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# Introduction

With the rising of Emerging Powers the challenge of the “New Directions in Economics and Ethics: Towards a New World Order” is back on the table. Francis Fukuyama was wrong when he predicted the end of the struggle between ideologies and the universalisation of Western political and economic liberalism in his well known publication “The end of history and the last man”.

Instead, a new competition around economic models arose. The Asian model of a developmental state in combination with an autocratic system and authoritarian structures seems to be attractive for many countries of the Global South. Over the last two decades Beijing’s “Market Authoritarian Model” in combination with a one-party-system produced growth rates around 10% and China became the second biggest economy of the world. However, massive environmental damages and human rights violations are part of the Chinese reality. From an ethical viewpoint the system is more than questionable.

On the other hand the global financial crises showed that a solely market-liberal system may end in crisis. Many private savings were affected negatively and poor countries suffered most under the consequences.

As an alternative to both models, the Konrad-Adenauer-Stiftung, promotes a Social Market Economy Model.

It has been tested in most of the continental European countries. Even though it is laid out differently in each country, it is based on some common basic elements.

One element is a strong state which sets the framework for the market in order to act competitively. Rule of law and contract certainty are further components. Nevertheless, a transparent social system is needed to counterbalance inequities which may appear if the market fails. All this is based on an ethical approach which constitutes as the fundament of the system.

Konrad-Adenauer-Stiftung and the St. Augustine College are working together in supporting a dialogue, on an intellectual level, in search of an efficient economic world order based on ethical values. The *St Augustine Papers* offer some thoughts from last year's conference.

***Dr Werner Böhler***  
*Konrad-Adenauer Stiftung*  
*Johannesburg 2011*

This edition of *St Augustine Papers* comprises papers delivered at a conference held by St Augustine College in co-operation with the Konrad Adenauer Stiftung on 15-16 September 2010 at the Sunnyside Park Hotel in Johannesburg. The theme of the conference was “New Directions in Economics and Ethics: towards a New World Order”. The programme included contributions which contextualized our present economic system and illustrated the changing functions of international economic institutions and global political power transitions. In addition, there were contributions which focused on the sociological implications of economic globalisation, the challenges of international migration and the need to include economic literacy in the education curriculum. The ethical challenges of the current economic system were explored as was the relevance of social market economics in the current global situation. Finally, new directions in economics and ethics were considered. This edition of *St Augustine Papers* incorporates a selection of the papers presented. We have also accepted the endnote and bibliographic formatting of the originals.

***Professor Marilise Smurthwaite***  
*St Augustine College of South Africa*  
*Johannesburg 2011*

# **International Financial and Economic Architecture: Is it fit for purpose?**

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CHARLES SIMKINS

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## **Introduction**

There is much to think about when tackling this topic and there are four interacting levels to consider:

1. The politics and governance of the relevant international institutions.
2. The capacities of the institutions: what they can do, compared with what they ought to be able to do.
3. The international economic regime within which they operate. It is generally held that there have been four main regimes in the last 140 years:
  - (a) the gold standard in the forty years before 1914
  - (b) a confused period consisting of the First World War and immediately after, the abortive return to the gold standard, a period of competitive devaluations and trade wars and the Second World War
  - (c) the Bretton Woods era lasting from 1945 to 1971, in which international capital flows were restricted and exchange rates were held constant for long periods of time, punctuated by explicit devaluations and revaluations.
  - (d) the post Bretton Woods era characterised by considerably more international mobility of capital and more extensive use of floating exchange rates.
4. The insights of economic theory as applied to international issues: trade and finance.

The focus of this study will be on politics, governance and institutional capacity, with regime type and theoretical considerations brought in only when necessary to advance the argument about governance and capacity.

A couple of preliminary points need to be made:

1. Although not all of the present international financial and regulatory architecture originated at the end of the Second World War, two key institutions (known as the Bretton Woods institutions) – the International Monetary Fund and the World Bank – date from 1945. Also from that era dates the General agreement on trade and tariffs, reached in 1949, and superseded by the World Trade Organisation in 1995. How well these organisations have fared in the nearly forty years since the end of the Bretton Woods system would be part of a full account of their current fitness for purpose. Here space allows an emphasis on the recent past only.

2. Generally accepted economic theory holds that there is a trilemma in economic policy. A country can do any two, but not all three of the following:

- (a) Determine its exchange rate
- (b) Have an independent monetary policy
- (c) Allow free capital mobility across its borders.<sup>1</sup>

Different goals can be sacrificed at different times. The Bretton Woods system sacrificed free capital mobility, whereas countries with floating exchange rates - such as South Africa at present - sacrifice determination of the exchange rate. Gold standard arrangements sacrificed independent monetary policy.

### **The political apex of the system: the G20**

The G-system started to evolve after the 1973 oil crisis. Originally it was the Group of Six, formed in 1975 and comprising France, Germany, Japan, Italy, the United Kingdom and the United States. A year later, Canada was added to form the G-7. Russia was added in 1997 to form the G-8. The G-20 was formed in 1999. In addition to the members of the G-8, the G-20 comprised Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, Turkey and the European Union, the European countries in the G-8 retaining individual representation. Together, the G-20 accounts for over 85% of world output<sup>2</sup> and two thirds of the world population.

In the last couple of years, the G-20 has emerged as the leading political forum for dealing with international economic issues. It ordinarily consists of ministers of finance and central bank governors, but heads of government or heads of state may join it for summits, which have taken place twice a year since 2008 in response to the global financial crisis. Meetings with heads of state included may become less frequent in future. The IMF and World Bank are represented at the meetings of the G-20.

The G-20 has no permanent secretariat and the chair rotates among members. The incumbent chair establishes a temporary secretariat for the duration of its term. The temporary secretariat co-ordinates the group's work and organises its meetings. After each meeting, the G-20 issues a communiqué. Between meetings extensive technical and some political work is carried out to provide meeting participants with analysis and policy options. Essentially, the G-20 provides a forum within which member states can consider international economic and financial issues and where these states can interact with the international financial institutions with a view to influencing the institutions' agendas.

The G-20 is not democratic but, in the light of the overwhelming share of world GDP accounted for by its member states, it is likely to be stable for quite a while. There are no formal criteria for membership. Decisions are made by consensus, as they have to be in a forum based on voluntary association. The outcomes will be shaped by three forces: a sense of what is acceptable in each member country, bargains struck between member countries and the search for the best technical solutions to problems the global economy throws up.

The communiqué from the Toronto summit held on 26-27 June 2010 gives a clear indication of what the G-20 has been working on recently. Not surprisingly, financial sector reform tops the list, with issues of regulation, effective supervision, individual country financial systemic risk and international assessment and peer review all being mentioned.

The global financial crisis has impelled countries to find consensus on measures to deal with it and has therefore cemented the G-20. Even so, the following tensions exist:

1. How the United States, still responsible for a quarter of the world's output, will behave. US foreign policy is mainly Hobbesian with 'Kantillations' now and then, which tend to get into trouble if they go beyond ideological decoration. The US is leery of international treaty obligations which might limit its future options.
2. Unresolved US-China issues, notably on China's exchange rate regime and on aspects of trade policy are likely to continue for quite a while.
3. The European part of the equation is also quite tricky. The old European G-7 countries (Germany, France, UK, Italy) are represented separately as well as through the EU. Further complications are that the EU and the eurozone are not co-extensive, that a divide in the eurozone has appeared in the wake of the global financial crisis and that the EU has to deal with Turkey in the G-20 against the background of a difficult relationship. In addition, there are tricky adjustments to be made to welfare states.
4. And then there is rough, tough, touchy Russia where capitalism is subordinate to an authoritarian Russian state, custodian of Russian nationalism, as the Yukos case so brutally demonstrated. Russian exports are a resources play and these are used to leverage political concessions from the 'near abroad'.

All these factors make international co-operation more difficult and make it difficult to decide on the allocation of roles between national institutions, international agreements and international institutions. Bank regulation is a case in point. Traditionally a national function, new modes are needed as the global financial system becomes more integrated. The response so far has been to call for colleges of supervisors which would be constituted through the cross border co-operation of national regulators. This leaves the responsibility for bank regulation at the national level, where it has always been, and circumscribes international regulation by the emergence of generally accepted norms at the international level. As the IMF points out, jurisdictional issues can come swiftly to the fore, as a result of national differences in thresholds for supervisory regulation and materiality of risk as well as the absence of rules governing cross-border bank resolution or burden sharing.<sup>3</sup>

It is too early to say whether the G-20 has cut the risk of global financial crisis. General statements of intent can fall apart as negotiations about detail proceed. And it takes time for new procedures to be embodied in the international financial institutions and in national practice, let alone whether the ideas behind the procedures will be proved adequate.

### **The International Monetary Fund, the Bank for International Settlements and the Financial Stability Board**

The IMF has 187 member countries. The Board of Governors, which meets once a year, has one representative from each country usually the head of the central bank. The Board is advised by the International Monetary and Financial Committee (dealing with matters of global concern) and the Development Committee (dealing with economic development in emerging and developing countries). The IMFC operates by consensus. Each has 24 members as does the Executive Board, to which most Board powers have been delegated. Five countries each have seats in the Executive Board: the United States, Japan, Germany and France. The remaining countries are grouped into nineteen constituencies and each group has a representative on the Executive Board. The Executive Board normally takes decisions by consensus but votes are sometimes taken. Votes are weighted, with the United States having a weight of 16.74%, Japan 6.01%, Germany 5.87%, France 4.85% and the United Kingdom 4.85%, with the remaining 61.68% spread across the nineteen constituencies. For some time, the IMF has been concerned with governance reform and changes can be expected in the years ahead.

It takes a Board resolution with three fifths of the members and 85% of the voting power to amend the IMF Charter, so it is infrequently done. Amendments became effective in 1969, 1978, 1992 and 2009. Sometimes, new functions are authorised by a Board clarification of its role in one field or another, but these clarifications have to be constructed carefully from the Charter.

The IMF's function is to promote stability in the international financial and economic system. In the Bretton Woods years, this involved making funds available to countries who were having trouble in making their international payments and who could not find sufficient funding on

affordable terms. This lender of last resort function remains in the IMF. Surveillance has developed over the years and took an upward move at the time of the Asian crisis of 1997, with the introduction of the Special and General Data Dissemination Standards. These were standards which countries were encouraged to sign up for. Once agreed to by a country, these standards became normative for agencies publishing economic and financial information. The incentive to sign up was expected reduction in foreign borrowing costs associated with a transparent financial and economic system. From the IMF's point of view, improved data made their surveillance task easier. In the wake of the global financial crisis, the IMF has been considering ways of improving surveillance. However, there are limits to what the IMF is empowered to require of its member countries. The third function of the IMF is to provide advice to low and middle income countries as they develop their economic financial institutions and policies.

Three key responses to the global financial crisis which involve the IMF have been (a) a tripling of IMF resources for lending to countries in difficulties, (b) efforts to co-ordinate fiscal responses to the crisis, including a fiscal 'exit strategy', and (c) the introduction of a flexible credit line for countries with strong fundamentals, policies and track records of policy implementation. There has been some debate about the efficacy of the latter, with the argument advanced that countries in a relatively strong position should delay fiscal consolidation in the interests of maintaining aggregate demand in the global system. Stronger countries might resist the implication that their fiscal position should deteriorate in order to pull weaker countries out of the mire. The unpopularity in Germany of that country's contribution to a European rescue fund is a case in point.

Another theme which has emerged recently is that of global demand rebalancing. Persistent large surpluses and deficits on the balance of payments are held to impose strains on the global economy. The recommendation in the case of excessive surplus countries is a shift to domestic demand, the reform of social safety nets, the improvement of productivity in the service sector and more flexible exchange rates. For economies with excessive deficits, the remedy is fiscal consolidation and financial sector reform, accompanied by growth raising structural reforms in the product and labour markets.

The Bank for International Settlements (BIS) was founded in 1930 to deal with reparations by Germany following the adoption of the Young Plan. It was also founded to promote central bank co-operation. The reparations function lasted a short time, since Hitler repudiated all reparations claims. But the 'bank for central banks' function remained. Apart from fostering monetary policy cooperation, the BIS has always performed "traditional" banking functions for the central bank community (e.g. gold and foreign exchange transactions), as well as trustee and agency functions. Occasionally, the BIS has also provided or organised emergency financing to support the international monetary system when needed. It was embarrassed by the acceptance of German payments using looted gold during the war and nearly did not make it through Bretton Woods. But European countries defended it and it played an important role in European economic integration for more than forty years. The BIS currently has 56 member central banks, all of which are entitled to be represented and vote in the General Meetings. Voting power is proportionate to the number of BIS shares issued in the country of each member represented at the meeting.

The BIS established the Basel Committee on Banking Supervision in the 1970s. In 1988 this Committee issued the Basel Capital Accord, introducing a credit risk measurement framework for internationally active banks that became a globally accepted standard. A revision of this Capital Accord, known as Basel II, is being implemented worldwide. Basel II has been revised from time to time, the most recent revision being in 2009. The BIS also has committees on the global financial system, payment and settlement systems, central bank statistics and financial stability in national systems.

The Financial Stability Board has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. A Financial Stability Forum was founded in 1999 and converted to a Board in 2009 by the G-20. Its membership consists largely of the G-20 countries

plus international organisations and international standards-setting bodies. The regulatory response to the global financial crisis is to attempt to capture all the risks in the capital framework of banks, to raise the quality of the capital base of banks, to prevent excessive leveraging, to build greater buffers against shocks and to establish minimum standards for funding liquidity risk. Reaching these goals will take consultation and negotiation, since a new system will be most stable if it is based on generally accepted norms. Consultation and negotiation will involve governments as well as the financial industry. Banks will probably be given several years in which to comply completely with the new norms.

### **The World Bank and regional development banks**

The World Bank consists of two Organisations: the International Bank for Reconstruction and Development (IBRD) and the International Development Agency (IDA). The IBRD was established in 1944 and raises most of its funds on the international capital market. It aims to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and analytical and advisory services. The IDA was established in 1960 to help the poorest countries. The IDA aims to reduce poverty by providing interest-free credits and grants for programmes that boost economic growth, reduce inequalities and improve living conditions. Governance of the World Bank is broadly similar to that of the IMF, except that the Executive Directors work on site and meet frequently.

There are three Organisations which work closely with the World Bank. The International Finance Corporation finances private sector investment in developing countries, mobilizes capital in the international financial markets, and provides advisory services to businesses and governments in developing countries. It helps companies and financial institutions in emerging markets create jobs, generate tax revenues, improve corporate governance and environmental performance, and contribute to their local communities.

The Multilateral Investment Guarantee Agency (MIGA) can help investors and lenders by insuring eligible foreign projects against losses relating to

currency transfer restrictions, expropriation, war and civil disturbance, breach of contract and non-honouring of sovereign financial obligations.

The International Centre for Settlement of Investment Disputes (ICSID) is an autonomous international institution established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID or the Washington Convention) with over one hundred and forty member States. The primary purpose of ICSID is to provide facilities for conciliation and arbitration of international investment disputes. The ICSID Convention entered into force in 1966.

The multilateral regional development banks (MDBs) are the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development and the Inter-American Development Bank Group. Alongside these are a number of functionally or regionally specialised multilateral financial institutions. The MDBs provide financing for development through the following:

- Long-term loans, based on market interest. For funding these loans the MDBs borrow on the international capital markets and re-lend to borrowing governments in developing countries.
- Very long-term loans (often termed credits), with interest well below market interest. These are funded through direct contributions for governments in donor countries.
- Grant financing is also offered by some MDBs, mostly for technical assistance, advisory services or project preparation.

The communiqué from the Toronto G-20 summit refers to the fact that the capital of the MDBs has increased by \$350 billion, allowing them to nearly double their lending. Substantial replenishment is planned for the concessional lending facilities of the MDBs, especially the IDA and the African Development Fund.

## **The World Trade Organisation**

The World Trade Organisation (WTO) is a negotiating forum where member nations go to sort out their trading problems with each other. Successful negotiation leads to rules signed by the bulk of the world's trading nations. These documents provide the legal ground-rules for

international commerce. They are essentially contracts, binding governments to keep their trade policies within agreed limits. And the WTO has dispute settlement facilities. It has 153 members, representing more than 97% of total world trade and 30 observers, most seeking membership. The WTO is governed by a ministerial conference, meeting every two years; a general council, which implements the conference's policy decisions and is responsible for day-to-day administration; and a director-general, who is appointed by the ministerial conference.

The WTO promotes five principles: (a) non-discrimination in trading regimes and between goods of national and foreign origin, (b) reciprocal concessions, (c) binding and enforceable agreements about the maximum levels of tariff which may be imposed, (d) transparency of trading regimes and (e) safety valves, i.e. a defined set of circumstances in which governments are able to restrict trade, even though the general object of the WTO is to progressively remove trade restrictions over time.

A round of negotiations is a set of activities designed to meet a common purpose. There have been seven more or less completed rounds. The eighth was the Doha round inaugurated in 2001 by the Ministerial Committee on which all members are represented. It had an ambitious agenda, stretching from agriculture, services, market access for non-agricultural producers in developing countries, trade related aspects of intellectual property rights, the relationship between trade and investment, the interaction between trade and competition policy, trade facilitation, WTO rules, the Dispute Settlement Understanding (the framework for settling trade disputes), trade and environment, electronic commerce, integration of small economies into world trade, technical co-operation and capacity building, assistance to least developed economies, and special and differential treatment principles.

