

# 33 pieces on economics (old and new) updated 1-1-2020

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## Introduction

Here I give a series of critical discussions of economics. It includes a review of different approaches and schools of thought in economics. It is based on my own experience with research on topics that do not sit easily in the body of mainstream economics, such as innovation, collaboration, and trust. And I make extensive use of the philosophical reflections in this philosophy blog. Related disciplines are sociology, (social) psychology, political science, philosophy, law, history, and cognitive neuroscience.

The context for the series is an ongoing debate in which I am involved, concerning a transformation of economics, among others a project for changing the economics curriculum in secondary education in the Netherlands, run by professor Lans Bovenberg at Tilburg University.

The motivation for the series is a growing protest against economic science, after the financial crises since 2008. It emerges in the 'Occupy' movement, in a protest against 'autistic economics', e.g. in France, a movement of 'rethinking economics' among young Dutch economists, to name a few movements. Even more or less orthodox economists are becoming open to criticism that a few years back they would have ignored.

There is an important economic aspect, concerning globalization and free trade, and an ideological aspect, concerning neo-liberalism, in the present populist revolt, on the political left (Bernie Sanders, Jeremy Corbyn) as well as on the right (Le Pen, Trump).

In the course of the series, the following questions stand out. What economics are we talking about. What is the core of it. What would need to be changed. Could that be done within economics, or would economics then fall apart. Would a new social science of relationships, in markets and society more widely, be needed. What would the core of that be?

A fundamental issue in all this is as follows. A consensus among many economists would be that economics is aimed at optimal allocation of scarce resources, given preferences. For that it is oriented at rational choice, calculating an optimum, and at a utility ethics. The point now is that in much criticism of economics and markets there is a plea to move from transactions to relations, and relations are most of all processes, which are mostly uncertain to the point that no optimum can be calculated. Can economics cope with that?

This relates to the issue of emergence, discussed in the preceding items in this blog. Certain phenomena within economics, such as innovation, are not subject to intelligent design, but are emergent processes. So are relationships. This relates to the other fundamental issue, of uncertainty, in the emergence rather than prior presence of preferences and resources, that precludes optimization on the basis of probabilities.

The step to relationships brings in the old theme from philosophy of the relationship between 'self and other', raising issues of altruism and free will., discussed earlier in this blog.

A second fundamental issue is one of ethics. Oriented towards optimal outcomes, economics is based on a utility ethic that looks only at outcomes, not intentions or processes. Therefore I have been pleading, as discussed in preceding items of this blog, for a step towards a virtue ethics.

Among other things, I will indicate different schools of thought in economics, the ‘core’ of mainstream economic theory, in the form of explanatory and methodological principles, objections to it, and possible alternatives, and their implications.

However, iconoclastic as this endeavour may seem, I will retain many notions from economics, beyond those fundamental explanatory principles, in the ‘nuts and bolts of analysis’ that remain useful.

### 387. The programme of economics

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As in other sciences, in economics there are diverse schools of thought: neo-classical, which is the mainstream, evolutionary, institutional and post-Keynesian economics. Here, I give an introductory survey. In subsequent items, I will discuss things in more detail. First, I focus on the mainstream.

How does one represent a school of thought? Imre Lakatos<sup>1</sup> proposed the notion of a *research programme*. That has a ‘core’ of fundamental principles, assumptions and directions for research, which must be protected from falsification at all costs, by means of a ‘protective belt’ of subsidiary assumptions that supplement or implement the core principles. When something comes up that falsifies the whole, it is attributed to the subsidiary assumptions, and a replacement is sought there to make the core work better.

Isn’t such tenacity to a core unscientific? There is an argument for it. If something has performed well you will not give it up at the first sign of imperfection. That is an economic argument, but also an epistemological one. All theory is abstraction, imperfect and incomplete. It is by sticking to a programme, and milking it for all it is worth, that one discovers where its real limits lie, and finds indications for improvement. It does constitute a form of conservatism, but if someone is dissatisfied, he can start a new, competing programme. And that is again an economic argument: the argument for competition. As I proposed in this blog: imperfection on the move.

This conservatism can derail into dogmatism, and that happened to mainstream economics. One reason for it is that unlike natural sciences, the falsifiability of economics is dubious. I will discuss that in another item.

There are two dominant characterizations of economics: optimal allocation of scarce resources, and exchange (through markets). In mainstream economics, the core assumptions are: rational choice by autonomous agents, in the calculation of optimal choice, and the operation of markets that yields equilibrium between supply and demand. The protective belt gives subsidiary assumptions of legal conditions (e.g. of ownership), technology of production, infrastructure, the role and availability of information, etc.

Research seeks ‘forbidden events’ (falsifications), to repair and improve the subsidiary assumptions. The process entails what Thomas Kuhn called ‘normal science’, solving puzzles

within the programme, such as, in economics, finding yet another, more sophisticated 'production function' to model production technology.

Game theory brought a major transformation, as a tool to model strategic interaction between agents, with the central notion of a Nash Equilibrium: an outcome of interaction that is stable, in that every player wants to maintain its present strategy, as the best in view of the strategies adopted by the others. It is a useful device, but the basic principle of optimal choice remained the guiding principle. It is assumed that the set of strategies players can choose from, as well as the 'pay-offs' of combinations of the strategies of players, are given.

A later, more fundamental change, towards 'behavioural economics' allowed a relaxation of the principle of optimal rational choice, in allowing for decision heuristics from social psychology that are not substantively rational, not yielding optimal outcomes, though they may be rational in the face of conditions. A methodological advantage was that experiments could be made in laboratory settings, often with students of the researcher. However, it sits somewhat uneasily in the research programme of mainstream economics, as a more or less separate appendage. In a collaboration in this between economists and applied psychologists, a complaint of the latter is that the former cannot desist from forcing the heuristics back into optimal choice.

In economics, a distinction is made between risk and uncertainty. With risk one knows what can happen, and one can then append probabilities to calculate optimal choice, such as the one with highest expected outcome (outcomes multiplied by their probabilities). Under uncertainty, by contrast, one does not know all that can happen: that is not given prior to choice but emerges after choice, in action.

There, economists stand empty-handed, cannot ply their trade of calculation, so they ignore or neglect uncertainty. However, in innovation and relations uncertainty is routine. Radical innovation is uncertain, and the most fruitful relations are the most uncertain: they yield the surprise of novelty that goes beyond present insights. One engages most fruitfully with others who bring in things one could not before have imagined. One does not know in advance even of oneself how one will respond to unforeseeable events. There, also game theory falls short. In technical terms: there is no longer a matrix of strategies of agents and the values of outcomes of their combinations, because those mostly emerge during strategic interaction.

Here, economics short-changes itself. If the most valuable relations are the most uncertain, incalculable in advance, then shying away from them for that reason foregoes opportunities for value, which is an uneconomic thing to do.

An exception is Keynes, who recognized uncertainty and used it to explain herd effects in the economy that produce booms and busts: if one cannot calculate optimal choice, then it is reasonable to follow choices others are making, especially others who claim that they know what they are doing, even if they don't. Keynesian economics has not replaced the mainstream, but it remains as a minority stream, in post-Keynesian economics.

Mainstream economics is focused on optimal outcomes, not on processes that may or may not yield those outcomes. Evolutionary economics recognizes uncertainty and models economics as an evolutionary process of more or less random initiatives, selected by markets and institutions, and transmission of what survives.

Institutional economics recognizes that markets do not work automatically and require institutions to function, and, more fundamentally, deviates from the assumption of autonomous individuals, recognizing that they develop their knowledge and their preferences in interaction with their environment.

### 388. A methodological sleight of hand

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Mainstream economics is based on the following three basic assumptions: economic agents are autonomous, have given preferences, and make rational, optimal choices between alternative ways of spending scarce resources.

This is not an ontological claim: good economists readily admit that these agents do not exist. In fact agents are limitedly rational, and routinely do not make optimal choices. The assumption is fictional, according to a methodology of *instrumentalism*: they serve as instruments for parsimonious, rigorous deduction of explanations of phenomena. It saves the enormous, complicated effort of explaining processes of decision making of individuals, which is the field of psychology, between individuals, which is the field of sociology.

Instrumentalism is not nonsense. In seeing the world one cannot see everything at the same time. Every view is conditioned, enabled and at the same time constrained by a perspective, a way of looking. The justification of counter-factual assumptions ‘as if’ is that they should lead to predictions that can be tested empirically.

The scientific scandal of economics is that this can hardly be done. The reason is twofold. First, predictions affect the choices that produce outcomes, and this can be self-fulfilling or self-defeating.

Second, in an economy there is little opportunity for controlled experiments, where one controls the factors that affect outcomes, next to the factors adduced from the theory. Society cannot be handled as a laboratory. As a result, predictions turn into retrodictions, tested after the fact, in retrospect, on the basis of statistics, in econometrics, where control of other factors, not part of the theory, is exercised with data on them. Great ingenuity has been exercised to develop ever more sophisticated tools for this. However, there still is the problem concerning the *ceteris paribus* assumption that factors other than those included in the process ‘remain the same’, as well as the causal structure, the logic of explanation.

Also, many relevant variables have not been and sometimes cannot be measured. Measurement being methodologically sacrosanct, research proceeds with what can be measured. This yields the cliché of the joke of the drunk man leaning against the lamppost at night: ‘Why are you standing there, at the lamppost?’ ‘I am looking for my car keys’. ‘Did you lose them here?’ ‘No, but this is where the light is’.

A deeper problem, discussed in the philosophy of science, is that facts are ‘theory laden’: the terms and conditions of observation and measurement are formed according to the forms of understanding: the basic, often tacit, taken for granted, assumptions and meanings, of the theory. That, however, is a problem for all sciences.

Next, and here lies the scandal, economists conduct a methodological sleight of hand. They begin with the admission that their assumptions are not realistic, they cannot perform strong

empirical testing, and then, as if the assumptions have nevertheless been proven justified, they deduce recommendations of policies from them as if they are scientific.

For that they employ the following, impressive, strong logic, as the core of economics. Going back to Adam Smith, the idea is that of the *invisible hand* of the market. Each consumer seeks to satisfy its own preferences, this creates demand for products, and when supply cannot cover it, prices rise, which draws producers to that product, until supply and demand are in equilibrium, and thereby scarce resources are directed automatically to where they have the most utility, in satisfying demand.

This is so appealing that, regardless of any lack of empirical tests, policy is invariably slanted in favour of the market. And so the market expands in all directions.

Another rationale that has been used for the instrumental assumption of rational agents making optimal choices is illustrated by the following metaphor. From Chicago (the crucible of market economics), cars randomly move out in all directions. There are gasoline stations only along a few of the roads. After a large number of kilometres there are cars moving only along the roads with gas stations. It is as if those drivers rationally chose the roads with gas stations.

The idea is that since markets select out inefficient firms, we observe only efficient outcomes, as if the agents made the optimal choices, so that is how we can proceed, explain phenomena as if choices were optimal.

The response to this has been<sup>ii</sup> that if the argument is in fact one of selection, as in evolution, one should conduct the study in that way: model markets as eco-systems. This gave rise to the birth of *evolutionary economics*. One should see, and model, how efficient markets are in fact, in selecting out suboptimal choices.

However, that becomes complicated, since it requires the modelling of a process, which depends on many subsidiary assumptions, and thereby economics loses its crystalline clarity and rigour that is its pride, the pride of a myth of equilibria of outcomes without an account of how they may or may not be achieved.

### 389. Locality and flexibility

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In mainstream economics, next to the assumptions of rationality and autonomy of the individual, the focus on optimal outcomes, and the neglect of uncertainty, a further problem is the assumption that local roots of people and communities hinder the flexibility that optimal allocation of resources requires. That is related to the assumption that the individual is autonomous.

The human being derives its identity from interaction, and that works best in local contacts of some duration. Some time is needed to get to know each other, cross cognitive distance, and to build trust and shared conventions, taken for granted habits and orientations. Human beings require a certain amount of community.

