4 Individuals and Institutions in Social Economics

This chapter will conclude the sampling of topics which are given as examples of social economics as a system of theory. As we look at some of the micro issues of human psychology which social economics must consider, it is worth beginning with the reminder that there is more than one body of knowledge which can be drawn upon to aid in an economic understanding of human behaviour; e.g., the various branches of psychology, as well as existing syntheses especially intended for use in the field of economics (cf. the work of George Katona, or Amitai Etzioni). As social economics develops there might come to be a standard (though, it is to be hoped, always evolving) set of understandings in this area – but nothing that could be so simply summarised as the statement that 'Rational economic man maximises his perceived self-interest'.

VII Issues of human psychology

In looking at micro-level behavior we need to remind ourselves that, in fact, neither neoclassical economics, nor any other imaginable system of theory that would obviously belong in the field of economics, is much concerned with tracing the behaviour of any one particular individual. The neoclassical system is concerned with economic outcomes which are the result of aggregated individual behaviours, especially in the intersections of the purchasing behaviours and the producing/selling behaviours which create prices. In order for the neoclassical system of theory to be 'correct' (i.e., to make good predictions and accurate descriptions of this level of activity), it is not necessary for the psychosocial axioms of the system to be realistic, but only for the outcomes to be the same as they would be *if* these axioms *were* realistic.

Often this parsimonious approach yields useful insights. Neoclassical economics has developed tools well adapted to model a micro-economic picture

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- in which individual actors are understood to behave atomistically, minimising the interaction effects among them;
- where these individuals may be simplistically understood as rationally self-interested, with 'rational behaviour' understood as *maximising* and *instrumental*;
- where economic gain may be understood as at least a reasonable proxy for most significant motivations, and prices adequately reflect the most important and relevant human desires and satisfactions;
- and where all significant actors are willy-nilly competitive.

However, in part because of what has been lost in this set of simplifications, the neoclassical system diminishes in power and relevance

- as the focus shifts from a micro picture of individual interactions to a macro picture of societies operating as complex whole organisms;
- where cooperative behaviours have an economic significance;
- as we try to understand changes in these organisms over time;
- as our concern focuses on values other than prices which are used in defining some notions of welfare;
- as we try to relate some real future with the real present (both of these being disequilibrium realities);
- or as we try to make certain necessary translations between reality and theory and back again.

Unfortunately, the neoclassical paradigm contains no way of predicting when its insights will be seriously off, or why; and those occasions are sometimes of great economic significance. This is why there is need for a companion/alternative to the neoclassical paradigm which will look inside the black box of human behaviour.

The psychosocial issues where it seems that the neoclassical model runs into trouble include:

- some areas where motivations other than 'maximisation of self-interest' (e.g., altruism, honesty and trust) have important economic effects;
- inframarginal motivations;[1]
- the motivations and behaviours that may best be understood in terms of the concepts which Alfred Marshall referred to as 'activities' and 'progress';

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- the economic importance of the distinction between needs and wants;
- issues of class, especially in relation to other divisions in human society (along lines of race, age, ethnicity, education, etc.);
- various kinds of power and coercion that arise from or impact upon the economic sphere;
- innovation and entrepreneurial activities;
- and various information and learning-related issues, including the role of advertising, the effects of fashions in thought and belief, and the value of collective behaviour for gathering and sharing information.

This chapter will take up only a few of these issues, as examples of the social economics approach to understanding human behaviours and motivations as determinants, consequences and goals for the field of economics.

VIIA Altruism Most people recognise that there are many altruistic motives, including some that have significance for economic behaviour. Although this recognition began with Adam Smith, and continued to be evident in the writings of most of the prominent economists up through the time of Alfred Marshall, it is not really compatible with the core of the modern neoclassical paradigm. There have been many ingenious efforts to integrate it into the core, but none of these have been incorporated into the mainstream.

The issue may be illustrated by reference to one such effort: Amartya Sen's concept of a 'two stage utility function'.[2] Sen's proposal was that we understand utility-driven choices[3] as occurring according to the following two steps: first we decide what kind(s) of utility are involved in a given problem (e.g., are we after the utility we will feel by doing our duty; by that associated with self-improvement; or is it simply hedonistic pleasure?) Having made this choice, we then choose the activity that will maximise the preferred type of utility.

As a description of reality, this is probably inferior to a psychology of choice which is not constrained to employ the vocabulary and concepts ('utility' and 'maximisation') of neoclassical economics. However – again, as a description of reality – it is a distinct improvement upon the restriction of utility to selfish gain which is the most useful definition for the neoclassical core.