The Doha round has not yet been completed. It has stalled principally over agriculture, industrial tariffs, non-tariff barriers (such as quotas), services and remedies in trade disputes. The principal fault line is between developed countries (the US and EU) and developing countries led by China, India, Brazil and South Africa, with agricultural subsidies in developed countries as a key issue. The most important decision in world trade has come not from the deadlocked WTO, but from the G-20 which has committed itself until the end of 2013 to refrain from raising barriers

or imposing new barriers to investment or trade in goods and services, imposing new export restrictions or implementing WTO-inconsistent measures to stimulate exports.

## **The United Nations Economic and Social Council**

The Economic and Social Council (ECOSOC) was established under the United Nations Charter as the principal organ to coordinate economic, social, and related work of the 14 UN specialized agencies, functional commissions and five regional commissions. The Council also receives reports from 11 UN funds and programmes. ECOSOC serves as the central forum for discussing international economic and social issues, and for formulating policy recommendations addressed to member states and the United Nations system. It is responsible for:

- promoting higher standards of living, full employment, and economic and social progress;
- identifying solutions to international economic, social and health problems;
- facilitating international cultural and educational cooperation; and
- encouraging universal respect for human rights and fundamental freedoms.

Only its economic functions will be considered here.

The Council's 54 member governments are elected by the General Assembly for overlapping three-year terms. Seats on the Council are allotted based on geographical representation with fourteen allocated to African States, eleven to Asian States, six to Eastern European States, ten to Latin American and Caribbean States, and thirteen to Western European and other States.

The Council holds a four-week substantive session each July. The session consists of the High-level Segment, Coordination Segment, Operational Activities Segment, Humanitarian Affairs Segment and the General Segment.

The high-level segment serves as a forum for ministers and executive heads of international institutions and high-ranking officials, as well as civil society and private sector representatives to discuss key issues on the international agenda in the area of economic, social and environmental development. At the end of the high-level segment, a ministerial declaration is adopted, which provides policy guidance and recommendations for action.

ECOSOC initiated in 1998 a tradition of meeting each April with finance ministers heading key committees of the Bretton Woods institutions. These meetings have helped to deepen the dialogue between the United Nations and international financial and trade institutions, and strengthened their partnership for achieving the internationally agreed development goals, including the Millennium Development goals which emanated from the global conferences since the mid-nineties. In addition to the chairperson of the development committee of the World Bank and the chairperson of the International Monetary and Financial Committee of the International Monetary Fund, the General Council of the World Trade Organisation and the Trade and Development Board of UNCTAD participate in this meeting.

The economic topics receiving most attention at present with ECOSOC include the Millennium Development Goals, financing for development and international development co-operation, climate change, food crises and global public health.

## **Interpretation**

How is this configuration to be understood? What can it achieve and what lies outside its scope?

More than twenty years ago, Francis Fukuyama wrote an extensively debated article entitled *The End of History*?<sup>4</sup> Its thesis was the world may have reached the 'end point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human government.' Liberalism's victory has occurred mainly in the realm of ideas or consciousness, argued Fukuyama, and is as yet incomplete in the real world, where many countries remain 'mired in history. But ideas are

crucial and will sooner or later work to close the gap between the ideal and the real.

One consequence would be the “Common Marketisation”<sup>5</sup> of world politics as a replacement for national competitiveness, accompanied by legitimization of the use of force between nations. This development has been accelerated by the emergence in the last two decades of various forms of capitalism in all but a very few and small countries. The varieties depend on national histories and international contexts. The emergence of liberal democracy is less complete and political divergences bring problems of their own.

The move from the G-7 to the G-20 can be seen in just such a light. It is also a consequence of a shift in world production. The United States Department of Agriculture has projected GDP by country to 2030 and the anticipated shifts are:

**Percentage of world output**

	<b>2000</b>	<b>2030</b>
United States	28.3	23.0
G7	62.7	44.4
G20	91.0	88.7

The gamble is that, while it will be harder to achieve consensus in the G-20, greater inclusiveness will yield greater benefits.<sup>6</sup> And more: the common enterprise of managing a global capitalist order might be expected over time to spread liberal practices at the domestic level in member countries, even in what are currently authoritarian regimes. If the net strengthens, it can be expected to pull along smaller economies as well.

One can see the effect of ‘G-20-isation’ on the international financial institutions as well. Another important development is more extensive interaction between the top actors in the G-20 and in the international financial institutions, aiding common agenda formation.

Of course, developmental issues can be expected to have a greater salience in the G-20 than in the G-7. The Toronto summit communiqué deals with the recent large augmentation in IFI capital and changes in governance, the

global agriculture and food security programme, a review of progress on the Doha round, and aid for trade.

What are the risks facing this global economic and financial architecture? The first is that it will fail to produce a good enough financial regulatory framework for several reasons. The technical issues are tough,<sup>7</sup> much of the work has to be done at the national level and will therefore be uneven,<sup>8</sup> and financial institutions have a profitability motive for resisting more extensive capital adequacy and liquidity buffers (though there are arguably offsets in a lower cost of funding). Moreover, if the world economy continues to move away from the depths of the global financial recession, the political momentum for financial regulatory reform will diminish. The weaker the regulatory framework, the greater is the potential for future crises originating in the financial system.

Finding the right rules and embodying them in regulations is a necessary advance, but it is not sufficient. Muscular supervision is essential as well. As Michael Dooley puts it:

There is an irresolvable conflict: profit motives and competition push leverage to levels that are going to invite crisis. The crisis is going to be costly because it involves an evaporation of collateral outside the insured system. Once you write down regulations they are useless. The banks and financial intermediaries are not going to do what you are prohibiting, but they are going to do the next best thing to get around your regulation, to increase leverage, increase profits and to make the system more and more vulnerable. You have to have a counterweight. This involves having people who are well trained and motivated to see what the banks are doing and to tell them to stop it.<sup>9</sup>

The second risk arises from the fairly recent realisation among economists that the traditional focus on trade as the mechanism for transmitting shocks through the global economy has to be complemented by an analysis of how changes in asset prices are transmitted through their effects on the balance sheets of highly leveraged financial institutions.<sup>10</sup> The implication is that there are large cross-border externalities in financial rescues and so financial policy co-ordination across countries gains in importance as international cross-holding of assets rises.

The third is poor growth. The latest IMF Economic Outlook does not project this for the world as a whole, but the EU and Japan are projected to have low growth:

	<b>Annual growth rate</b>		
	2009-10	2010-11	2011-15
Advanced economies	2.3	2.4	2.3
United States	3.1	2.6	2.4
Euro area	1.0	1.5	1.7
Japan	1.9	2.0	1.7
Emerging and developing economies	6.3	6.5	6.7

The greatest hazard to the system is poor performance in the United States, which would reduce the prospects for emerging and developing economies.

The fourth is difficulties with fiscal consolidation, of which Greece has been the most spectacular example in recent months. The Governor of the Bank of England is on record as saying that the government which carries through the required fiscal consolidation in the United Kingdom will be out of power for a generation. The United States has yet to consider its options for dealing with its bulging debt profile. The difficulties are not only political. There is also the risk of undermining growth by too hasty an exit from fiscal stimulation of the economy.

The fifth difficulty is agreement in principle, but failure to agree on practical measures to implement the agreement. There is widespread agreement in the G-20 that taxpayers should not have to bail out financial institutions again. However, a proposal for a bank levy to create insurance funds to be used in times of financial stress failed to command sufficient consensus in Toronto.

Sixth, there will be some major areas of bargaining, which can be listed in rising order of difficulty.

1. A number of developing G-20 countries are going to want more say in the governance of international financial institutions and more

flexibility in lending. Concessions have already been made on both these fronts and more can be offered as occasion demands.

2. US-China relations over currency and trade issues will be a permanent fixture. China has made some concessions on its currency, but they have been small and designed to forestall bigger moves. The relationship will be jagged as long as the two countries have very different systems of governance.

3. Europe is a major issue. It is far from clear where the European project will go in the next ten years. Keeping the Eurozone together will be no easy task and new members of the common currency area seem unlikely in the next while. Europe's demography is now against growth. A difficult period of low growth consolidation lies ahead. It is therefore not surprising that the new Conservative government in the UK prefers to strengthen ties with South Korea, Saudi Arabia, Turkey, India and China. Furthermore, the heavy and partly doubled representation of Europe in the G-20 will attract criticism from a number of other members. The situation is not helped by the desire of Spain and the Netherlands to join the G-20 in their own right.

Seventh, it is not clear where the global public goods issues of the coming decades will be dealt with: climate change and pollution, water and fuel supplies, public health. Many of these issues are mainly in the domain of the United Nations, which works up a storm when it comes to consultations, high-level meetings and declarations. But the United Nations, by itself, has not the capacity to implement. It will take more of a crisis in each of the fields to produce the political will to develop the necessary rules, institutions and investments.

Is the international financial and economic architecture fit for purpose? Fully fit, no. It never has been and never will be. The architecture depends on politics and politics, as Bismarck rightly observed, is no exact science. Or, as Hillary Clinton put it in a recent interview: 'You don't realise how shocking it is until you get into the arena'. But equally, it would be foolish to write off what has been achieved over the last sixty-five and the last twenty years. The struggle to resolve world economic and social problems will take place in the institutional framework here described and as it evolves to meet new challenges.

## Notes:

<sup>1</sup> The theoretical basis for this conclusion is the Mundell-Fleming model. Obstfeld, Shambaugh and Taylor have tested the trilemma hypothesis against extensive historical data and conclude that the trilemma makes sense as a guiding policy framework. Both the exchange rate regime and capital controls affect the autonomy of monetary policy. A combination of a floating exchange rate with capital controls provides unfettered monetary policy autonomy. Pegging the exchange rate or removing the capital controls diminishes monetary policy autonomy. See Maurice Obstfeld, Jay C Shambaugh and Alan M Taylor, *The trilemma in history: tradeoffs among exchange rates, monetary policies and capital mobility*, Centre for International and Development Economics Research, Working Paper C04-133, University of California, Berkeley, 2004

<sup>2</sup> The original G-7 countries now account for about 55% of world output

<sup>3</sup> International Monetary Fund, strategy, policy and review department, *Initial lessons of the crisis for the global architecture and the IMF*, 18 February 2009

<sup>4</sup> The National Interest, Summer 1989

<sup>5</sup> The term then used for what would become the European Union

<sup>6</sup> Some insurance exists in the form of the continued existence of the G-8

<sup>7</sup> One of the toughest is deciding just which variables to monitor, include in risk assessments and to act upon, both at the micro and at the macro level

<sup>8</sup> John Eatwell argues for the creation of a World Financial Authority to formulate and implement a coherent set of principles. He sees a creeping internationalisation of the regulatory function in international financial markets. That internationalisation is confederalist in nature with national jurisdictions being the predominant legal actors guided by international soft law. Soft law embodies basic standards and norms which are recognised in either formal or informal international agreements, but does not create binding obligations. (John Eatwell, *The challenges facing international financial regulation*, Cambridge, 2001) A simple meliorism whereby a better international financial architecture emerges continuously from the present is subject to doubt. Acemoglu and Yared document a 50% rise in military spending round the world between 1996 and 2007, with a depressing effect on trade growth. (Daron Acemoglu and Pierre Yared, *Political limits to globalization*, 2010). Mervyn King, Governor of the Bank of England, observed that world trade shrank by 15% in the six months following September 2008, a faster decline than in the Great Depression. And Freedom House reports in its 2010 Freedom in the World Report that for the fourth consecutive year, declines have trumped gains, the longest continuous period of deterioration since Freedom House started its annual report nearly 40 years ago.

<sup>9</sup> Michael Dooley, *Central bank responses to financial crises*, Bank for International Settlements Paper 51, 2010: 33-34

<sup>10</sup> See for instance, Paul Krugman, *The international finance multiplier*, Princeton, mimeo, 2008

# **Global Political Power Transitions: States, Regimes and Regions in the post Cold War Era**

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RAPHAEL DE KADT

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The principal questions that inform this paper are: are we living through a “major shift in global political power relations that is of ‘world-historical’ significance?” If so, “what are the distinctive features of this transition, and what challenges does it pose?”

## **The triumph of liberal democracy?**

I take, as my point of departure, Francis Fukuyama’s famous claim that the collapse of the state-socialist systems in Eastern Europe heralded ‘the end of history’ (Fukuyama, 1992). Of course, in neither his original article nor in the subsequent book, did Fukuyama mean that history as a sequence of events or actions had ended. Rather, the end of the Cold War marked the end of a period in which the principal conflict that defined global politics was between two fundamentally different and incompatible economic systems, and between the broad ideological constructs through which they were represented and defended. It marked, in international relations, the end of the ‘bipolar’ order that had evolved once the wartime alliance between the Soviet Union and the USA (and its allies) had fallen apart.

The key outcome of the collapse of the ‘state-socialist’ system in Eastern Europe was that, in global terms, power came to be predominantly vested in the liberal democratic states of the north-Atlantic world and in its geographically distant allies such as Japan and various countries such as those of Australasia. It seemed that there were no challenger systems left, in terms of principles of political and economic Organisation, to these now dominant, capitalist, liberal democracies. They were hegemonic -

economically, technologically, politically, militarily and ideologically. And, it seemed, their patterns of political, social and economic life were destined to steadily envelop the globe as countries became wealthier and adopted the political forms of the western countries. It seemed as though the promises and predictions encapsulated in ‘modernization theory’, in its various guises, had been broadly - if with qualifications - redeemed.

The praise singers for ‘western style’ liberal democracies were and are not, for the most part, simple ‘ideologues’ and wishful-thinking protagonists of the western system of power. There was - and continues to be - a growing body of empirical literature that underwrites, with various qualifications, their main claims. The global values survey undertaken by Ronald Inglehart and his collaborators at the University of Michigan, for instance, has strongly intimated that there is a broad, if complex and varied, global convergence of values as societies modernise and post-modernise. This convergence is also seen to have political implications: economic growth leads to cultural and societal shifts which, in turn, impact on political dispensations (Inglehart and Welzel 2008).

Economic growth and democracy have long been seen, in modernisation theory and other literature, to be linked. The classical account of this link was offered by Seymour Martin Lipset (Lipset, 1960). Once economies reach a certain level of development, regression to pre-democratic or ‘authoritarian’ regimes appears less likely (Przeworski *et al*, 1999; Przeworski, 2010). Yet another line of enquiry has suggested that many of the features of democratic dispensations are, *ceteris paribus*, conducive to better long-term economic progress. This optimistic view of western liberal democracy’s prospects came close to being encoded in a mantra in Michael Mandelbaum’s - *The ideas that conquered the world: Peace, democracy, and free markets in the twenty-first century* (Mandelbaum, 2003).

The salience of Mandelbaum’s title lies in the three principal elements and their interconnection: peace, free markets and democracy. The state-socialist systems imploded, at least in considerable measure, because they did not have, in Charles Lindblom’s terms, a ‘market system’ (Lindblom, 2003). They were economies based on the institutionalisation of shortages, poor articulation and feedback between economic actors and governments and few incentives for entrepreneurship. *Dirigisme* and central planning

had failed to secure economies that could compete with the capitalist systems of the West. The drivers of economic growth - technological and scientific innovation - were largely concentrated in the capitalist West and, especially, the United States of America (Kornai, 1999: 292-301; Walker, 1995).

While not without empirical warrant - the rich capitalist democracies were, after all, not only richer but also generally better off in human development terms than their erstwhile state-socialist competitors - there was an element of triumphalism in the pronouncement that liberal capitalist democracy embodied the culmination of human progress (Benjamin Friedman, 2007; Mandelbaum 2003). The triumphalism was underwritten by the long economic boom that characterised the last years of the 20<sup>th</sup> century and the first eight years of the 21<sup>st</sup>. It was also reinforced by evidence that a 'third wave' of democratisation was sweeping across the world and that ('consolidated') democracy held the key to solving many of the most urgent challenges confronting both the 'world as a whole' and specific parts of it. Free market capitalism had generated, through competition and rewards to innovation, hitherto unimaginable wealth. Democracy, too - even in poorer economies - had seemingly contained and limited the impact of famine and natural disasters (Sen, 1999). Finally, as if in empirical vindication of Kant's anticipation in *Perpetual peace*, 'republican liberalism', when sufficiently widespread and consolidated, had spared its bearers from war amongst themselves (Sorensen and Jackson, 2010: 109).

It is, however, important to analyze these terms, and especially 'democracy', more closely. 'Democracy' is a 'contested concept' (Gallie, 1956; Connolly, 1974). There have been many interpretations and definitions, ranging from C.B. Macpherson's broad, inclusive and somewhat ostensive account in *The real world of democracy* to Schumpeter's canonical definition of democracy as a method in *Capitalism, socialism and democracy* (Macpherson, 1963; Schumpeter 1941; See also Held, 2006). In very broad terms, the key distinction is between 'thick' theories of democracy - that enunciate the substantive virtues of democracy as educative and as valuing and 'improving' the quality of citizenship and enhancing the well-being of citizens (the 'classical' theories) - and those that see democracy as essentially a

political decision-making instrument, a device to facilitate some kind of optimal collective choice process.

