

INTRODUCTION

This volume is about what economics has become. By its end, we will have a preliminary vision of the destiny of economics.

We are concerned about where economic science is today and where it is likely to be tomorrow. We do not stray entirely from the first principles laid down by Adam Smith, David Ricardo, Thomas Malthus, John Stuart Mill, Alfred Marshall and John Maynard Keynes. They remain as the base for the modern superstructure.

We continue to consider the social and intellectual influences that have shaped the thinking of economists. In this regard we begin with the economic conditions prevailing in the United States and other economies during the early 1950s, continue with the textbook exposition of economic growth through most of the 1960s, explore the inflation of the 1970s — all followed by the Great Recession of 1981–82, the punctuated expansion of the 1980s, and by recessions and slower growth. We come right up to date with the financial and economic crises of the spring of 2008.

Although Newtonian mechanics characterizes mathematical economics and the evolving concepts of equilibrium, there are some new developments in economic science. Characteristically, the leaders in these changes are dominated by Nobel Prize winners. Two of these winners stand out from the crowd, Paul Samuelson and the late Milton Friedman, followed closely by Robert Solow, the late James Tobin and Robert Lucas. From these emerged both refinements of Keynesian economics and the famous Lucas Critique. Behind the scenes lurked the great mathematician John Nash and the idea of general equilibrium. We bring Nash forward and to center stage by the middle of this volume. Thereafter game theory and experimental economics are introduced.

The dogmatic position formerly held by many economists that economic science had achieved its final and permanent state had to give way with new mathematical applications and experimentation. Even those ideas not woven out of the fabric of economic history are subject to history's verdicts: even a science mimicking mathematical natural science eventually comes to be judged by humanity. Perhaps the greatest challenge to financial and economic orthodoxy at the theory and policy levels is globalization. The reduced cost of transportation and communication has made nations more interdependent. The more rapid spread of information has brought more nations into the developed world. In this process the ties between finance and the real economy of the world have loosened. To a great extent finance became like the "wild West" of the USA just prior to Mark Twain's Gilded Age.

While we focus more narrowly on economic thinking, we cannot overlook entirely the social and economic conditions to which policymakers necessarily respond and so we consider the relationship between what economists think and why they think it. Like men and women in every walk of life, most economists reflect the values of their culture and want to be accepted by their fellow citizens as responsible members of society. Their thinking, therefore, is a reflection of their social world, and vice versa. In this volume we nonetheless find notable exceptions.

We do not even take complete leave of Adam Smith (1723–90), who thought and wrote as the Industrial Revolution was getting under way in England. Smith's economic theories conformed with a business atmosphere of intense competition, and thus he wrote, in a sense, what most of the 18th-century traders and merchants wanted to read. This tendency has not been entirely lost, for the New Classicals and the Lucas Critique still bear the mark of the physiocrats' motto, *laissez faire, laissez passer* (Let things be the way they will), even as that influence is denied. In short, technique, no matter how complex, can hide only so much. This is not to deny the forward march of the Nobel Prize winners, merely to express caution as we sail into turbulent times.

We still have to recall how the universe pictured by English scientist and mathematician Isaac Newton (1642–1727) operated with the order and precision of a giant clock, even as that metaphor is both used and abandoned. Adam Smith adapted Newtonian harmony to 18th century commercial activity, finding, for example, an almost perfect equilibrium between supply and demand in a business world of perfect (or nearly perfect) competition. The superstructure economists have used more advanced probabilistic tools in a tremendous effort to escape Newtonian gravity, much as modern physicists have done.

Economists have always struggled with the differences between assumptions and reality, between what they imagine and what the real world delivers. In building the superstructure, many of the Nobel Prize winners worked at the threshold between the internal world of imagination and the external world of reality. Policymakers do not have this luxury. Like it or not, while they may genuflect to Nash equilibria, game theory, experimental findings from small samples, and so on, ultimately they remain accountable to the body politic. Real-world people also have values and ethics, but increasingly are aware of what policymakers are doing and what the consequences might be. When economic models have been around long enough, at least the well-heeled and well-informed on Wall Street become tuned in.

Reality is the ace in the hole. If policies based however loosely on theory fail to deliver, they will be trumped by reality. And so, no matter how rarified the mathematics becomes, economic science cannot completely ignore the realities of hunger, depression, inflation, war, stock market crashes, financial instability, unemployment, homelessness, social discontent, and other maladies. Such problems are central to turning points in the transformation of economics.

Economic problems remain with us today because we have not yet resolved conflicts that have plagued humanity throughout 5,000 years of history. We are still quarreling over such fundamental issues as the degree of private ownership versus common ownership; individual freedom versus the common good; the virtue of

private versus public monopolies; the advantages of rapid technological change versus the pastoral pleasures of an undisturbed natural world; and the gains of science versus its danger to human survival.

Any new vision must recognize the existence of conflict. Eventually we will come to note that the scientific system of Adam Smith has failed to resolve society's long-standing problems of scarcity, equitable power, equitable income distribution, work satisfaction, and poverty — not because of scientific imprecision but because of the assumptions underlying the system. In Volume I we demonstrated how Smith borrowed his assumptions from the Scientific Revolution that closed the Middle Ages. As a consequence, even today too much of modern economics supposes that people behave like inanimate particles. This obvious distortion of human values can continue to influence economics only if we continue to regard the science as an end in itself. To meet the crises of the postmodern age, we must supplant naive 18th-century natural science with a concern for the survival of the human race.

As with *The Foundation*, the only prerequisite for *The Modern Superstructure* is an inquiring mind. A beginning reader in economics can easily read this book, as I do not presuppose any prior study of economics. It would be useful nonetheless to read the first volume as preparation for what is to come. Over the years *The Making of Economics* has provided, I am told, the beginning reader with meaningful insights, and, I am also told, the book has been of great interest and valuable to those who possess a sophisticated understanding of economic theory and history. In like fashion, this volume will be anticipatory of the third volume, *The Radical Assault*. The third volume opens with Karl Marx, who defined “revolution” in more than one sense.

Like Marxism, the Victorian Age and the dominance of English economic thought seemed to have no ending. At the time the United States was becoming the exceptional home to the “American Dream,” a dream that gained much of its optimism thru 18th century belief in a beneficent, finely tuned universe

based on Newtonian Mechanics. The British orthodoxy was too busy to notice the relative decline of the British Empire as the Industrial Revolution spread to the United States by the time of the Civil War.

The robber barons matured during the years preceding the Civil War. While Haratio Alger's stories and the Protestant Church went a long way in defending the antics of the robber barons, they were to reach out to the Social Darwinists for the "scientific" justification for their corruption. Social Darwinism became Thorstein Veblen's foil.

Thorstein Veblen (1857–1929) would follow Marx as a radical economist. Well, he was more than that; Veblen founded the only uniquely American school of economics, the institutionalists. A strange man whose furtive eyes were often for women, for whose attraction was nearly fatal for his academic career as Veblen bounced from college to college in the USA. His understanding of capitalism was in sharp contrast to the marginalist orthodoxy. His first popular book, *The Theory of the Leisure Class*, introduced bitingly sarcastic language such as pecuniary emulation and conspicuous consumption for the ostentatious display of wealth that remains part of economics today. In contrast to Alfred Marshall, waste in the expenditure of superfluities became respectable. Veblen managed to turn the Social Darwinists on their heads. Their ideas became just another outmoded "institution." Veblen saw ideas lagging behind reality as laissez faire continued to defend business corruption and the monopolistic practices of the robber barons.