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Selfish gain is not, of course, the only meaning of utility in the neoclassical paradigm. However, it has been well argued (see, e.g., Chapter 2 in Etzioni, 1988) that attempts to broaden the definition further result in either a tautology or a mystery. This has been particularly true since the historical time of the transition from classical to neoclassical economics. One of the characteristics of that transition was an attempt to excise from the field dependence upon beliefs which, however widely held, could not be proved. In particular, a number of the assumptions of Utilitarianism were formally removed (though their presence often remained felt on an informal or unconscious level). One consequence of this was the following:

> If interpersonal comparisons of utility are impossible, then we are no longer able to maximise the sum of utilities across people. So the neoclassical utilitarian defends a weaker kind of maximisation process in which one maximises his own utility. The classical utilitarian's moral principle, which says to maximise the sum of utilities, is strong in the sense that it sometimes directs people to act against their own selfish interests. The corresponding, weaker neoclassical utilitarian's moral principle says that we should move toward Pareto optimality. This principle is weaker in not requiring individuals to act against their own selfish interests. It is also weaker because in many situations it does not tell us what to do.[4]

The neoclassicist, with his/her beautifully structured system, suffers from a serious problem:

- all normative inputs have (theoretically) been removed from the field;
- 'you cannot derive ought from is';
- yet the economist is constantly in the position of needing to be able to say what *ought* to be done.

The fall-back upon efficiency is often not enough, for the question arises: Efficiency to what end? We shall see throughout this book (and even more in Volume 2) instances of where this untenable situation is uneasily resolved by the injection of normative elements back into the foundations of the field – even into the psychological assumptions, from which they are supposed to be absent. The argument over altruism, and the appeal to sociobiology to settle it (by proclaiming what the nature of Man *must* be, as a result of evolution) is but one symptom of this malaise.

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VIIB Trust Karl Marx popularised the concept of a callous 'cash nexus', or web of commercial relationships, which, he claimed, was all that bound people together in a capitalist system. In fact, in a variety of ways, modern industrialised economies are more than ever dependent upon what might be called 'the trust nexus'. There is a web of informal rules, ethical principles, habits and traditions which clearly work for the public good and which often do not (at least in any obvious way) serve the private, selfish interests of those who abide by them. The more complex and interdependent a society becomes, with increasing specialisation and rapidly developing technology, the more critical these are.

Social economics could usefully devote some attention to examining this issue through such questions as these:

- What different forms does the 'trust nexus' take? How does it vary among different groups of actors (e.g., workers, managers, consumers, entrepreneurs, taxpayers, etc.)?
- Who plays by these rules, and who does not?
- Under what sorts of circumstances is it most prevalent, where most absent?
- What effect, if any, does social science (including economic) theory have upon the trust nexus?
- How can the trust nexus be encouraged and strengthened? And what side effects might result from efforts to do so?

VIIC Incentives and motivations Inframarginal motivations are an important class of motivations which are hard to discern in the neoclassical system. Examples include the pleasure which is taken in work in the early hours of the day, before fatigue sets in; or a welfare recipient's sense of decreased welfare associated with the boredom, and perhaps a feeling of reduced value to the world, consequent upon not having work to do.

There are, additionally, a large set of incentives which do not get represented in prices. The use of a person's own time may be an example: when I commit my *time* I also commit my *self*. The other 'human values' which are then involved ('What will I learn from this experience? How will it change me? How will I feel during the hours in which I am so engaged?' Etc.) are not easily converted into money values.

Another significant set of motivations which are not normally represented in prices is that associated with non-marketed exchanges

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and non-marketed work, such as volunteer activities. Home-making and child-care – activities critical to the wealth and welfare of societies – are other outstanding examples. Economists have not neglected these areas; where they have dealt with them successfully, however, they have generally done so by abandoning much of the core of the neoclassical paradigm, stepping, perhaps, into the area to be defined as social economics.

VIID Learning; fads and fashions; familiarity and strangeness

There is an educable aspect to humankind. It shows up in such economic places as our ability to adapt to higher petrol prices with energy conservation measures; as well as in the ability of advertisers to manipulate tastes (towards careers in teaching as well as towards the purchase of deodorants); not to mention the advertising industry's manipulation of the values and self-images of large populations. It is, in fact, when tastes, preferences or values change that many interesting economic events are likely to occur. This is precisely when the light of the neoclassical economic system is apt to fail because it takes consumer preferences as 'given' and 'sovereign': in assuming that each person is the best judge of what s/he wants, it fails to consider what people 'should want to want', or the possibility that people might benefit from changing wants through a learning process.

We may refer here to Alfred Marshall's unabashedly normative concept of 'progress'. He assumed that the moral structure which is part of the foundation for individual motivations is, or should be, one of society's most important ends; the ultimate public good lies in a kind of progress wherein human wants are trained so that individuals will increasingly want what is good for them.[5] What is good for people, Marshall felt, is to want the kind of reward which a good person wants; i.e., fame, honour, and the pleasure, for its own sake, of serving others. If the moral structure of the society and of its individual participants can gradually be brought toward this orientation the whole society will be better off, for honour will increasingly replace pay as the most sought-after reward, permitting an evener distribution of income without loss of productivity; and consumer satisfaction will increase as individuals at every level care more about the quality of the work they perform.