This latter view of democracy as process and procedure has perhaps become predominant as ever greater emphasis has been placed on generating empirical studies of political systems across the world. We may even speak of a ‘neo-Schumpeterian’ moment. ‘Thick’ or ‘strong’ conceptions of democracy - deriving either from a nostalgic disposition to re-ignite the normative impulses that informed classical Athenian democracy or deriving from later thinkers such as John Stuart Mill - have been eclipsed by more modest (some might say cynical or ‘instrumentalist’) views of the scope and prospects of democracy (Finley 1973). One of the consequences of this move towards the deployment and further development of descriptive or empirical theory in political science has been a recognition that the spread of north-Atlantic style liberal democracy has been less compelling, and more complex and varied in its manifestations, than stylised interpretations of Fukuyama’s vision and the identification of the ‘third wave’ (Huntington) may have promised. Rather, what has emerged is that the political forms that have been embraced are often hybrid, ranging across varieties of ‘competitive authoritarianism’ to variations on the theme of ‘western style’ parliamentary or liberal democracy (Levitsky and Way, 2010, Brownlee, 2009, Schedler 2006). Some recent evidence suggests that the steady, onward march of democracy has been, if not completely halted, certainly slowed down and forced into temporary retreat at least in some countries. The latest Freedom House index suggests a possible recent ‘retrenchment’ of democracy - a fact adverted to as well in recent writings by Larry Diamond (Diamond 2008).

This has implications for international relations if the ‘liberal republican’ view of international relations and of the behaviour of nation states towards one another is warranted. On this view, the nature of states’ political regimes has implications for whether they are likely to go to war against one another. In particular, liberal democracies - on this view – have a very low propensity to wage war against one another. A world of ‘liberal republics’ would, ideally, be a world of perpetual peace.

The facts are encouraging: since the end of the Cold War, there has been a long-term secular decline in the number of wars. In particular, there has

been a notable decline in the number of wars between states (only four of any significance) and these - except in one instance (the invasion of Iraq by the 'coalition of the willing') - have not involved any 'developed' economies. Particularly notable has been the complete absence of war between liberal democracies. The wars that have been fought have largely been civil wars and these, for the most part, have been in 'failed states' and relatively poorer regions of the world.

The twentieth century brought, in terms of political and economic systems, a number of key 'challengers' onto the world stage. Very loosely following the rich, wide-ranging and suggestive account provided by Philip Bobbitt in *The Shield of Achilles*, these were Fascist-type systems, communism or state-socialism and 'western' parliamentary constitutionalism or 'liberal democracy' (Bobbitt, 2002). The conclusion of the Second World War saw the decisive defeat of Fascisms (despite minor, residual manifestations in Portugal and Spain) and emergence of Soviet-style state-socialism and western style liberal democratic capitalism as the remaining contenders. 1989 marked the beginning of the cataclysmic implosion of the state-socialist systems in the Soviet sphere of influence and heralded the triumph of the 'western' system. It was this moment that heralded a world-historical shift that the idea of the 'end of history' and Mandelbaum's mantra captured.

If, indeed, a global power transition is under way, and the newly emergent powers do not adopt political forms that fall broadly in the domain of liberal democracy, the conflicts of the future may well be less 'peaceful' than those that characterised the relations between the countries of the north-Atlantic world (and its 'family relations' elsewhere).

### **The nature of power transitions**

The approach in this paper draws in part, and with significant qualification, on 'power transition theory'. This was first articulated by A.F.K. Organski in the 1950s and further developed by Organski, Jacek Kugler and Douglas Lemke among others. It posited an alternative to 'traditional' balance of power approaches to international relations, and asserted that, on the basis of historical evidence, wars between states were less likely to occur when there existed a clearly hegemonic or 'dominant'

state that stood at the apex of a pyramid with subordinate 'great powers' beneath it that were basically satisfied with the rules of the international system. Beneath the 'great powers' were regional and 'lesser' powers. Such hegemonic systems, where the system's basic rules of association are defined by the dominant power and are accepted by the 'great powers', are stable. As new, discontented, 'great power' challengers to a dominant, hegemonic, power arise the system becomes less stable (Organski 1958; Lemke, 1997). In terms of power transition theory, the stability of the Cold War era could be attributable not so much to the 'mutual balance of terror' or 'mutual deterrence' but to the effective dominance of the USA - dominance attested to by the ultimate collapse of the Soviet Union. The post Cold War era, in turn, has been characterised by the continued dominance of the United States of America and by the broad, if not complete, acceptance of the rule-system that it has effectively put in place or sanctioned.

Power transition theory is thus able to account both for the outbreak of the Second World War and for the 'long peace' that followed its conclusion. It would suggest, too, that as long as 'great powers' in the hierarchical scheme are 'satisfied' with the rule structure, they will not be inclined to start wars. For the evidence adduced by proponents of power transition theory suggests that it is the dissatisfied 'great power' challengers to the dominant state that are the aggressors. Though one needs to deploy the insights of power transition theory cautiously and with many caveats, it would tend to reinforce the view that the spread of competitive capitalist democratic systems - along 'republican liberal' lines would constitute a global political dispensation which, by virtue of institutional 'family resemblance', will be more rather than less pacific, and that indeed the long term secular decline in wars between states will continue.

One of the marked features of the post Second World War era has been the decline in wars between states. The number and scale of wars has steadily decreased, with a shift in the locus of violent political conflict away from developed states to internecine wars and armed conflicts in areas where there has been 'state-failure' (Goldstein and Pevehouse, 2009: 83-84, 149-155).

## **The nation-state, globalisation and a world of regions**

The 17<sup>th</sup> century witnessed the birth, in still somewhat embryonic form, of the modern nation-state system. The signal event that defined the modern template of international relations was the Treaty of Westphalia (1648) and the basic character of the modern, secular, state was - as Martin van Creveld has put it - 'invented' by Thomas Hobbes. The principal purpose of the nation-state's creation, apart from the provision of order as a public good, was to wage war (van Creveld, 1999).

The question of whether the nation state, as the principal organisational form of political life, is becoming obsolete has been a recurrent refrain since the advent of the recent wave of 'globalisation' and the growing evidence of the 'retreat' or 'retrenchment' of the state that began with the fiscal crisis of the state in the 1970s and with the Reagan-Thatcher era in which the state in capitalist economies, at least with respect to regulation and the provision of social welfare, was pared back (O'Connor 1973). Van Creveld has argued that the nation-state - that is, the state as we know it - is, in consequence, in 'decline'. Philip Bobbitt has spoken of the transformation of the nation-state, in the economically advanced countries, into a 'market state' (Bobbitt 2002). Many of the reasons for the claimed demise of the state relate to its perceived 'transience' - a political form 'sandwiched' between the great 'religious sodalities' of the medieval world and the so-called 'new economy' characterised by the global presence and power of transnational and multi-national corporations. The general line of argument is that 'form' and 'function' have become disconnected. Famously, as Daniel Bell observed, the nation-state had become too big to deal with the small problems and too small to deal with the big problems. These 'big problems' have become associated principally with environmental challenges and the vexed and complex tasks associated with the governing of the global commons.

The original, larger, historical purpose of the early nation-state system was to provide a collective security solution to the turbulence that the European religious wars had brought with them. The fortunes of this systemic solution were mixed: the Napoleonic wars tested the arrangement, but the Congress of Vienna put in place a structure that - though punctuated by relatively minor wars such as those of German and Italian unification - provided Europe with almost a century of peace. This 'peace' ended with

the outbreak of the First World War and the modern nation-state became, in the rich world, a 'martial' entity that was the mobilisational pivot for waging the most destructive wars in history.

The leadership of the victorious powers at the end of the Second World War put in place a global financial architecture and a global collective security structure that would, ideally, bring the age of 'total war' to an end. These arrangements, designed to remedy the failures of the League of Nations and to remedy the ills associated with the 'Twenty Year Crisis' (Carr 1964) were, respectively, the Bretton Woods institutions and the United Nations Organisation.

Equally important was the recognition of the destructive potential of nationalism, most especially in Europe which had borne the brunt of the slaughter and destruction. This disenchantment with aggressive nationalism played itself out in Europe in the form of a long process of 'functionalist' integration, beginning with the European Coal and Steel Community and culminating with the formation and spread of the European Union. This process was informed both by the desire to transcend intra-continental international conflicts and by the great power struggle between the Soviet system and the capitalist west from the late 1940s until 1980. The result was the construction of Europe as a major regional economic power bloc.

The Cold War dictated that the attempt to find a global solution to the collective security dilemma was doomed. The Security Council of the United Nations could not operate in concert when the two most potent 'veto-players' - the USA and USSR - were custodians of two competing and incompatible economic, political and ideological orders. Collective security was provided - to the extent that it was - by the move towards regional integration in the case of Europe and, more broadly, the 'western system of power'.<sup>1</sup> NATO and the EEC (later EU) were the instruments of this. A similar, ultimately less successful, attempt at consolidating regional power in the Soviet geopolitical sphere occurred under the aegis of the Warsaw Pact and Comecon. At another level, collective security, in those theatres not affected by 'proxy wars', was underwritten by the mutual balance of terror that assured the stability of an essentially bipolar system - or by the *de facto* hegemony of the USA.

In the post Cold War context, global collective security remains a challenge. Further, the issues are no longer properly confined to those of peace and war. They extend, in the 21<sup>st</sup> century, to environmental matters such as climate change, and include issues such as food security and the governance of the 'global commons' such as fisheries and rain forests. Addressing collective security problems is easier, *ceteris paribus*, when there is normative or ideological consensus. While the ideological conflict that characterised the Cold War era may no longer be salient, the necessary normative consensus around matters of environmental management and the diverse needs of countries and regions at very different levels of economic development and facing diverse developmental challenges has not been - and is unlikely to be readily - met.

## **Europe: The 'new-old' continent<sup>2</sup>**

Much emphasis is presently placed on the 'rise of the east'. This began with the emergence of Japan and the so-called 'Asian tiger' economies which shed the tattered mantle of backward, 'third world' status and became alternative models of capitalist development and even suggested concepts such as the 'developmental state' (Johnson 1982). However, in addition to the extraordinary ability of the United States of America to 'reinvent itself' and to re-marshal its economic dynamism, sight should not be lost of Europe in the post-World War II period.

Views of Europe's achievements, prospects and challenges differ and sometimes diverge quite sharply. Some of this divergence has been occasioned by specific circumstances - such as Europe's failure, at the time of the Balkans' crisis, to deploy a regional collective security capability through to the strain placed on the European Union by the recent Greek sovereign debt crisis and the hesitant and controversial ways in which immigration and ethnic integration (especially of those from north Africa and the 'Islamic world', as well as Roma) are handled.

However, the key fact about Europe is that, as a new regional 'sodality', it has come to constitute a major, multi-dimensional and formidable presence and force in world affairs. Europe's advocates point to its essentially normative and institutional advantages - as well as to the sheer magnitude of its market and its not inconsiderable success in having lain to rest the

ghost of its genocidal past (Leonard, 2006; Hill, 2010). They advert, especially, to its remarkable achievements in health care, public transport provision and the provision of social security and that, in having developed these 'social democratic' or 'social market' arrangements, it has accomplished an institutional balance between freedom and equality that is unmatched by, for instance, the United States of America. For Mark Leonard and for Stephen Hill, Europe's appeal is based on its normatively compelling institutional accomplishments which, for Hill, should be appropriately embraced by the USA. For Leonard, more generally, Europe's appeal is both normative and economic. Countries in reasonable cultural and geographical proximity to Europe are, and will continue to be, drawn into its large and comforting embrace. Europe, in Leonard's provocative prediction, will 'rule the twenty first century' (Leonard, 2006). But entry into Europe's domain comes at a price: conformity to the advanced regimes of human rights protection and non-martial behaviour that now characterizes European policy and practice.

Europe's critics advert to its structural weakness and policy failures. In particular they are exercised by the challenge to future wealth creation by an ageing population, an over-generous social welfare dispensation, an economic culture that does not sufficiently reward risk-taking and a university and knowledge production system that is relatively inimical to innovation (Alesina and Giavazzi, 2006). Other commentators point to the deep variance in Europe's political systems, that the elision of countries into a political and cultural 'sodality' is illusory or at least fragile and that the disconnection between the achievements of monetary union on the one hand and fiscal sovereignty on the other is deeply problematic to the maintenance of an effective Union (Anderson, 2010).

While the jury may be out on Europe's future, it is important to emphasize what has been achieved. Europe has evolved from being a war-torn continent with fire-bombed cities, through a bitter and difficult division between the Soviet-dominated east and Anglo-American influenced west, to a continental domain with a parliament and a 'quasi-federalist' bureaucratic and executive centre. In so evolving from the early achievements of the European Coal and Steel Community via the Treaty of Rome and the EEC, Maastricht, Nice and Lisbon - it has effectively drawn in countries that had earlier fallen under the Soviet aegis. In this, Europe has become an authentically post-Westphalian regional bloc.

The European Union has born testimony to the virtues and feasibility of international integration along functionalist lines of the kind espoused by David Mitrany (Mitrany, 1965). It is a regional arrangement in which sovereignty has been shared, disseminated and redefined in such a way as to suggest the possible early dawn of a post-national world - a world, defined by a highly progressive value system, that may only be joined if those wishing to join it pass the normative test. It may well be that the welfare state system in Europe is a global normative benchmark that remains, in both political and ethical terms, unsurpassed (Berman 2006).

### **China, India and the ‘Rise of the “Rest”’<sup>3</sup>**

The rise of China and India has signaled the emergence of potential ‘great powers’ that might - if dissatisfied - challenge the hegemony of the United States of America. This, to some extent, invites one to recall the earlier, post-Second World War rise of Japan - the then ‘emerging superstate’ as Herman Kahn described it - and the rise of the so-called Asian ‘tiger economies’ (Kahn 1970; Amsden 2003). One feature of the rise of these economies has been the invitation to revisit the role of the state, and the relationship of state and market, in the process of capitalist economic development. This revisiting of the role of the state has been captured by the concept of the ‘developmental state’ (Johnson 1982). Politically, Japan - on account of conquest and American suzerainty, ‘converged’ with the North Atlantic postwar system. By virtue of the effective normative concord between the north-Atlantic network of advanced economies and Japan, Japan was never likely to emerge as a ‘great power’ challenger to the United States of America. China’s rise, by contrast, signals a decisive ‘power transition’ moment - as might India’s.

Whether one agrees with Martin Jacques’ prognosis that China will reconfigure the world in its own cultural and civilizational image and thus end the material and normative hegemony of the West, or is persuaded by Will Hutton’s more cautious estimates of China’s prospects, there is little doubt that the sheer magnitude of China’s economy and its rate of economic growth ensure that it will be a major player in the global system in any foreseeable future (Jacques 2009; Hutton 2007).

The normative implications of this are as yet unclear. Will China - notwithstanding Jacques projection - pass thorough a societal and cultural transformation that will render it both organisationally and normatively more convergent with the north-Atlantic systems (which, if Sergio Fabbrini is correct are themselves converging in political character), or will its societal and political systems evolve along distinctive paths that diverge in significant ways from those of Europe and north America (Fabbrini 2009)? It is too early to discern clear patterns, and too hazardous to read too many political and societal consequences from the fact of economic growth?

However, one may at least hazard some guesses. One is that, should China continue to grow at or near its recent historic rate, and should it become a truly wealthy society in per capita GDP (in the league of wealth associated with the USA or the countries of the European Union) distributional conflicts - and the modalities of such conflicts - that have been evident elsewhere will likely manifest themselves. A recent edition of the *Economist* magazine has pointed to the significance of China's emerging working class (*The Economist*, July31 - August 6, 2010). 'Class struggles' might well become an increasingly salient feature of China's economic success, with implications for its global competitiveness. Its ability effortlessly to undercut labour costs in other parts of the global economy may then be impaired and constrained. This could curtail the expansionary role that China's cheap labour market has had on the global economy.

Yet another prospect is that, as China becomes ever wealthier, its ability to sustain a modern democratic-style of government will improve. For if it does democratise along broadly polyarchy-type lines, the findings that, above a certain threshold, regression from democracy is unlikely, might well apply (Przeworski et.al, 2000). It is an open question whether China will move towards a more conventionally 'polyarchical' political system as it continues to urbanize, industrialize and – more generally – to modernise and, indeed, to 'post-modernise'.

Should China do so, it will become more like Europe and the USA in a number of key dimensions. Such convergence would mean that, even though the Chinese economy would continue to have many distinctive features, the weight of Chinese power in global terms would likely be felt as more rather than less benign (see Huang, 2008, for a discussion). In

other words, the ‘power transition’ that it betokens would not be conducive to military confrontations with other developed economies. The general pattern that broadly similar liberal democratic regimes do not go to war against one another would likely hold. Loosely deploying Michael Mann’s four-fold characterization of the sources of social power, it could be claimed that as societies become more economically developed, so the salience of military power declines in relative terms and that of economic (and perhaps also ideological and political) power increases (Mann 1986). The key point, however, is that the latent magnitude of military power is a function of economic power (and by extension the technological capacity that underlies it).