I don't want to idealize such communities. The sharpest of conflicts and excesses of rivalry, jealousy, and revenge, developing into feuds, can arise there. To prevent such festering and

stagnation, loosen dependencies, and obtain fresh ideas, there must be variety and room for entry and exit, and outside contacts.

Also, local bonding can increase what I discussed in this blog as ‘parochial altruism’, with altruism within the group and discrimination of outsiders, further worsening its isolation.

Nevertheless, some continuity and locality of relations in communities is needed. Formerly, people found community in religious associations and bonds of neighbourhood, school, sport, pubs, etc. And in a job, in the community of a firm, often on the basis of teams. For the lower educated, all these bonds have largely disappeared, as a result of increase of scale, resulting in concentration outside local communities, move to low wage countries, and spatial development of roads, office blocks, and shopping malls that destroyed social infrastructure.

And some of what remained of facilities went with priority to immigrants who needed to integrate; at least that is how it was perceived. More highly educated and mobile people found community of some sort in departments and teams in larger firms or professional bonds, which did not depend on geographic locality. But that now is also crumbling through individualization of work and shorter and more flexible employment.

These losses have been an important part of the feeding ground for populism.

The dominant stream in economics, excluding spatial economics and economic geography, had no eye for this. On the contrary: the central dogma was that of ‘comparative advantages’ and maximum flexibility, needed for the optimal allocation of resources. Locally one should engage in activities in which in comparison one was best, and other things needed to be acquired in trade with others. Labour and capital should not be locally bound but maximally flexible, to move to where their yield was greatest.

Local roots were seen as causing rigidity, and that, the suggestion is, is always bad. That is part of the rhetoric of maximal flexibility. The more the better. But that is often counter-productive, also from a purely economic perspective. That applies to both local communities and firms. It is good for both the firm and for the people working in it that one invest in knowledge and capabilities that are specific to the firm, yielding higher profits with specialties and novelties. That requires sufficient continuity of jobs and teams, because otherwise such investments are not made since they require continuity for them to be recouped. That lack of specific investments lowers quality of products, and the intrinsic quality of working in teams.

The goal should not be maximal but optimal flexibility: sufficient duration of location and relation without yielding rigidity. That is to be part of a new economy.

### 390. Forms of efficiency

published 24-9-2018

In economics efficiency is defined purely in terms of costs of input relative to output. Contribution to quality of process, such as labour, or virtues, such as justice, do not count.

Economics recognizes three forms of such efficiency: allocative, productive and dynamic. Allocative efficiency forms the core of market thinking: scarce resources are optimally allocated to where needs are highest. Productive efficiency concerns the use of resources for

production. That depends on a number of factors, such as economies of scale. Dynamic efficiency concerns efficiency in innovation. All three are desirable, and are adduced as arguments for markets, but in fact they obstruct each other.

Increase of scale can yield higher productive efficiency but tends to reduce competition, lowering allocative efficiency. Concentration in large firms allows firms to hinder entrance of to the market of new competitors, yields powers of lobbying for advantage, and can slow down innovation by obstructing its development. There is the incentive to protect existing investments and prolong their life. Small innovators may be bought to slow down the further development and introduction of their innovations.

Dynamic efficiency is the most difficult because of the uncertainty involved, which economics cannot well deal with, as discussed in a preceding item in this blog. Because of uncertainty, one needs reserves to absorb misfiring innovation, but for allocative efficiency there should be no such reserves.

In the literature on innovation there has been a long discussion whether large or small independent enterprises are the most innovative. Large firms have the advantage of more financial reserves, spreading risks across a portfolio of products, cross-subsidization of weak products by strong ones, lobbying power to affect the choice of projects for subsidy and its acquisition, and the establishment of technical standards and standards for safety, and that again reduces allocative efficiency.

Small firms have advantages of speed of development and flexibility to change direction when needed, due to less bureaucracy, more motivation to succeed, since success yields the entrepreneur's income, and closer proximity of management to the market and to incoming technology. They can suffer from high costs of small scale, lack of specialized support, difficulty of attracting finance, which all reduce productive efficiency.

Which form of efficiency deserves precedence? In fact, there are often combinations and compromises between them.

Concerning strengths and weaknesses large and small business are complementary. For example, in biotechnology small firms invent and develop new active substances or new processes of production which are then taken over by large firms with advantages for further development, testing, regulatory approval, and large scale production, distribution and brand name of products.

With digitalisation and informatisation, effects of scale in innovation have decreased, since production is now more virtual than physical, machines are replaced by computers, large production facilities are no longer needed, production can be better automated, and testing can often be virtual rather than physical, in computer simulation. On the other hand, new effects of a scale have come up, as in the large internet platform companies where volume of customers is part of the business model.

Economists claim that they do not make value judgements, but only indicate the economic consequences of policy. But the theory they use does implicitly harbour an ethics, even though many economists are not aware of it. Of what sort is that ethics?

There are several systems of ethics. Liberalism, and with that economic science, rests on utility ethics. That only looks at outcomes of choice and action, in this case utility, in the form of the greatest good for the greatest number of people. The ethical quality of other considerations, such as honesty, justice, forbearance, solidarity, etc. are irrelevant. 'Greed is good' as long as it leads to a higher level of prosperity, and the equity of its distribution is less relevant.

That stands in sharp contrast with duty ethics (going back to the philosopher Kant), where the issue is the ethical quality of motives of action, regardless of their consequences in terms of utility. The claim is that moral rules are universal, valid under all circumstances. The central principle is the ancient *golden rule*: One should (not) treat others as one would (not) want to be treated oneself. Here, that became the *categorical imperative*: an act is good if you would want to raise it to a universal rule. Lying is good if you would want everyone to do it. You don't want that, so you should never lie.

I don't go along with that because what is good or bad depends on circumstances. And what I find good for myself is not necessarily good for another: needs and demands vary.

A third system is virtue ethics, going back to the philosopher Aristotle. Virtues are character traits, dispositions to conduct. Many virtues are eligible, depending on circumstances. The classical 'cardinal' (pivotal) virtues are: reasonableness (or prudence), courage, moderation, and justice. There is nothing wrong with pleasure, but it should be in combination with moderation and justice. That is missing in present theory and practice in economics.

Resistance is increasing against the conduct of a number of large firms, such as banks and pharmaceutical companies, those firms are suffering from that resistance, and they come up with plans for self-regulation. The key question is whether when push comes to shove and this leads to less profit it will be accepted by shareholders.

For this I give an anecdote. Two years ago I was asked by a colleague in Scotland if I would want to take part, as advisor and possibly as a teacher, with a bank, in the teaching/training of employees in trustworthiness. Trust is one of my subjects, so I accepted. The first step was a skype meeting for an exploration of ideas. We agreed that I would develop a proposal. In the discussion of that, in a second meeting, I asked whether it was part of the plan to educate employees to be trustworthy also to customers, not to sell them opaque products that work out to their disadvantage, as was customary among banks in the crisis of 2008. 'Of course', they answered. 'But what if that leads to foregoing opportunities for profit, would that be accepted by shareholders?'. I received no answer and the meeting was abruptly ended. I tried to get in the comment that if you are the only bank that can make good on the promise to such trustworthiness, that might be very profitable, but it could no longer help.

In the course of the present series on economics, in this blog, I will argue for a transformation of economics, with as the most fundamental part replacement of utility ethics by virtue ethics, where utility still counts, but next to considerations of moderation and justice. That is needed for justice but also for protection of the environment, which under the present regime of economics seems unattainable.

Theories of capitalism usually depart from the assumption of greed: the urge towards profit and income. People are driven to pursue them to survive, in a job or in a market, under the regime of competition, in shareholder capitalism.

But perhaps more important than greed and survival is the urge to manifest oneself: to ‘make a difference’, to be noticed, acquire attention or power. Salaries are not only sources of income but also signals of success in a power game.

The philosopher Plato spoke of reason as a charioteer that tries to reign in two horses: one of *eros*, desire, and one of *thymos*, the urge to self-manifestation. The philosopher Spinoza called it *conatus*. The philosopher Nietzsche claimed that the urge to power is stronger than the urge towards survival.

One can appreciate that: it is also the urge of ambition, to ‘make something of your life’, and to ‘make a contribution to society’. That is also, more than profit, a drive for independent entrepreneurs. And they feel wronged when set aside as mere money grabbers.

An outcome of a mountain of research on happiness is that happiness consists of a combination of ‘pleasure and purpose’, in giving ‘sense’ to life. That concerns something bigger than yourself, or *transcendence*. That can be vertical, towards a God or heaven, but also horizontal, towards society. Not one’s own immortality but a contribution to what you leave behind at death. And if in that you make the best use of your talents, that can be pleasurable.

Then the drive to manifestation can be a virtue, and virtue ethics makes room for it, provided it is accompanied by, or is held in check, by the charioteer, in virtues of reason, moderation and justice.

However, success often leads to a neglect of such virtues, in self-aggrandisement, a feeling of being superior, elevated, ‘beyond the law’.

Money and manifestation are both addictive, not only for managers but also for stars in thirst for applause, and for scientists in search of publication scores and citations.

In capitalism, both greed and the urge for self-manifestation have become institutionalised, ingrained, in business culture, fed by managers having followed courses in economics in which they were told that self-interest rules supreme, as the motor of the economy. It has become an internal ethic that drives careers, salaries, and bonuses.

When confronted with increasingly vociferous critique from society, the inmates of these institutions honestly feel treated unfairly: they are only doing what society needs. Even supervisory boards of firms, having the task to correct management, go along, because those boards are recruited from the wider population of managers of other firms, sharing the same internal ethics and habits of thought.

So, part of the change needed is to compose such boards differently, with people not only from other firms, and not only as representatives of shareholders, but also from other groups of ‘stakeholders’, such as employees, customers, suppliers, local communities, and society at large, in particular with a view to the longer term future, in the interests of future generations and the environment.

### 394. Rationality and heuristics

published 27-10-2018

How could one still maintain, as economic theory did, that people make rational decisions? Already long ago (in the work of Herbert Simon), theory took bounded rationality into account, but only in a limited sense. The idea was that the capacity for rational thought is limited, and should be used where priority is highest.

A distinction was made between substantive and procedural rationality. Procedurally, it is rational not to evaluate everything in a substantively rational mode. That makes sense and still applies. One encounters it again in Kahneman’s distinction between ‘system 1 and system 2’. The first is based on unreflected routines where one acts without conscious deliberation, while the second entails conscious, critical reflection.

Without routines, life would not be practically viable. Imagine that in walking, or driving a car, one must reflect on it. Then one would not have attention to where one needs to go, and why, and to talk with another passenger.

But there is more, as understood in more recent ‘behavioural economics’, which has adopted insights from social psychology, in the form of decision ‘heuristics’, shortcuts for fast decisions, which are procedurally but not substantively rational. Here is a survey of some of them.

The heuristic of ‘availability’ is that people pay attention to what is ‘available’, in the sense of forcing attention, being emotionally laden, as a threat or opportunity. That can go wrong, in an excess of impulse, neglecting less salient but still important issues, but it helps in setting the agenda for scarce attention. Also, the danger of routines is that they are also practised where they do not apply, and then emotion of danger or opportunity is needed to catapult one into critical awareness.

Another well-known heuristic is that of ‘loss aversion’: a perspective of loss (‘loss frame’) weighs more heavily than that of gain (‘gain frame’). One goes to greater extremes of conduct to keep what one stands to lose than to gain what one does not yet have. In evolution, that contributed to adaptiveness: loss leads sooner to death or harm than gain does. This has a stabilising effect on relationships: the one who wants to break the relationship does it to gain, the other stands to lose, and will go to extremes to prevent it.

Another heuristic is to raise incidents to the level of laws: ‘You always with your .....’, while it happened only once or twice. That is unreasonable, but can have survival value to respond in time to threats.

