markets hypothesis') and by the perhaps inevitable backlash. A substantial and potentially influential number of people now find particular aspects of the free market and associated globalisation both unappealing and inherently anti-social, if not actually immoral, and more than worthy of aggressive if not terrorist opposition.

Kaletsky argues that we are now witnessing the beginnings of Capitalism version 4.0 – in which governments and governance will re-emerge as being entirely necessary, if not necessarily sufficient, to generate benign, socially responsible and acceptable capitalism. As the Economist remarks in reviewing the book⁵, "*skating breezily across swathes of economic*

³ See, for example, Harvey, 2004.

⁴ In simple terms, the ending of fixed exchange rates removed the Balance of Payments constraint on over-heated economies and gave more power to domestic monetary policy as a lever of control. Excessive monetary expansion in developed economies (especially the UK and the US) in the face of rapid increases in the prices of raw materials, especially oil, generated major inflation and inflationary expectations, which then took both time and pain to unwind.

⁵ Economist, July 8 2010.

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policy, his theme is that new capitalism will be defined by experimentation. Governments will become far more involved in some areas of the economy, such as macroeconomic management and financial regulation. But they will retreat from others, such as education and health. Pedants will find plenty to quibble about in Mr Kaletsky's analysis of the past, let alone his predictions. His tirade against Mr Paulson is unseemly as well as unconvincing. But his book is full of clever insights."

The idea that we are set for a period of experimentation with our socio-political and economic systems implies that we know, at least in principle, what we are doing and what we are trying to do. However, the current state of the social sciences might suggest otherwise. Against the increasing tendency to blame everything on catch-all phrases such as 'globalisation' or *laissez-faire* (mis) government, economics as a discipline is now facing a major crisis of its own. How come we (collectively) could not see the credit crunch coming, at least not in its dramatic form? How come so many of our students find the subject either boring, or ill-fitted to modern life, or simply too mathematical, clinical and so obviously stupidly simplified in its attributions and perceptions of human behaviours and motivations? How come many lay people still regard economists as hopelessly out of touch with the real world, or too stupidly simple as to ignore real human values and motivations? Have we got our story of the way the world works wrong? Or are we simply not telling it right? More importantly, have we still got enough room to make the mistakes which experimentation implies? Or do we have to be more intelligent and careful about what we are doing? If the latter, then we rather urgently need to better understand our socio-economic systems.

An evolutionary perspective

Back in 1950, Alchian suggested that we re-phrase our economic parables as stories of an evolutionary process. "*The suggested approach embodies the principles of biological evolution and natural selection by interpreting the economic system as an adoptive (sic) mechanism which chooses among exploratory actions generated by the adaptive pursuit of "success" or "profits"* (p211). Alchian notes that the ideas of profit or utility maximisation as motivations for behaviour are sufficiently unrealistic as to be nonsensical, especially in the real, uncertain and complex world. As he says (p. 212), "*In the presence of uncertainty - a necessary condition for the existence of profits - there is no meaningful criterion for selecting the decision that will maximise profits.*" He goes on (p 213) "*This is the criterion by which the economic system selects survivors: those who realise positive profits are the survivors; those who suffer losses will disappear. . . Positive profits accrue to those who are better than their actual competitors, even if the participants are ignorant, intelligent, skilful etc. . . The greater the uncertainties of the world, the greater is the possibility that profits would go to venturesome and lucky rather than to logical, careful, fact-gathering individuals. . . Success (survival) accompanies relative superiority; and, second, it does not require proper motivation but may rather be the result of fortuitous circumstances.*" Alchian pursues this analysis by separating the elements of good fortune (luck) from conscious adaptive behaviour by considering a socio-economic environment which only *adopts* "appropriate" survivors (in the absence of any adaptive behaviour). This system is, in essence, the natural selection system, in which the single organism or gene has no discernable *individual* motivation or adaptation capacity whatsoever.

Alchian, in a footnote (p. 215) also comments: "*The undiscerning person who sees survivors corresponding to change in the environment claims to have evidence for the "Lysenko" doctrine. In truth, all he may have is evidence for the doctrine that the environment, by competitive conditions, selects the most viable of the various phenotypic characteristics for perpetuation. Economists should beware of economic "Lysenkoism."*" Providing that we know (or can make educated guesses about) the system's prerequisites for success, survival and replication, we can still predict the characteristics of the revealed successful firms (households), even if these entities have no individual motivation or adaptive capacities at all,

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even if the whole system is simply driven by chance actions. “*Individual motivation and foresight, while sufficient, are not necessary*”, *ibid*, p 217.

Of course, motivation and conscious adaptive behaviour are human (if not also higher animal) characteristics. Alchian notes two behaviours in particular: imitation of apparently successful behaviours; innovation by conscious trial and error. As he says (p. 219), “*Adapting behaviour via imitation and venturesome innovation enlarges the model.*” In short (220), “*The economic counterparts of genetic heredity, mutations and natural selection are imitation, innovation and positive profits.*” As Winter, 1988, notes: “*natural selection and evolution should not be viewed as concepts developed for the specific purposes of biology and possibly appropriable for the specific purposes of economics, but rather as elements of the framework of a new conceptual structure that biology, economics and the other social sciences can comfortably share.*” (p 614).

Initial Implications

The correspondence between natural selection and economic behaviour, if sensible, has two important implications. Firstly, the typical benchmark of pure economic competition is not a natural climax condition of the economic world. Competition, specialisation and trade thrive on and self-generate diversity, not homogeneity. Trade and specialisation (the foundation of economics) cannot happen in a uniform and undifferentiated world. A uniform world does not trade. A level playing field is a thoroughly misleading metaphor for the real world, despite its apparent rhetorical appeal. The more differentiated and diversified become the products and the associated ideas, the more niches are established. The richer the ecology (and the economy), the more diverse are its ‘species’⁶ and the more niches it contains. Winners do not and cannot take all in a sustainable evolutionary system. Indeed, the existence and prosperity of the winners (as those at the top of the food chain) may be an important indicator of the vitality of the whole system on which they depend. The supposed inefficiency of monopolistic compared with perfect competition should be seen as the price we pay to be different, to have options and thus exercise choice. Perfect competition with homogenous products is indeed nasty, brutish and short, as marketing experts and consumers well know, and which producers, as well as policy makers and analysts, ignore at their peril. There is no real choice in perfect competition – evolutionary stable strategies in a perfectly competitive (and totally unrealistic) world are practically pre-determined.

Secondly, the sophisticated calculus of our economic models representing the optimum allocation of scarce resources does not represent the actual behaviour of participants, a fact that our textbooks and erudite analyses frequently forget or ignore. The marginal conditions for an optimum, and the supposed production and utility functions to which they refer, simply define the conditions that characterise the best-fitted allocation. They are derived from severely reduced forms of the actual relationships and processes that produce these (so far) best possible outcomes. The underlying structural equations (even if they exist) are currently far beyond our ken, and we do ourselves no favours to pretend otherwise.

Blume and Easley, 2002, explore the mathematical logic of an evolutionary process of economic behaviour and development using an evolutionary general equilibrium model. Their theoretical model results are important. They find that profitable firms grow and unprofitable firms shrink if the economic environment is held constant, as Alchian (*op cit.*) argues and as Nelson and Winter (1982) explore in considerable and convincing detail. However, in a general equilibrium system, prices change as factor demands and output supply evolves. Blume and Easley examine, first, a world without capital markets, where firms can only grow

⁶ We do not need, at this level of discussion, to be side-tracked into the actual mechanisms of evolution and the precise entities on which selection operates in socio-economic or cultural evolution – see, e.g. Nelson, 2005.

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through retained earnings, and find that in this case, evolution favours profit maximization, again as Alchian argues and Nelson and Winter demonstrate. However, Blume and Easley do not find, even in their necessarily fairly simple model (e.g., with consumer preferences fixed) that the dynamic equilibrium paths are necessarily Pareto optimal, or even have automatically stable steady states. In other words, even such a simple reflection of our general equilibrium system can be susceptible to cycles and to sustained depression – the Keynesian condition – echoing natural population cycles generated using the same ‘mechanistic’ principles.