What is, however, indisputable is that China has already become, and will continue to develop as a major player as the global system evolves and that its massive economic capacity will likely translate into significantly greater military potential. Those societies that have transactions with China will need better to ‘get to know’ and to understand China. That will place specific demands on elites. In very general terms, the fortunes of countries, and not least significantly, the fortunes of democracies, depend in substantial measure on the capabilities and qualities of elites. The skill with which the leaderships of countries that are engaged in trade, diplomatic and political relations with China manage their interactions with the emerging superpower will be critical. The United States of America’s foreign policy establishment has clearly identified the task of understanding China as a priority. This is clear from the emphasis placed on analyzing China by the Council for Foreign Affairs in its journal *Foreign Affairs* to the comprehensive and thorough studies collated by the Petersen Institute under the aegis of Fred I Bergsten (Bergsten *et al* 2009). That China is aware of its rapidly growing presence on the global stage is registered in the fact that the Chinese elites are themselves thinking hard about their role on the international stage, and about how to effectively engage with the West. China is itself, to this effect, spawning think tanks at an astonishing rate (Leonard 2008: 7-9).

Whether China emerges as a global actor of unparalleled scope and power, as Martin Jacques suggests, or whether its prospects are more curtailed as Will Hutton suspects, is a moot point and not material to the larger case that I am making. The crucial point is that China is party to the broad shift in relative power terms from the north Atlantic world, where it has

historically been centered from at least the 17<sup>th</sup> century, to Asia. Whether this impels the world in the direction of yet another multi-polar dispensation, with a distinctive 21st century 'balance of power' collective security arrangement to contain and manage conflict, has yet to be established. Whether, too, it means that a power of a 'classical' nation-state or empire-like kind will emerge to challenge, and perhaps displace, the USA or the 'western system' is unclear.

### **Clashes of 'civilizations' and the resurgence of the sacral**

An alternative and influential 'grand narrative' to that offered by Fukuyama was suggested by Samuel Huntington in both an article in *Foreign Affairs* and a subsequent book-length study (Huntington 1993; Huntington 1996). The 'return of the sacral' as a force in world politics - especially represented by certain stripes of radical Islam such as that associated with Al Qaeda, militant Hinduism and some varieties of 'Christian fundamentalism' - have given seeming credence to Huntington's 'model'. The attacks of 9/11 gave impetus and an added sense of resonance and urgency to this account. However, despite the appeal of this as a 'phenomenological' account, the available global evidence would suggest a convergence rather than divergence in terms of value systems as societies modernise and post-modernise. There appears to be a general shift away from values-oriented towards 'survival' to values-oriented toward 'self-realisation'. This is not to say that the patterns of convergence that have been identified are 'one-dimensional' and that there are no cultural or 'civilizational' variances. Indeed, the evidence suggests that as societies converge in normative and institutional terms, they do so in a manner that reflects the impact of distinctive cultural histories and dispositions. However, it is my view that the functional features of societies as political and economic systems shape the predominant patterns of behaviour. That is, it is the 'axial' institutions - the economy and political systems, states and markets - that have the most significant impact. For this reason, I would want to argue that, for all that phenomena such as Al Qaeda-style militant Islam will add turbulence to the global political system and test qualities of statecraft and leadership, they are structurally not significant in the way that are the shift of economic power towards Asia, and the global entrenchment of capitalism in its several and varied manifestations (See Hall and Soskice, 2001).

## Ethics and Political Economy

Matters of justice and freedom need to be addressed in light of the institutional character of the world. Principles and theories of justice and right action may serve as regulative ideals, as the source of norms which guide action. They need not be relativistic nor simply represent, in a normative register, the immanent rules that inform existing institutional arrangements. The weakness of such relativism is revealed in works such as Michael Walzer's *Spheres of Justice* (Walzer 1983). The prudential and pragmatic application of principles, however - as guides to action and as the bases of policies - must necessarily be cognisant of the configurations of power to which they relate. Each of the great civilizations contains, as Amartya Sen has noted, normative traditions and resources that can be mobilised in ways that are congruent with the most compelling ethical perspectives that have been articulated in the West (Sen 2009; de Kadt 2009). But such mobilisation, to be effective, turns on an appreciation of what is possible – both in terms of the nature of economic systems and the nature of the political institutions through which such mobilisation must be effected.

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**Notes:**

<sup>1</sup> This is Ralph Miliband's term, the subtitle of his seminal '*The State in Capitalist Society*' (Miliband, 1969)

<sup>2</sup> The title of this section is borrowed from Perry Anderson's new book by that title.

<sup>3</sup> The heading for this section was suggested by the title of Alice Amsden's book.

# **The Relevance of Social Market Economics in the Current Global Situation<sup>\*</sup>**

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JÖRG M WINTERBERG

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## **Introduction**

The Washington Consensus has been the offspring of the neoclassical counter-revolution of the 1980s (Williamson 1989, 2002, 2004). Like no other buzzword in recent economic history, the term Washington Consensus has been at the heart of a controversial debate among economists, politicians and civil society. Laboratory economic research seemed to have taken over many societies irrespective of their historical, cultural, or geographical context. Yet, many societies have begun to fight back, be it in the form of popular protests, re-nationalisation and democratisation reversals, and a search for a new economic development paradigm is now underway.

In this paper we argue that the social market economy as a true political-economy philosophy constitutes a serious alternative for many developing countries. As the social market economy is devoted to competition with equal opportunities, it tackles one of the biggest problems of many developing economies.

A distinct feature of social market economics is its thinking in terms of orders. Inequality of income and economic opportunities, for example, would neither constitute a social order in line with the social market economy's explicit commitment to values of justice, nor would it be considered favourable to the attainment of a functioning competitive order.

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<sup>\*</sup> This paper builds on the working paper: "Washington Consensus vs. Social Market Economy – The Role of the State for Development Revisited", written by the author in co-operation with Marcus Marktanner, American University of Beirut, Lebanon

By making explicit normative social and economic order commitments, the founding fathers of the social market economy drew lessons from historical experiences. In order for a state to live up to its role as an “empowerer” of equal economic-opportunity citizens, also state-constituting-principles need to be considered and fiscal capacity given.

## **The basic ideas of the social market economy**

The basic idea of the social market economy is to combine the efficiency of competition with governmental alertness for social imbalances. In political-economic terms, this means that the state acknowledges that a discriminatory primary distribution of resources or untamed competition may lead to social costs in terms of social inequality, monopolisation, and cartelization that may outgrow the economic efficiency gains from liberalised markets.

Whenever marginal social costs outweigh marginal economic benefits from non-governmental intervention, the state would interfere. In order to be able to assess the trade-off between the economic benefits and social costs from market-oriented economic development, a political leadership responsive to citizens and committed to citizen sovereignty will be necessary.

In the philosophy of the social market economy, governmental interference is perceived as a public good, which the state provides through progressive taxation. The government may then use these funds for direct income redistribution, but preferably for public investments that promote economic empowerment and social upward mobility in a way that they conform to the market so that the price mechanism remains untouched. In order to accomplish this goal, fiscal capacity building is a crucial prerequisite. In the social market economy, fiscal, social, and economic components form a systemic loop of socioeconomic development. In this system the state draws on a tax base, safeguards balanced social development, and stimulates economic activity through public investments and proactive anti-trust legislation.

## **Ordo-liberalism and the social market economy**

What are the theoretical fundamentals of the philosophy of the social market economy? A distinct characteristic of the philosophy of the social market economy is the classification of a political economy in terms of orders. This particular thinking is captured in the German language by the expressions “Ordoliberalismus” and “Ordnungspolitik”, only incorrectly translated as ordo-liberalism and institutional order-policy. The intellectual home of the thinking in orders is the so-called Freiburg School around scholars such as Walter Eucken, Constantin von Dietze, Wilhelm Röpke and Alexander Rüstow. In the 1930s, The Freiburg School created a blueprint for an economic and societal framework of a democratic and market-oriented Germany, based on liberal political and economic thinking: Liberal, but with a strong role for the state.

From an order-theoretical perspective, the principle of individuality is in the centre of all orders and expressed economically by a commitment to the competitive allocation of scarce resources through the market process, where producers are endowed with decentralised, private, and secure property rights of the means of production and consumers are sovereign in their choices. In the context of Germany, this was an answer to the take-over of economic activities by the Nazis.

Although the individual and the market process are the solution to the scarcity problem, they are still subordinated to broader orders. These orders refer to the principles of economic policy, state organisation principles, as well as the normative definition of social values and objectives.

Walter Eucken (1952/2007) defined the principles of economic policy by seven constitutive, four regulatory, and four supplementary principles. The constitutive principles are non-interventionism in the price-mechanism, primacy of price stability over employment objectives in monetary policy, open markets, private property rights, freedom of contract, prohibition of state bail-outs of losses incurred by economic actors, and economic policies oriented at long-term objectives. Despite many similarities to, for example, Anglo-Saxon economies, there are also obvious differences, most notably in the principle of monetary policy and the long time orientation of economic policy. Social market economists essentially

represent the monetarist, as opposed to the Keynesian view, of monetary policy. It might be interesting to stress that the Commission on Growth and Development (2008 p. 3), a research partnership between World Bank economists, academics and practitioners, note in their final growth report, in line with order policy and the spirit of the social market economy, that effective government “requires patience, a long planning horizon, and an unwavering focus on the goal of inclusive growth.”

Institutional order policy, moreover, means to anticipate market failures and to watch constantly over the market process. Eucken formulated additional regulatory principles of economic policy. These are an effective anti-trust policy, income redistribution, policies to internalise negative externalities, and policies to avoid non-normal labour supply curves. Again, these regulatory principles may show many similarities to standard neo-liberal concepts, especially regarding the importance of anti-trust policy, but they go far beyond them by also acknowledging explicitly the possibility of markets failing and social imbalances arising. Historically, the formulation of these regulatory principles was a response to rising inequalities and social miseries that occurred during mercantilism and the industrialisation.

The labour market receives particular attention in the social market economy, which was a result of fears that the huge labour supply relative to the number of available jobs after World War II would lead to ruinous competition among workers. The answer to this problem was the development of a social partnership between employer associations and labour unions. This partnership also included the principle of co-determination, which defines a common responsibility for companies' performance.

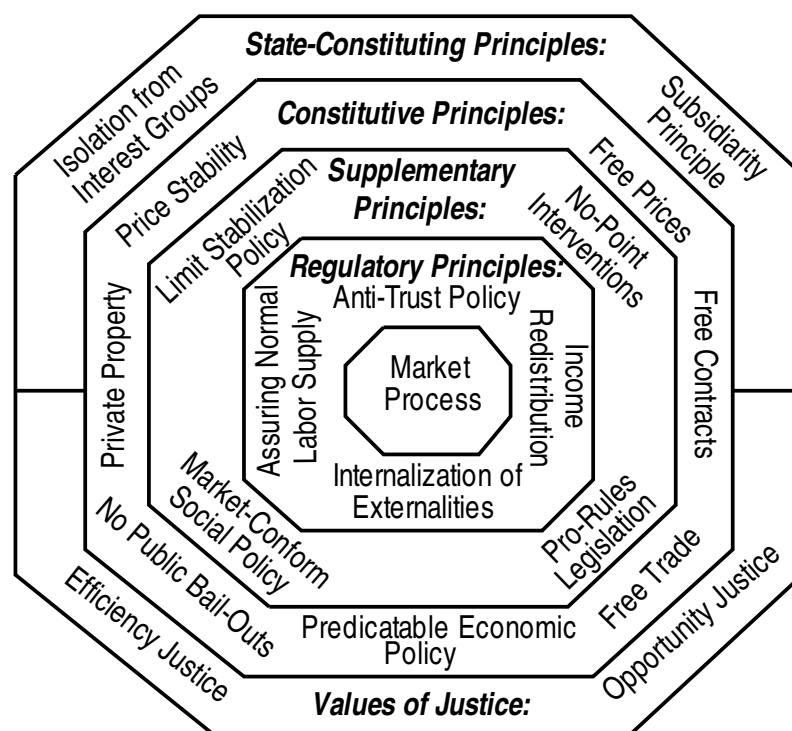
Eucken also formulated supplementary principles of economic policies, which are avoidance of punctual interventions, formulation of legislation in terms of general rules rather than interventionist policies, discretion with stabilization policies, and market conformity of social policy in the sense of a primacy of investing in people over providing consumption opportunities.

Although the constitutive, regulatory, and supplementary principles of economic policy are at the heart of the social market economy, there are

also state-constituting principles. They are the limitation of the power of special interest groups, primacy of rules-based policies over market-interventionist policies, and the subsidiarity principle, the latter typically found in the design of federal states and social partnerships.

The highest order is the one that refers to the formulation of social values and objectives. The formulation of social values and objectives refers to the kind of justice that shall prevail. Distinguishing justice based on efficiency, consumption, and opportunities, the social market economy is committed to justice, based on efficiency and opportunities. In contradiction to this, neo-liberalism tends to prioritize ‘efficiency justice’ and socialist economies ‘consumption justice’. Figure 1 provides an illustration of the concept of ordo-liberalism.

**Figure 1: Ordo-Liberalism in a Nutshell**



## **Social market economy as an alternative development strategy?**

While ordo-liberalism shaped both economic theory and policy in Germany after 1948, it barely found international recognition. The social market economy was discussed in some international political science

journals as a kind of “German Neo-Liberalism” (Friedrich 1955; Megay 1970), but its ideas were in essence academically limited to German-speaking countries with Karsten (2005) being a recent exception. One reason for this may have been that the fathers of the social market economy were too consumed by the public debate of Germany’s post World War II political course to publish in English-speaking outlets. Another reason may have been that the concept is too prosaic and, as such, difficult to access by mathematical approaches to economics, which increasingly began to shape economic methodology. A final reason may have been that the world perceived Germany after World War II to be under US influence and equated this with the adoption of US institutions, policies, and philosophies. Yet, Germany was a far cry from that. When the US imposed price and wage controls to contain inflation, it was Ludwig Erhard, economic advisor to the military governor of the US zone, who announced the liberalisation of prices without even informing the US. When asked by General Lucius Clay, US commander in Western Germany, why he had changed the price controls, Erhard replied that he had not changed price controls, but abolished them (Erhard 1957).

Obviously, social policy plays a strong role in the concept of the social market economy. Although many neo-liberal scholars concerned with inequality may argue that anti-trust policy is enough social policy to fight inequality, the social market economy again goes further. It also calls for a tax system based on progressive taxation to finance governmental investments in social security systems where markets fail. Historical evidence suggests that this is typically the case in elementary education, unemployment insurance, and retirement plans. A major argument of this paper is that it is exactly this spirit of a pro-active state that is committed to investment in justice of opportunities that makes the social market economy a viable option for developing countries.

The concept of the social market economy as a theoretical concept is often equated with real developments in Germany and has been blamed for the sclerosis of the German economy and other welfare states of Europe since the 1980s. But, as elsewhere, German politicians of all parties have not implemented the ordo-liberal concepts in the spirit of their founding fathers, but deviated from them for the sake of short-term political objectives at the expense of the primacy of a predictable and non-erratic economic policy course. Accordingly, theory and reality are also two pairs

of shoes in Germany and it would be wrong to hold this against the social market economy as a theoretical, normative, and state-philosophical concept. On the contrary, the mistakes made in Germany should even lend additional support to the soundness of its theoretical foundations.

The current global financial crisis has shown the limits of an Anglo-Saxon capitalist system without long-term oriented rules. A single social market economy cannot totally protect against such a crisis starting in the world economy like an epidemic, but according to ordo-liberalism, rules could be provided to avoid the outbreak of such a crisis. On the other hand, the development of the German economy and especially the German labour market during the crisis shows that the system operates successfully: Unemployment rates have increased at a much lower rate in Germany than for example, in Great Britain or the United States, even if the banking sector was touched heavily and the German economy was, and still is, one of the most export-oriented economies in the world.

## **Conclusions**

The social market economy must therefore be seen as a dynamic model, which uses the catalogue of ordo-liberal principles as a constant reference model. This ordo-liberal reference model then serves as a constant guide, which may bring about different social and economic policies on the ground, especially in different developing areas. This contrasts positively with many other approaches, such as the Washington Consensus, which ignored all factors that come from outside the microeconomic box and proposed a one-size-fits all philosophy with a one-size-fits all policy.

Either way, the social market economy will always depend on fiscal capacity. Cross-sectional evidence suggests that fiscal-capacity building corresponds to inherent dynamics that are in the heart of the social market economy: It brings about more equality and greater competitiveness of the economic base. A stylised simulation of the development dividend associated with the social market economy for various developing areas shows that the social and economic returns of fiscal capacity building are substantial.

In contradiction to other liberal concepts of market economies, the ordoliberal idea of the social market economy attributes a strong role in the economy to the state. The state is not seen as a night-watchman, only lighting and extinguishing the lanterns. The most important roles for the state are:

- to create an order of competition and to achieve it even against the possible pressure of the competitors
- to combine in this creation the principle of economic freedom with a social balance, so that even the results on the markets reflect social responsibility.