A fourth heuristic is that of ‘escalation of commitment’: the more loss one has incurred in a certain position, the more one commits to it, since ‘otherwise the losses would have been in vain’. That is not rational: the past is water under the bridge and cannot be changed; one

should look only at possible further losses in the future. That heuristic also works in favour of the continuation of a negative relationship. A classic example is that of George Bush, for whom it was difficult to withdraw from Irak, because then all the American deaths ‘would have been in vain’. It would also amount to an admission of having made a mistake, in entering. A new president, Obama was needed for withdrawal, and then he made the same mistake of increasing the commitment in Afghanistan.

A fifth heuristic is that of engaging only upon incremental deviations from existing policy, even if the initial position does not make sense, and a radical turnaround is needed.

A sixth is ‘cognitive dissonance’ or ‘confirmation bias’, where after a choice one only has attention for information that confirms that it was a good choice, not to what denies that. In a difficult to end relationship one only wants to hear the good things of the partner, and when one has broken the relationship only the bad things.

### 395. Individual and social

published 3-11-2018

*The theme of self and other has been discussed extensively in this blog, and a bundle of items on that theme can be downloaded from my website [www.bartnooteboom.nl](http://www.bartnooteboom.nl) A combination of elements from the blog and my 2012 book ‘Beyond humanism: the flourishing of life, self and other’, and my 2015 book ‘Beyond nihilism: imperfection on the move’, and an essay with the title ‘Beyond nihilism: self and other between Nietzsche and Levinas’ which can also be downloaded from that website. Here I give only a brief summary.*

The human being is individual but not autonomous, as economists would have it. It is socially constituted, on the basis of interaction with others, and shared culture. Culture here is anthropological: habits and customs, but also an ethic and morality. While those may be shared, what is made from it becomes individual, along a personal path of life.

That yields diversity, or what I called ‘cognitive distance’, and that may hinder mutual understanding but also offers an opportunity, to learn, and to escape, more or less, from personal prejudice and myopia. For this, one needs to develop the ability to understand people who think differently, intellectually and morally. That also yields economic advantage, in a better ability to innovate by combining different ideas.

For its development, the human being needs recognition, acceptance and respect, in local communities with some stability, needed also to develop and maintain trust, but those communities also need some external contacts and some entry and exit of inhabitants, not to get mired in rigidity, myopia and prejudice.

Strong bonds of interaction and mutual understanding are difficult to achieve on a national level. That requires decentralisation of governance to municipalities or city neighbourhoods, with an elected mayor, council and citizen panels, with or without political parties. That carries problems, as discussed earlier, but those are not insuperable (see item 347 of this blog).

A second need is to put an end to the present excessive flexibilization of work, with more continuity of work and teams. That is good for the quality of labour and the quality of products, which require ‘specific investments’ in mutual understanding and trust, for which

some continuity of relationships is needed, in order to recoup those investments, which otherwise would not be made.

For this, and for innovation, the environment, and a just future for the young, a perspective of the long term is needed. No longer the obsession with profit in the next quarter. If shareholders cannot muster this, then they should not have a majority in supervisory boards. Those would also contain membership from employees, customers, suppliers and the local community. The latter especially with a view to protection of the environment.

Economists will comment that then the price of capital will increase, because opportunities for profit are foregone, which would lead to lower prosperity. Yes: that would have to be accepted: a bit less prosperity for the sake of a more humane and sane society.

### 396. From optimal to adaptive

published 10-11-2018

The assumption, in economics, that people exhibit rational choice that leads to optimal outcomes yields an excuse not to look at processes that may or may not yield optimal outcomes. That may contribute to simplicity, avoidance of complexity, but also leads to neglect of important realities, of actual decision making, conduct, market imperfections, and differences between industries. And when optimality is impossible, due to uncertainty, one needs a different, adaptive stance.

It is needed, for government and management of firms, to act on the basis of insight in those realities. There is a myth afoot that for management it does not matter where you are manager, because it supposedly is the same everywhere, and that is not the case. Economic variables such as economies of scale, concentration, integration in mergers/acquisitions or alliances, entry barriers to markets, transaction costs, transparency of product quality, technology, knowledge intensity, uncertainty of markets, investments and their lead times, type of labour, importance of teamwork, fluidity of knowledge, etc. vary with industries.

On the macrolevel it is useful to see the economy and industries as evolutionary systems of variation, selection and transmission of what survives. State interference is then seen as exerting influence on those processes, rather than direct interference in conduct, though the latter may have to be part of it. In any case, an evolutionary, adaptive approach is modest concerning planning, especially planning of innovation. That would be as if evolution planned, designed new species. There is little scope for 'intelligent design', as in biology.

In economies, variation arises from entrepreneurship and invention, selection is performed by markets and institutions, and the transmission of success lies in growth of successful forms, imitation, publication, and teaching. One can influence variation by enabling entrepreneurship, with financial and fiscal measures, and employing it in the innovation of public policies and services. One can further the selection by markets by preventing monopolies and oligopolies, entry barriers to markets, and other conservative ploys of existing firms. One can improve transmission of success with policies concerning communication, information, education and training.

In the further filling in of the processes of variation, selection and transmission, important differences arise in comparison with biological evolution. There is artificial variation in combining genes other than by breeding, in genetic manipulation. Firms can influence

selection by markets and institutions by political action, such as lobbying. They can test products before they are brought to market. Invention still involves trial and error, but it is not entirely random, as variation is in biology, because it is fed by learning, logics of inference and science.

The logic of adaptation in evolutionary systems avoids the problem of rational choice, on the basis of calculation, with probabilities attached to possible outcomes, that it cannot deal with uncertainty that is 'radical', in the sense that one does not know all that can happen. Given the impossibility to predict, due to uncertainty, and the consequent impossibility to find an optimal strategy, one can make use of scenario's, alternative imagined possible futures, and seek a strategy that performs reasonably well across them, without optimality in any single one of them. One can use computer modelling, simulation, for this. In the development of products one can mimic evolutionary processes of variation and selection, as happens, for example, in the development of robots and algorithms.

On the level of the individual also, uncertainty has its implications, requiring adaptiveness. One should grow up to be robust under unforeseeable setbacks, be resilient, learn to fall and stand up, have reserves to fall back on, and be flexible and creative in taking new directions when needed, even when they are not known in advance.

### 397. Power, dependence, control and trust                      published 17-11-2018

Economists shy away from discussions of power, because power should not play a role in supposedly anonymous market forces. Economists do talk of market power as a disturbance of markets by monopolies, oligopolies and firms erecting entry barriers to markets. That is to be fought by competition authorities. But power is more widespread. Power creates dependence. But it can also be positive. Even monopoly can be beneficial.

I use the (customary) definition of power as having influence on the choices of others. It can be positive, in an extension of options for choice, and freedom of choosing from them, or negative, in reducing them.

If for choice one is dependent upon another, than he/she has power over you. One can avoid or reduce that by avoiding him/her or by creating counter-power, by constraining the actions of the other. Trust is leaving room for conduct for others, control is constraining it. Control can result in a vicious circle of accumulating mutual constraint. A danger looms of excessive oversight and control.

What forms and sources of dependence are there? One is that the other has a unique offer, with few adequate alternatives. That is the power of monopoly. Or there is no way out, no exit: you are locked in. That is the power of enforcement. Or there are incentives to submit to power, for the sake of income, position, protection or prestige.

How to deal with power?

One can fight negative power by constraining the room for power play, and punishing it by means of contracts, legal coercion. However, the specification of activities, rights and duties constrains action, and can act as a straightjacket that inhibits innovation. Contracts are also

costly and may be difficult to enforce, particularly if it is difficult to monitor the partner's conduct.

One can also exert direct hierarchical control by taking over the partner, becoming his/her boss. That is a cop-out: one does not face the challenge of collaboration between independent partners.

One can also employ a reputation mechanism, where the partner will not cheat for fear of losing his reputation. Or one can use a hostage, in the form of some commercially sensitive information one has of the partner, with the threat, often implicit, not pronounced, to divulge it when the partner misbehaves. The hostage may also take the form of a package of shares that one has in the partner's business that one can sell to someone with the intent of a hostile take-over of the partner.

There are also more constructive, benevolent ways of dealing with power.

In relations of collaboration there is the following 'paradox of specific investments'. To create unique novelties, in innovation, connecting each other's competences, one typically needs 'specific investments', dedicated to the relation, that have no use elsewhere. That makes dependent: if the relation breaks, the investment is rendered useless. If the investment is asymmetric, mostly on one side in the relationship, dependence is one-sided. On the other hand, if the investment makes you special, offering something unique, that gives countervailing power. A monopoly, in fact. This can generate a race not to the bottom but to the top: partners keep investing in themselves to maintain a unique offer. Another possibility is to demand shared payment and ownership of the specific investment. Yet another is to make the partner dependent in some other way, by offering some other unique benefit, such as access to a market, a brand name, special knowledge, technology, or a patent, or to some other resource (a lobby, perhaps).

One may also rely on other sources of reliability that are not oriented towards control, such as trust based on ethics or personal bonds of friendship, family, clan, or custom.

With the latter, however, one can get caught in systems of paternalism and enforced loyalty that does not allow for exit, thus imposing another constraint from power. Obligatory bonds limit the variety and freedom of outside contacts needed for learning and innovation.

Sometimes there is no alternative to such personal bonding, as in countries where there is no institutional basis outside personal relationships, such as a legal system to support contracts, reputation systems, or a shared ethic and morality. I found that to apply, for example, for different reasons, to Japan and the Ukraine.

In Japan the reason is a strong tradition of family values, which is now weakening. In the Ukraine the reason is widespread corruption and lack of a reliable legal and democratic order and justice.

398. A paradox of international trade                      published 24-11-2018

There is a long tradition, since Plato at least, to reach for pure, fixed universals that transcend the messy, shifting variety of particulars experienced in the world.

On the other hand, since Aristotle there is an appreciation of the variety of particulars that appear in reality, emerge, realize their potential and decay.

The opposition between the two is reflected in a long line of contestation within religions: in Catholicism, Protestantism, and the Islam, between two streams: the strict, orthodox, intolerant universalists, and the more lenient, tolerant, liberal particularists.

The opposition is also reflected in a difference between relatively lenient, tolerant cultures in cities that are based on international trade, and more rigid cultures in internally oriented, craft based communities. The rationale for this difference seems clear: tolerance of variety is needed to conduct international trade. An example of a port culture is Amsterdam, which has been a hub of trade for four centuries. One would expect something similar in other port cities.

However, current globalisation is borne by a universalist market fundamentalism, an ideology of the market as a pure universal, the same everywhere, that will automatically establish itself if only one abolishes all the obstacles of intervention by states.

In reality, markets require institutions to work, and markets vary greatly between industries, due to differences in factors that shape markets, such as economies of scale, degree of concentration, monopolisation, technological change and resulting uncertainty, entry barriers to markets, transaction costs, including different degrees to which users can judge the quality of products, switching costs between products from different producers, separability or complementarity of products and production processes.

The focus of the development of the EU lay on the internal market as a universal good that would develop automatically as soon as different government rules were dismantled, in what has been called 'negative integration'. The expectation was that this would eradicate complexities of rules and regulations, and that prosperity and goals of employment, living conditions, labour conditions, and the abolishment of exclusion would automatically follow.

It did not work out that way. As markets spread across different sectors of society, in drives of liberalisation and privatisation, complexity of rules and regulations did not decrease but increased, because of the imperfections of markets and differences between those sectors.

This unexpected complexity became one of the sources of irritation and opposition towards the EU as an excessive regulator, constraining freedom.

Meanwhile, the dream of the market as a magical source of prosperity and quality of life and society also was not realised. The exclusive focus on the internal market was seen not to fulfil social goals but to thwart them, and now the EU belatedly has to take a more socially oriented turn.

In sum, there is a paradox of universalist ideology versus particularistic reality of markets, and society has suffered again from the illusion of universalistic dreams.