Tibor Scitovsky gets at Marshall's closely related concept of 'activities' by dividing the sources of achievable 'satisfactions' into

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two sets, *comforts* and *stimuli*, where the latter often include activities such as work, sports and cultural pastimes. Scitovsky stresses that an important source of human satisfaction is the mental stimulation that is associated with novelty. This fact, however, creates 'a logical difficulty which seems to rule out consumer rationality in the sense in which we know and accept it as the governing principle of consumer behaviour in other areas of consumer choice.'[6] The logical difficulty comes from the fact that there are stimuli which include novelty (or surprise) among their satisfying elements and which, at the same time, require an 'investment' of time and effort in learning. Why make the investment if you do not know what the reward will be? But if you do know the reward in advance, you are robbed of the element of surprise. An example given by Scitovsky is 'the impossible situation of having to have musical knowledge to be able rationally to decide whether that musical knowledge is worth acquiring. Nor', as he then adds, 'is that problem confined to music; it is common to all forms of stimulus consumption that require a skill for their enjoyment.' (ibid., p. 124). His conclusion is that this paradox is resolved when the previous generation, having experienced the rewards to be had from 'education in consumption skills', provides such 'humanistic education' for the young.

The characteristic which most separates 'comfort' type experiences from 'stimulating' experiences is on the spectrum from familiarity to strangeness, or novelty. A little of the latter is exciting; too much is nerve-wracking.[7] In spite of the varying range of tolerance that different people have for the boredom of familiarity or the alarms of strangeness, one can, nevertheless, make some useful generalisations about the relevance of this point with respect to economic groupings. For example, most people tend strongly to prefer working among people they know to working among strangers. Employers tend to prefer to hire an individual who has some connection, however tenuous, with someone they know, rather than a person who is completely unknown – even though the information gained from the 'introduction' may have no bearing on qualifications for the job in question.

The economics of consumption, as developed in practice by those who produce in order to sell to consumers (and who 'sell' to consumers what it is that they produce) may depend most obviously upon being able to tickle the desire for novelty; but the economics of production, insofar as it relates to relationships among people who are working, brings out the neglected importance of the desire for familiarity.

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VIIE Activities The economics of Alfred Marshall will be a particularly useful source for an area of human psychology that is notably lacking in the modern neoclassical paradigm. Marshall saw humans as rounded beings whose human values are of central importance. He saw those values not as fixed, but as evolving in response to the environment and, most importantly, through the activities of their possessors. And he saw the whole society as the responsible locus both for the value-shaping environment and for the opportunities for individually value-shaping activities.

Marshall's emphasis upon studying productive activities not only in terms of their contribution to consumption, but also as forces for societal, cultural and ultimately economic change, is dramatically different from what is to be found in neoclassical economics. The latter, stressing individual wants and their satisfaction, makes no pretence of attempting to recognise social or cultural change aside from the level at which existing wants are satisfied. The strongly Utilitarian character which continues to provide the ethical/philosophical framework for neoclassical economics casts activities as instrumental. The *process* is regarded as relatively unimportant (another way of avoiding a dynamic issue), while the emphasis is upon what one *gets* at the end of the process. What one *gets* can be fairly easily fitted into a static system. What one *does* – the activities themselves – the process again, as distinct from the goal – is a dynamic reality deserving of study within a theory which would, however, need to be quite different from neoclassical economics.

A social economics with a practical and sustained emphasis upon the values of Man as worker – not just after-hours, but the worker on the job – will have an additional advantage in possessing a special line to the findings of adjacent fields (sociology, psychology, etc.), and a special way of using these insights to organise economic concepts and data. It will also have a point of view sufficiently distinct from the point of view of neoclassical economics as to help clarify the existence and the nature of the latter's point of view.

In this connection, the logical structure of the earlier exercise in goal-definition may be made somewhat clearer. The primary goal, welfare, analysed in terms of four aspects (survival, happiness, self-actualisation and moral or spiritual development), is to be understood as referring to states of being. As such, this is at some remove from the subjects with which economics can be expected to grapple directly; yet it is critical to keep the 'being' goals in mind to assist in prioritising and balancing the secondary goals.

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The secondary goals may be roughly categorised under two headings: 'having' and 'doing'.

- *Consumption* and *sustainability* are mostly about having.
- Education and work, as examples of *enhancing activities*, may be ends in themselves, and then they are importantly concerned with doing; but under some circumstances they are perceived as more relevantly means to the ends of having.
- *Hope* has been strongly attached to the materialistic definition of progress with respect to consumption in the last two hundred years; but resource constraints may require that, if this is to remain a goal, it will have to be experienced increasingly with respect to the doing aspects of life.
- *Economic justice* continues, and probably will continue for a long time, to be most concerned with who gets what ('having'). Normally related to this, of course, is the critical importance of the question of who may participate in what activity. This may, in turn, be closely linked with issues of self-esteem as well as pleasure in life. There are not a few people for whom these last-mentioned 'being' issues are the chief motivation to press for equal access to work and educational opportunities; but for many others the critical issue is a survival level of consumption, for themselves and for their children.