One might think that the addition of capital markets to this general equilibrium model would save our conventional economics in this evolutionary-logical world, and both stabilise it and ensure that it reaches Pareto optimality. First, Blume and Easley (*ibid*) suppose that all investors have rational expectations (which are, as a result, the same across all investors), in which case the market structure is dynamically complete. However, this rational expectations assumption proves to be practically tautological – non-maximising firms never get any investment, and so do not exist – there is no \$10 note on the pavement; if it was ever there, it has already been picked up by someone. There is no real evolutionary selection – the market gets it right from the outset and by assumption (as noted above for the perfectly competitive model).

In a more realistic example, where investors have differing expectations about firms’ profitabilities, there is no guarantee that non-maximising firms will disappear. This will only happen if the investors who turn out to have the wrong expectations also disappear (become out-competed by those with better expectations). However, the accumulation of (accidental or erroneously based) wealth by investors can, in the Blume and Easley model, persist, and the wealth of irrational investors can grow, even if only by accident. In short, the addition of capital markets to the Blume and Easley model makes the correspondence between our conventional general equilibrium model’s constrained optimality and an evolutionary system even worse. This result seems to echo Shleifer and Vishny (1997), who show that rational arbitrageurs can be forced out of the capital (finance) markets by a lack of liquidity. Asset price collapses reduce liquidity and leverage, hence exacerbating stock market crashes when they are triggered.

Further propositions

Nelson, 2005, suggests that there are (at least) four critical differences between natural selection and cultural (socio-economic/political etc.) selection. First, humans are (or at least believe they are) intentional and intelligent – we think we know better and behave accordingly. Secondly, the selection criteria seldom relate directly to human survival and reproduction, but are more often concerned with persistence of ideas and practices, rather than survival *per se*. Third, the entity which evolves is a firm, group, community or network, which cannot be “simply characterized as the aggregation of the population of traits possessed by individuals, but has a collective property” (p12). Fourth, the processes of selection, replication and persistence (survival) are very different in many ways from those with apparently operate in the natural world.

I argue (e.g. Harvey, 2004 and 2008) that the critical difference between natural selection and human (cultivated or civilized) selection is even more fundamental. In cultural or socio-economic evolution, the selection criteria are *endogenous* not exogenous. In biological evolution, the criteria for survival are pre-determined by the coherence and consistency of the chemical and physical processes and associated laws. Either a phenotype is sufficiently well adapted to the prevailing environment and competition that it can persist and replicate its genes, or it is not, in which case it and its genes will die. In social (cultural) evolution, we get to choose, and we make up and continually re-make the rules about what behaviours and outcomes are allowed to persist and what are not. To all intents and purposes, we are in charge of our own evolution, with or without the help of our gods, depending on what we choose to believe. The echoes of the biblical account of the beginnings of the human race are

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strong – humans, gaining knowledge (though not, necessarily, understanding), are kicked out of the natural selection system (the Garden of Eden) and, in effect, told that: ‘if you think you are so smart, then get on with it and see how you do’. And we are still wrestling with the problem, and are now running out of space and time to make many more mistakes.

Human (cultural) evolution depends on the rules we make and how we make them. We cultivate and try to civilise our own selection systems. Our institutions, the social codes, constructed realities and authorities (North, 1990) are the manifestations of the ways we choose to do this – our governance structures. We seek to practice civilized selection, and to do so with intent and purpose, albeit frequently misguided or mistaken. So what? Our economic choices are exercised through economic power as income and wealth, which (aside from government intervention) determine, or at least substantially influence further production and investment. In our conventional general equilibrium models, the sole driving motivation is consumption, which in turn is supposed to satisfy personal utility. Investment is only a means to an end – more consumption in the future. The richer we become, the less pressing are the resource constraints and the greater are our feasible sets of choice. We face the curious paradox: the poor have very little choice, survival is all; the rich have so much choice that any given option typically carries very little salience, which makes actual choices both difficult and likely ephemeral.

Furthermore, the logic of the market encourages the agglomeration of resources and wealth, since markets are driven by rent-seeking behaviour. Adam Smith’s free market relies on the freedom of individuals to pursue their own welfare, both as consumers and producers, competing with each other for necessarily scarce resources. The equilibrium outcome, under a freely competitive market, is supposed to be a Pareto optimal allocation of resources, given the initial distribution of these resources. However, even under this simplified system (absent any public goods and externalities, or complications of transactions and organisation costs, or information gathering and processing costs) the inevitable dynamics of the pursuit of an ever-changing equilibrium (as technologies and tastes change) must result in temporary accumulations of super-normal profits, as the signal for market adjustment. Super-normal profits manifest as pure rents in excess of transfer earnings, and accrue to the underlying resources (their owners and/or managers). Economic theory cannot explain initial endowments of wealth and capital (of all forms). Rather, it relies on the continual pursuit of profit and rent, and on the happy accidents of well-fitted inventions, each leading to temporary accumulations and differentiated distributions of wealth. These become augmented by life-cycle and inheritance effects - the accidents of birth. Blume and Easley show, if I read them correctly, that this accumulation (and subsequent exercise of the associated power of choice about what to produce and how to produce it) can lead to both socially (Pareto) sub-optimal outcomes, and also to dynamic instability. What a revelation – isn’t that exactly what many of the critics of economics and market system have been continually telling us?

Evolution of Political Economy

An evolutionary perspective (see, e.g. Harvey, 2004a) suggests that the tendency for initial distributions of wealth (resources) to become more concentrated through the processes of both market and capitalist transactions is socially unsustainable. The rich become richer while the poor remain at least relatively poor. As Marx (1887) suggested, naked and unrestrained capitalism may well contain within it the seeds of its own destruction, though perhaps for different reasons that Marx advanced. In simple terms, we can expect that, eventually, the poor will try to do something about their condition, aided and abetted by sympathizers and social critics. Furthermore, it is to be expected that the rich will anticipate (or experience) the opposition of the poor, and will take steps to preserve their power by doing just enough to dissuade the poor from doing too much. Competition for resources in the market place now becomes competition for the rights to social control – the rights to make the rules of social

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engagement - either as a means to individual prosperity and persistence/replication, and/or as a means of social enhancement.⁷

The anarchy of an ungoverned market economy is insufficient to be socially sustainable, for two major reasons. First, the long arm of the law is necessarily attached to Adam Smith's invisible hand: to protect the specie; to enforce market contracts; define and protect property rights; and outlaw theft, corruption and fraud (e.g. Bromley, 1997).⁸ To implement and enforce authority, government must coerce society to conform to social laws and choices. As Dunn (1999) observes: "coercion is the core of states." Equal first, expectations are frequently frustrated and confidence in the market is misplaced, so we seek redress. Collectively, we try to manage the arbitrary distribution mechanisms of the market to achieve a more stable, sustainable and perhaps humane society.

In short, we choose whether or not to accept the social outcomes of trade and exchange, and their associated income and wealth distributions. These choices are necessarily made through the coercive state apparatus. We inevitably concede the power to make social or communal decisions (including the definition of property rights) to government. And, for the state to be sustainable, we have to respect this authority and its arbitration of disputes. Williamson (2000, p 598f) notes that the market theory of property rights, following Coase (1937), needs to take account of the costs and difficulties of organising and implementing the associated transactions. However, even these theories necessarily presume that the arbiters and organisers themselves have the confidence and trust of the people involved, otherwise neither the rules of the game, nor its various plays, will be legitimised by the participants. Our governing systems – autocracies, plutocracies, dictatorships, and (perhaps only when we have found the rest wanting) democracies and associated bureaucracies – all wrestle with the same fundamental problem – how to persuade their constituencies of the legitimacy and authority of the 'government' – our arbiter of our own cultural selection criteria. We choose which games we play, so long as we are rich enough to have the choice.⁹

If producers cannot win control over their market conditions, due to atomistic (perfectly competitive) structure, then they can be expected to pursue these ambitions through the political machinery of the state. Here, the marginal net returns to political action for producers are more concentrated than for consumers, because of specialisation in production. Consumer dominion over the market place is thus over-ridden by producer (or factor ownership) domination of public intervention in the name of fair and just distribution or of prudent economic management. Developed country agricultural policies are the archetypal examples (e.g. Harvey, 2004b), typically resting on arguments about just farm incomes or contributions to economic activity and trade balances, or, more recently, environmental (even social) care.