In item 387 in this blog I used Imre Lakatos'<sup>iii</sup> notion of a *research programme* to characterize mainstream economics. To recall: such a programme has a 'core' of fundamental principles, assumptions and directions for research, which must be protected from falsification at all costs, by means of a 'protective belt' of subsidiary assumptions that supplement or implement the core principles. When something comes up that falsifies the whole, it is attributed to the subsidiary assumptions, and a replacement is sought there to make the core work better.

That notion arose from a debate, in the philosophy of science, on the falsifiability of science. Popper had demanded falsification as the central purpose of scientific conduct, but then, in a famous article 'Two dogmas of empiricism', the philosopher Quine proposed that a theory is never tested as a single proposition, but as a system of propositions with main assumptions plus subsidiary assumptions and principles (e.g. about the direction and method of research, measurement), which is falsified as a whole. Then the question is which assumption or principle to consider falsified and in need of replacement. According to Lakatos' scheme the core assumptions are to be held on to, and revision is sought in the 'protective belt'.

I now present the core of a new programme of economics, to replace the old one. The cores of the old and the new are compared in the table below. Criticism of the old and arguments for the new were presented in preceding items in this blog.

#### Old and new economics

Old	New
Rational actors	Limited rationality, decision heuristics
Autonomous individual	Socially constituted individual
Optimal outcomes	Processes of adaptation and development
Competition	Competition and collaboration
Risk	Uncertainty
Utility ethics	Virtue ethics

The table shows a virtual reversal of core assumptions, from the old to the new. That illustrates how fundamental, radical, my proposal is. The components were discussed in preceding items in this blog. Here I recall some of the main connections.

A key feature is uncertainty, going beyond risk, formerly recognised, in economics, by Keynes (and Frank Night). With risk one knows what can happen, so that one can append probabilities and calculate an optimum expected outcome. With uncertainty one does not know what might happen, and options for choice emerge from action rather than being given in advance. That has a number of implications. Since optimal outcomes cannot be calculated in advance, that perspective of economics drops out, and one falls into the need to analyse processes of adaptation, to emerging outcomes, possibilities and options.

The most interesting and innovative relationships are the most uncertain. That requires trust, as a leap of faith across a gap of uncertainty. In contrast with earlier economic thought that trust cannot survive in competition because it requires giving without being able to count on receiving, the proposition is that in present economies next to competition firms also need to collaborate for innovation, which entails uncertainty, so that to survive one must handle the art of trust (without trust thereby becoming blind).

A switch is needed from the utility ethic underlying mainstream economics, looking only at the utility of outcomes, to a virtue ethics, looking also at virtues, not only of reason, and courage, but also of justice and moderation. Justice is needed for pressing social and political reasons, and moderation especially for saving the environment.

Relations also need to have some stability and some local roots, without falling into rigidity, and without surrendering international trade, but with necessary regulation of it. That is required for justice, political recognition of locality, and by an economic need for collaboration that also requires trust.

How realistic is this shift? I don't know, but in view of present populist revolt and the climate crisis, something has to change radically, or society will be destroyed.

I do not want to claim that the old economics is always wrong. It still applies under the following, clear conditions: the values involved can be measured, preferences and all options for choice are known, plus the possible outcomes ('pay-offs'), for oneself and any others one is dealing with. Then one can calculate an optimum, or equilibrium (in game theory), and it would be silly not to use that opportunity. If, on the other hand one or more of those conditions are not satisfied, under uncertainty, and preferences, options or outcomes are emergent rather than being given in advance, then one should shift to the new economics.

This goes back to an experience I had, when working for Shell in London, in the 1970's, as a project leader in the computing centre, where we used optimization techniques for the scheduling of refineries, routing of ships, location of gas stations, and design of loading stations for natural gas. For strategic planning, however, given the uncertainties involved, we developed scenario analysis, where we did not optimize, which was impossible, but used simulation to analyse the robustness of policies across different possible futures.

#### 406. Why capitalism is unbeatable

published 19-1-2019

In spite of a number of crises, capitalism is still thriving. How come? Does it satisfy more than material needs?

The human being is confronted with a range of antagonisms: the sacred/eternal and the profane/temporal, heaven and earth, body/matter and soul/spirit, desire and contentment, the universal and the particular, self/individual and other/collective, unity and variety, true and false. How can one deal with these? One needs a combination of fooling oneself, in 'cognitive dissonance', denial of the tension, and having an eye only for one side of an antagonism, with ideology that enshrines one's preferred option. Capitalism does both superbly.

It opts unequivocally for the self and denigrates the social, communal and local. It even proves (mathematically!) that greed is good, produces the highest possible level of prosperity. What is more alluring than that? It appeals to natural urges towards greed and self-manifestation, in both production and consumption. Opposition from altruism is blocked because that cannot survive in markets.

Its individualism is sanctioned by the Christian belief in individual, immortal souls. The magic of markets is that they offer variety, but under unity of universal market principles.

It appeals to the unquestionable, universal truth of markets, in a mystique of the automatic force of the ‘invisible hand’ of Adam Smith. ‘Laissez faire’: the magic will work itself. No counterforce can rival it. And no developing country must close itself off from international markets (while developed countries did that in their infancy).

In going for the individual it obstructs collective forces that may curtail it, such as unions, consumer societies, and ecological societies. It does constitute an interest group in itself. It lobbies for advantage, but not overtly, in secrecy, and denied when publicized. It is in the guilty interest of government to contribute to its secrecy, enhanced by revolving door careers between business and government.

In the stimulus of unending consumption, with new desires, it helps keep the boredom at bay that follows the satisfaction of desire. Shopping then becomes a way of life. The opposite of Buddhism, one could say.

It appeals to two forms of Romanticism. One, going back to Rousseau, is that of the free, autonomous individual against the coercion, manipulation and distortion of society. ‘There is no such thing as society’, was the motto of Margaret Thatcher. Breaking out of plodding mediocrity.

The second form of Romanticism is that of the transgression of boundaries: of the discoverer, the imperialist, the heroic entrepreneur, and the heroic scientist, breaking old constraints and opening new avenues to untold power, insight, pleasure and convenience. According to Harari<sup>iv</sup> it is the combination of capitalism, the scientific spirit and credit (to finance expansion and growth) that has produced European prominence in the world. And now Europe is being taken over by others imitating that perspective, first in the West (the US) and then in the East (China). They now practice capitalism in a purer or more complete form than Europe. Europe began to have qualms about capitalism, in communism, socialism and humanism, and now has lost its position of power.

It is Nietzschean, in its creative destruction, breaking up the old, not letting oneself be held back in power by the mediocre, with their jealousy, grudges and slave mentality. However, in large part this is myth. Large capital focuses on incremental innovation that leaves sunk investments intact for as long as possible, prolonging their life to save capital and squeeze it for profits. The most radical innovations are conducted by smaller firms, which then get bought by the large ones, to be frozen for as long as possible.

Ethical objections, and pleas for justice and benevolence, are waved off with the liberal claim that morality is a private matter, for behind the front door. The ruling ethic is that only outcomes count, in terms of utility, measured as prosperity. It considers instrumental, extrinsic quality of tools, capital and actions, not the intrinsic quality of processes (work), conditions and intentions. Justice beyond prosperity is not on the agenda. Of the classical virtues of reason/prudence, courage, moderation and justice, capitalism satisfies reason, in pursuing science, and courage, in crossing boundaries, but it violates the virtues of moderation and justice.

It pursues the truth of pragmatism: truth is what works. No nonsense, not the airy idealism and speculation of stuffy, ivory tower idealists.

Finally, while once upon a time the expectation was that capital would be overwhelmed by the power of labour, now with globalization the power of capitalism has only increased, and subdues labour, with the threat of capital to move its employment elsewhere if it does not get its way, in tax evasion, low cost, and low security and intrinsic quality of labour, subsidies for energy, and lenient environmental restrictions.

#### 407. Growth and the good life

published 26-1-2019

What is the value of economic growth? It is needed to achieve enough prosperity, but why seek ongoing, endless growth beyond that? Why should we go on generating more wealth instead of working less, with more leisure to spend on other pursuits than consumption and material acquisition? This question was asked in a book ‘How much is enough?’ (2012), by Robert and Edward Skidelsky. They eloquently argued that ongoing growth is not conducive to the good life. There, as I do in this blog, they employ an Aristotelian virtue ethic, to replace the utilitarian ethic that rules economic science and from there politics.

The most fundamental point is that the good life entails a number of disparate dimensions that are incommensurable, cannot be added and subtracted in a single measure of value (see also item 79 of this blog). This upsets the paradigm of utility maximization that rules economic thought. There is not one single value to be maximized.

The literature offers a variety of lists of the good things in life, such as: health, courage, freedom or autonomy, love and friendship, empathy, material well-being, pleasure, moderation, prudence, security, intrinsic value of work, leading a useful life that contributes to society and nature, and more. Incommensurability entails that they cannot easily be traded off. How can I trade off love of knowledge and of my children, seeking satisfaction and contributing to society, self-interest and altruism? They are qualitatively different. And many of the goods of life are not tradeable.

Why does economic growth crowd out many aspects of the good life? One factor is the insatiability of human desire. Schopenhauer, for example, argued that satisfaction of one want evokes new wants and if satisfaction were ever achieved it would generate insufferable boredom.

The Skidelsky’s recognized further factors. It is often the satisfaction not of wealth itself but of having more than others that drives acquisitiveness. An institutional factor is that with growth the poor can be pacified with the prospect of rising income, reducing the need for the politically tougher measure of more re-distribution of wealth, against the powerful lobby of the rich.

Implicitly or explicitly, economics, basing itself on liberal ethics. has made a fundamental moral assumption. It is not up to government but to citizens to determine what the good life is and how it is to be achieved. Governments should be neutral with respect to values, preserving freedom and avoiding coercion and paternalism.

There are two faults with this view. First, governments do in fact, and necessarily, make moral judgements in protecting the poor, sick and unemployed, fighting crime, promoting security, protecting the environment, and promoting health, education and culture. If in fact policy is value driven, it is better to make that explicit and bring it into debate.

Second, it is an illusion to think that consumers are autonomous in their preferences. They are affected by advertising and other actions that fuel desire, acquisitiveness, and spending.

Third, goods are produced with built-in obsolescence. For example, the software of old hardware, in computers and phones, is no longer supported, which forces people to buy ever-new hard- and software with features they do not need.

The underlying error of economic thought is two-fold. First the idea that preferences are given, not affected by options of choice and processes of choice. In fact, particularly from the pragmatist view set out in this blog, ideas, including preferences, develop in interaction with the social and natural environment. That also upsets the assumption that economic agents are autonomous.

So, economics is fundamentally misguided, and we must look how preferences are fed, formed and mobilized or ignored, and how that affects the good life.

#### 408. How universal is the good life?

published 2-2-2019

The great power of economic thought is five-fold. It is simple and parsimonious, it is amenable to technocratic calculation, satisfying urges towards rational choice and design, it is purported to be universal, applying always and everywhere, it conveniently avoids difficult ethical questions, and it supposedly promotes freedom. As argued earlier, concerning capitalism, in item 406, this makes economics virtually invincible, and its corrosive effects on the good life may be inevitable.

An approach from an Aristotelian consideration of the good life has corresponding weaknesses. It is complicated, discursive rather than calculative, difficult to universalize, and hence complicated and expensive, and it is to a greater or lesser extent paternalistic. It reigns in opportunities for further economic growth and concentration of wealth. As a result it can expect powerful opposition from an unholy alliance of the wealthy, established interests of industry and commerce, libertarians, technocrats, gluttons and consumption zombies.

Dare we proceed? Let us take it bit by bit.

One serious drawback to consideration of the good life is that it seems subjective and relativistic, flying off in all directions, depending on the identities, preferences and positions of individuals and the social and economic environments they are in.

In their book 'How much is enough' (2012), Robert and Edward Skidelsky try to remedy this. They first specify what conditions elements of the good life should satisfy, and then proceed to give their list of the good things. Much as I sympathise with their endeavour, I think they go wrong at the first condition they specify, that the good things should be universal. I disagree: the list of goods depends on taste and conditions.