VIII Human groupings and interactions

VIIIA Issues of aggregation

Statistical smoothing, as an effect of aggregation, can sometimes cause realistic results to be deduced from unrealistic assumptions. An example is the assumption of maximisation of self-interest. At times this may be unusefully unrealistic, but it should be stressed that there are many other places where it works very well, precisely because, in the aggregate, human behaviour may average out to a pattern which is consistent with the core neoclassical assumptions – even though those assumptions would not be an accurate description of the underlying individual choices.

However, the problems which can arise out of the initial simplifying assumptions may also be compounded by the interdependencies and other types of interrelationships which occur in aggregations, but which tend to be ignored in neoclassical models.

For example, neoclassical economics cannot well accommodate to its areas of real strength explanations or predictions which take into

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account the way work groups behave differently from what would be predicted as a simple sum of the parts (e.g., instances of compensation for the weakness of a member who does not produce as effectively as the rest). There is much relevant group economic behaviour wherein an incentive which would produce a given effect upon most of the members individually will have a different effect in the context of group dynamics. Leadership may play a special role here; also concern for how one is perceived by other people; and a variety of other motives and interactions, some of which may be subsumed under the term, group solidarity.

In addition to sorting out the variety of incentives which may go beyond narrowly construed self-interest, it is also important to note that incentives may have different impacts, depending upon whether they are felt by individuals, groups of individuals, firms, groups of firms (e.g., by sector), by ethnic or interest groups, regions, nations, etc. 'Social systems differ in the relative mix of the different classes (private, collective, sectoral, spatial) of incentives. Incentives interact and the system outcome depends upon such outcomes. In some societies the incentive mix may promote a high incidence of competitive behavior among the institutions; in others, dominant bureaucratic behavior; in still others, cooperative behavior, etc.'[8]

VIIIB Institutions, including governments The term 'institution' is sufficiently broad[9] so that it can be employed to cover most, if not all, of the human groupings wherein additional sophistication is needed to explain economic behaviour. To answer this need social economists might go to the field of sociology; or they might draw on digests of sociological understandings such as institutionalist economists have sometimes made. Again, an evolving, standard literature may develop for this area.

Over the years a number of first-rate sociologists have been individuals who started their educational careers in economics (Talcott Parsons is just one example), then discovered that economics was not dealing with the questions that had driven them to the field, and so moved over to sociology. We need to reverse this drift – to attract into social economics individuals with a strong background in sociology, who can bring with them an ability to see *societies as networks of relationships* – among individuals, creating institutions; and among institutions as well.

Obviously, not all relationships can be studied at once, and the defining feature of the field of economics is its focus upon things that

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have an economic meaning. The point to be made here is that institutions, governments and networks of relationships must be understood within a more comprehensive context than that traditionally accorded them in the neoclassical system if we are accurately to perceive which of their aspects do, indeed, have the most significant economic meaning. The challenge for social economics is to view whole economic systems – on local, national and transnational levels – *as* wholes; and to see the integral part played by all institutions, including governments, within the systems at each of these levels.

The role of governments is one of the most important of economic topics, and one of the least well addressed. The subject is equally an embarrassment to Marxian economics, where the expectation was stated by Marx that, if everything else was done right, governments would simply wither away; and to neoclassical economics, where, too, the decision to call on government implies a kind of failure ('market failure', in this case).

Among the institutional issues which will require special attention from social economists, two of the most important are power and competition. Economic and non-economic power which can be used to reduce economic competition is one among many anti-competitive forces to be found in human nature and in the nature of institutions.

If, as suggested earlier (in Chapter 1), idealisations of competition and cooperation occur in the neoclassical and the Marxian paradigms as simplifying assumptions which are, however, inadequate to handle some real world complexities – so, too, is another alternative, coercion, inadequately recognised by both systems. In the neoclassical system coercion, as a power relation, is only considered in relation to the activities of government. Relations in society are assumed to be divided up in such a way that free choices about production and allocation always and only occur in the economic (market) realm; while coerced choices, determined by power relations, are seen as exclusively political (governmental). In fact, government is an important actor in the production and allocation of public goods and services; and coercive, power relations are to be found at many points in the economic sphere. Power relations affect, e.g., the purchase and sale of labour power, as well as transactions between large and small firms, etc.

For different reasons, coercion in relation to economic matters is also insufficiently analysed in the Marxian system. The diversity of kinds and sources of power in the economic sphere is hard to see in a system which relegates all power to a class source. Moreover, communist economics are ultimately concerned with the ideal world

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when political and economic coercion will have ceased to exist. In the meantime, the coercion of the state – one of the outstanding features of life in a communist system – is handled with kid gloves, if at all.