It follows that income and wealth distributions under any political economy general equilibrium, even under ideal competitive conditions, are determined by political influence and authority, typically manifesting as an uneasy balance between labour and the owners of capital. Left and right are thus natural manifestations of capitalist state politics. The right believes in the supremacy of the market, which apparently generates the factor incomes. Paid labour and atomistic sectors, on the other hand, are apparently at the mercy of the market and capitalists, and seek remedy through the political system. Arrow's impossibility theorem (see, e.g. Heap *et al.*, 1992, p 209ff) demonstrates that such systems, even if defined as perfectly as possible, will frequently generate inconsistent public preferences, and will thus

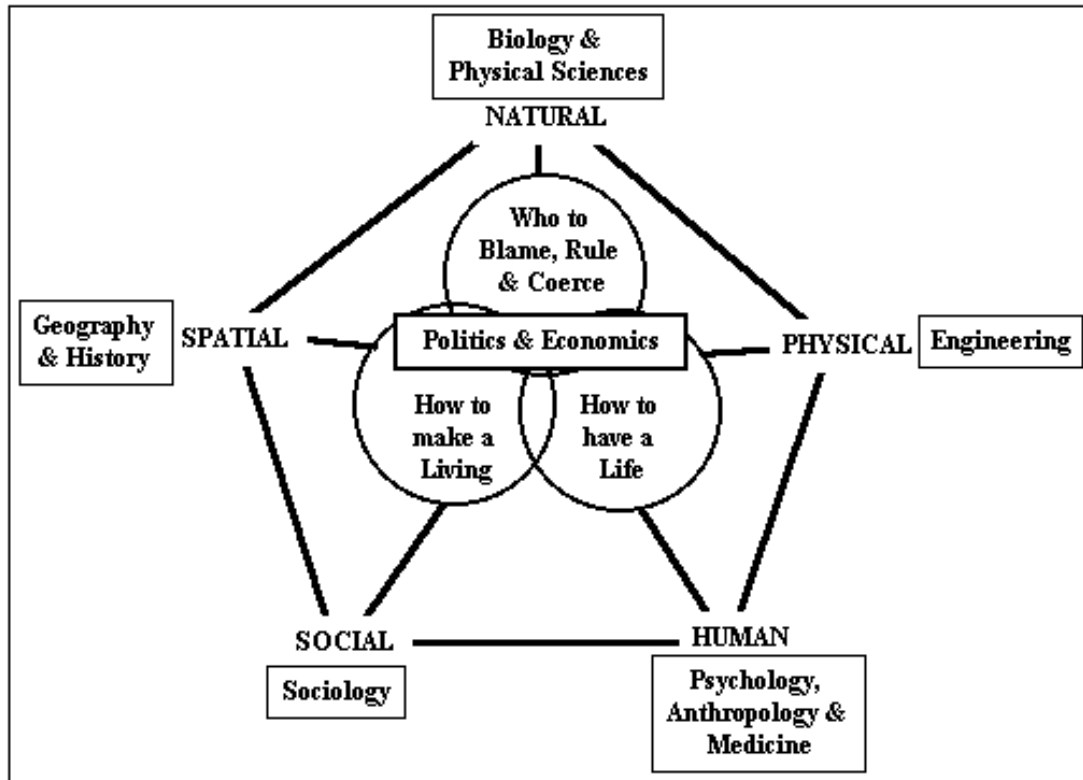
⁷ This assertion is little more than an extension of Becker's theory of social interaction (1974).

⁸ Colman (1994) deals with the associated observation that many of our economic relations are also strongly influenced by *invisible handshakes* (Okun, 1981, p. 82) as well as by the invisible hand.

⁹ See Barrett, S., 2003, for an exemplary exposition of the insights afforded by a game theory approach, especially to international environmental conventions and treaties.

cycle over different political control of the negotiating agenda, depending on rhythms of conviction about the social desirability of unrestrained markets. In short, the apparently neat and self-contained theory of general equilibrium is not self-contained. It requires and exploits government – the critical social construct and constraint on the animal magic of the invisible hand. Figure 1 illustrates the story so far – the structures of our social systems.

Figure 1 *The Structure of Social Systems – from an economic perspective.*



This figure borrows heavily from the sustainable livelihoods literature (e.g. DfID, 1999, Ellis, 2000, Chambers and Conway, 1992). Our scarce resources can be categorised as natural, social, physical, human, and spatial.¹⁰ Rational use of these scarce resources to satisfy near infinite desires generates the enormously powerful notions of opportunity cost and comparative advantage, as people continually engage in collaborative ventures, including their governments, to both earn a living and have a life. General equilibrium concepts are the consequence, which show that real supply curves necessarily slope upwards, and real demand curves slope downwards. Trade, and the associated specialisation in production, are the rational corollaries. Through these systems we augment or abuse our finite resources through a process of choice, which is necessarily constrained, otherwise there is no choice.

The development of our human systems for making these choices is subject to a fundamental evolutionary logic – those that fit best with the surrounding social environments and political climates will survive, prosper, reproduce and perpetuate. Ill-fitted systems will fail to survive.

¹⁰ The Sustainable Livelihoods framework does not separately identify *spatial* capital as a dimension of the overall resource base. Instead, it refers to *financial* capital. However, finance is the major means of converting both income streams and different resource bases into each other, rather than constituting a logically separate sort of real capital. Finance is a transformation system, while the remaining capitals are structures. Positional (spatial) capital, on the other hand, includes a critical feature of much of the resource base – where it is in relation to other people and other capitals, including its temporal relationships - where things and people are in relation to their histories.

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But the critical difference between social evolution and its natural counterpart is that we get to choose who lives and dies – we try to govern ourselves, rather than submit to the exogenous authority of bio-physical laws.

Proposition 1: *Teaching or preaching economics without including politics and recognizing the interactions with other social disciplines makes little sense and will continue to be misleading if not actually counterproductive;*

Corollary: *our ‘specialisation’ in the (mathematical) calculus of economics is worthless unless and until we cultivate a more common story about how the world works. Otherwise, the necessary associated trade in ideas and concepts with our social science cousins is impossible.*

Implication: *until we develop a more common story about our social worlds, social science generally, and economics specifically will continue to be part of the problem rather than part of the solution.*

Capitalism.

There is, however, a clear but seldom remarked distinction between the free market, as envisaged in the general equilibrium story, and capitalism. Capitalism involves one important additional step in the argument. Capitalism arises through the divorce of the ownership of capital (assets) from its operation and deployment. Capitalism depends on trade (exchange) of capital stocks and assets, thus facilitating the transfer of value from the declining to the growing sectors of the economy, and the balance between savings and investment. The dynamics of these transfers of ownership and associated adjustments in the purchasing power of the assets generate additional agglomerations of wealth, and thus of economic power, as margins are shaved from the mere transfers of asset ownership and continual stock revaluations. Any economies of size in capital and organisation aggravate the agglomeration. The Blume and Easley (*op cit.*) results strongly suggest that these capitalist dynamics can themselves undermine the supposed social benevolence of the market system – a Marxist critique in definitively non-marxist style. The apparent coherence of an evolutionary system, which encourages fitness between competing entities in real markets involving exchanges of flows of goods and services does not, necessarily, translate to the exchange of ownership of physical stocks or their derivatives.