This immediately shows up in their list, which next to health, respect, personality (autonomy), friendship, and leisure (absence of external compulsion, intrinsic value of activity), includes security (especially in income). I disagree with an unqualified good of security, which to me

smacks too much of avoidance of risk. In the vein of Nietzsche I value the taking of risk for a flourishing life, at the pain of pain and loss that it involves.

Incidentally, in an attempt to regain voters in upcoming elections, the Dutch labour party recently launched a guiding motto of 'security'. I think that is a bad choice. Insecurity is an uneliminable part of life. Such a promise cannot be fulfilled and evokes a further fall of trust when it turns out not to be fulfilled. And it is counter to the interest of citizens. It would be better to help them accept insecurity and deal with it.

For Aristotle the good life consists in development of the potential one has, especially spiritual potential, and the striving for excellence in the realization of potential. I fully endorse that. Material conditions and pleasure are also part of the good life, but in moderation. Aristotle's list included courage, moderation, generosity, justice, and wisdom, and the external goods necessary to realize them.

So how relativistic is the good life? Between the extremes of universalism and individualism there are intermediate forms of unity in diversity. There can be community without equality or any shared essence.

Music varies enormously but it always uses tone and pitch. The variety of gables along canals in Amsterdam is unified in the use of the golden ratio between the heights of windows on successive floors. Why could humanity not have a similar variety in views of the good life and yet have some form of resemblance in common?

Wittgenstein offered the notion of *family resemblance*: A has features in common with B who has features in common with C while A and C have nothing in common. What families share is chains or networks of resemblance without any clear familiar essence. Views of the good life might be like that.

But the most important thing, I think, is this. For Aristotle the overarching virtue, in common between all lists of goods, was *prudence* as the ability to deal with the variety and frequent contrariness of the other goods, in trying to find a good 'middle'. For example, courage as a 'middle' between recklessness and cowardice. One can seek some middle between risk and security, self-interest and altruism, spiritual and material goods, between work for money and for its intrinsic worth (of enjoyment, social relations, value to society, .....).

The kind of economy, and of politics, we should be looking for is one that caters to this.

#### 409. Revival of risk and variety

published 9-2-2019

The Dutch political scientist Paul Frissen proposed that a number of countries (he pointed to the Netherlands) are caught between a *cramp of control* and a *cramp of conformity*. The cramp of control arises from the modernist, technocratic dream of a society that is rationally designed, and where all risks and contingencies are under control. The cramp of conformity arises from a romantic populism of national spirit and culture that are to be kept pure and uncontaminated by foreign influence.

This is a disastrous situation. Especially for a country (such as the Netherlands) that used to derive its strength from pragmatic improvisation and tolerance of the foreign. Attempts to

eliminate risk yield a glut of regulations and restrictions that squeeze out all *room* for novelty and creativity, and produce an explosion of cost. Xenophobic elimination of difference kills the variety that is a *source* of novelty and creativity. Together, risk avoidance and xenophobia suffocate society. The first halts breathing and the second takes away the oxygen.

How to get away from this? How to regain room and incentives for risk taking and variety? Those are precisely virtues of markets. I am deeply critical of market ideology, but instead of eliminating markets, if anyone were to plead for that, I advocate to harness their power while bending it and preventing perversities.

In this blog I discuss economics and markets. I argue that the core virtues of markets are that they allow for and utilize diversity, variety of local ideas and initiatives, while efficiently selecting out ventures that are not viable. This selection of course entails risk of failure, the risk of entrepreneurship. Not many people would want to take such risks, but entrepreneurs do. The virtue of markets is that they privatize risk. Risk are not imposed on unwilling taxpayers but on entrepreneurs, who take them voluntarily. But then they must be allowed to reap the advantages of profits when those occur, at least up to a point. And obstacles from institutions and vested interests must be eliminated to give them room.

In a perverse effect of markets, the conduct of bankers led to the reverse, the socialization of risk: private risks of banks were hived onto the public.

There are complications. Entrepreneurial innovation entails *creative destruction*, eliminating old technologies, industries, skills and employment. Unjust consequences for the victims are to be compensated by schemes of re-training and of social security for those who cannot catch up.

This is my not so new plea for an apparently neglected combination of markets and social security, in a society that is open to diversity and to risk and compensates for the latter's injustices when those arise. We had that to some extent in past capitalism, but have somehow lost it.

#### 410. Conditional goods

published 16-2-2019

In what way is the good life not universal but *contingent*, dependent on conditions, in economies? For at least some actions, goodness is not absolute, universal, but depends on conditions. Consider the sticky issues of environmental protection, world trade, child labour, slave trade, trade in babies, and trade in organs.

This view follows from my Aristotelian stance of finding the good in between extremes, in *phronesis*, the practical wisdom of judging according to context.

It is easy to say that poor people should not, and should not be allowed to sell their organs. What would you do if that were the only way to save your sick child? It is too easy to simply forbid and prevent it everywhere. One should first create economic conditions where people are no longer forced to do it. A similar point applies to child labour. It does not necessarily improve matters to simply take the children out of work. Again, conditions should first be created to do so, in employment of parents and availability of affordable schooling. Surely, one might say, we would draw the line, as something never to be tolerated, at slave trade, and

in particular trade in babies, which do both occur. But even there, what would you do as a single mother who can only feed her several children by selling one?

Is it reasonable to demand that developing countries levy the same taxes on pollution, reducing their opportunities to catch up, while developed countries pollute much more due to a higher level of production?

Is it reasonable that developed countries that became prosperous by protection of home industries now deny the right to emerging economies?

In this vein the good is subject to debate that takes conditions into account, and recognizes the contingency of goods, in a *debatable ethics*, as I argued in item 118 of this blog. What about the case of the mother selling one baby to save the others? We would see if that really were the only option, rather than taking on some nasty job that would still not be as bad as selling a baby.

In item 79 of this blog I recognized that incommensurability, the condition that not all values can be brought under a common measure, requires debate and that this can become very costly. Therefore we should try to make calculative trade-offs whenever that is warranted, i.e. does not do too much violence to incommensurability.

For economics there is no problem in any of these issues. Whatever people do, within the law, is an expression of their preferences, which they are free to satisfy. Moral constraints are up to laws and regulations that should apply equally to all, to ensure a 'level playing ground' for competition, regardless of considerations of justice, history, compassion or any aspect of the good life apart from satisfaction of wants.

Amartya Sen and Martha Nussbaum go further, with a *capabilities approach* that wants to ensure that people have access to the means needed to make a free choice. For the Skidelsky's, in their book 'How much is enough' (2012), this does not go far enough. It is still too much based on a liberal idea of autonomy. The question should not only be what people are capable of but what they actually achieve. What Sen and Nussbaum call capabilities, such as knowledge, access to jobs, to social relations, etc. are not mere *instruments* for the good life, but *constitute* the good life. However, the Skidelsky's do maintain that 'on any reasonable definition, the good life is an autonomous, self-determined one' (2013 version of the book, p. 149)<sup>1</sup>.

I want to stretch it a little further. In this blog and elsewhere (Nooteboom 2012)<sup>2</sup> I argue that to achieve the highest level of freedom, which includes freedom from one's own prejudice and errors of thought, one needs opposition from the other, and for this one needs to develop openness and empathy. Autonomy is self-defeating.

#### 411. Possible ends of capitalism

published 23-2-2019

Karl Marx predicted that capitalism would break down in revolution. To maintain capitalist profits, a shrinking class of superwealthy would increasingly exploit labour, until the

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<sup>1</sup> Robert and Edward Skidelsky, *How much is enough?*, Penguin, 2013.

<sup>2</sup> B. Nooteboom, *Beyond humanism: The flourishing of life, self and other*, Palgrave MacMillan, 2012. It can be downloaded from my website [www.bartnooteboom.nl](http://www.bartnooteboom.nl)

populace rose in revolt. What Marx did not take into account was that innovation, in technology, markets and organization, continually raised labour productivity, which allowed for wage increases without affecting profits. The working class was sucked along in compulsive consumption that further fed profits.

Yet the current situation does resemble Marxist crisis. The ‘occupy’ movement is a manifestation of accumulating frustration and anger concerning the untrammelled, immoral acquisitiveness and opportunism of the 1% richest people, in particular in the financial sector, which makes increasingly disparate gains at the cost of citizens, who carry the risks that banks hive off onto society. Governments allow themselves to be taken hostage by business interests.

The movement seems to have petered out, and there are signs that the financial sector is ready to persist along its path of social destruction. As I indicated before, the alliance between economic logic, vested power interests, and governments that are taken hostage, is difficult to break through.

One scenario now is that tension and popular anger will keep on building up until it indeed does break out in revolution. Present populist protests may augur that.

A second scenario is a crumbling of central government and large business in decentralisation and localization of economic activity, social action, and finance. Such localization has been likened to the Middle Ages (by Alisdair Macintyre).

In finance we see it in the growth of crowd funding, of economic, social and cultural small scale activity, and in ‘Fintec’, the rise of small entrepreneurial activity outside the purview of banks, using new opportunities of digitalisation. Local providers of capital are beginning to deal directly with local entrepreneurs. Any resulting economic disadvantages of small scale, in lesser spread of risks and opportunities, may well be offset by lower risks of default due to local reputation effects and social control.

In social activities we see it in people organizing their own day care for children, care of the homeless and poor, and home care of the old and ill. People cook for people also outside the family. Unemployed set up repair shops. People set up systems for the exchange of used goods. Sometimes services rendered yield credits that can later be used to buy services. These are ways to bypass, to circumvent centralized powers that have gone haywire.

However, we should not romanticize this. There will be increasing inequality between different communities with different intellectual, financial and social capital. The poor communities may be tempted to come and rob the rich ones, which would then set up defences. Perhaps not unlike medieval fortified cities. Local bonzes may accumulate and misuse power, perhaps not unlike medieval barons.

Some remaining central government would be needed to provide safety, control power, and mitigate inequalities. It might be chosen on the basis of representation of local communities, not unlike the ‘states’ of old.

A third scenario is that present capitalism and economic theory be drastically reformed ‘from inside’, from within the system, to stop market corrosion of the untradeable elements of the good life, break down concentration of economic power, reduce complexity of the system by

uncoupling and decentralization, establish a new balance between risk and security, and between autonomy and sociality. However, what earlier (in item 109) I called *system tragedy*, with established powers of business and institutions holding each other in the deadlock of prisoners dilemmas, on different levels, makes such change from within unlikely.

So, the most likely end is some form of ‘creative destruction’, in revolution or emergence of new forms outside the dominant system, emerging on a small scale, in a variety of forms that sooner or later will settle down in new dominant forms that are difficult to foresee.

How is capitalism defined? If we define it as markets plus private ownership of capital, new forms are likely to be new guises of capitalism.

## 412. Identity in economics

published 2-3-2019

Earlier in this blog (items 8, 9, 10, 265) I noted that identity is personal as well as social/cultural. I also proposed that both individually and culturally identity is not single but multiple, and that it is not fixed but subject to development. There is no given, fixed essence that constitutes identity.

Socially, identity arises, in particular, from one’s being held accountable for one’s actions and utterances. Individually, identity develops from interaction with others, with their contrasting ideas and actions.

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Is Hume, right, then? Is there no coherence in some sort of identity, even if multiple? I proposed that some coherence arises from the fact that what emerges in the brain is connected with survival of the body in which it forms thought, because that survival requires functional coherence, and that constitutes identity. Individuality is next produced by the assimilation of experience, and accommodation to it, along one’s individual life trajectory.

How does all this sit in economic theory? It doesn’t. In economics, identity is only individual, not social, and it is assumed as given, in sets of preferences. To include identity, economics needs to include preference formation. For that, it would need to include the interaction between people by which preferences and identity are formed. For that, economics would have to integrate with sociology and cognitive science.

Liberal individualistic market theory prides itself on yielding the widest possible scope for individual freedom. But, as I argued in item 49 in this blog, the highest form of freedom is

freedom also from one's own prejudices, and for that one needs the opposition from others. To profit from that, one needs to develop empathy: understanding what makes other people tick.