Disaggregation will be important for the social economics approach to institutions. While there are useful things to be learned from finding the similarities between such institutions as families and firms, firms and governments, etc., there are also important differences to be noted. The neoclassical paradigm has tended to use the firm as the typical institution, and has made significant progress in some areas by seeing how far the theory of the firm can then be made to apply to other institutions. There are, however, important areas where maximisation of a single function (by analogy with profit maximisation) is not the most useful assumption to impose upon institutional behaviour.

There is a logical chain to be observed between (a) the purposes for which institutions exist; (b) their actions; (c) policy advice to support those actions; and (d) the theory on which that policy advice is based. Though *goals* (purposes) and *theory* are at opposite ends of this chain, they remain importantly linked; the emphasis of theory needs to be affected by the goals, just as much as the realism of the goals should be affected by the theory.

A concrete example of what is meant here would be the analysis of such public institutions as national governments, or the World Bank. Some recent work in public choice theory has emphasised the positive observation that individuals in these institutions are often motivated by private self-interest, and may be understood from the assumption of selfishness which is sometimes used as the micro basis for the theory of the firm.[10] Such positive observations on the nature of actual human motivations are obviously of great importance, to be discussed and debated without inhibitions stemming from preferences as to the way the world 'should' be. At the same time, social economists who operate near the 'theory and advice' end of the chain would be expected to accept some responsibility for knowing the broad goals of the institutions and for reflecting on the relationship of theory and advice *vis-à-vis* those broad goals, as well as with respect to the narrower tasks for which they might have been called in.

For instance, if a social economist has been called upon to advise a government on which ones, among a variety of available new technologies, should be promoted as most efficient in carrying out some agricultural task, s/he would not only answer the question that was asked, about economic efficiency, but would also comment upon whether the technology which promised the most output for the least

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investment would also have important impacts upon employment or other elements of the broader welfare to which the government is, presumably, committed.

IX Economic systems

A distinction needs to be made between *a system of economic theory*, as a set of abstractions about the perceived world, and *an economic system*, as the actual structure of some grouping of real world economic activities.

The system of neoclassical economic theory has co-evolved along with capitalist economic systems; it is best adapted to explaining capitalist economies, and to assisting in achievement of the capitalist goal of maximising a society's total consumption opportunities through efficiency in production.

The system of Marxian economic theory evolved on a path that took about seventy years before converging with a real communist economic system, but it is nevertheless designed to aid in understanding communist economies, and to promote their objectives of fair distribution of work and consumption.

With what 'economic system' shall we associate 'the system of social economic theory'? That question can be answered in two ways.

First, we may note that the capitalist system described by neoclassical theory does not, in fact, exist; any more than the communist society described by Marxian theory is to be found anywhere in the real world. Both systems of theory describe ideal economic systems: one of perfect competition, the other of perfect fairness and cooperation. Social economics, rooted in the period when the evolving field of economics was dominated by Alfred Marshall (see Chapter 5, below), is more directly related to neoclassical than to Marxian economics; we could begin to understand its place in the world of actual economic systems by saying that it will attempt to describe some aspects of economic life in so-called capitalist countries with more accuracy and relevance than the neoclassical paradigm can do. If it is successful in this goal, it may then also be of use to historically Marxist or socialist countries, as they, too, seek for an alternative way of organising their understanding of changing economic realities.

The other way of addressing this question is to note that we are living in a time of great transitions, where what have for two centuries been analysed as national economies are now often better comprehended as parts of a global economy – but the latter has yet to be fully analysed or understood. Rules and realities are changing;

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issues that had not previously seemed important enough to be included in our accounting are now emerging as critical elements of our economies; and goals, too, may be changing. In many ways humanity is at present more affluent than ever before; that very affluence arouses demands for the subordination of the goal of productive efficiency to the goals of economic and social justice. At the same time the costs, to a rapidly approaching future, of production and consumption are being discovered to be much higher than previously imagined. Something like social economics is needed, not only as an alternative to the neoclassical economic explanation of capitalism, but to promote clear thinking, in an increasingly globalised world, about alternatives to both capitalism and communism – neither of which, in any case, really exists as described by neoclassical or Marxian economics.

IXA Macro and global economics Some elements of macro theory are so loosely or uncomfortably connected to the core of neoclassical theory that they may be regarded as lying outside of the neoclassical pool of light; fair game, in fact, for any other system that can do a better job of incorporating them.

As suggested earlier, the macro elements which do fit into the neoclassical core are, generally, those areas:

- where the aggregation of micro elements can be simply made, because the theory of the atomistic cases is applicable to the aggregation thereof; and
- where social welfare may be achieved by maximisation of individual welfare.

Trade is an example of where neoclassical economics usefully, but in disregard of some aspects of its own theoretical consistency, employs aggregate concepts as though they resulted from a simple addition of atomistic units. Neoclassical economists often present their argument as though they were 'building up' from a one person, one good economy. This procedure is, in fact, a logical impossibility in light of the phase-shift that occurs when people and goods are aggregated so as to permit trade; one of the most important outcomes of the neoclassical system is, indeed, the welfare-raising effect of trade, which could not be predicted from knowledge of all the actors individually, disregarding interactions among them.