Therefore, the main instruments of social policies are not only (expensive) systems of social security, but also

- a framework for competition that prevents rent seeking strategies and limits the economic power of syndicates and monopolies;
- a tax system that demands a greater input from those members of the society who are more capable – mostly by using a progressive income tax;
- a system of social insurances, that protects against the risks of unemployment and the costs of diseases, and a pension scheme; all on a financial level, that can be achieved by the society;
- independent organisations on the labour market, which organise the labour conditions and the wages corporately;
- an educational system that is affected by the idea of equal chances for all members of the society and develops a high level of education.

On the other hand, the role of the state is not to drive the economy. There are no proofs for the hypothesis, that politicians, for example, know better in which products and what technology money should be invested. In the business sector of a social market economy, the strong role of the state is strongly limited: to refereeing in conflicts and to safeguarding the rules.

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# **Ethics and the Economy : A Critique from the Perspective of Catholic Social Thought**

**New Directions in Economics and Ethics:  
toward a New World Order**

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RODNEY MOSS

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## **1. Introduction**

Yet it must be acknowledged that this same economic growth has been and continues to be weighed down by malfunctions and dramatic problems, highlighted even further by the current crisis....

The different aspects of this crisis, its solutions, and new developments that the future may bring, are increasingly interconnected, they imply one another, they require new efforts of a holistic understanding and a new humanistic synthesis (Benedict XVI, *Caritas in Veritate*, 2009:21)

These words from Pope Benedict XVI's encyclical *Caritas in Veritate* introduce this paper and provide a strong clue to the direction to be taken in its exposition. My belief is that Catholic social thought as developed over the past 120 years is a valuable legacy that has a unique contribution to make to an ethical, social, political and theological inquiry into the current economic trends within a globalized world and provide a possible way out of the present impasse.

This paper will begin by giving a brief exposition of what has become known as the Catholic intellectual tradition - an academic method that uses the tools of reason, the essential sacramental nature of reality, evolving tradition and an integrative, rather than an atomistic and reductionist approach to the solution of the economic, social, ethical and political problems of the contemporary world. Next a brief introduction to classical neo-liberal economics, its strengths and its limitations particularly in a globalized world will be presented. Two critics from within the system, Geoffrey Sachs and Joseph Stiglitz, suggest a reform of neo-liberal economics in the face of the new challenges presented by globalisation.

The critics from outside neo-liberal economics, the so-called social economists, will be treated next. They refuse to separate the social and economic aspects of reality and seek to re-think economic theories from a social and human perspective. Their approach is consequently more integrative.

The next section will present some of the core elements of Catholic social thought (hereafter known as CST). The autonomy of secular affairs is affirmed on the one hand and yet, on the other hand, it is acknowledged that the Gospel presents guidelines for the just ordering of society. Firstly, CST establishes clearly the essential dignity of the human person made in the image of God. Secondly, the social nature of the human person is stressed and this prepares the way for a deeper reflection, solidarity: the essential unity of the human race and the co-responsibility and co-dependency of the individual and all fellow humans and indeed of the whole human community. The further principle of subsidiarity with its strong political and democratic undertones maintains that the governance of the globalized world must be “articulated into several layers and involving different levels that can work together” (Benedict XVI 2009 :57). Lastly, human development, if it is to be authentic, must be integral, that is, must involve the whole person and every person. Development is not mere economic growth; it is multifaceted - people must flourish on multiple levels.

The final section will attempt to establish the contribution that CST can make to economics and globalisation. It will surely be to humanise the process of globalisation, to restore a communitarian perspective, to foster new forms of interaction and interdependence among people and guide new forms of global connection and co-responsibility.

## 2. The Catholic intellectual tradition

The Catholic intellectual tradition is best understood as a product of the interaction of Christianity and the culture of which it is a part. This Tradition learns from culture, is shaped by culture, borrows some things from that culture and modifies many others.

Firstly, this tradition is grounded in the belief that thinking (*reason*) is a valuable intellectual tool. The theological foundation for this belief is that God, the creator, is the source of Truth as well as of Goodness and Beauty. Since reason seeks the truth it will therefore ultimately bring us to God. Consequently, there is a long history of the relationship between faith and reason in the Catholic experience. For example, the harmony between faith and reason is dominant in the thought of Aquinas and made him open to considering widely divergent ideas and arguments. Thus he used Greek philosophy, principally that of Aristotle, considered by many of his contemporaries to be irreconcilable with Christianity to articulate Christian theology and even engaged with Islamic philosophy in attempts to wrestle with the religious and secular ideas of his day. The contemporary Catholic Intellectual Tradition then, is part of this continuing dialogue between faith and reason. It is worthy of note that faith of some form or other is part of the experience of the majority of people on this planet, part of past and current human experience and therefore an eminently worthy subject of academic discourse. This continuing dialogue is represented, for example, by the current dialogue between faith, philosophy, ethics, and science including economics.

Secondly, the Catholic intellectual tradition is grounded in a strong *sacramental* principle. It affirms the material world and the belief that the matter of this world is a means of making God present. Therefore, the world in all its forms and expressions must be studied, lest through ignoring the world, we miss God's self-communication. However, not only nature is sacramental but also the work of human hands and minds (i.e. art, literature, music, technology and science). These works all have a sacramental character and are a means of making God present for God permeates all things. In the sacramental world view, memory and imagination, too, are important for they demonstrate that there is more to the world than meets the eye. This conviction can free us, from what I call, the tyranny of the present which is the tyranny of thinking that the way the

world *is*, is the way it *must be*. The prophetic tradition within Judeo-Christian religion is a living witness within biblical and church history of this conviction. On the other hand, a narrow understanding represented by the so-called tyranny of the present and often characteristic of contemporary thought can lead to despair on the part of those for whom the world is not a good place and defensiveness on the part of those for whom it is.

Thirdly, a two thousand year interaction with the world involves a respect for *Tradition* which is the cumulative wisdom of those who have come before us. Such a respect will surely engender a humility about our own contemporary positions and engender a readiness to learn from others, the dead, as well as the living. We ought to be attentive to Socrates who demonstrated that humility and a willingness to learn from others, is a necessary condition for learning. Moreover, knowing that the world has not always been the way it is, can, like the sacramental world-view, help us to resist the over preoccupation with the “present.” It can stimulate us to imagine ways in which the world could be different and better.

Fourthly, the Catholic intellectual tradition seeks *integration*. This means that it seeks to connect through dialogue the various pieces of knowledge into a more coherent whole. In consequence it seeks to connect learning with living and raises perennial questions of meaning and purpose. It pushes for cross-disciplinary connections and what has come to be called an education for the whole. Thus, it is concerned with the whole person within the whole human community (an obvious counter to post-modern fragmentation). Catholic intellectual life is thus open to ongoing concerns, discussions, or debates from a variety of perspectives to ensure a critical appreciation of the central points of disagreement among scholars on a variety of subjects.

I will begin with an attempt to understand neo-classical liberal economics, the dominant economic theory in the world today. What are its characteristics and its basic philosophy?

### 3. Neo-liberal economics

Classical economics has as its driving or motivating force, self-interest. The needs of society can be more effectively provided for, not by direct, intentional societal interest, but rather by each following his/her own interest.<sup>1</sup> Effectively this means that they who promote their own interest promote the common good without either being aware of it or even intending it.

According to Stegmann (2004a:9-12) the capitalist system has the following five characteristics:

- Separation of capital and labour. Expressed simply, some own or control the capital, others work in the economic process.
- Predominant position of the owners of capital
- A striving for a permanent increase of capital. Effectively this means that the growth of the business becomes an end in itself.
- Economic Rationalism. Rational, scientifically calculated methods of production and buying and selling were to be introduced: “minimum possible input/ maximum possible output.”
- Ethical Minimalism. Influences from outside the economy were to be restrained as much as possible. Factors regarded as alien to the economy, such as ethical and social limits, were to be reduced a minimum.

Classical economics rife in current forms of globalisation argues that free trade and minimally regulated markets will result in high levels of economic growth throughout the world. Therefore neo-liberal globalisation argues for “decreased governmental regulations, privatization of government owned enterprises, reduced government spending, and the lifting of barriers to international trade and investment...”(Sniegocki 2008:322) Contemporary neo-liberal principles have generally advocated structural adjustment policies and free-trade agreements.<sup>2</sup> Critics of free trade agreements cite the following negative consequences: harm to small farmers, small businesses unable to compete with multinational corporations, “sweatshop conditions” involving

offering lower wages and minimal environmental and workshop conditions, decreased access to cheap generic drugs, the spread of consumer values and the homogenization of cultures, the undermining of democracy (note the often secret manner in which free trade treaties are approved), increased conflict due to growing economic inequality and a furthering of the ecological crisis due to the exploitation of natural resources by large corporations and consequent decreased environmental regulations and enforcement (Sniegocki 2008:325-327).

I wish to address criticism first from within neo-liberal economic theory: from Geoffrey Sachs and Joseph Stiglitz. Both support conventional economic theories but feel that these theories often overlook important areas of reality. Sachs contends that certain countries particularly in Africa are excluded from effective participation in international markets due to what he calls “poverty traps” - lack of capital, poor geographical conditions, and endemic diseases. He proposes a plan including debt relief, substantially increased foreign aid and major investment in areas such as agriculture, infrastructure, health, education, and clean drinking water sanitation. Sachs contends that these plans will enable the poor in these countries to get, what he calls, a foothold on the “ladder of economic development”(Sachs 2005:18)

Stiglitz suggests that the result of neo-liberal policies encouraged by the US government, the IMF and the World Bank

has all too often been to benefit the few at the expense of the many, the well-off at the expense of the poor. In many cases, commercial interests and values have super-ceded concern for the environment, democracy, human rights and social justice (2002:20)

Both Sachs and Stiglitz assert that the problems are not inherent to globalisation and capitalism. Stiglitz, in particular, suggests that attention needs to be paid to the implementation of the moves toward economic liberalization (Stiglitz 2002:18).<sup>3</sup> He argues, in a significant departure from neo-liberal theory, for a significantly stronger role for government in economic life. “Without appropriate government regulations and interventions markets do not lead to economic efficiency” (Stiglitz 2006: xiv).

More radical critics, sometimes known as “grassroots critics” cite the following problems that have accompanied modern forms of wealth creation: global warming, deforestation, desertification, massive soil erosion, declining soil fertility, species extinction, declining fish populations, diminishing water supplies, toxic contamination of air, land, and water and numerous ecological problems ( Sniegocki 2008: 334-335).

What are the alternatives proposed by these critics? They propose the revitalization of local industries, a primary emphasis on ecologically sustainable forms of production to meet local needs, international trade while still given importance needs to play a more secondary role, redistributive policies, grassroots participation in economic and political decision-making, the use of tax, credit, investment and regulatory policies to support revitalized and diversified small-scale agriculture, support for small businesses, local industries, worker-owned co-operatives, strong regulation of large corporations including a new legal framework for governing corporate activity and a ban on corporate involvement in the political processes (Sniegocki 2008:336).

In the next section we will look in more detail at the alternatives that a new generation of economists provide.

#### **4. Other Economic Models**

Some economists hold that financial markets cannot be controlled. Others hold that markets ought not to be interred with. Others still, advocate some controls, some restructuring. Some Christian thinkers hold that because of the incarnational principle of their religion, social and economic realities cannot be separated from their embodied and material bases.

A financial economy that is an end unto itself is destined to contradict its goals, since it is no longer in touch with its roots and has lost sight of its constitutive purpose... [and] essential role of serving the real economy, and, ultimately, of contributing to the development of people and the human community ( Pontifical Council for Justice and Peace 2004:369).

Even Adam Smith who had claimed autonomy for the economic processes did not exclude moral restraints.<sup>4</sup> Gradually some economic theories have been re-thought from the viewpoint of social economic theory. Herman Daly, Paul Ekins and Thomas Power are examples that we shall briefly examine followed by the system known as Social Market Economy.

Herman Daly from the World Bank (co-author with John Cobb) has been busy constructing a new economic paradigm (Cobb 1989). While Daly respects the achievements of economics he is highly critical of what he calls the “reductionism” which focuses on the part rather than the whole. The consequences, as he sees them are human and environmental disaster. Daly pleads for a new conceptual framework and alternative economic policies (Cobb 1989:377).

Paul Ekins’ concern for the common good and community building has led him to launch the Living Economy Movement. He claims that economics is

at an impasse. Its instruments are blunted. Its direction is confused....Nothing seems to work as it used to. Investment doesn’t bring down employment. Neither does growth....most paradoxical, perhaps, is the continual existence, even in the richest societies, of poverty with progress. Even as technological change promises virtually unlimited production, the most material needs go unmet...A crisis of such dimensions indicates a fundamental failure of method. The very assumptions which form the basis of conventional economics are now unsound. Having ceased to describe the real world in its theories, economics has now become incapable of acting coherently on the real world in practice. A new start is needed, an economic approach that is consistent with the science, technology, values and attitudes of the late twentieth century ( Ekins 1986:1)

Thomas Power, another economist who seeks to redefine the mission of the science of economics, denounces the “anti-rationality of conventional economics” and the “amorality of economic analysis and the market economy” (1988:200-201). He contends that “conventional economics is not value free. It quite clearly espouses the virtues of individualism, of competition, and of unlimited expansion. It reacts against the imposition of moral limits in public policy” (Power 1988:202).

We turn attention next to Social market economy which is an attempt to combine freedom in the market place with social responsibility. Stegmann states that

[t]he core of the model is the regulated competition that presents and guarantees economic efficiency and productivity...[and] at the same time rejects unlimited freedom in the market place, as well as the disregard of social elements and social responsibility” ( 1991b: 23).

In this model then economic freedom is neither the only nor the highest value but is linked with other values such as social justice, the common good, and solidarity, values which will be more fully considered in the next section.

Central to Social market economy is the distinction between the framework of activities and the activities within the framework. The *framework for activities* includes the regulatory conventions of the community such as the constitution, various economic laws and the legal order of competition. *Activities within the framework* are company investment policies, strategies for buying and selling, indeed the business activities of the individual participants in the market (Stegmann 1991b:24).

The Pastoral Statement, *The Common Good and the Social Doctrine of the Catholic Church* published by the Catholic Bishops’ Conference of England and Wales in 1996 takes up this theme and provides an introduction to the next section, Catholic social thought: “The good functioning of the market requires...a regulated and legal framework” (Stegmann 1991b:78).

## **5. Catholic social thought**

Catholic social thought emerges from a self-understanding of the Christian faith. It opposes the view that the Church should not involve herself in the shaping of economic and political life and consequently ought to abstain from interaction with the social world and with secular reality as such. Goulet observes that

[t]he church presents itself, no longer as a perfect society, but as the people of God inserted in history and engaged in reading the signs of the times. It seeks to interpret important events of contemporary life under the light of God's revelation and providential action in human affairs (1992:514).

He notes that church teaching as evidenced in encyclicals and pastoral letters has made a methodological shift: from a method that is “extrinsic, deductive, [and] unidisciplinary” to one that is “more intrinsic, inductive, and pluridisciplinary” (Goulet 1992:514). Consequently, there is a search for truth in the human sciences.

What then is the nature of the relationship between the Christian faith and the shaping of the secular world? The institutional church may not exercise a direct political, economic or any other secular role. This point is affirmed by the Second Vatican Council which in the document, *The Church in the Modern World*, affirmed the “rightful independence” and the “autonomy of earthly affairs” (Art.36,2,4). The message of Christ, as such, does not contain direct, concrete instructions for the solution of problems that are of a specific political or economic nature. These problems require either political or economic competence or both. As Stegmann notes,

It therefore follows that it is not up to the Church to intervene directly in the world of politics, commerce and industry, etc or to prescribe “model structures” of a political, economic or any other kind” (Stegmann 1991a:7).

However, the Christian message does contain general guidelines for the social ordering of the lives of human beings. The gospel has a social dimension and therefore is related in some sense to the political and economic ordering of society. The Christian message then involves a vision for the shaping of a humane social order.

The central point of CST is that the gospel understanding of the human person includes a very basic affirmation that each human being is created in the image of God and consequently endowed with an incomparable unique value. The encyclical *Pacem in Terris* states “that every human being is a person, that is, his (or her) nature is endowed with intelligence and free will” (John XXIII 1963:9).

Secondly, Catholic social thought, insists that the human person is a social being. “By his innermost nature man is a social being” (Vatican II 1998:12,5). Community is an expression of the basic unity of humankind. Solidarity implies that the very nature of the human person means that he/she depends on and is responsible for fellow human beings, to the community. On the other hand, community itself is based on the social nature of the human person. John Paul II’s encyclical *Sollicitudo Rei Socialis* (SR5) is a deep reflection on solidarity. Solidarity or interdependence is defined as “a system determining relationships in the contemporary world” (SR5:38). He states further that solidarity “helps us to see the ‘other’ - whether a person, people, nations - not just as some kind of instrument ... but as our ‘neighbour’, a ‘helper’, to be made a sharer, on a par with ourselves, in the banquet of life to which we are all equally invited by God” (SR5:39). Therefore it follows that each human being should behave in such a way as to take responsibility for his/her fellow human beings and indeed, for the community. True solidarity will ensure then that the emerging global order will serve, not just a section of the world’s population, but rather the well-being of all peoples. This brings us to a central point of CST, the theme of the common good. A perennial theme of CST has been that the state has to take responsibility for the common good. John XXIII had stated that the “attainment of the common good is the sole reason for the existence of civil authorities” (John XXIII 1963: 54). When addressing the existence of a global common good he saw a *lacunae*. What institution was to be responsible for the global common good on the same level of accountability as the national common good? (John XXIII 1963:137). It is obvious in this age of globalisation that institutions and policies need to be created for a different emerging world order so that the global common good can be promoted.