For partnership in development one also needs trust. The most fundamental reason for this is that the development of identity, and of relations needed for it, entails radical uncertainty: one does not know in advance how even one's own preferences and options for choice will develop, and this renders calculative rational choice concerning relationships inoperable. One has to dare the leap faith of trust or forego the social and cultural sources of the development of identity. However, in economics trust that goes beyond rational control, in the exercise of hierarchy, contracts or incentives, cannot exist.

In sum, for an answer, the apparently simple question of identity in economics requires a fundamental revision of economic theory. The crux of it lies in the social and cultural sources of identity, and the radical uncertainty involved in identity formation.

In present times of 'filter bubbles' or 'echo chambers', many people take note only of opinions similar to their own, in social media. That robs them of the opposition from contrasting views, as a source of identity development. That development will then be stunted.

With its view of the individual as autonomous, economics has contributed to this.

#### 409. Revival of risk and variety

published 9-2-2019

The Dutch political scientist Paul Frissen proposed that a number of countries (he pointed to the Netherlands) are caught between a *cramp of control* and a *cramp of conformity*. The cramp of control arises from the modernist, technocratic dream of a society that is rationally designed, and where all risks and contingencies are under control. The cramp of conformity arises from a romantic populism of national spirit and culture that are to be kept pure and uncontaminated by foreign influence.

This is a disastrous situation. Especially for a country (such as the Netherlands) that used to derive its strength from pragmatic improvisation and tolerance of the foreign. Attempts to eliminate risk yield a glut of regulations and restrictions that squeeze out all *room* for novelty and creativity, and produce an explosion of cost. Xenophobic elimination of difference kills the variety that is a *source* of novelty and creativity. Together, risk avoidance and xenophobia suffocate society. The first halts breathing and the second takes away the oxygen.

How to get away from this? How to regain room and incentives for risk taking and variety? Those are precisely virtues of markets. I am deeply critical of market ideology, but instead of eliminating markets, if anyone were to plead for that, I advocate to harness their power while bending it and preventing perversities.

In this blog I discuss economics and markets. I argue that the core virtues of markets are that they allow for and utilize diversity, variety of local ideas and initiatives, while efficiently selecting out ventures that are not viable. This selection of course entails risk of failure, the risk of entrepreneurship. Not many people would want to take such risks, but entrepreneurs do. The virtue of markets is that they privatize risk. Risk are not imposed on unwilling

taxpayers but on entrepreneurs, who take them voluntarily. But then they must be allowed to reap the advantages of profits when those occur, at least up to a point. And obstacles from institutions and vested interests must be eliminated to give them room.

In a perverse effect of markets, the conduct of bankers led to the reverse, the socialization of risk: private risks of banks were hived onto the public.

There are complications. Entrepreneurial innovation entails *creative destruction*, eliminating old technologies, industries, skills and employment. Unjust consequences for the victims are to be compensated by schemes of re-training and of social security for those who cannot catch up.

This is my not so new plea for an apparently neglected combination of markets and social security, in a society that is open to diversity and to risk and compensates for the latter's injustices when those arise. We had that to some extent in past capitalism, but have somehow lost it.

#### 410. Conditional goods

published 16-2-2019

In what way is the good life not universal but *contingent*, dependent on conditions, in economies? For at least some actions, goodness is not absolute, universal, but depends on conditions. Consider the sticky issues of environmental protection, world trade, child labour, slave trade, trade in babies, and trade in organs.

This view follows from my Aristotelian stance of finding the good in between extremes, in *phronesis*, the practical wisdom of judging according to context.

It is easy to say that poor people should not, and should not be allowed to sell their organs. What would you do if that were the only way to save your sick child? It is too easy to simply forbid and prevent it everywhere. One should first create economic conditions where people are no longer forced to do it. A similar point applies to child labour. It does not necessarily improve matters to simply take the children out of work. Again, conditions should first be created to do so, in employment of parents and availability of affordable schooling. Surely, one might say, we would draw the line, as something never to be tolerated, at slave trade, and in particular trade in babies, which do both occur. But even there, what would you do as a single mother who can only feed her several children by selling one?

Is it reasonable to demand that developing countries levy the same taxes on pollution, reducing their opportunities to catch up, while developed countries pollute much more due to a higher level of production?

Is it reasonable that developed countries that became prosperous by protection of home industries now deny the right to emerging economies?

In this vein the good is subject to debate that takes conditions into account, and recognizes the contingency of goods, in a *debatable ethics*, as I argued in item 118 of this blog. What about the case of the mother selling one baby to save the others? We would see if that really were the only option, rather than taking on some nasty job that would still not be as bad as selling a baby.

In item 79 of this blog I recognized that incommensurability, the condition that not all values can be brought under a common measure, requires debate and that this can become very costly. Therefore we should try to make calculative trade-offs whenever that is warranted, i.e. does not do too much violence to incommensurability.

For economics there is no problem in any of these issues. Whatever people do, within the law, is an expression of their preferences, which they are free to satisfy. Moral constraints are up to laws and regulations that should apply equally to all, to ensure a 'level playing ground' for competition, regardless of considerations of justice, history, compassion or any aspect of the good life apart from satisfaction of wants.

Amartya Sen and Martha Nussbaum go further, with a *capabilities approach* that wants to ensure that people have access to the means needed to make a free choice. For the Skidelsky's, in their book 'How much is enough' (2012), this does not go far enough. It is still too much based on a liberal idea of autonomy. The question should not only be what people are capable of but what they actually achieve. What Sen and Nussbaum call capabilities, such as knowledge, access to jobs, to social relations, etc. are not mere *instruments* for the good life, but *constitute* the good life. However, the Skidelsky's do maintain that 'on any reasonable definition, the good life is an autonomous, self-determined one' (2013 version of the book, p. 149)<sup>3</sup>.

I want to stretch it a little further. In this blog and elsewhere (Nooteboom 2012)<sup>4</sup> I argue that to achieve the highest level of freedom, which includes freedom from one's own prejudice and errors of thought, one needs opposition from the other, and for this one needs to develop openness and empathy. Autonomy is self-defeating.

#### 411. Possible ends of capitalism

published 23-22019

Karl Marx predicted that capitalism would break down in revolution. To maintain capitalist profits, a shrinking class of superwealthy would increasingly exploit labour, until the populace rose in revolt. What Marx did not take into account was that innovation, in technology, markets and organization, continually raised labour productivity, which allowed for wage increases without affecting profits. The working class was sucked along in compulsive consumption that further fed profits.

Yet the current situation does resemble Marxist crisis. The 'occupy' movement is a manifestation of accumulating frustration and anger concerning the untrammelled, immoral acquisitiveness and opportunism of the 1% richest people, in particular in the financial sector, which makes increasingly disparate gains at the cost of citizens, who carry the risks that banks hive off onto society. Governments allow themselves to be taken hostage by business interests.

The movement seems to have petered out, and there are signs that the financial sector is ready to persist along its path of social destruction. As I indicated before, the alliance between

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<sup>3</sup> Robert and Edward Skidelsky, *How much is enough?*, Penguin, 2013.

<sup>4</sup> B. Nooteboom, *Beyond humanism: The flourishing of life, self and other*, Palgrave MacMillan, 2012. It can be downloaded from my website [www.bartnooteboom.nl](http://www.bartnooteboom.nl)

economic logic, vested power interests, and governments that are taken hostage, is difficult to break through.

One scenario now is that tension and popular anger will keep on building up until it indeed does break out in revolution. Present populist protests may augur that.

A second scenario is a crumbling of central government and large business in decentralisation and localization of economic activity, social action, and finance. Such localization has been likened to the Middle Ages (by Alisdair Macintyre).

In finance we see it in the growth of crowd funding, of economic, social and cultural small scale activity, and in 'Fintec', the rise of small entrepreneurial activity outside the purview of banks, using new opportunities of digitalisation. Local providers of capital are beginning to deal directly with local entrepreneurs. Any resulting economic disadvantages of small scale, in lesser spread of risks and opportunities, may well be offset by lower risks of default due to local reputation effects and social control.

In social activities we see it in people organizing their own day care for children, care of the homeless and poor, and home care of the old and ill. People cook for people also outside the family. Unemployed set up repair shops. People set up systems for the exchange of used goods. Sometimes services rendered yield credits that can later be used to buy services. These are ways to bypass, to circumvent centralized powers that have gone haywire.

However, we should not romanticize this. There will be increasing inequality between different communities with different intellectual, financial and social capital. The poor communities may be tempted to come and rob the rich ones, which would then set up defences. Perhaps not unlike medieval fortified cities. Local bonzes may accumulate and misuse power, perhaps not unlike medieval barons.

Some remaining central government would be needed to provide safety, control power, and mitigate inequalities. It might be chosen on the basis of representation of local communities, not unlike the 'states' of old.

A third scenario is that present capitalism and economic theory be drastically reformed 'from inside', from within the system, to stop market corrosion of the untradeable elements of the good life, break down concentration of economic power, reduce complexity of the system by uncoupling and decentralization, establish a new balance between risk and security, and between autonomy and sociality. However, what earlier (in item 109) I called *system tragedy*, with established powers of business and institutions holding each other in the deadlock of prisoners dilemmas, on different levels, makes such change from within unlikely.

So, the most likely end is some form of 'creative destruction', in revolution or emergence of new forms outside the dominant system, emerging on a small scale, in a variety of forms that sooner or later will settle down in new dominant forms that are difficult to foresee.

How is capitalism defined? If we define it as markets plus private ownership of capital, new forms are likely to be new guises of capitalism.

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In sum, for an answer, the apparently simple question of identity in economics requires a fundamental revision of economic theory. The crux of it lies in the social and cultural sources of identity, and the radical uncertainty involved in identity formation.

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## 429. Why is it impossible to integrate economics and business?

Published 29-6-2019

Here I recount a personal experience. In the 1990’s, I was charged with the task of setting up a research institute integrating faculties of economics and business, at the university of Groningen, the Netherlands.

That ended in failure. In the end we had erected a nice semblance, a stage set of unity, but behind that everybody went on with their own sweet old practice.

It was, however, an interesting failure: why was integration so difficult, seemingly impossible? There is of course a simple behavioural factor: people don’t like to be pushed away from their routine. But there are also more substantive reasons. It took me some years to figure this out.

Earlier in this blog, in items 387 and 421, I discussed scientific schools of thought in terms of Imre Lakatos’ notion of ‘research programmes’, which are characterized as having a ‘hard core’ of fundamental principles of theory and method.

For economics, this included an orientation towards optimal outcomes, regardless of processes by which they may or may not be achieved. Second, aiming at optimal outcomes, it was oriented at rational choice. Third, choices are made by autonomous agents. Fourth, economics deals with risk, where one does not know what *will* happen but does know what *can* happen, but cannot deal with uncertainty, where one does not know the latter either. Fifth, the approach in terms of optimal outcomes offered the opportunity for mathematical calculation of optima and equilibria, and mathematical modelling became part of the core.

Business organization, by contrast, is oriented at processes, of production, development, decision making, which seldom achieve optimal outcomes. Second, it cannot ignore the limited rationality of choice, of people and organizations. Third, it cannot assume autonomy of agents, with which organizations could not function. Fourth, it cannot ignore uncertainty, with the reality that often options and contingencies of choice and action emerge after choice rather than being known in advance. Processes and uncertainty precluded calculation of optima. Some change is now occurring, with agent-based simulation of economic processes, which lends some of the reputation of mathematics.

Therefore, integration of the two faculties of economics and business would require either of the two to drop its core and allow oneself to be assimilated into the core of the other.

I had hoped to use, as bridgeheads for connecting the two disciplines, areas of non-orthodox economics that could be rhymed with the logics of business and organization. Those were evolutionary economics, which is process-oriented, institutional economics, which recognizes that agents are socially, institutionally constituted, enabled and constrained, and post-Keynesian economics, which follows John Maynard Keynes as one of the rare economists who recognized and incorporated uncertainty. Alas, those side-lines of economics were not present at this particular economics faculty. The economists present were purist mainstream economists.