It is worth clarifying the concept of ‘capital’. For Marx, in essence, capital was embodied labour – the fruits of labour encapsulated in physical assets, plant and equipment, and in the paper (financial) assets derived from and based upon the values of these physical (and human) assets. From this perspective, property is, in effect, expropriated from an exploited proletariat and workers, who can be immiserised without penalty, other than outright revolution. However, as outlined above, this scenario is not the only, or even the most likely, result of capitalism. The immiserised can be expected to complain loudly and increasingly violently, and their more enlightened or humane capitalist employers (and exploiters) can be expected to take steps to reduce or even eliminate their complaints and make them more compliant.

For more conventional economics there are two distinct and rather separate ideas of capital. The general equilibrium version is, more or less explicitly, the physical plant and equipment used in the myriad of production (and consumption) processes, and accumulated/augmented by physical investment – the replacement and addition of new machines, plant, buildings etc. The rate of return earned by (the owners of) this physical stock of real stuff is sometimes known as the ‘rate of profit’. As the capital stock is increased, so, according to the law of diminishing marginal returns, the rate of return (profit) falls, other things being equal (which, of course, they never are). There is an inherent measurement problem in this concept. The value of the capital stock is the rate of profit times the physical stock of capital, but the physical stock of capital is made up of widely different and heterogeneous physical stuff,

which cannot be reduced to commensurable units, other than by value. The valuation is necessarily circular – the rate of profit affects the ‘quantity’ of the physical stock of capital and *vice versa*. The ‘Cambridge Capital Controversy’ of the 1950s and 60s (see, e.g. Pasinetti and Scazzieri, 2008) was, at least in substantial part, about this aggregation/valuation problem. But this debate has been largely confined to an intellectual backwater since then.

However, it is centrally relevant to the arguments of this paper. From an evolutionary perspective, the equivalence of rates of return (marginal value products) with the price (value) of capital can only hold in an equilibrium state (which we might consider as the climax ‘vegetative’ state of the socio-economy). There is no substantive reason to suppose that these equilibrium characteristics and relationships have much meaning for the processes of getting to this state, any more than it is necessary to believe that each and every firm consciously maximizes profits to the best of its ability, or that each and every consumer consciously maximizes their utility.¹¹ For capital investment in plant and equipment to approach the supposed equilibrium, it is necessary that investors in physical capital which turns out to prove profitable are more likely to persist and prosper than those who invest unwisely. But, as Blume and Easley (*op cit.*) demonstrate, this is not necessarily true, even when investment is restricted to individual firms using only retained earnings, i.e. with no ‘capital’ market

Finance markets, as the second idea of capital markets, concern the invested and loanable funds accumulated through savings (everything which is not consumed), which are supposed to more or less balance with the demand (mostly by business) for new investment in physical assets through adjustment of “the rate of interest”. Through this mechanism, the rate of profit in the real world of physical assets and their employment might be supposed to balance with the rate of interest to be earned (or paid) in the financial markets, which simply exchange ownership of these assets. The circularity in the valuation of capital, however, is not removed in this process. It cannot be, since, according to the argument of this paper, it is simply a reflection of the endogeneity of the rules for selection of the fittest.

However, the rate of interest (as shorthand for a constellation of inter-related short and long term interest rates associated with varying levels of risk) is actually determined in the *money* market, rather than the *financial (asset)* markets. Government monetary policy (now largely delegated to central reserve banks) can either try to control the stock (supply) of money in the economy, or control the central bank’s base lending rate. Given that what is used as money is inherently fungible, its direct control is difficult if not impossible, and modern monetary policy centres on setting the central bank’s base lending rate. Since the central bank is the lender of last resort, the base lending rate effectively governs the interest rates. At this rate, the effective stock of money is determined as the total money balances the economy wishes to hold at this interest rate, rather than ‘invest’ the balances in other assets. This interest rate, in turn, affects the real economy of lives and work through its effects on savings and real investment rates, and also on the values of assets and wealth – since values depend on the opportunity cost of money – the interest rate.

¹¹ An exactly similar argument applies to the value of labour, and also to the value of non-marketed environmental and ecosystem services. As, for instance, Heal (2000) remarks, in the case of ecosystem services: “Valuation is neither necessary nor sufficient for conservation. We conserve much that we do not value, and do not conserve much that we value. ... Providing the right incentives is not the same as valuing the services: we can provide the incentives without valuing the services, and we can value the services without providing incentives for conserving them. In fact, valuation may sometimes be a by-product of providing the incentives. If we manage to establish a market in an ecosystem service, then we have a price for it and thus a basis for valuing it. And markets are probably the best ways of providing conservation incentives. So logically incentives come before valuation: *Incentives are critical for conservation; valuation is not necessary for establishing the correct incentives*” (p 29, emphasis in the original).

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The emergence of finance and stock markets – effectively markets in virtual, rather than real, assets, based entirely on expectations about the future (hence virtual) – is a ‘natural’ evolutionary step. Any persistent (i.e. successful, well-fitted) barter economy, as at least one of our ancestral cultures must have been, will find it necessary and useful to store assets (grain, precious metals etc.) as wealth, both for precautionary and investment (speculative) purposes. Records of these assets quickly became negotiable (exchangeable) in place of the actual commodity. Similarly, as technology evolves, so the idea of a joint stock company emerges, which grants shares in the company’s profits (and losses) to a number of (perhaps distant and rather disconnected) people, in order to access a greater volume of investment (speculative) finance necessary to operate the business. These shares also quickly become negotiable. As soon as a market develops for the exchange of these shares, enticing opportunities for ‘getting rich quick’ appear. All that is necessary is to be able to buy these shares when they appear underpriced and wait for their value to increase. Simple – except that judging when the price is cheap is difficult without knowledge, which in turn is difficult (expensive) to obtain (see, e.g. Stiglitz, 1985). So, specialists emerge, who make it their business to seek out information and either trade stocks on their own account or sell their advice on what to buy and sell to others, or manage the stock trading accounts of others.

One important aspect of stock markets and their derivatives, which is frequently forgotten or ignored, is that they are stock markets – which are permanently in disequilibrium. Equilibrium in a stock market would be characterized by a constant price for all stocks and no trades – each investor (including potential investors) being content to hold their current holdings of each stock, and no investor wishing to either sell or purchase any stock. The total supply in a stock market is, to all intents and purposes, fixed.¹² Purchases represent an exercise of excess demand on the part of purchasers, wishing to add to their present holdings at the going price. Sales represent a negative reservation demand on the part of the sellers, who are no longer willing to hold their existing holdings at the going price. Transactions can, and do, take place with no change in price. On the other hand, prices may change (as signaled by bid and ask prices moving together) without any trades occurring, if all participants agree about the conditions affecting their valuations of the stock.

Following this outline logic, Samuelson and Fama independently framed the “efficient market hypothesis” (EMH) in the 1960s.¹³ An efficient market, in this context, is simply one in which securities prices reflect all available information, implying that every security traded in the market is correctly valued given the available information. If so, then a perfectly efficient (stock) market would be inherently unpredictable, since only new information could change prices, and new information is, by definition, unknowable *a priori*. Furthermore, in the absence of any frictions or imperfect information accumulation and transmission, adjustment to new information would be near instantaneous, and current stock prices would already incorporate fully the revised expectations about future earnings – there can be no unclaimed \$10 notes lying on the pavement. Playing the stock market then becomes no more than playing the casino. As Lo, 2008, says: “*individual investors form expectations rationally, markets aggregate information efficiently, and equilibrium prices incorporate all available information instantaneously.*” However, stock markets cannot be perfect in this sense, as Grossman and Stiglitz, 1980 argue. “*Because information is costly, prices cannot perfectly reflect the information which is available, since if it did, those who spent resources to obtain it would receive no compensation (and hence would be unable to survive and persist). There is a fundamental conflict between the efficiency with which markets spread information and the incentives to acquire information*” (p405).