Thirdly, the further principle of subsidiarity, taken together with solidarity are the “laws for building a society” (John Paul II 1991: 42,2;19,1-2). *Quadragesimo Anno* provides a definition of subsidiarity. The higher (or larger) body must not take to itself “functions which can be performed [effectively] and provided for by [individuals or] smaller and lower bodies.” The higher (or larger) body may only intervene in order to motivate or enhance the abilities of the individual or smaller body but “never to destroy or absorb them” (Pius XI 1931:79). The community has the particular task to create the conditions which will enable the individual to develop and enhance his/her own abilities and so safeguard freedom and

liberty. Subsidiarity is in essence a decentralisation, a transfer of decisions to the lower level, the grassroots level. In this sense it is a consequent democratic form of decision-making which respects and enhances the dignity of the human person.

The US Conference of Catholic Bishops claims that a consistent theme in CST is that “human dignity can be realised and protected only in community” (1985:14). Kenneth Himes contends that “[b]uilding bonds between individuals and groups helps to foster conditions within which human beings can flourish, precisely because we are social beings” (2008:276). David Hollenbach argues that a needed corrective to what he calls the contemporary resurgence of economic liberalism, is the restoration of a communitarianism that puts “the connections among people back at the centre of social and moral inquiry” (2002:44). He notes further that globalisation is creating new forms of interdependence and interaction which should stimulate more reflection on the nature and quality of human relationships and the kind of community involvement that can foster integral development (Hollenbach 2002:56).

Fourthly, CST maintains that a correct view of the nature of the human person is essential if we are to develop political, economic, and socio-cultural institutions that promote the authentic integral development of humanity. Paul VI in *Populorum Progressio* addressed the subject of integral development. “Development cannot be limited to mere economic growth. In order to be authentic, it must be complete: integral, that is, it has to promote the good of every person and of the whole person” (Paul VI:14). Development is multi-faceted, hence economic growth is part of a wider whole and needs to be integrated into the wider setting of development.

Paul VI described characteristics of a multifaceted approach to development based on a complete and integral humanism: satisfaction of material needs, reformed social structures that eliminate oppression, opportunities for learning and appreciating a culture, co-operating for the common good, working for peace, acknowledgement of moral values and their transcendent source, the gift of faith, and the deepening of unity in love (Himes 2008:275).

For CST the economy is but a part of a comprehensive social transaction where economic actions have important societal implications. These are determined by ethical and human values, overall by the dignity of the human person. John Paul II notes in *Centesimus Annus* (1991) that “[t]here are collective and qualitative needs which cannot be satisfied by market mechanism. There are important human needs which escape its logic” (Centesimus Annus 1991:40). As Stegmann notes, “The quality of an economy is therefore to be measured by the extent to which it contributes to the creation of humane conditions of life for all” (1991b:26).

In conclusion, integral development highlights the need to pay attention not only to economic growth but factors such as

...just distribution, ecological sustainability, and the impact of economic policies on community, culture and spiritual well-being. Also very useful are CST’s affirmation of a holistic conception of human rights (including social and economic rights), its emphasis on the “universal destination of goods” (which highlights the need for an equitable distribution of the world’s resources and places limits on the right to private property), and its stress on the importance of subsidiarity and participation. All these principles culminate in an affirmation of what John Paul II termed “economic democracy” (Sniegocki 2008:338).

In the next section we will look at the resources: ethical, social and political that CST can provide in order to steer globalisation in the proper direction.

## **6. Conclusion: The way forward**

The issues facing the economy have grown more complex over the past centuries linked as they are to the contemporary rise of globalisation. Globalisation has been defined as a “complex, rapidly evolving phenomenon” (Coleman & Ryan 2005:14) that is neither good nor bad in itself. The key issue according to John Coleman is to seek to “humanise globalisation and make it serve our habitat and humanity” (2005:14).

Theologically, too, the phenomenon of globalisation is ambivalent: “globalisation offers a new hope for human solidarity and

interconnectedness, which co-exist against the emergence of age-old constants like greed, selfishness and sinfulness” (Groody 2007:21). Yes, there have been benefits, but economic globalisation has to this point taken the form of global capitalism bereft as it is of sufficient restraints and “frameworks” (especially global). I believe that CST can provide both elements in common with and elements distinct from, social economics that may provide an ethical response to the market in an era of globalisation. These elements are: a creative retrieval of the common good expanded into a global common good; a new appreciation of integral humanism involving the authentic development of humankind; a renewed emphasis on the social nature of humanity, that is, human solidarity linked to justice and finally subsidiarity that will ensure greater democracy and individual and group participation in the economic, social and political processes.

CST with its strong communitarianism and a central focus on the common good with the state as the institution responsible for its protection and promotion, has expanded in its scope to embrace a global common good. John XXIII in *Pacem in Terris* declares,

Today the universal common good presents us with problems which are world-wide in their dimensions; problems, therefore, which cannot be solved except by a public authority with power, organization, and means co-extensive with these problems, and with a world-wide sphere of activity. Consequently the order itself demands the establishment of some such general form of public authority(1963: 137).

The challenge of identifying a universal common good or set of goods is daunting because of the pluralism revealed by globalisation. However, an inductive, dialogical approach may lead to some consensus on the basic good required, on the one hand, and the negatives to be prevented or resisted on the other hand. “Pursuing such a model of inquiry will allow CST to be enriched by the insights of scholars who do not share the broader theological framework of the tradition but who are committed to developing a humane world that promotes an authentic development of persons” (Himes 2008:384).

An integral humanism so evident in *Populorum Progressio* exposes the dangers posed by an economic reductionism. The principle of human

dignity is the touchstone of CST. This dignity is God-given, equal in respect of each individual, unrelated to market value, enhanced by responsible political and social action and expressed in cultural patterns which give meaning to each person's values and beliefs. The authentic, integral development of each and every person will be CST's contribution to counter any truncated, partial or distorted view of the human person.

A fundamental claim that CST makes about the nature of the human person is that we are social beings. "Human dignity can be realised and protected only in community" (US Conference of Catholic Bishops 1985:14). The essential realism of Christian experience however, makes us only too aware of the dark side of community experience: racism, sexism, nationalism, religious intolerance, xenophobia (Himes 2008:276). Globalisation, indeed, creates ties of interdependence but "[t]he danger is that the empirical reality of interdependence will not be accompanied by the moral reality of solidarity" (Himes 2008:276). Indeed it is all too evident that the relationships forged by globalisation reflect inequality and marginalisation. Hence CST can help us to establish normative standards of solidarity to which future developments in globalisation can be held accountable (Hollenbach 2002:220).

Catholic social teaching first emerged as a response to the abuses of liberalism during the early stages of the industrial revolution. Today some adherents of this tradition see a parallel situation in the age of globalisation. Inequality and other social, cultural and environmental ills are written off as unfortunate but necessary byproduct of the freedom (free trade, free contracts and freedom of capital) required to reap the benefits of globalisation (Hug 2005: 249).

CST's understanding of justice has evolved in a substantive manner by its adoption of the language of human rights...The human rights theory of CST embraces both those rights commonly called civil and political as well as those labeled socio-economic. These rights are understood as deeply rooted within the teaching of CST about human dignity (Himes 2008:278).

In a distinct contribution appropriate for current globalisation, Paul VI, in *Octogesimo Adveniens* 1971, gave increased prominence to a theory of participation which is closely linked to subsidiarity. He identified

participation along with equality as “fundamental aspirations” that are “two forms of human dignity and freedom” (1971:22). Human beings have a right to share responsibility for decisions that will shape both their individual and collective futures. Joseph Nye maintains that present global institutions suffer from a “democratic deficit” (Nye 2001:2-5). In summary, “the democratic deficit” of globalisation means that large numbers of the world’s population lack a meaningful participative role in decisions that affect their wellbeing. This, a grave injustice to the dignity of the human person, is a further demonstration of the relevance of CST to the new world situation.

In conclusion, then, John Paul II proposed this solution to the present state of globalisation and the economy:

There can be little doubt of the need for guidelines that will place globalisation firmly at the service of authentic human development - the development of every person and the whole person - in full respect of the rights and dignity of all. It becomes clear, therefore, that globalisation in itself is not the problem. Rather, difficulties arise from the lack of effective mechanisms for giving it proper direction. Globalisation needs to be inserted into the larger context of a political and economic programme that seeks the authentic progress for all (2003).

It has become clear that the world faces new economic, social and developmental problems in our globalized world. The insights from CST are indeed valuable as I have attempted to demonstrate. However, a still fuller development of this tradition is necessary to address the new problems and their many challenges.

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## Notes:

<sup>1</sup> See Smith, Adam, 1776, *Der Wohlstand der Nationen. Eine Untersuchung seiner Natur und seiner Ursachen*. (Ed.) Horst Claus Recktenwald (1990): Munich, n.17 quoted in Stegmann, "Classical Economic Liberalism (Capitalism) and Approaches to Critical Judgement", endnote 12.

Adam Smith taught that the driving force in the economy is self-interest. Each one "following his own interest, frequently promotes that of society more effectively than when he intend to promote it."

<sup>2</sup> "Among the common features of structural adjustment policies are strong emphasis on production for export (rather than production to directly meet local needs), decreased government spending( which has often led to decreased investment in areas such as health and education), privitization of government enterprises (which has often led to higher prices and reduced access for poorer consumers), reduced regulations on the activities of multinational corporations, the elimination of policies protecting small farmers, currency devaluation, increased interest rates, and related measures." (Sniegocki 2008: 323)

"Common features of free trade agreements include the reduction and/or elimination of tariffs and other barriers to trade, deregulation of investment and other capital flows, and increased protection of intellectual property rights such as corporate patents." ( :325)

<sup>3</sup> Stiglitz, while generally supporting privitization and free trade, argues that many pre-conditions need to be met before these measures can have positive results. Should these conditions not be met, the results can be disastrous.

<sup>4</sup> Stiglitz while generally supporting privitization and free trade, argues that many preconditions need to be met before these measures can have positive results. Should these conditions not be met, the results can be disastrous.

# **Malthusian Misery or the Promised Land? : Reflections on Mobility, Violence and Africa's Urban Future\***

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LOREN LANDAU AND JEAN PIERRE MISAGO

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Human mobility is transforming Africa's urban centres. Few doubt a relationship among migration, development, and poverty, but the causal relationships remain ill-defined and contested.<sup>1</sup> In finding ways of understanding - and assisting - this chapter enriches the discussion by highlighting four areas that deserve additional, critical attention: social services and accommodation; economic investment; human security and violence; and the creation of common and accountable institutions.

The chapter begins by arguing that existing policy responses - shaped by fear and the absence of adequate information and institutional capacity - are heightening health and security risks, infrastructure degeneration, corruption, and poverty. It concludes that combating urban poverty demands policy frameworks that consider increasingly mobile urban residents who do not yet and may never see the cities as their homes. This means developing institutional and economic incentives that build common rules of engagement if not a sense of a shared future among all city residents. However well intentioned, we must recognize the limits of planned interventions and the importance of sub-municipal and trans-local actors, incentives, and institutions in Africa's urban centres.

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## Evaluating migration and poverty

Understanding migration and poverty in Africa (and elsewhere) is as much a conceptual as empirical exercise. It is impossible to fully explain this proposition here, but a few comments are in order. Firstly, due to the poor quality of research in and on Africa, there is a severe paucity of sound data.<sup>2</sup> That most urbanisation is a result of domestic or “irregular” international migration (i.e. undocumented and uncounted) means it is effectively invisible to government statisticians’ offices and planners. Secondly, there is little clarity on the meanings of migration, urbanisation, poverty, and development. Migration can include everything from moves within a community, to shifts from peri-urban townships to wealthy suburbs, or relocations half-way across the world. With all of this confusion, where do we measure the effects of complex multistage journeys on poverty - in the sending community, along the way, or at the final destination? Until there are consistent means of coding and tracking the diversity of migration types - including both international and domestic movements - it will be impossible to determine the effects of migration on poverty.<sup>3</sup> Thirdly, classifying urbanisation raises the seemingly farcical question of “What is a city?” That as much as 40% of urban growth is due to a combination of rural-urban migration and the *reclassification* of rural locations into urban sites, highlights the importance of defining boundaries and remaining consistent.<sup>4</sup>

Given this chapter’s broad focus, we speak of urbanisation ecumenically as movements from environments characterised by lower population densities and the potential for natural resource-based industries to contexts of higher population densities with economies based on industrial production, petty trade, or service provision. Recognizing that these processes are not necessarily geographically bounded means that the analysis also places “the urban” within vast circuits of trans-local material and symbolic exchange. For present purposes, migrants are people who perceive themselves as outsiders due to their mobility or who are considered as such by host populations, governments, or development organisations. This includes domestic and international migrants as well as those who move frequently within urban settings.

Measuring poverty is an equally critical and no less challenging endeavour. Given the diversity of African cities, there can be no absolute or

quantifiable definition. Recognizing the difficulty of defining quantifiable measures of poverty, we work from a position that fighting poverty means resisting social fragmentation and marginalization, enhancing health and security, promoting accountable public institutions and, most importantly, forging a willingness to co-exist under a shared set of rules of engagement. In this model, informed by Sen<sup>5</sup>, Putnam<sup>6</sup>, Evans<sup>7</sup>, and DFID<sup>8</sup>, investment in a common future not only facilitates trade, but also facilitates effective planning and promotes political accountability. In today's cities, planning is less about developing future scenarios and concrete means of implementing them than about "trying to hold together long enough to develop a collective imagination" or means of engagement.<sup>9</sup> This means that poverty reduction demands formal and informal mechanisms that facilitate interactions among and service provision to all city residents.<sup>10</sup> Working from these definitions, we begin by exploring what we know about the relationship between migration and poverty. In places this veers towards speculation as what we know is vastly overshadowed by what we do not.

### **Is the answer out there? What (little) we know about migration and poverty in African cities**

Despite data and conceptualization problems, it is nevertheless possible to offer a broad outline of migration and urbanisation in Africa. One of the things we know for sure is that Africans are an increasingly mobile and urbanizing population. Africans outside the continent have attracted considerable attention from politicians and the media, as have the remittances they send home.<sup>11</sup> However, the most significant movements take place within the continent. Indeed, the greatest numbers of people remain within their countries of citizenship while increasing numbers shift from rural to urban areas or from city to city.<sup>12</sup> Together with the HIV/AIDS pandemic, urbanisation is now among the most important dynamics shaping Africa's socioeconomic and political realities.<sup>13</sup> Africa has yet to claim a spot among the world's twenty largest cities, but estimates of accelerating urban growth mean that cities will become far more important to the African political economy in coming years.<sup>14</sup>

Understanding the nature of African migration and urbanisation is perhaps more important than pinning down the number of people on the move. Critically, migration is increasingly becoming a state of existence for

many, with people constantly moving or preparing to do so. As with cities elsewhere, African urban centres are fast becoming spaces of flows, with people maintaining an ever-expanding array of localized and translocal commitments and loyalties.<sup>15</sup> Although the newly urbanized Latin Americans described by Perlman<sup>16</sup> see their countries' primary cities as ultimate destinations, many Africans continue to see cities as sites of temporary residence or as transit points en route to elsewhere in Africa, Europe, and North America.<sup>17</sup> Even within cities, people move frequently to find better housing, to be closer to work, or to fulfil (or escape) social obligations.<sup>18</sup> In predicting future movements, we must also remember that while most movements into African cities are motivated by economic reasons, disproportionately high numbers of Africans move due to conflict and persecution. In some instances, these are movements from cities to cities, although increasingly people are leaving refugee camps where they have been "warehoused" for years in search of economic opportunity and dignity in cities.<sup>19</sup> This further contributes to cities' demographic and political heterogeneity and variations in socioeconomic status, and creates an expanding diversity of expectations and aspirations among urban residents.

Accelerating urbanisation means that ever larger numbers of people are moving into cities that were not built for a substantial indigenous population. Rather than sites of residence, most African cities were conceived and constructed to serve as nodes of extraction and homes to a small, colonial elite. Indeed, until recently, few African cities boast a significant "native" population or distinct urban culture. Even people who have grown up in cities often consider themselves as "from" somewhere and retain primary loyalties to their village or ancestral home.<sup>20</sup> The functions of African cities have become more domesticated in the postcolonial era, but few have the institutional capacity or physical infrastructure needed for their current residents. In many instances city leaders do not even know the number or nature of those residents. It is, therefore, often inappropriate to speak about social integration of migrants and immigrants. Rather, these are cities of strangers and social cohesion means finding commonality among both newcomers and long-term residents.