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With this said, and accepting some theoretical inconsistency, the neoclassical system nevertheless possesses powerful tools for explaining certain aspects of international trade. Other aspects remain relatively less understood.

As an example both of some neoclassical strengths and of some of its weaknesses, we might consider the global grain trade. We can find here many of the ideal conditions listed in the overall description of the neoclassical core areas: there are relatively complete markets which tend to be capitalistic; many of the conditions for perfect competition (e.g., homogeneous products, many final buyers and sellers) are present; and there are such an enormous number of actors (including a majority of the people in the world, one way or another) that at least some local 'irrationalities' get lost in the averaging out of behaviour. Neoclassical analysis has, therefore, a basis on which to build demand-supply diagrams that are quite realistic. However, this approach loses its grip, for example:

- where attention has to be paid to how the aggregate groups of actors are defined (a nation? a farmers' lobby in the EEC? a multinational trading company? a trading bloc?);
- where power transcends the neoclassical list of market forces (military or political as well as economic power; or even the power of world opinion or of prevailing fashions in ideas); or
- where tastes change. For example, the preference for meat is sometimes as relevant as the ability to pay the premium for it. Also cf. the growing taste for wheat (promoted in part by the US policy of PL480 exports of surplus grain at below-market prices) in areas of the world not well equipped to grow it.

In such areas as these, where neoclassical economists have been most effective in understanding the global grain trade it is often because they have, on their own, ventured outside the neoclassical system of theory.

More generally, the issues of aggregation which we have seen both helping and hurting the effectiveness of neoclassical theory are critical of its welfare predictions and prescriptions. It gradually came to be recognised, during the time that Alfred Marshall dominated economic theorising, that the letter of the Utilitarian philosophy could not be followed, for it was impossible to sum up individual utilities for anything like Bentham's 'felicific calculus'. However, nothing has really replaced the concept of maximisation of non-interactive, individual utility sums as a way of linking together neoclassical micro-economics

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with its macro aspirations to address social welfare. One problem, which social economics must be designed specifically to avoid, has been the over-balancing of the neoclassical system of theory towards a micro grounding. In spite of the rejection of Utilitarian summing just cited, neoclassical theory has continued, in most respects, to proceed as if human aggregations were in no way different from the sum of the parts. Given this bias, it is probably the case that the neoclassical/Utilitarian approach has the greatest likelihood of contributing to social welfare when it is applied to highly homogeneous societies.

When neoclassical economics is applied to a society with important heterogeneities, it can still *appear* to work if there is a homogeneous group which is sufficiently dominant so that what applies to that group appears to apply to the whole society. Dissenting voices have been raised in Western societies by various groups, including women, who have argued that there has existed an unrecognised division between the most generalised interests of men in these societies, and those of women; and representative of the poor, who have said that their interests, too, differed from those of the dominant group. From such points of view, the most damning criticism which can be made of the neoclassical system of economic theory is that it has often operated like the theory of the status quo; the theory of the group in power; 'privileged' or 'macho' economics.

Macro economics, as it now exists in the neoclassical system, is a theory addressed to the interests of nation states. It is generally accepted that the goal of macroeconomics (its 'definition of success', as this term will be described in Chapter 9, below) is to maximise the welfare (usually interpreted as the GNP) of a given nation, which includes attempting to improve the competitive position of each nation with respect to other nations. For an economist who is an adviser to a particular national government, this is often the appropriate position to assume.

However, 'micro' and 'national' are not the only levels of economic interest. Very different understandings will emerge from a recognition of the place, the goals, and the powers of other relevant actors on all levels. To name just a few of those that should be taken into account:

- there are cities such as New York, Los Angeles, Bonn or Mexico City, that deal directly with foreign and multinational entities, bypassing their own national governments in important, recognised ways

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- there is the United Nations, with its agencies; also the International Labor Organisation
- there are research networks, such as the CGIAR system which has created, supported and disseminated the Green Revolution
- there are multilateral agencies such as the ones formed at Bretton Woods
- NGOs such as OXFAM, Amnesty International, or International Physicians Against Nuclear War
- international professional organisations, such as those to which physicists, psychiatrists, or archaeologists the world over feel allegiance
- multilateral corporations, such as the giant agribusinesses, or firms in microprocessing, telecommunications or automobile production
- international crime syndicates, such as the drug cartels
- internatiuonal accords and agreements such as the Montreal Protocol to limit emissions of chloroflurocarbons
- and there are abstractions demanding allegiance, such as the Sullivan Principles.

All of these examples illustrate the forces which go under, or over, or around, or through, the force-field of the nation states.[11] In addition to their social and political ramifications, they have important economic impacts. Recognition and understanding of these impacts requires a 'global economics' that does not at present exist: neither market analysis nor distinctions of class are sufficient to define the relevant actors on the modern world scene.