¹² Incremental additions to the physical capital stock over short time periods (1 year) are marginal compared with the total stock.

¹³ Lo, 2008, provides a convenient and presumably authoritative summary, although the hypothesis still generates very considerable controversy, with at least some unwilling to grant much intellectual authority to others on the opposite side of the argument.

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Achieving efficient prices (in these terms) for existing stocks of physical assets, and their derivatives, has rather limited connections with the general equilibrium notion of efficient real (and new) capital investment. Efficient asset pricing refers to the average value of existing stocks, if anything. Efficient new physical investment ought to refer to the marginal values of new physical investments as additions to the existing stocks. Where, exactly, is the connection between the average and marginal values and how does it happen? Supposedly, it happens by venture capitalists – those specializing in finding profitable new investments – comparing their own returns with those to be earned by simply buying ownership of existing stocks, as practiced by the so-called investment bankers. In so doing, venture capitalists are expected to arbitrage between the marginal returns offered by new investments and the average returns being generated by existing capital stocks. But, the average returns on existing capital are dependant on the prices (values) of these stocks, which in turn are heavily dependent on what other people are currently willing to pay for them, which may or may not have much to do with their fundamental value (discounted expected future rents to be earned from them).

The efficiency of the capital market, in these terms, isolates the essential characteristics of the perfect competition paradigm. It identifies the characteristics of an ideal steady state, but says nothing substantive about the mechanisms for getting there, and even suggests that the state itself is a mirage – a ‘can’t-go-to’ future. Supposing that there is some mechanism by which savings are efficiently and effectively allocated to the most promising real investment opportunities, then one might suppose that, at some steady state, the associated capital market might appear as ‘efficient’ in these terms. But so what? While the perfectly competitive market ideal might perform a useful benchmark for the real goods and services markets, the EMH hardly serves even this purpose for the capital market. The EMH is an unattainable perfection. The hypothesis ignores the fact that the actors in the market are widely heterogeneous – perhaps rational within their own terms of reference, but with differing time preference rates, attitudes to risk, understandings and perceptions of information salience etc. Changes in the balance of any of these amongst the population of traders will affect stock prices. Furthermore, guesses about how these factors might change (or persist) in the market can also be used to rationalize investment behaviours – so long as enough investors believe values to be increasing, it does not matter what you think, go with the flow. Even better, bet on the flow.

More importantly, as a stock market, there is no natural counterbalance of supply adjustment to demand changes. Pure profits earned in the stock market are not competed away by new entrants on the supply side. Rather, they simply attract new entrants on the demand side, driving values even higher. There is no natural counterbalance, other than loss of faith and confidence. As Lo (*op cit.*) observes, in making the case for an evolutionary approach to finance market behaviour (the adaptive markets hypothesis): “*The extraordinary degree of competitiveness of global financial markets and the outsize rewards that accrue to the ‘fittest’ traders suggest that Darwinian selection – ‘survival of the richest’, to be precise – is at work in determining the typical profile of the successful trader. After all, unsuccessful traders are eventually eliminated from the population after suffering a certain level of losses.*”

Survival of the fittest in the natural world, and too in the real world of goods and services, becomes survival of the fattest in the finance and capital markets. What is missing from this account, however, is how society benefits from the perpetuation of these fittest traders - the richest and fattest traders. In the real world, fitness is determined by the extent to which entrepreneurs and businesses actually meet peoples’ demands (albeit that these necessarily reflect the riches of consumers). Pure profits are competed away by imitation, innovation and new entrants to the market. The pursuit of wealth in the real world is constrained by the reactions and responses of the market – consumers and users – who judge what is acceptable and what is not, albeit that advertisers and marketers try to persuade consumers to behave and consume in ways and at levels which they otherwise might not.

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In the virtual financial world, however, fitness makes no direct reference at all to consumers or society, other than by accident. In short, it is almost perfect ‘natural’ selection – with money wealth the sole determinant of fitness, the more you have the more successful you are. But, it is only almost perfect. Perfect natural selection requires that fitness be replicated and passed on to successive generations. Can these successful traders persist and replicate? If wealth is the only requirement for persistence, the answer appears to be yes. Unrestrained capitalism, according to this argument, can be expected to mimic natural populations – expanding until the carrying capacity of the environment is exceeded and then collapsing in natural cycles – a Marxian argument, though not in Marxist terms.

Over the long term, the stock market (and its derivatives) have surely to be driven by underlying real economic growth prospects, the so called long-term fundamentals – there is no other long-term driver. However, as Keynes and others have noted, in the short run (which is of indeterminate length, and in which we all live), stock prices are driven by the ‘animal spirits’ of investors. During economic booms, general expectations of future growth are strong, and may well become amplified in stock prices reflecting these expectations about future returns. In so doing, escalation of stock prices themselves become an important attractor of investment funds, and provide additional leverage with which to exploit rising prices on borrowed funds. As and when faith in these optimistic expectations falters, so stock prices begin to decline, which is frequently exacerbated by short-selling, declining leverage and credit recalls. As we have recently witnessed, such crashes can reverberate with serious consequences into the real economy.

Consequences:

The proximate and ultimate causes of the Credit Crunch 2007 – 09 are still being debated¹⁴. With no implied priority ordering, they include: the growth of massive leverage of debt to assets (of the order of 30/1); rapid securitisation of debts (mortgages); deregulation of finance markets, following powerful lobbying by financial market interests; naive views amongst regulators about the self-regulation and self-correction capacities of liberalised capital markets; sustained low interest rates and easy money, financed and legitimised by large developing country surpluses used to finance developed country deficits and debts through massive capital inflows; opacity of CDOs and related derivatives (described by Warren Buffet as “weapons of mass destruction”); banks’ unwarranted focus on residential & commercial mortgages and speculation, rather than productive investment; misunderstanding of risk and poor corporate governance, especially in the banks; belief in models (when all models are wrong); systemic interactions through ‘machine trading’ on wrong models; poor credit agency performance; consumerism, hedonism, greed, and excessive speculation, coupled with unwarranted and ungoverned bonuses.

Whatever, the world now demands that capital markets are better behaved in the future and that their governments should take urgent steps to ensure that they do. The *Financial Times* (09.03.2009) thundered: “*The great mistake was to rely merely on self-interest in as imperfect and as important a market as the financial sector. The huge profits bankers reaped reinforced their collective blindness to the illusory value of the assets they traded.*” But the same influential paper seems to consider that the only sensible way forward is through international (global) rules: “*As finance grew global, national rules could not prevent some companies from becoming too large for bankruptcy. We have discovered that to close down financial giants we must bail out their creditors or risk a global recession. At the same time, those too large to fail may also be too large for national governments to save, for fiscal and political reasons. Few countries can even afford to rescue truly global institutions. Taxpayers may in any case refuse to meet failed institutions’ liabilities to foreigners. The biggest question raised by the crisis is how to resolve this contradiction. The current mismatch of globalised*

¹⁴ See, for example, a brief synopsis at The *Financial Times* web site on [The Future of Capitalism](#).

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finance and national governance is unsustainable. Either governance becomes more globalised or finance less globalised” (FT, 13.04.2009). If these are really the only two options, then the future does not look good. International regulations are difficult to negotiate, and (perhaps) even more difficult to enforce. Less globalised financial markets imply costly, and probably ineffective (and perhaps even counterproductive) national regulations. In any event, we are likely to see a mixture of responses, with no consensus on the appropriate balance of measures: “Too big to fail sometimes seems too hard to solve” (Fingers in the Dike: what regulators should do now, *Economist*, 11.03.2010).