Out of frustration with this impossibility, and the scheming that went along with it, I left the university.

Later, I heard, the two faculties were merged, and this was realised by assimilating business studies into economics, surrendering its core.

From colleagues I hear that this issue arises in many places, world wide, usually with economics winning out.

#### 442. Economic freedom and trust

published 27-9-2019

Do economic freedom and trust help or oppose each other? I come to this question from an article by Johan Graafland, who investigated the issue empirically.<sup>v</sup> Economic freedom consists of property rights, freedom of competition (free entry into markets), small government, and low taxes.

That is mostly ‘negative freedom’: absence of interference, no constraint on action, as opposed to ‘positive freedom’, which entails access to resources.

Trust yields a constraint on action, not to cheat, not to lie and make promises one cannot keep, not to take unfair advantage of people, to be loyal, and thus by definition limits economic freedom.

Now, are economic freedom and trust complements, reinforcing each other, or substitutes, replacing each other?

The institutions of economic freedom, such as property rights, legal contracts, access to courts, access to markets, do contribute to trust. Also contributing to trust is access to courts at low cost, and intelligibility of legal process and communication. All these provide ‘institutional trust’, a basis for trust to build on.

There are more institutions that support trust. Trust entails positive expectations, and fake news undermines expectations and thus hinders trust. Reliable news is thus needed for trust. So do reputation mechanisms..

Economic freedom is regularly limited by limits to competition. When left unchecked, markets develop into their antithesis, with entry barriers to markets, created by monopolies and oligopolies. By way of economies of large scale, concentration arises in large firms, which then exercise lobbying on government for advantages. This reduces economic freedom

and creates distrust. Oversight by a competition authority and countervailing power of government to curtail economic power are needed for trust.

On the other hand, institutions can never be complete, to foreclose all the opportunities for coercion, cheating, lying that inhibit freedom of choice. Contracts can never be complete, must leave things to be taken for granted. Then, trust is needed to fill the gaps, so to speak.

Alternatively, one can try to fill the gaps with oversight by institutions, such as a competition authority, a consumer authority, a health authority, an education authority, a central bank, etc. but that can constrain freedom too much. Such efforts tend to accumulate and stifle freedom of action, in excess of control from the perceived need to close off all loopholes, which is impossible. Every time a new breach or work-around is invented, a new regulation is heaped onto the stack. If trust can come in its stead, it helps economic freedom.

Also, it is often expensive to make contracts as complete as possible. Trust can allow for more limited contracts, thus reducing ‘transaction costs’.

Trust is more needed to the extent that contracts and control are more difficult, and that is the case, in particular, under the uncertainty of innovation, where by definition one does not know what will happen or even what can happen, so contracts cannot be specified.

Trust fosters collaboration, and that can lead to obstruction of economic freedom. But sometimes relationships require a certain stability, also for economic reasons, when jointly produced added value demands investments that are specific to the relation, for mutual understanding and adjustment, specific installations, instruments or training, and for building trust, and require a certain duration of collaboration to make the investments and recoup them. But for the duration that by definition excludes other participants, and hence limits competition. In other words, sometimes institutions for economic freedom need to be relaxed for economic reasons.

And, finally, apart from economic value, trust-based relations can have intrinsic value that merit a bit less economic value, if needed. They may enhance social conditions and personal satisfaction.

So, in conclusion, economic freedom and trust are both substitutes and complements, and need to be carefully mixed.

443. Freedom, economy and basic income

published 4-10-2019

A virtue of liberal society is freedom of choice, or part of it. Such freedom requires two things: freedom to make a choice, selecting from options, with little constraint, in ‘negative freedom’. It also requires that one have a choice, options to choose from, and the means to realise them, in ‘positive freedom’.

A familiar idea of economics is ‘quid pro quo’: to get something you must give something. To have money one must earn it. There is no free lunch. The idea of an unconditional basic income (BI), with no condition of work and no obligations, seems to go against that principle.

That is no doubt part of the deeply rooted political resistance to a BI, as inimical to a market-based, liberal society. But it is not.

For poor people, however, the virtue of a BI is that it frees people from the stranglehold of poverty, with constant worry about food, ability to pay for bills, educate children, sapping opportunity, strength and initiative to get out of 'the poverty trap'.

A BI increases negative freedom, from the shackles of poverty, as well as positive freedom, in lending some access to resources for improvement. But why not use the usual avenue of loans to set up enterprise? That should be promoted, as is happening with 'micro credit', but a problem remains that the poor lack 'collateral' to cover the loan, and in case of default the pit of poverty would deepen.

Time and again, experiments or practice of basic income, unconditional but often only for some, the trapped poor, and for some time, show that it works. There is evidence from Brazil, India, Rwanda, Ghana, Ethiopia, Kenya and Malawi. People receiving the benefit generally do not spend it on consumption but on some investment to improve their economic position. It is also used to get children to go to school who before had to contribute child labour for the family to survive. They use it to buy a sewing machine to make clothes to sell, a fishing net, or boat, or to sink a water well, together with others. So, here we have a non-economic thing with beneficial economic as well as social outcomes. A BI is a means to economic development.

But at the same time, there must also be economic freedom, in absence of corruption, access to markets, ownership rights, and fair legal process, for people not to be robbed of the investments they make, and to earn their returns.

A BI is also an efficient means of development aid, more efficient than aid in the form of goods produced elsewhere and shipped and distributed in developing countries, often on the basis of ill-informed guesses about needs, costs of transport and distribution, and with spillage in corruption.

The BI can efficiently be allocated through cell phones that are now available everywhere, also in developing countries.

And concerning ideology: it is not that the recipients do not do something for the BI, it is just that they do it after, not before receiving it.

In sum, economy and basic income can go well together, complementing each other. Institutions of economic freedom are needed for BI to have its positive effect, with the negative freedom of preventing constraints for enterprise, while BI provides the positive freedom of access to resources for it.

445. The dogma of efficiency

published 18-10-2019

The good thing about institutional economics is that it does not take markets for granted but investigates how institutions may enable, disable or pervert markets.

Institutions can be formal and written, such as property rights, access to markets (competition law), and a variety of government regulations (for the environment, advertising, labour conditions, etc.). There are also unwritten, informal, cultural effects, such as norms and customs of behaviour, with underlying ethics and values. Language is an institution that enables communication.

There still is, even among institutional economists, the dogma that all institutional analysis should be based on the assumption of efficiency, as recently propounded by Douglas Allen, in a book 'Research agenda for New Institutional Economics'.<sup>vi</sup> Allen defined efficiency as the outcome of the maximization of a utility function under constraints. If an institution appears inefficient, that is because one has neglected some part of the utility function or some side condition.

This is in itself an institution, stating the rule of the game for institutional economists to belong to the tribe.

Here, Allen quotes Coase, one of the founding fathers of institutional economics as saying that '... to not appreciate that institutions are efficiently chosen is to end up doing welfare economics that "ultimately dissolves into a study of aesthetics and morals"'.<sup>vii</sup>

Now, I would not claim aesthetics as a basis for the study of institutions, but I would certainly include morals as perhaps the most important aspect of the role of culture in the making of institutions. Trust, for example is based, in part, on morals. It is risible to denigrate morals in the way that Coase did.

There are two problems with the dogma. The first is methodological. The claim that institutions are efficient is taken to be true by definition, therefore is not falsifiable and therefore not scientific.

The second problem is substantive. The assumption of efficiency appears to ignore the vast evidence that people routinely make decisions out of ignorance, mistake, impulse and irrational shortcuts to decisions (called 'heuristics'). Developed in social psychology, all this is now part of behavioural economics.

Now, the response to this criticism of the dogmatic economist would be that this conduct only seems irrational, inefficient, because one has not included the proper goals or constraints of conduct. But that only confirms, or deepens, the methodological problem. All conduct becomes rational even if it is not rational.

The solution of the dogmatist would be to rationalize the heuristics by including in the objective function the cost of mental effort and delay of rational analysis. In this way one can rationalize any conduct, no matter how absurd, by including the assumption that this what people want. The point is, of course that no matter how you twist it, the fact remains that the conduct is irrational.

A whole industry of 'nudging' is developing, where policymakers or business strategists develop ways to improve the rationality of conduct, by affecting ('nudging') preferences and habits, the way heuristics work, to improve their optimality, by showing how choice can be improved, or by sheer manipulation.

This requires the recognition of inefficiency and irrationality.

#### 446. How rational is altruism?

Published 26-10-2019

In this blog I discussed several aspects of altruism. How would an economist deal with it? Altruism, recall, is defined as making a sacrifice to someone else without counting on an adequate benefit from it.

What an economist would probably say first, as has indeed been claimed, is that under the pressure of competition one cannot afford it. To survive one needs to grasp every possible opportunity for profit. In fact, the pressure of competition is often not so sharp, with firms doing all they can to soften it, in limits to competition.

However that may be, suppose that nevertheless altruism is observed? The economist, seeking to explain everything on the basis of the maximisation of some 'objective function' under constraints, would say that then it must be rational, and that it can be reconstructed by including in the objective function a reward in the form of feeling good about making the sacrifice.

The problem with this is as follows. Assuming that the sacrifice is material, i.e. monetary, in the form of profit foregone, the benefit is not material but ....., yes what? Is it a feeling of moral duty, or a personal sense of empathy, or friendship, or love (agape), or response to a need, or a habit, or a favour in return to a favour received, or creating a good reputation?

Is it clear to the decision maker himself which is at issue? Is he honest to himself about the motive? Recall the issue of limited freedom of the will, according to which many, perhaps most decisions are made subconsciously, by impulse, which then are often rationalized afterwards. Could one still call that rational?

And suppose he knew which motive was at play, how measurable would its benefit be? The 'value' of it would be uncertain, dependent on contingencies the decision maker cannot fathom. If the party the sacrifice is made to also has limited freedom of the will, who can say how he will respond? How measurable is all this? If not, what remains of the notion of maximizing an objective function?

One should recognize that here, as in many other cases, there is uncertainty in the sense that one does not know all the things that could happen, and what the costs and benefits would be. Then, one cannot calculate and be rational in that sense. One operates by hunch or guess, or more or less at random. Not knowing what the outcome will or even can be, one needs the courage of making a leap of faith, relying on one's intuitive hunches and impulse.

Research shows that often decisions made that way are surprisingly effective. It is just that one cannot explain how. After all, we operate subconsciously but effectively on the basis of routines in so many everyday activities.

Algorithms operated by 'platform businesses' such as Google and Facebook can predict your choices better, on the basis of masses of data collected on your conduct and choices, than you can yourself. Could one still maintain that our choices are rational?

#### 447. Does China need democracy for growth? Published 2-11-2019

This is a third piece on dogmatism in economics. I discuss an article by Cheryl Long in a recent volume on 'A research agenda for New Institutional Economics'<sup>vii</sup>. It raises the familiar issue whether 'ultimately' economic growth requires the liberal democratic economic institutions familiar in the West: universal laws concerning property, access to markets, low government interference, especially in business, and low taxes.

In China things are different. Instead of universal laws of property, supported by an independent judiciary, there is decentralization to regions in the scope allowed for regulations and interference by local government and its collaboration with business, in expropriation and allocation of locations, tax, and the granting of permissions, and with an opaque sharing of interests and deals of give and take. Also, instead of legal ordering, activity to a large extent rests upon 'guanxi', networks of family members and partners supporting each other on the basis of reciprocity, reputation and trust. Long calls these 'substitutes' for Western institutions, implying that they compromise what is taken to be the ideal, i.e. the Western institutions. This raises doubt concerning Chinese perspectives for continued growth.

Yet, China has had an ongoing record of growth, and still continues to grow, albeit less, ostensibly due to trade conflicts with the US. So, perhaps one should consider the possibility of other paths to growth than only Western institutions. What might be the rationale for that?