Returning to the area that has traditionally been defined as 'macro' economics – the area of the nation and its concerns – there remain important areas for exploration which also require some different approaches. Neoclassical economics has not come to terms with the fact that, even in 'capitalist' countries, the private sector is only one of four: the other three being the government, the not-for-profit, and the non-monetised sectors. Models based upon the assumption of profit-seeking fit poorly when applied to these last three sectors. They go a long way to explaining the allocation of resources within the first sector, but not within the second, third and fourth; and they leave much to be explained regarding the allocation of resources *among* the sectors (one of the most critical issues for a modern economy). Finally, if profit-maximisation is not sufficient, what definitions of success shall be sought for each sector?

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IXB A third alternative; system and theory

Karl Marx predicted that the defects in capitalist systems would lead to their collapse. With a few different twists of history he could have been proved right: the evils of the first century of capitalism after the Industrial Revolution might well, had they continued on their path, have led to violent political revolution. There was increasing consciousness and resentment of such social ills as great concentrations of power in the hands of property owners; cruel practices (often virtually necessitated by the system, regardless of the wishes of individual employers) in the employment of relatively powerless individuals, especially women and children; the virtual abandonment of those unable to support themselves in the market system (orphans, the old or disabled, others who could not find employment); neglect of such public goods as health care or rural transportation; and increasingly violent economic swings, the 'boom and bust' cycles. However, the most critical of these defects were corrected by what J.K. Galbraith has called the 'Bismarck/Lloyd-George/Roosevelt revolution',[12] whereby systems of social security, old age pensions, and unemployment insurance, along with agricultural price supports and the progressive income tax,[13] irrevocably altered the nature of capitalism. It ceased to have both the ideal character of perfect competition and free markets portrayed in neoclassical economics, and the perfidious character of absolute exploiter portrayed in Marxian polemics.

As the end of the twentieth century arrives, communist countries are making decisions which amount to an admission of failure in their economic systems; the degree to which they have achieved their goals of equity in allocation of work and consumption seems insufficient compensation for the loss of efficiency in production. This may make it easier for capitalist countries, and the economists therein, to examine the weaknesses, even while they continue to build upon the strengths, of the socio/political/economic compromises which constitute modern capitalist systems. Some of the requirements for a new, co-evolving economic system and system-of-economic-theory relate to the following points:

– Change and development will continue to be critical realities and needs in all parts of the world – not only the developing countries – for the foreseeable future. We need a system of economic theory which can perceive, analyse, and, where desirable, give assistance to a variety of *sources for change and development*. For instance:

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- 'Bottom up' and 'top down' approaches, and ways of combining those two
- NGOs and multilateral organisations of many kinds
- cultural, religious and/or ethical impulses
- centre-periphery relations
- domestic unrest
- migration
- planning
- education
- foreign inputs
- markets
- technology
- basic needs

all of these need to be understood as forces which, for good or ill, may initiate, channel, structure, or block change and development.

- Profit-maximisation rears its head even in communist societies. If it were the ubiquitous force supposed in capitalist societies, neoclassical economics would have smooth sailing in its predictions, descriptions and prescriptions for the socialist as well as the market-oriented parts of the world. In fact, profit-maximising is an important, but not the sole important, motivation; and we need to be able to make use of and encourage, as well as simply to recognise, other impulses and goals that motivate human beings as economic actors.
- The systems of farm supports which are the rule, not the exception, in industrialised countries, make what has been held up as the classic textbook example of the conditions for perfect competition into a state-regulated industry, with effects on national and international markets and prices which threaten increasingly to outweigh the humanitarian claims for protection of the (mostly large) farmers.

  At the same time, from the global perspective, stabilised high prices in one or a few major producing nations may be used (as they were during the late 1970s in the USA) to create global grain stockpiling against times of poor harvest; this is the other side of the coin to the EEC's 'mountains of butter' etc. that have offended the sensibilities of those in favour of free trade and cheap food. It is not clear that completely unfettered agricultural markets are the best mechanism to serve global needs and maximise global welfare in face of the uncertainties of the long as well as the short run.
- Neither the play of market forces nor government interventions have yet shown the way to solve what emerges as the single largest economic problem of modern times: how to make markets and

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institutions (especially bureaucracies) responsive to broader conceptions of welfare than narrow, short-run self-interest.

Human societies are becoming increasingly global societies in which we find that 'we are all poisoning our neighbour's well, and we are all drinking our neighbour's water'. If the reality were as simple as that metaphor, simple pricing mechanisms would solve our problems. In the astonishingly complex world of ever greater globalisation, a value system (undergirded by appropriately redesigned macro and global accounting systems) which assumes a primary importance for the future of the whole human race is the most efficient way to internalise the intertwined, boundary-ignoring chains of causes and effects.