Implications

The conventional ‘efficient market’ perspective presumes that any government (or governance) intervention is needed to cope with market imperfections and failures. Consequently, it tends to focus on regulation of otherwise predominantly self-interested behaviours, which ignore the externality or systemic effects of their own struggles for persistence and wealth accumulation. While the provision of better information and more systematic reporting of financial structures and instruments, according to pre-defined rules, is typically acknowledged by all as being useful and sensible, there is no agreement about the rules. Most suggestions about these raise counter-arguments about conditions in which the proposed rules would lead to counter-productive outcomes. More importantly, suggestions about increasing regulation of banks (and, therefore, other financial intermediaries such as pension funds and insurance companies) typically fall foul of arguments about the supremacy of markets versus regulation and intervention. The ‘efficient market’ presumption dominates the discussion on both sides of the arguments. Either it is presumed efficient, in which case more regulation is inherently costly, or it is not, in which case it is presumed that the authorities necessarily know better. The arguments are sterile without a common understanding of what the markets actually do and behave, and quickly deteriorate into highly specialized arguments about the details, with no over-arching conception. It is frequently remarked that the ‘devil is in the detail’ – a remark which might equally have been applied to the failed experiment in central planning.

Perhaps, though, the devil is actually in the conception – with life providing the necessarily and inherently messy detail. Considering finance markets as part of an evolutionary system offer some insights missing from the conventional paradigm. Finance markets have evolved to become separate and largely independent of the system of trade and exchange which spawned them. The only remaining connection is the wealth they accumulate from and dissipate to the real economy, and the consequent waves and storms they generate in the real economy. They do not, except indirectly through channeling savings to real (physical and tangible) investment, generate real wealth. They only churn it. As the financial system grows and becomes both global in spatial coverage and near instantaneous in operation over time, it becomes more difficult to control. More importantly, since it attracts both the clever and the innovative, almost any attempt to control or regulate it is more than likely to generate mal-adaptations rather than benign consequences – the law of unintended consequences as a property of complex systems (especially those in which the participants consider themselves intelligent). Whether or not these systems are efficient is really beside the point – they exist, and we cannot do without them, much as our natural environment. If they did not already exist, we would pretty soon invent and discover them. But, like our natural environment, we need to cultivate and civilise them to be useful.

How might we do that? We need to do (at least) two things: first, discourage them from going wild; second, reconnect them with the real world. Going wild, in this context, means chasing market price movements in the hope of making money despite apparent long-run ‘irrationality’ of such price movements. This can only be achieved through relatively rapid transactions. Part of the volatility of these markets arises from such short-run behaviour, exactly as happens in foreign exchange markets. Tobin (1978) suggested that a way of reducing this short-term speculative herd behaviour is to hobble the exchange of financial

assets (originally, currency holdings) by imposing a transactions tax. This tax, imposed at a marginal level (say 0.1%) on each and every transaction could remove the incentive to chase short-term market movements and encourage speculators to take a longer-term view. In addition, it would raise substantial revenues which could be used to alleviate hunger, assist the poor or act as a fiscal buffer against the counter-cyclical spending needed to avoid finance market generated recessions. However, McCulloch (2010) examines the evidence that such a tax would actually reduce ‘excessive’ volatility and finds it wanting – by reducing the liquidity of the markets, the tax might actually increase volatility. He suggests a more sophisticated tax, an induction¹⁵ or ‘panic’ tax, which “*would tax transactions at a variable rate proportional to the rate of change of the aggregate market price – in contrast to the Tobin Tax’s small fixed rate. Sales and purchases would incur virtually no tax during normal times when the aggregate market movement is very small. But during crashes and booms they would face heavy penalties. Market participants expecting heavy taxation would be discouraged from making these trades thereby lessening the mania or panic.*”

How might finance markets – better, the major participants – be re-connected to the real world? The answer depends on the extent of and reasons for the disconnection. The foregoing arguments suggest that the finance world is virtual rather than real, and only loosely connected with the real world of investment in physical (and human and environmental) capital. Furthermore, the apparently expanding volume of derivatives implies ever more distant relations between the financial assets being traded and their physical counterparts (Figure 2).

Figure 2 Disconnect between finance and the ‘real world’?



* OTC = Over the counter’ (i.e. not traded on a formal exchange). *Source:* Wolf, M, “This crisis is a moment, but is it a defining one? *Financial Times*, The [Future of Capitalism](#) Series, 19.05.2009.

Of course, the wealth generated (and dissipated) in the world’s finance markets does impact on the real world of pensions, insurance premia and sources of loanable funds for real investment, as well as generating substantial tax revenues (in addition to occasionally triggering substantial counter-cyclical fiscal stimuli). Superficially, the disconnect is a reflection of the massive domination of finance markets by exchanges of paper based on existing assets rather than the flow of funds into new investments. Profits (and losses)

¹⁵ So called because it uses the same principle as the induction coil used to remove undesired high frequencies in electronic circuits with ‘low pass filters’.

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associated with such exchanges seem hardly to reflect genuinely productive activities. What, exactly, do these markets and their profit (or greed) driven participants actually contribute to human welfare? More secure and stable savings opportunities, more intelligent and productive investments for our collective futures?

Of course, these ambitions necessarily rely on judgments about an inherently uncertain future, and are necessarily subject to Knightian uncertainty – for which it is impossible to calculate reliable probabilities or risk assessments. There is no reliable or external algorithm through which appropriate actions can be taken. The only alternative is to make use of a ‘market’ – as an exchange of information and judgments, backed with purchasing power (willingness to pay) – which is what these finance markets do. Poorly though they may seem to perform at times, they are better than anything else we have yet discovered.

More fundamentally, the image of the ‘masters of the universe’ and the ‘greed is good’ philosophy which apparently underlies the workings of the finance markets gives extraordinary credence to the social criticisms and condemnation, not just of capitalism but of the whole foundation of economics as currently taught and practiced. Even conventional economics, at its simplest, argues that the profits earned from the ownership of assets, as opposed to their deployment, are rents accruing to existing assets and, as such, can be taxed for the greater good. As with land (which virtually no one is making anymore), the rent is simply a signal of relative scarcity – the appropriation of returns generated by the rents is, in the limit, irrelevant to the appropriate allocation of the resource (asset). Rents are certainly an appropriate score-card through which a market judges the efficiency of allocation, but the distribution of the returns is a more or less arbitrary consequence of the ownership pattern, and not a reflection of the marginal value product of the asset owner (as opposed to the asset itself). While returns earned on the real worlds of markets for goods and services can, perhaps, be justified as equitable in terms of the values of consumers, this case is difficult, if not impossible to make for returns earned by simply exchanging assets. The latter are likely to be judged inequitable, if not actually immoral by many, hence undermining the social and political legitimacy of both capitalism and the market philosophy.

So, one answer is to tax these ‘ill-gotten’ gains to the hilt – the ‘unearned income’ tax rates should be set substantially higher than earned income rates. Again, however, such an apparently simple answer raises more questions than it solves. Is the pensioner’s income unearned? Is the insurance payout unearned? Is the successful entrepreneur’s or entertainer’s wealth unearned? Are the returns of successful venture capitalists unearned? Furthermore, is the public sector (government) any more legitimate and equitable as a manager and organiser of the wealth than the ‘lucky’ (and perhaps perspicacious) capitalists?¹⁶ Communism had at its heart the expropriation of private wealth for the public good as a core responsibility of the state. We have learned that, at least as it has been practiced by the former Soviet Union, this solution generates at least as many problems as it solves. The state cannot be relied upon to be generally more benign than private wealth, and perhaps no more accountable either.

The suggestion that the financiers are disconnected from the real world flies in the face of the recent announcement by Warren Buffet and the Gates (Bill and Melinda) of their Giving Pledge, encouraging the rich to pledge at least 50% of their wealth to charity.¹⁷ In this, they

¹⁶ In this context, an interesting comment is provided by Dipankar Gupta, writing in the [Indian Times](#) (13.08.2010) about the Gates-Buffett factor. Gupta notes that philanthropy is not at all common amongst the present Indian super-rich, although this was not always so. In the past in India, “donors were assured that their money would be put to good public use. They were confident that corrupt administrators and politicians would not squander away their hard-earned wealth. This comfort factor, so necessary for charity to flourish, is missing in India today.”