If existing data and localized accounts afford a broad characterization of migration and urbanisation in Africa, they tell us little about the

relationship between human mobility and poverty.<sup>21</sup> Unsurprisingly, this has not prevented scholars, politicians, and the press from asserting strong relationships between the two. Adebayo, for example, argues that the “high concentration of migrants moving away from poor conditions in rural areas and townships has put unprecedented pressure on the cities’ resources and infrastructure, straining them almost to breaking point.”<sup>22</sup> In line with current fascination with climate change, the United Nations Centres for Human Settlements (Habitat)<sup>23</sup> warns that urbanisation may also have serious, largely negative, environmental implications. These and other negative assessments also appear regularly in political discourse, a result of government officials who capitalize on anti-migrant sentiment or fear they are being swamped by peasants and refugees.<sup>24</sup> Indeed, Malthusian projections about population growth and economic/environmental disaster are almost ubiquitous in the literature on migration and urbanisation in developing countries.<sup>25</sup>

Although there are reasons for caution about migration’s negative developmental effects, a panel of experts assembled in the mid-1990s by the National Academy of Sciences found that there are generally beneficial effects of urbanisation in the process of development.<sup>26</sup> White<sup>27</sup> is even more measured (if inconclusive) in arguing that, “urbanisation in contemporary countries is mostly neutral, bringing with it some benefits and some costs.” Similarly, Usher<sup>28</sup> finds that “migration can be either the cause or the effect of poverty. Likewise, poverty might be reduced or amplified by migration. The inter-linkages are as complex as the individual migrants’ situations.” While migration may not inherently reproduce or reduce poverty, public responses to migration and urbanisation - including the absence of a conscious coordinated response - have tended to exacerbate mobility’s negative effects.

The remainder of this paper acts as a prologue to such an effort, highlighting four areas of intersection where migration can affect poverty. In doing so, it draws particular attention to the social and political consequences of migration that are often ignored or downplayed in more economic analyses. Given the paucity of data, these should not be viewed as conclusions, but rather as a challenge and provocation for further deliberations and research.

## **Governance, migration and urban poverty**

### *Investment, employment, and economic development*

Much of the academic and policy literature on migration and poverty centres on the short-term impact of mobility on labour costs, skills, and job creation. Reflecting the sentiments of anti-immigration advocates in Europe, Australia, and North America, African leaders regularly offer a zero-sum assessment of this relationship: every job filled by an immigrant is one less job for a citizen. (Conversely, every skilled employee who leaves the country is one less doctor, teacher, or engineer; as if everyone can find suitable jobs if they stay put.)<sup>29</sup> In the words of South Africa's former minister of home affairs, "free movement spells disaster for our country."<sup>30</sup> Many city leaders also paint urbanisation of their own citizens in the same terms, decrying the floods of peasants and the damage they do to antipoverty initiatives.

Urbanisation may lead to heightened competition, but it can also lead to job creation. Viewed globally, for example, studies of "immigrant-native job competition have generally found only modest substitution effects, except in certain highly focused settings."<sup>31</sup> Hunter and Skinner<sup>32</sup> argue that new businesses emerge in settlement areas with people drawing on transnational links to bring in new products and capital. Research in inner-city Johannesburg also found international migrants were more likely to hire South Africans than South Africans themselves despite widespread xenophobia and other socio-legal obstacles that prevent foreigners from accessing credit, banking services, or formal employment.<sup>33</sup> As with many aspects of migration, the overall impacts are likely to vary depending on the social, economic, and political context; the host populations' skills and resources; and the availability of transport, communication, and financial institutions.

Although central in current political debates, job creation/substitution is only one of migration's economic effects. Research suggests that in Latin America and elsewhere, remittances have now surpassed foreign investment as a source of hard currency and may soon rival exports as a source of national revenue.<sup>34</sup> Movements of highly skilled Africans and others have certainly provided key human resources for European countries, but remittances do not necessarily solve the problems of migrants or their families.<sup>35</sup> In some instances, remitted funds simply allow

for survival, not long-term poverty reduction. Moreover, it is often relatively prosperous families that can afford to send migrants to cities. There is an even more pronounced selection bias for those leaving their countries of citizenship or moving into cities outside the African continent. Remittances, therefore, risk heightening economic polarisation by channelling resources to the relatively wealthy. This may create jobs, but is unlikely to provide the schools, water and sanitation systems, other social services, or improved infrastructure needed to combat generalized poverty.

When viewed from within the cities that are most likely to send international migrants, there are also considerable social and economic costs: lost productivity and skills and absent parents and other leadership figures. Such people may be underemployed in their countries of origin, but they nevertheless represent a key resource in fighting poverty: more doctors does not automatically translate into better health care, but the absence of more than 30% of doctors from Guinea-Bissau, Zimbabwe, and Uganda and upwards of 50% from Ghana undermines the possibility of an effective health service.<sup>36</sup> There may be replacement of others from elsewhere in the continent or rural areas, but as long as there are regional scarcities, such movements will only transfer poverty elsewhere.

Of course, African cities are not only sites of departure, but also serve as destinations for international and domestic migrants seeking protection and prosperity. Here, too, the issue of remittances appears as both a resource and a liability in addressing poverty. Resource transfers from newly urbanized populations may help combat poverty in rural areas by keeping children in school, promoting small-scale investment, or enabling people to access social services. Viewed from within the city, the magnitude of these remittances, and the social value attached to them, are obstacles to poverty alleviation. Because material transfers are often tied to emotional investments and translocal investment strategies, they are a further indication that many migrants do not see themselves as a permanent part of the cities in which they live. At the very least, such transfers mean they have limited resources for investing in their communities of primary residence. Rather, they strive for usufruct rights that allow them to use the city without the responsibility of ownership and belonging. As discussed in later sections, the lack of financial and psychological investment in sites of residence have potentially significant political consequences that affect urban planning for poverty reduction.

## *Health, education, and accommodation*

An urban population's skills, education, and physical health are critical capital for improving individual and collective welfare. Not only are healthier and better skilled people more economically productive and more likely to generate tax revenues, they are better able to innovate and dedicate energies to social reproduction. Moreover, a better educated and healthier population is less likely to need social assistance or seek costly emergency services, allowing both public and private resources to be dedicated elsewhere. Accommodation is both a productive resource in its own right and critical to promoting health, education, and human security. However, while migration is often posited to spread infectious diseases and heighten pressure on schools and accommodation, we understand little about the intersections of migration and access to basic social services. For present purposes, we wish to (superficially) raise three concerns affecting migrants' ability to access needed services and accommodation: economic and linguistic exclusion, socio-legal discrimination, and institutions designed for stable populations.

Migrants, especially "irregular" international migrants, are physically within cities but often remain socially, economically, or legally excluded from access to education and public health services such as medical care, water, and sanitation. Some of the obstacles are linked to the relatively poor or underserved areas in which they live. However, there are other factors tied specifically to their outsider status: the inability to pay service fees - often higher for those without citizenship or documentation - and language are but the most obvious. In terms of education, international migrants may also be considerably older than the mean age for their skill level, a justification for many teachers to limit access. The inability or unwillingness of officials to distinguish among different classes of migrants also means that even legally recognized and documented migrants and refugees are denied services or charged inappropriate fees. Although poor citizens face significant obstacles in accessing education and health services, "locals" are often able to call on social networks to sponsor children or pay for emergency care. Moreover, long-term citizen residents are unlikely to face the widespread xenophobia that prevents international migrants and others from unfamiliar groups from accessing social services.

The fact that most bureaucratic systems are designed for a stable citizenry also prevents migrants and their families from receiving appropriate health and education services. To be effective, education and (especially) health services need to retain accurate records on those whom they serve, and both schooling and treatment are often far less effective when regularly disrupted. Apart from the ethical concerns of making medical or education records widely available, few African countries have the telecommunications infrastructure to allow people to access services at multiple sites. In terms of health, this makes it difficult to provide regular treatment and monitoring or to ensure that emergency treatment does not include harmful medicines. Many people may, moreover, simply be refused access to schools or clinics if facility staff cannot call up records of those seeking service.

In addition to concerns over health and education, there are at least three issues worth flagging regarding access to accommodation. The first relates to the widespread claim that migrants increase the demand for housing.<sup>37</sup> Although this may reflect a generalized pattern, it assumes everyone is seeking the same sort of accommodation. What may be more significant is that migrants often generate a fragmented housing market as they attempt to access fundamentally different forms of accommodation than more stable populations or use existing housing stock in different ways. As long as housing plans remain oriented towards single family, permanent residents, they may effectively exclude people whose housing requirements are more flexible and more affordable. Indeed, they may only foster severe overcrowding and insecurity in flats that are sublet to multiple families or individuals. Again, this is not a problem linked to migration per se, but is due to a housing market and housing schemes that misunderstand how people use and access accommodation. In some areas there is an effort to provide single residency occupancy facilities, but these are rare in African cities.

There are also potentially significant long-term consequences of excluding migrants from education, health services, and accommodation. Most obviously, migrants' inability to access health care raises the spectre of public health crises. Although medical staff may discriminate between citizens and non-nationals, infectious agents are less discerning. As long as people continue to share urban space - often living in close proximity - those unable to access treatment become a danger to all those around them.

Although the effects of education are often less immediately visible, it too is critical in fighting poverty.<sup>38</sup> Amidst the transformations of Africa's urban centres, education serves a dual role. The first is to provide children and youth with the technical and analytical training they need to compete in and contribute to a specialized, skills-based economy. Obstacles to any group acquiring those skills will, consequently, project existing inequalities into future generations and limit the country's ability to adapt to new economic opportunities. Education also serves a second, but no less critical role: forging communities from strangers. Through the sustained interactions within the classroom, diverse groups learn common sets of rules, how to exercise civil rights, and mutual respect. Exclusion from education can create a subset of the population without the knowledge or skills to interact productively within the city. As discussed later, forging a sense of mutual recognition is not only an end in itself, but is critical for creating public space and accountable public institutions.

The inability to access housing also has significant consequences for fighting poverty. First, a well-housed population is likely to be a healthier and more productive population. This is especially true in environments where residences are not only sites of social reproduction, but are key resources in economic production: petty industry, restaurants, shops, and offices. For students, adequate space also allows opportunities for studying; a rare luxury for those in overcrowded and poorly lit rooms. A well-housed population is also better able to protect their bodies and belongings from the predations of criminals and corrupt police. As the following section suggests, insecurity is one of the key obstacles to fighting poverty in African cities.

### *Human security*

There are long standing concerns about the ability of societies to adapt to rapid urbanisation and the possibility that mobility will generate political instability and urban violence.<sup>39</sup> In Johannesburg, Dar es Salaam, Maputo, and Accra, the police have made unsubstantiated public statements linking foreigners to crime. In Durban, the police targeted West Africans for drug dealing and then, based on their arrest statistics, spuriously announced that West Africans were almost solely responsible for drugs reaching the city. For present purposes, urban violence refers to collective and extensive destruction of lives and/or property in an urban context.<sup>40</sup> In Kenya,

political leaders are now working to position co-ethnics in certain neighbourhoods in preparation for what many see as further political violence.

As with the generalisation discussed above, there is little evidence of a direct causal relationship between migration and urban violence. That said, there can be little doubt that urban growth can contribute to violence when in interaction with other factors such as economic crises and weak states<sup>41</sup>. Rather than blaming mobility, it makes more sense to address these factors. Using the case of the xenophobic violence in South Africa during which over 60 people were killed and 150 000 displaced in just over two weeks (May-June 2008), this section shows that urban violence is not as much a result of migration as it is of 'micro' politics of urban life. It identifies and briefly discusses a number of specific factors that are directly linked to urban collective violence.<sup>42</sup> These include: economic and political opportunism; absence of or weak socio-legal controls; and spatialised understandings of rights and belonging. While recognising that social and economic exclusion might lead migrants to be exposed to and attracted by illegal activities such as drug dealing, prostitution and crime, we work from the position that in many urban centres of the developing world, migrants or at least 'newcomers' are more victims of crime and collective violence than they are the progenitors.

Many commentators and analysts have presumed that the May 2008 violence against foreign nationals and other outsiders - one third of those killed were citizens belonging to minority groups - was triggered by a sharp increase of migrants into already poor and insecure neighbourhoods. However, research suggests that instead violence was organised and led by local political players (formal and informal) as an attempt to claim or consolidate the authority and power needed to further their political and economic interests.<sup>43</sup>

Confirming existing theoretical assertions that collective violence is more likely in regimes and societies that lack adequate social controls and stabilizing mechanisms,<sup>44</sup> it appears as though three elements combined to trigger the violence: political and leadership vacuums, lack of conflict resolution mechanism and culture of impunity. Areas and communities affected by the violence were characterised by the absence of a strong and competent institutionalized authority, which allowed the emergence of

undemocratic violent leadership structures. For these structures, the removal of unwanted foreigners was a useful tool to claim their leadership legitimacy and supremacy that grant them access to associated economic and political benefits.<sup>45</sup>

Not surprisingly, the absence of competent institutionalized leadership is accompanied or manifested by the lack of effective conflict resolution mechanisms capable of solving community concerns and diffusing tensions. Without denying that South Africa's townships have a documented history of violence used as a means to solve problems, it appears that communities resort to violence, vigilantism and mob justice only when relevant institutions and existing conflict resolution mechanisms have failed to adequately address issues of concern. Police and local authorities were aware that the attacks were being organised and did nothing to prevent the violence or stop it when it occurred. The perceived inability or unwillingness of local authorities to address community concerns around the presence of foreigners in their communities led residents to resort to mass violence (attacks on foreigners) in the same manner they do when dealing with crime if the criminal justice system does not or is perceived not to take appropriate action. A long standing culture of impunity only enables these structures and incentives to develop. As long as the benefits of engaging in violent expulsion of foreign nationals are perceived to outweigh the costs in terms prosecution and reparation, it is only fair to assume that such violence is unlikely to stop.

The May 2008 violence also targeted South Africans; 21 citizens lost their lives. They were attacked not necessarily because they were mistaken for foreigners but because they were perceived not to belong and ascribed an 'outsider' status. The violence was not only about ridding the country of people from beyond the country's border. It was about sections of the South African citizenry defining who has rights to the cities and the potential wealth and power they contain. Local leaders (official and/or self-appointed) and citizens mobilised discourses of nationality, political affiliation, ethnicity and territorial belonging to claim exclusive control over sub-national space. The attacks reveal a violent 'nativist revivalism',<sup>46</sup> resulting from a growing localised, territorialized, nationalistic and ethnic understanding of rights and entitlements. If not monitored closely, local tensions and competition can easily escalate into violence whose target

will not only be foreign nationals, but anyone who can be labelled an outsider. In a world where violence against unpopular groups makes political and economic sense, everyone is at risk.

### *Community and political accountability*

To ensure that cities are places of security and prosperity for all who live there, residents must interact in ways that help to define a common destiny and help build the capacity - whether within government or non-governmental/social organisations - to achieve common goals.<sup>47</sup> Given African cities' ethnic, class, religious, and political heterogeneity, the possibility of sustained fragmentation is greater than it is almost anywhere else in the world. The challenges are ever more acute as people become increasingly mobile. In many instances, residents do not stay put long enough to develop, articulate, and respond to some form of collective imagination and aspiration.<sup>48</sup> Such mobility, coupled with fear of heightening heterogeneity, is generating cities that are increasingly divided: cities of walls<sup>49</sup> or fragments<sup>50</sup>; archipelagos of enclaves<sup>51</sup>, and "territories of urban relegation."<sup>52</sup> Amidst cities' competing and overlapping networks, fighting poverty means overcoming these divisions in ways that span these divisions.

Legally, socially, or economically marginalized migrant communities only create additional obstacles to achieving a common objective. This is already visible in migrants' widespread sense of permanent dislocation fostered by the violence, abuse, and discrimination they experience in new residential communities. Rather than striving to integrate, foreigners instead cling to their outsider status, make conscious efforts to avoid close personal relationships with those around them, and spend their time planning their move elsewhere.<sup>53</sup> Indeed, more than three-quarters of respondents in a 2003 survey by the Forced Migration Studies Programme at the University of the Witwatersrand felt it important for migrants to retain a distinct culture and identity during their stay in the country; only 40% of the non-South African respondents predicted being in South Africa in two years. These numbers may be elevated by Johannesburg's place in the circuits of global mobility, but reports from other cities suggest such self-marginalization is not unique.<sup>54</sup> Critically, journeys home or onwards often remain practically elusive for reasons of money, safety, or social

status. This leaves large numbers of non-nationals effectively marooned in the city, but not wishing to take root in it.

When viewed from the objective of building inclusive cities and accountable public institutions that respond to all city residents, migrants' sense of isolation and transience is deeply problematic. Firstly, it may limit their interest in investing in the cities in which they live. People preparing for onward journeys will not dedicate themselves to acquiring fixed assets and may maximize immediate profits at the expense of long-term planning. Those who do not feel welcome are also less likely to respect the rules and institutions dedicated to governing the cities they inhabit. This may become visible in efforts to dodge tax regulations, avoid census takers, or subvert regulatory agencies they feel are more likely to prey on them than to promote their interests. Those who feel excluded are also unlikely to join in participatory planning exercises or elections, even when they are legally entitled to do so. This prevents planners from seeing or hearing from these often subterranean communities. Without their voice, they have little choice but to learn of these populations through the media or rumour. Policies based on such accounts are unlikely to address city residents' priorities and needs; rather, they will respond to stereotypes and elite interests. Ignoring a significant minority in policy-making will, however, ensure that even these interests are poorly served. The continued failure of these policies to serve any interests will only harm public institutions' efficacy and legitimacy.