The diversity of associations between local government and business, in China, yields competition between regions that may stimulate growth. It also turns the country into a huge laboratory of experiments in economic arrangements that may be a source of innovation. And after all, in other countries there have also been experiments with public-private enterprise.

Second, concerning the guanxi, in Japan also, trust networks of family and associates play an important role in business.<sup>viii</sup> That has the possible downside of locking activities into the network, closing it off to possibly more productive alternatives and inspiration from outside. On the other hand, the alternative of extensive contracting, via the law, carries high transaction costs. As argued elsewhere in this blog, innovation is a crucial source of growth, and under the uncertainty of innovation trust is needed as a 'leap of faith', backed up by relational goods. And apart from its instrumental value, trust may also yield a higher intrinsic value of relationships.

Third, concerning government involvement, much of economic growth in the West has also arisen from government initiatives and subsidies, i.e. in defence industries and its spinoffs. The EU offers large subsidies to a variety of projects in research and development. Japan also has based its prosperity partly on large government planned and financed projects.

So, it may not be good news politically, but a sense of realism compels one to recognize other paths to growth than democratic institutions.

#### 454. Beyond utility

published 27-12-2019

In his recent book 'Is there a future for heterodox economics?', Geoffrey Hodgson, a well known heterodox economist, characterized orthodox economics as maintaining the approach

of ‘utility maximization’ or ‘Max U’. He criticized that, as I did in previous items in this blog. The principle of Max U is unfalsifiable, since utility cannot be measured.

One of the reasons that a one-dimensional measure of utility is assumed, is that it enables simple mathematics, and math rules as the paragon of ‘scientificness’.

When people say that human conduct entails more than self-interest, such as the interests of others, or other moral values, one can simply add corresponding variables. Hence, the principle of Max U is unfalsifiable. Here, I reiterate the problems I noted in previous items in this blog, and add an insight from Hodgson. The problems with Max U are as follows:

First, as mentioned, utility is not observable, and the principle of Max U is unfalsifiable, while that is one of the criteria of a theory being unscientific.

Second, there are different dimensions of utility that are not ‘commensurable’, cannot be subsumed in one variable of utility.

In particular, moral values are of a different order from economic ones. Buying a house one cannot afford is not of the same category as not killing someone. It is unconditional, imperative, and not a matter of self-interest. Likewise, the being of another, in his/her dignity is not an economic value to be bargained with. Not everything can be subsumed in self-interest. Kant already argued this. You Follow moral rules not for pleasure or other utility, but because following the rule constitutes who you want to be.

Jobs, and perhaps relations have extrinsic, instrumental value, for achieving some purpose, but can also have intrinsic value, value by themselves, and moral principles certainly do.

In other words, the other person and moral values cannot be subsumed under ‘utility’.

In a recent book, entitled ‘Uprooting economics’, I pleaded to replace ‘utility ethics’ with the ‘virtue ethics’ of Aristotle. The first looks only at outcomes, for example in the form of utility, and ignores intentions and morals. The second includes consequences but also looks at intentions, morality. The classical virtues are: reason, courage, moderation and justice. They are connected. For example: one needs moderation for justice. Also courage to make sacrifices for the sake of another, or resist temptations to violate a moral stricture. In this way, morality may not only be incommensurable, of a different order from economic value, but may go against it, in moderation and justice.

Third, the future can be uncertain, in distinction with calculable risk. This disables Max U. To deal with uncertainty, one needs trust, and courage to make a leap of faith, be vulnerable.

Liberalism excluded morality, discussions and expressions of faith from public debate, and relegated it to religion, behind doors of the private sphere. But that was in the effort to avoid religious wars, which were rampant in the past. Now, with the need for environmental protection, excesses of inequality of income and wealth, there is a need for public debate on it, on morality.

Social psychology teaches us that much of our decision making, choice, is made subconsciously, impulsively, not subject to deliberation, let alone Max U. This was adopted in economics, as ‘behavioural economics’, but a psychologist trying to collaborate with

economists on this reported that those keep on trying to fit this in max U, and this is reported also by Hodgson. But how can you talk of maximization when it is not deliberate?

Behavioural economics was already considered by Herbert Simon 60 years ago. He proposed that people ‘satisfice’: stop doing Max U from a certain point. That can easily be incorporated in Max U by assuming that there is a psychic cost of rational calculation. Thus it is much less fundamental than choice being subconscious.

An alternative to Max U is adaptation, as in Evolutionary Economics, as discussed in item 396 in this blog. Much has already been written about evolution in this blog (items 27-30, 46, 82, 161, 195, 205, 279, 376. These 11 items were collected in a bundle, presented on my website bartnooteboom.nl). It is similar to the satisficing advocated by Herbert Simon, in that one can stop when survival is assured.

#### 456. The meaning of rationality

published 4-1-2020

In item 394 of this blog I discussed rationality and non-rational decision heuristics. Here I return to the subject, from a different angle.

What does ‘rationality’ mean? It can mean the use of logic, facts and their combination in the ‘scientific method’ of hypothesis and empirical test. Logic then requires that scientists seek to falsify their theories ( Popper). In fact, scientists seek confirmation, to protect their reputation and gain attention and resources. Criticism and falsification are up to competition in the scientific community, not the individual.

Sometimes, especially in economics, ‘rationality’ means doing what is ‘good’, in agreement with goals, maximizing utility. The question then is who determines that. It is known, in social psychology, that often choices, decisions, are not made ‘rationally’, with the use of reason, consciously and deliberately, but unconsciously and impulsively. That is not always bad, in situations that one has often experienced, as in walking and driving a car, things for which you have developed a routine.

Sometimes, however, they go against ‘optimality’. Use is made of non-rational decision heuristics, as discussed in item 394. That has led to ‘nudging’, where impulsive or routine behaviour is used to steer decisions in the direction of optimality. An example is the ‘opt-out’ in insurance, or the donation of organs, where you indicate if you don’t want it, instead of the earlier ‘opt-in’, where you indicate it if you want it. That employs the inertia or unwillingness to choose, whereby people remain underinsured or donate organs too little. The ethics of nudging is that it may only be done in the interest of the people involved. One can see that as benevolent guidance, but also as manipulation. That is not new: it has been happening for long in advertising, but not always in the interest of the consumer. It happens in the use of ‘algorithms’, on the basis of data of conduct as collected via Facebook, Google or Amazon. Those ‘know you better than yourself’ in your subconscious conduct. Is that rational? No, because it does not make conduct more ‘optimal’, but is to the benefit of those who do the manipulation. Yes, maybe, if it is used for nudging.

In Object oriented philosophy (OOO) Harman claimed that an object cannot be fully known, in all its features, but is partially ‘withdrawn’, with features that are inaccessible, because hidden or caught in an incomprehensible code or structure, or are not(yet) there. Bhaskar and

DeLanda proposed that objects have potential to produce features, depending on circumstances. Then they are not yet present and hence unknowable.

Rationality, the use of reason, is a virtue, but has its limits. We do some things without rational deliberation, in routines, as mentioned above, and some things can only be grasped by hunch. Also, emotions set the agenda for rational thought.

And then there is morality: rules for conduct that are not rationally deliberated, subjected to calculation, but adopted and followed unconditionally, having intrinsic value of a different order than interests.

#### 457. Issues for change in economics

published 11-1-2020

The criticism of dominant, orthodox economics, and demands for its change, have intensified since the financial crisis in 2008. Sources of those protests are heterodox economics, such as post-Keynesian economics, evolutionary economics, (new) institutional economics, and social economics, and the international movement of young economists with the name 'Rethinking economics'.

Some of the criticism and proposals for change were given in previous items of this blog, collected in a bundle posted on my website [bartnooteboom.nl](http://bartnooteboom.nl). They were also elaborated in a recent book<sup>ix</sup>. Here I review them and make additions. The order is arbitrary, does not signify priority.

1. The issue of uncertainty. Keynes was one of the few economists to take it seriously and see its consequences. Under uncertainty one cannot calculate, and calculative rationality is a cornerstone of orthodox economics. The results are bandwagon effects and hypes, as Keynes recognized.
2. The issue of maximizing a utility function. People are not only limitedly rational (see below), but things of value cannot all be subsumed under a single utility. They can have intrinsic value next to extrinsic, instrumental value. That applies to work, as a source of income and a source of satisfaction, in giving pleasure or a sense of accomplishment, and social recognition. It applies, in particular, to moral values that one does not always practise for their utility, but because they constituted what one feels one should practise, and that is who one wants to be. That can apply also to trust, which can be useful, as a 'lubricant for relations' but also has intrinsic value. Another problem of utility is that it is purely conceptual, and cannot be observed directly. Utility maximization is unfalsifiable: one can always conceive of some utility function whose maximization reproduces observed behaviour. That makes it scientifically dubious.
3. The already present 'preferences' that underlie choice are partly formed, or adjusted, in the process of choosing and acting upon it.
4. Due to the role of subconscious processes of choice, as taught in social psychology, people are limitedly rational: do not always make rational choices. That can be very effective, in routine conduct, but it does not satisfy the assumption, in economics, of rational choice.
5. Transaction costs, such as caused by imperfect information, cause 'market failures', of misjudging quality and reliability, the incompleteness and cost of collecting information, making contracts or other agreements and controlling their execution.

6. The condition that relations imply ‘specific investments’ that have value only, or mostly, in that relationship, which make one dependent, and create a need for the relationship to last some minimum tie, to recoup that investment. This pleads for ‘optimal’, not maximum flexibility.
7. The human need for local roots, which obstruct the economic credo of maximum mobility of resources, including labour, which in globalisation erode local communities and work relations, and sources of respect and reputation.
8. The self is not autonomous, as assumed in economics. One does not only need the other for the advantage of division of labour, but one is constituted in action in the world, in interaction with others. Opposition by others yields the highest form of freedom: freedom from prejudice.
9. The need for trust, for agreeable relations and the economy. Some economists claim that trust cannot survive in markets, due to competition, but competition is not always so strong as to prevent some slack for sacrifices for trust, and, more fundamentally, in so far as survival requires innovation, that brings uncertainty, which requires the ‘leap of trust’, and therefore I turn it around: in markets one needs trust.
10. In so far as economists take into account issues of information and knowledge, they take it for granted, tacitly most of the time, that in relations there should minimum of ‘cognitive distance’, difference in ideas. But such difference also has value, as source of innovation. Rather than minimum difference there should therefore be ‘optimal distance’, in a trade-off between distance as an obstacle for understanding and as a source of difference for innovation.

Most of these points entail a ‘paradigm shift’, and one can ask if this is still economics. That is probably why they tend to be ignored or neglected by economists.

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<sup>i</sup> Lakatos, *The methodology of scientific research programmes*, Philosophical papers volumes 1 and 2, J. Worrall and G. Curry (eds), Cambridge University Press.

<sup>ii</sup> I think the first was Sidney Winter, in his PhD study.

<sup>iii</sup> Lakatos, *The methodology of scientific research programmes*, Philosophical papers volumes 1 and 2, J. Worrall and G. Curry (eds), Cambridge University Press.

<sup>iv</sup> Yuval Noah Harari, 2011, *Sapiens; A brief history of humankind*, Penguin.

<sup>v</sup> Journal of Institutional Economics, .....

<sup>vi</sup> Douglas Allen, ‘Recognizing and solving institutional puzzles’, in: Claude Ménard & Mary H. Shirley, *A research agenda for New Institutional Economics*, Cheltenham UK: Edward Elgar, 2018, p. 269-277.

<sup>vii</sup> Cheryl Long, ‘The China experience: an institutional approach’, in: Claude Ménard & Mary M. Shirley (eds.), *A research agenda for New Institutional Economics*, Cheltenham UK: Edward Elgar, 2018, p. 135-142.

<sup>viii</sup> Bart Nooteboom, ‘Uncertainty and the economic need for trust’, in Masamichi Sasaki (ed), *Trust in contemporary society*, Leiden: Brill, 2019, p. 60-76.

<sup>ix</sup> Bart Nooteboom, *Uprooting economics; a manifesto for change*, Edward Elgar, 2019.