¹⁷ See, e.g. “[The \\$600 billion challenge](#), *Fortune Magazine*, 16.06.2010, and the [Giving Pledge](#) website. However, the response that this announcement generated has not matched its apparent

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continue a well-established and laudable tradition of a number of past successful capitalists in establishing serious benevolent foundations (e.g. Ford, Rockefeller, Carnegie, Kellogg, Getty, Hewlett etc.). Clearly, at least some of the billionaires who have profited from the capitalist system are well connected with and cognizant of the real world and its major problems and challenges. While their own motives for this philanthropy are probably complex, and necessarily their own affair, their actions speak louder than the words. The effect of this pledge (already massively demonstrated by both Buffett and the Gates Foundation contributions to social benevolence) is to express both the recognition that personal wealth is at least in part a consequence of the socio-economic conditions and happy accident, rather than personal contribution, and also that wealth is not simply (or even) a right under any sustainable human code, but more importantly a major responsibility.

Proposition 2: *Capital markets are presently crude and primitive forms of cultural selection. [It is easier for a camel to pass through the eye of a needle etc.] These markets rely solely on the accumulation of money wealth for their selective pressure. As a consequence, they are socially unsustainable without further checks, balances and adaptation. They need governance.*

Corollary a: *Charity and/or paternalistic benevolence provides some legitimacy for capitalist riches, failing otherwise demonstrable contribution to social good. Coercion (regulation), however benign and well intentioned, is not sufficient and could well be counter-productive.*

Corollary b: *Pure wealth is socially unsustainable as a selection criterion, not only for capitalists, but also for the socio-economic system as a whole. Continual striving and strife for yet more consumption (the foundation of current economic theory) is self-defeating. It matters how we use our wealth, which is more a responsibility than a reward.*

So what? Implications for Further Transition

Economics is alone amongst the social sciences in purporting to tell a story about how the (socio-economic and political) world works. None of our sister disciplines try to explain how all the social transactions and interactions fit together into a coherent whole. Indeed, most other social sciences consider it madness to even try, and are derisory about those who do, pointing to the stupidly simplistic and quite unrealistic simplifications economists make. Economists have a strong tendency to believe that they are the ‘social physicists’ of social science – there are two sorts of science: physics and stamp collecting (Rutherford’s classic aphorism defining scientism). Our sister social sciences, rightly, repudiate such claims, pointing to the obvious deficiencies and simplicities of the economic picture of the world. Many economists, too, are more than fully aware of our own deficiencies and are seeking to deepen and extend our concepts of transactions, information accumulation and organization, political economy, charitable and not-for-profit activities and so forth. Yet, to date, and following the ‘defeat’ of Marxism, there is no competing paradigm which seeks to explain and understand our global condition, other than capitalism. The arguments of this paper

generosity. According to the [Weekly Standard](#) (09.08.2010), “the comments ran 2-to-1 against Buffett and Gates. The included 36 percent of who readers described the philanthropy plan as “a publicity stunt/dangerous/the work of socialists” and another 26 percent who said the money that Buffett, Gates, and the other billionaires were proposing to spend on charity should be spent in other ways – to pay off the U.S. debt, to help individuals, or reinvested in the creation of new businesses and job opportunities. Any number of readers wrote in to urge Buffett and Gates to remember that they were supposed to be *capitalists*. As one put it, “For all their vast wealth, these people don’t have a clue about how economies flourish and fail. Don’t give your money away. That’s called putting it in a bottomless pit. Invest it. Create some badly needed jobs by creating something called businesses with that capital.” It seems that whatever the rich do, they will be castigated by at least some of the rest of society.”

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strongly suggest that this paradigm continues to contain within it the seeds of its own destruction.

Meanwhile the world faces a major crisis – how to ensure that 9bn. people are able to live with reasonable prospects of increasing functional capability (Sen, 1999) in the face of increasing scarcity of natural resources and an increasingly less reliable and less benign climate. We need urgently to develop more sustainable systems. Up to now, our history, as a species, has been one of trial and error – the latest major one being the trial of communism and the discovery of its errors (at least as practiced, if not necessarily in principle). Our history also strongly suggests that humans are only capable of addressing major challenges and of making progress with the assistance of a guiding ideology or worldview. At present, capitalism is our global guiding ideology. Yet it is abundantly clear that this worldview does not command universal respect or admiration, and is even incapable of generating majority acquiescence.

I argue that we need rather urgently to develop and proselytize one, and that capitalism in its present form, and as mostly argued by its most ardent advocates, will not do. What, then, does the alternative look like? Hofstede (e.g. 2001), on the basis of extensive empirical research, proposes that different cultures solve their fundamental social problems of harmonising personal and social ambitions, with their associated attributions and transaction system mixes, in identifiably different ways. Hofstede detects five major axes of cultural difference, where differences can be measured according to the balance particular societies chose along these principal axes. Hofstede's principle axis – the balance between individual and collective ambition and aspiration – is fundamental, since for any society (of whatever form) “positioning itself between these poles is a very basic problem all societies face” (*op cit.*, pxx).¹⁸

In Harvey, 2008, I argue that we ought to be able to identify the principle *phyla* of our complex socio-economic and political transaction and negotiation systems by considering their real world exhibitions – the social science disciplines which seek to explore and understand them. In the natural world, evolution has generated a distinct and recognizable taxonomy of living systems, as species and genera and phyla. We should expect that social evolution would also generate such a taxonomy. Perhaps we are too closely involved with this taxonomy to recognize it. However, the survival and persistence of the major disciplines of social science strongly suggests that the appropriate taxonomy has already been exhibited in the nature of these disciplines. Of course, the ‘devil is in the detail’ as far as this simple hypothesis is concerned – the disciplines themselves cannot agree even what their own central focus is, other than as more or less meaningless generalities. An alternative perspective, however, is that ‘life is in the detail’, the devil is in the conception. Instead of searching within the current disciplines for the central, guiding pre-occupation of each in terms of specific transactions, perhaps we can identify these major strands by re-considering our history as a species.

In brief outline, the argument is as follows. Capra (1996) notes that biological life ‘minds and responds’ to its environment, in contrast to physical (and chemical) ‘simple’ existence and reaction. Human life, however, goes further. Humans (as Weber noted¹⁹) not only mind and respond, but also care and reply to their fellows and environments, and generate *consent* (Anthropology) as a major transaction system as a consequence. Further, we become

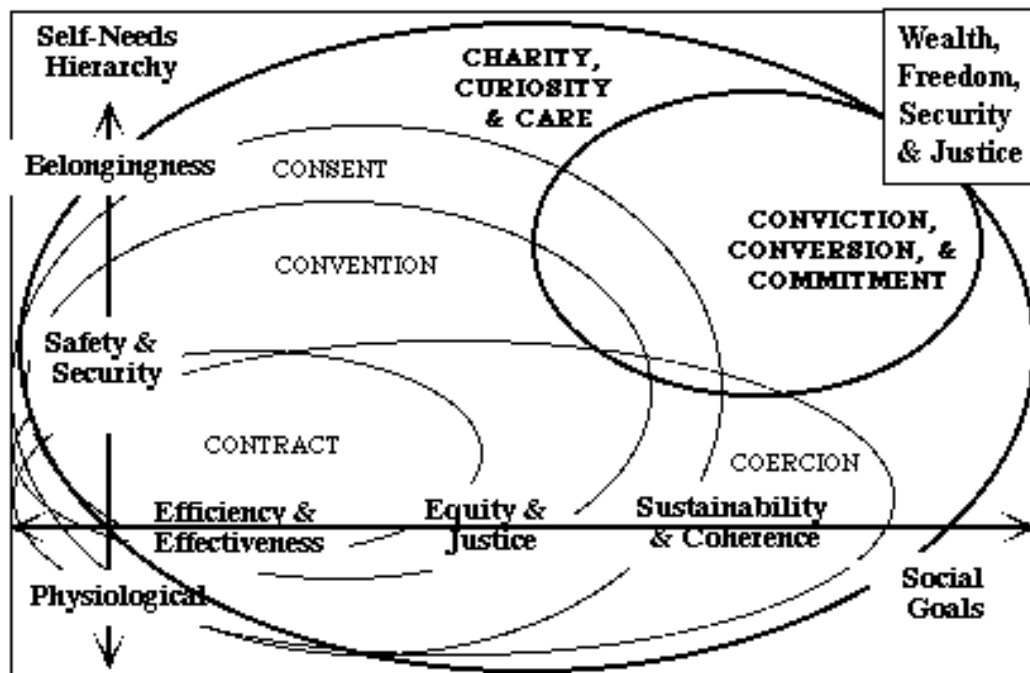
¹⁸ The other four axes identified by Hofstede are: uncertainty avoidance (the extent to which society tries to control for or guard against the unknown and uncontrollable); power distance (the degree of inequality the society is prepared to accept and expect); male/female (a major emotional dimension of society's accepted practices); long term/short term (the extent to which society accepts delayed gratification of ambitions and is prepared to be patient and wait).