- In a world where resource constraints will take on a newly compelling force and urgency, we need to think differently about the relationship between consumption and welfare, and between work and welfare. Production needs to be designed, on the one hand, to allow reduced throughput of the '*mm*' factors (see section VIB in Chapter 3, above). On the other hand, if some types of production are thereby limited, the goal must be for other '*ii*' (information intensive) work and leisure, things and activities, to make up for that loss.
- We need a system of economic theory that can deal directly with economic issues that are not all market issues. Problems do not necessarily leave the sphere of economics when they do not have good market solutions. Economists must be able to address the issue of *balance* between markets and other forces: governments, bureaucracies, and the third and fourth sectors – the not-for-profit and the non-monetised (or domestic) spheres of action.
- We need, finally, a system of economic theory which can deal overtly with the multiplicity of irrepressible but not always compatible welfare goals that have been left to the unconscious or unadmitted corners of existing theories. We have to have ways of formally recognising the desirability of dispersion of power and enhanced equality of access to the means and the results of production, for example via democratic institutions and general education, as well as via effective markets.

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Notes

1. For the non-economist, marginal analysis is concerned with decisions taken on the knife-point of yes-or-no, when the decision-maker is hard put to it to decide, e.g., Shall I buy this? Shall I employ another worker? Shall I work another hour? Inframarginal motivations are the ones that are made before the worker is ready to decide about his/her last hour of work, or the consumer his/her last item of purchase, etc.
   See also Section VIIC, below.
2. Amartya Sen, 'Rational Fools: A Critique of the Behavioral Foundations of Economic Theory', in *Philosophy and Public Affairs*, vol. 6, 1977; pp. 317–44.
3. Which are probably best understood as instrumental choices – see below. Choice is more readily understood in the context of instrumental than of expressive behaviour.
4. Talbot Page, 'Intergenerational Justice as Opportunity' in Douglas MacLean and Peter Brown (eds) *Energy and the Future* (Rowman and Littlefield, New Jersey, 1982) p. 45.
5. Cf. A. Marshall, 'The Old Generation of Economists and the New' (1987) in *Memorials*, esp. pp. 302–3. Cf. also a comment by Albert Hirschman:

   > men and women have the ability to step back from their 'revealed' wants, volitions, and preferences, to ask themselves whether they really want these wants and prefer these preferences, and consequently to form metapreferences that may differ from their preferences . . . . the concept of metapreference must be of concern to the economist, to the extent that he claims an interest in understanding processes of economic *change* . . . .
   >
   > When a change in preferences has been preceded by the formation of a metapreference . . . it typically represents a *change in values* rather than a change in tastes ('Against Parsimony: Three Easy Ways of Complicating Some Categories of Economic Discourse, *AER*, 74, nos 1–2, 1984; pp. 89–90. Italics in the original.)

   See also Paul Streeten's Appendix ('Recent Controversies') to Gunnar Myrdal's *The Political Element in the Development of Economic Theory* (International Library of Sociology, London, 1953) esp. p. 215.
6. Tibor Scitovsky, 'Can Changing Consumer Tastes Save Resources?', essay written in 1979, repr. in *Human Desires and Economic Satisfaction: Essays on the Frontiers of Economics* (Wheatsheaf, Brighton, 1986) p. 123.
7. See Tibor Scitovsky, *The Joyless Economy* (Oxford University Press, 1976).
8. T.R. Lakshmanan, 'Knowledge Technologies and the Evolution of the Economic Landscape', paper presented at the International Workshop on Technical Change at the Center for Energy and Environmental Studies, Boston University; 11-12 October 1988, p. 13.
9. It is also a word which is rather clumsy to use. For example, 'institution' may refer to the idea of a firm, and to 'this particular firm'; it may refer to the idea of marriage, but not to 'this particular marriage'. It is generally

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used, in the social sciences, to mean something quite abstract, e.g., 'recognised patterns of practice around which expectations converge' (O. R. Young, 'International Regimes: Problems of Concept Formation', in *World Politics*, 32, 1980); but in common speech it is probably most often used with reference to something thought of as a building – a jail, or a mental hospital, within which inmates are 'institutionalised'. These semantic difficulties have likely been a factor in the lack of cohesion of the 'institutionalist' school in economics.

10. This matter is, in fact, a little more complicated, as the most elegant firm theories assume profit-maximising as the only motive; and that is not necessarily a selfish one, as it requires the agents' motives to be identical with those of the principals.
11. For more discussion of these 'challenges to sovereignty' see the forthcoming special issue of *World Development*, *Global Commons: Site of Danger, Source of Hope*, N. Goodwin (ed.), to appear in early 1991.
12. From a lecture by John Kenneth Galbraith at the American Academy of Arts and Sciences, 5 April 1987. The historical sketch presented in this paragraph draws upon his selection of details.
13. As Arthur Okun has commented, 'In their ten-point radical program of the Communist Manifesto, Marx and Engels put [the progressive income tax] in second place – behind only the abolition of private land ownership. Yet, by 1913, that means had become law through a constitutional amendment in this bastion of free enterprise [the USA]' (*Equality and Efficiency: The Big Tradeoff*, The Brookings Institution, 1975, p. 101).

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