¹⁹ See, e.g. Gerth and Mills, 1946; see, also, Swedberg, 1998

cognizant, and recognize others as different from self, and relate to these others (including the environment). *Cognition* (as the second major transaction phylum – explored in detail by Psychology) leads naturally to rationalizing and reasoning about others behaviours and seeking to fit better (or fight) with those behaviours, developing *care* into a major transaction system as a consequence, as explored by Sociology. *Contract*, as specialisation and barter trade emerge, rapidly follows as a major transaction type, and Economics is centrally concerned with these transactions. As already outlined above, *coercion* and *convention* are necessarily co-inventions with contract, an exhibit as the disciplines of Law and Political Science. These ‘last’ three major transaction systems dominate the western common hegemony: *contract* – the liberal free trade and exchange systems; *coercion* – the rule of law, and their international institutions; *convention* – the politics, habits and practices of government. However, I argue that these three, on their own, are constitutionally incapable of securing our collective wealth, freedom, security and justice, illustrated in Figure 3 as the harmonisation of self and social (public) interest.

In particular, our social science understandings need to more thoroughly incorporate our arguably more primitive and fundamental transaction systems of cognition, care and consent, which typically manifest most completely in smaller, even closed, societies – i.e. at the local level, as evident in much of the practice of development studies. But, perhaps more importantly, this perspective strongly suggests that we are very far from reaching the ‘end of history’ (Fukuyama, 1992 and 1995). The end of history, in an evolutionary system, is the end of the future as well. There are, I suggest, further transaction systems we need to embrace to cultivate a more sustainable future.

Figure 3: A schematic representation of social systems



More sensibly, since evolution (as a chaotic system) is inherently unpredictable: what would we like our future to look like? If we can agree on a desirable future, it might be possible to cultivate it. Presumably, one world we are striving to create involves the development of genuine *commitment* to our social governance institutions, which implies not simply research and criticism of existing systems but development of new (or re-invention of old) transaction systems. These are only superficially covered under such maxims as ‘participation’, ‘accountability’ and ‘inclusion’. It requires a conversion of our present stories of the ways in

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which the world works to be much more convincing as genuine, coherent and credible accounts of what we are trying to do, and how we come to be in our present condition.

Consider, for instance, an ideal, though dynamic, outcome in which the world's population can become convinced that all is for the best in this best of all possible worlds. In such an idealised state, one can imagine a fully *committed* population, willingly and enthusiastically merging their own self-interests with those of the community in near unanimous harmony - the communist ideal in a nutshell. Obviously, this condition is extremely difficult, if not impossible, to achieve.

However, suppose that we could achieve it. A penultimate phase of institutional evolution then becomes possible, in which a significant fraction of the population engages in creative *imagination* of how things might be even better and more harmonious, and is engaged in continual *re-creation* of the community and its environments, with the full support and commitment of the whole community in these endeavours. Such societies could reasonably be described as being driven by the pursuit of fun and *curiosity* - where imagination and re-creation appear as scholarship or as play. In short, such societies might be characterised as having a common faith in the ultimate benevolence of their communities and in the 'fitness' of their world views, and an associated freedom to doubt (and hence question and seek to change) the rules, rulers and power-bases, in the common belief and trust that such activity will be regarded as perfectly legitimate, respectable and socially benevolent. Note that there will never be unanimous consent that the ultimate has yet been achieved. What we might reasonably aspire to is near-unanimous consent that the principles and practices of the community systems in conjunction with all its associated environments is both capable of moving towards this state of perfect harmony, and that the whole population is committed to this pursuit above all others - in short *careful charity*. We could, perhaps, label such an institution as a sustainable **culture** (or a mirage).

An evolutionary perspective suggests that we need to cultivate and civilise our social transaction and negotiation systems to recognise that the selection criteria are of our own making - we need to make better rules and tools for our livelihoods. This is, primarily, a social science enterprise, yet our social sciences presently seem to be part of the problem rather than the resolution. Even within economics, there are factions arguing about the role of the state, the appropriate ways of representing the world's market systems, and the meaning of the evidence. We are not going to get rid of this, and nor should we, but we do need to be far more constructive than at present in trying to develop a metaphysical story on which we can broadly agree. Following this, we might then have reason to hope that we can indeed cultivate a more sustainable future.

Conclusions: Transiting from what to what?

The transition between centrally planned and communist inspired socio-economic management and more or less governed capitalist economic systems has produced some traumatic and bizarre outcomes. The social infrastructure embedded in the collectivist organizations has not yet been fully replaced with a welfare state. The 'privatisation' of many former state owned resources and assets has generated a number of oligarchs, especially in Russia and the Ukraine, who appear to the outside world to have been lucky enough (at the least) to capture their wealth without any obvious merit or desert. Although the economic performance of many of the former Soviet countries has improved dramatically since the fall of the wall, there is still good reason for many people to question the practical superiority of the capitalist system in the light of their experience.

While it is obviously important to learn from this transition experience, it is also important to realize that the next transition is still to be made. The communist experiment was supposed to

be an alternative socio-economic system to provide for each according to needs from each according to ability – a benign aspiration, though the devil was clearly in the detail. The details are the myriad of transactions and associated information exchange, which transmit willingness to pay (and hence some sort of value) from consumers to producers, and, in return, indicate some sort of estimate of the real costs of production and delivery back to consumers. The critical questions about who decides how to produce what and for whom are dissipated and democratized through the market. The market itself is, effectively, a massive organic and distributed computer system for organizing production and consumption – capable of evolving apparently without the need for any central guiding hand. It is the people who decide, continually and reflexively. The advantages of the market over central planning are not in dispute, as is being demonstrated in the growth of the Chinese, Indian and Brazilian economies.

But it is not so clear that the capitalist system is actually better-fitted to meet the future challenges facing us. Much of the Marxist critique, though not the Marxist analysis, still has considerable force. It is not difficult to find more or less extreme examples of capitalist stupidity and brutality, immorality and outright exploitation. Even in the better democracies, there are still strong and debilitating examples of alienation and exclusion. Have we really found a better ideology? Many answer: no. In addition, the major challenges facing the world clearly do now need a communal guiding hand – how to price fossil fuels and the natural environment, and how to co-ordinate global efforts to deal with major natural events and disasters, and their consequences. But, what provides the credibility and legitimacy of the guiding principles? Science, alone, is not enough. We need a coherent and believable creed – a second coming. History, however, suggests that we will not recognize such a second coming if it happens, and will conspire to crucify it if it does. The answer has to lie in our own hands. As (agric) cultural economists, we have the capacity to contribute to better answers, which are critical to the further transitions we need to make towards a sustainable future. To do so, we need to change our perspectives, not just our conditions or our tools and rules. Our present rules and rulers are insufficient – the challenge is to find better ones before it is too late. To do so, we need guided experiments – and therefore need a more coherent and sensible story about the way the world works than we currently have.

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