Anti-foreigner scapegoating has a second, more insidious, effect on realizing accountable and responsive public institutions. In the words of one immigrant in Johannesburg, 'It is like, "Thank you, foreigners, that you are here, now we can blame you for everything." South Africans . . . pretend that foreigners cause all their problems.'<sup>55</sup> Although such attitudes are not universal, they appear in cities across the continent in responses to Somalis in Nairobi, Congolese in Dar es Salaam, or Nigerians in Maputo and Accra. Removing foreigners from cities is not only ethically unacceptable, it is practically impossible. Even if successful, it would not solve acute social challenges. But the willingness to accept that foreigners are responsible for children not finding places in school, for continued insecurity and unemployment, or for declining quality of health services distracts people from the fundamental structural and institutional issues behind these pressing social concerns. Migrants do not cause most urban

problems, but their presence can offer a convenient scapegoat that prevents citizens from holding public institutions responsible for shortcomings and failings.

## **Conclusions and Recommendations for Policy Formulation**

Given the magnitude of mobility into and through Africa's cities, effective urban poverty reduction strategies must consider the real and potential effects of migration as both cause and consequence. Although migration often challenges institutions and planners accustomed to stable populations, migration's effects on poverty are not inherently negative or positive. As with any challenge, denying its significance helps ensure negative outcomes. To quote one of Johannesburg's councillors, "as much as we might not want them here, we cannot simply wish these people away. We must find ways to reach out to them."<sup>56</sup> By way of summary, we offer a number of generalized suggestions on the nature of deliberations towards these ends.

The only way of concretely identifying those factors that maximize the benefits of migration for poverty alleviation will come through further research. To develop evidence-based policies - policies more likely to be effective than their predecessors - there is a need for much more evidence.<sup>57</sup> As Robinson<sup>58</sup> notes, "appreciating a city's distinctness as a place, as well as its role in wider networks, are both crucial to imagining and planning for potential city futures." Yet we know very little about migration and urbanisation in Africa.<sup>59</sup> We must not only collect more information, but more holistic data that will surface the multiple intersections among mobility, poverty, and social marginalization. But to improve our evidence base on migration and poverty, there is a need for a careful conceptualization of migration and poverty and further research into each.

Clearly, we must no longer see human mobility as exceptional, but as an enduring dynamic of today's globalizing cities.<sup>60</sup> When speaking of migration, however, we must not assume it is primarily a North-South phenomenon or a series of one-off events. Policies need to be shaped by an understanding of migration's multiple facets including temporary, circular, and seasonal movements within and between developing countries, as well

as from South to North.<sup>61</sup> Whenever possible, these must be disaggregated and their effects on poverty carefully parsed. Even within specific spaces, it is important to reflect on the diversity of experiences and explain divergent outcomes. Measures of poverty must also be carefully considered in ways that move beyond individual-level attributes and strategies to include the presence of a shared purpose/trajectory, accountable institutions, and government capacity. These are all primary resources in countering poverty, and anything that fosters fragmentation or prevents the creation of common objectives and rules of engagement should be seen as an obstacle to poverty alleviation.

In line with the multilevel analysis called for above, there is a need to understand the reactions of host populations that result in discrimination, exclusion, or lack of opportunities. Accepting that migration does not happen in a vacuum, our analytical lens should include “host” populations and other categories of migrants. It should also include a critical focus on policy frameworks at the local, national, and regional level. Along with documenting laws and institutions, these should include detailed analyses of how policies are translated into practice and their effects on the behaviour of and relationships among employers, host populations, and migrants.<sup>62</sup> As indicated above, many of the policies designed to control or prevent migration do little to halt or even slow migration and urbanisation. Instead, they generate responses that do little to alleviate poverty.<sup>63</sup> Building common and accountable institutions also means considering the institutional frameworks that facilitate or prevent newcomers and noncitizens from participating in the planning process. Continuing to exclude any group may have, “devastating consequences for many people in the city, especially the poorest in terms of service provision, equality of access and redistribution.”<sup>64</sup>

In addition to the proactive suggestion above, there are a number of pitfalls that may hinder effectively responding to migration in ways that counter poverty. First, although we argue in favour of incorporating migrants into planning processes, we cannot assume that migrants and others seek a closer relationship among citizens, migrants, and state institutions. Social and legal exclusion can facilitate informal trade and other forms of social interactions while avoiding the obligations that come from denser social networks. For these and other reasons, people may actively resist even the most well-meaning efforts to include them in

planning exercises. Given their exposure to Africa's corrupt and predatory state institutions and agents, one can hardly fault them for being so evasive.

There is also a need to consider local governments' complex roles in responding to migration and reducing urban poverty. On one hand, efforts to maximize the benefits of migration will not be successful when local governments ignore the social dynamics occurring within their cities. However, effective advocacy and action vis-à-vis migration may mean challenging national immigration and migration policies if they promote poverty and marginalization. Elsewhere in the world, subnational administrations have begun issuing identity documents, translating legislation and policies into appropriate languages, and reaching out to communities that national governments deem illegal. But taking on this advocacy role represents a significant break from the centralized ethos and party structures that still dominate many African policies.

Although local and national governments can play an important role in shaping and implementing migration-oriented policies, we must also be cognizant of the severe limits they face in addressing migration and urban poverty. These limitations take at least three forms. Firstly, the growing informality of many African cities means that that much of what takes place within them already exists outside direct government influence or control. Moreover, there are often powerfully institutionalized interests that will resist the expansion of government activity into new areas. Secondly, as indicated above, national governments often make policies that shape urban economies, but without consulting them. The structural adjustment programs of the 1980s and 1990s, for example, dealt a severe blow to many rural economies and stimulated urbanisation on a large scale. Cuts to social service programs and government agencies made at the national level have also encouraged the out-migration of skilled labour from the cities while leaving many local governments without the human resources needed to learn about, manage, and assist the urban populations for which they are responsible.<sup>65</sup> Indeed, as the Global Commission for International Migration GCIM<sup>66</sup> notes, "There is a need for capacity-building in African states, enabling them to collect better migration data and to formulate and implement more effective migration policies." Since the effects of migration are most pronounced in urban areas, this is where assistance is most needed. Lastly, and most fundamentally, the continued

marginalization of most African countries in global trade and policy-making limits the ability of cities to accumulate the financial and human resources needed to tackle poverty.

Those interested in fighting urban poverty must reconsider models of urban planning and governance in ways that account for human mobility. This means rethinking what we mean by urban community to include people who do not - and will not - see their city of residence as their home. This means that local and national governments, together with donors, international organisations, and scholars, must find new ways of building a sense of a shared future among all urban residents. Promoting such emotional investments - to be followed by physical and financial inputs - in Africa's cities is an acute challenge, but essential if migration is to coincide with or promote poverty reduction.

#### Notes:

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<sup>2</sup> See Samers 2002; Crush, J., and V. Williams. 2001. "Making Up the Numbers: Measuring 'Illegal Immigration' to South Africa." *Migration Policy Brief No. 3*. Cape Town: Southern Africa Migration Project; H. 2005. "International Migration Trends Since 1980." Pp. 13-28 in *International Migration and the Millennium Development Goals: Selected Papers of the UNFPA Expert Group Meeting*. Marrakech, Morocco (11-12 May); Crisp, J. 1999. "Who Has Counted the Refugees?" UNHCR and the Politics of Numbers." *New Issues in Refugee Research, Working Paper No. 12* (June). Geneva: United Nations High Commissioner for Refugees.

<sup>3</sup> See Skeldon, R. 2005. "Globalization, Skilled Migration, and Poverty Alleviation: Brain Drains in Context." *Working Paper T15*. Brighton: Development Research Centre on Migration, Globalisation and Poverty.

<sup>4</sup> See White, M.J. 1996. "Urbanisation and Population Dynamics: City as Villain, Savior, or Bystander?" in *Preparing for the Urban Future: Global Pressures and Local Forces*, eds. Michael A. Cohen, Blair A. Ruble, Joseph S. Tulchin, and Allison M. Garland. Washington, DC: Woodrow Wilson International Center for Scholars; see also Brenner, N., and R. Keil. 2006. "Editors' Introduction: Global City Theory in Retrospect and Prospect." Pp 1-16 in *The Global Cities Reader*, eds. Niel Brenner and Roger Keil. London, New York: Routledge; Taylor, P.J. 2003. *World City Network: A Global Urban Analysis*. London and New York: Routledge; and Robinson, J. 2002. "City Futures: New Territories for Development Studies." Pp. 141-204 in *Development and Displacement*, ed. Jenny Robinson. Oxford: Open University in association with Oxford University Press.

<sup>5</sup> Sen, A. 1999. *Development as Freedom*. New York: Alfred A. Knopf; and Sen, A. 1981. *Poverty and Famines: An Essay on Entitlement and Deprivation*. Oxford: Clarendon Press.

- <sup>6</sup> Putnam, R.D. 2000. *Bowling Alone: The Collapse and Revival of American Community*. New York: Simon and Schuster; and Putnam, R.D. 1993. *Making Democracy Work*. Princeton, NJ: Princeton University Press.
- <sup>7</sup> Evans, P. 2002. "Political Strategies for More Livable Cities: Lessons from Six Cases of Development and Political Transition." In *Liveable Cities? Urban Struggles for Livelihood and Sustainability*, ed. P. Evans. Berkeley: University of California Press.
- <sup>8</sup> Department for Foreign International Development (DFID). 1999. "Sustainable Livelihoods Guidance Sheet." London: Department for International Development (April).
- <sup>9</sup> Healey, P. 2002:1788-89. "On Creating the 'City' as a Collective Resource." *Urban Studies* 39 (10): 1777-92.
- <sup>10</sup> Gauteng Provincial Government. 2005. *A Growth and Development Strategy (GDS) for the Gauteng Province*.  
<http://www.gpg.gov.za/docs/misc/gds>, accessed 4 August 2005; see also Adebayo, A. 2002. "Viewpoint." *Cities* 19 (5): 351-55; Borja, J. 1996. "Cities: New Roles and Forms of Governing." Pp. 242-63 in Michael, A. et al. 1996.
- <sup>11</sup> See World Bank. 2006. *Global Economic Prospects 2006. Economic Implications of Remittances and Migration*. Washington, DC: World Bank; MacGaffey, J., and R. Bazenguissa-Ganga. 2000. *Congo-Paris: Transnational Traders on the Margins of the Law*. Bloomington: Indiana University Press.
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# **Positive and Normative Aspects of Economics in Basic Education:**

## **An Investigation into the Economics and Management Sciences Curriculum in South Africa**

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In this paper, I wish to discuss the intersection between economic activity and ethics within the realm of basic education. There is a reason for this. Within the context of a free and democratic society, the basic numeracy and literacy of its citizens is paramount, if only for the purpose of keeping accountable the leaders who serve them. Within the last few years, however, we have seen decisions taking place in political economy that have affected people throughout the world, which have been beyond the capability of most people to understand. The lack of understanding in the role of economics in everyday life has led to decisions being made by governments and private parties that have destabilized the global economic system. They have touched people in terms of employment and other pursuits of meaningful living. One wonders if the average citizen were better informed about the financial realm and the decisions they make daily (financial education) whether it would have made a difference in the fateful choices made that have borne bitter fruit in the present.

In this sense, it may be time to reconsider the basic aspect of education, and to suggest that the enterprise not just deal with issues of linguistic and numerical literacy, but also economic literacy as well. Therefore it will be useful to consider a basic education curriculum, particularly as it deals with economic matters, and to evaluate it in the way it prepares a young person to consider and keep accountable her leaders in the future. Furthermore, the paper will also consider additions to, or modifications of the current curriculum that will strengthen the civic foundation that every educated person must have for useful participation in a healthy democracy.

## A framing of the “Conflict” between economics and ethics

An illustrative paper by Carrithers and Peterson provides a useful insight into contemporary struggles between normative and positivistic predispositions to the understanding of economics. The authors describe a situation in their university where they claim harm was being done to their students because of conflicting ideological and disciplinary engagements between matters of ethics and economics. Faculty members of the business and economics departments, consistent with contemporary views of the discipline, would present the content of their discipline with unstated pre-suppositions of the benefits of the market, leaving out considerations of issues of social justice and distributary inequity as matters to be dealt with elsewhere. Unfortunately, faculty members of other disciplines, especially schools of theology or the humanities broadly speaking, where matters of ethics were a critical concern, would make the matter of social justice of salient inquiry, with capitalism a target of critique as the source of much injustice. Students who were business or economic majors who also had a passion for social justice and the common good often found themselves in frustrating situations where the colleagues of both faculties would speak past each other on the matters of resources and distribution, offering the unfortunate students few contexts for a healthy integration and assessment of the issue. As a result, the authors concluded, their students were being done a disservice by this failure to address a disciplinary divide with a holistic approach (Carrithers and Peterson, 374).

This conflict is the final fruition of a critical split in epistemology with regard to economics and its related disciplines. Ironically, we are to be reminded that the field actually started as a branch of ethical enquiry: Aristotle, in particular, was suspicious of wealth acquisition as an end unto itself, emphasizing its need to be directed toward a positive purpose (Booth in Kohls and Christiansen, 374). Even the earliest articulators of modern capitalism were informed by a strongly religious framework, where “every dimension of human activity to serve the common good and the honour of God, was still very much in the back of their minds” (Roussouw, 559). Adam Smith (a professor in Moral Philosophy at the University of Glasgow), for example, wrote his famous *An Inquiry into the Nature and the Causes of Wealth of Nations* with the assumption that “economic activities were not something to be pursued for their own sake, but were part of a bigger picture: the common good of the whole society”

(Roussouw, 559; Kohls and Christiansen 225). It was not until the 19<sup>th</sup> century that a more positivistic shift took place within the field, where the study of wealth generation was considered apart from its normative aspects. An illustrative sense of this new direction was revealed by Francis Amasa Walker, the second president of MIT, who declared in 1888 that wealth and its creation was the objective of the discipline, and that its followers “take care not to allow any purely political, ethical or social considerations to influence his investigations” (Walker, 1888, p. 1, cited in Kohls and Christiansen, 225). Kohl and Christiansen stress that this runs counter to Smith’s emphases, and provided the justification especially for neoclassicist economists in particular to consider wealth creation apart from its social ramifications (Kohls and Christiansen, 225).

As this paper will show, Walker’s insistence on compartmentalising economic and business inquiry from ethical inquiries remains the norm in the education of the fields, right down to primary and secondary school level. The concern is that students who are taught in such compartmentalised ways, with no integration, are at risk of considering their financial and economic decisions with no sense of obligation or consideration of the common good or of the dignity of the person. It leaves the potential future citizens ill-equipped to reflect on policies, approaches and other decisions in the financial realm that affect daily life. More and more economists and people involved in business management are beginning to show that economic and business questions have a necessary ethical dimension; indeed, the recent global economic crisis has made the matter of utmost urgency going forward. It reveals the need to consider how we introduce persons to basic matters of economics and business, and the need for them to consider the ethical dimension at the earliest levels.

## **The economic and management sciences curriculum**

The National Curriculum Statement of the South African Department of Education is a useful context to illustrate this tension at work. At the General Education and Training level (grades R through 9), the overall curriculum is divided into several learning areas, of which one, Economic and Management Sciences (EMS), deals with basic understanding of economics and business practices. For the purposes of this paper, I will

pay close attention to the Senior Phase of this curriculum, which focuses on grades 7 through 9. I do so for two reasons: firstly, because the 1996 South Africa Schools Act has designated grade 9 as the last grade of compulsory education for South African children; secondly, for those students continuing their education beyond this point (grades 10-12, called the Further Education and Training level), economics and business education is no longer compulsory. Grade 9 is the last level where a student is guaranteed to be exposed to education in these fields. We can assume, therefore, that the basic education in economic matters for any citizen is at this level.

From the four learning objectives in the EMS curriculum which cover broadly an understanding of the economy, its role players, the economic cycle as well as financial and basic managerial skills, we wish to consider two which reflect this epistemological split between the normative and positivistic emphases of economics and business studies: the first which discusses the role players in the economic cycle, and the fourth which deals with the basics of entrepreneurialism.

### *The economic cycle*

#### *Learning outcome 1: The economic cycle*

The learner will be able to demonstrate knowledge and understanding of the economic cycle within the context of ‘the economic problem’ (Revised National Curriculum Statement-Economic and Management Sciences (RNCS-EMS), 36)

The assessment standards for this learning outcome all reflect conventional understanding of contemporary economic theory; unlimited needs and wants, limited resources, various types of economic (business) activity that create goods and services to meet needs and wants, consumers and producers, the role of government in the economy, the role of money in societies, different economic systems, factors of production, the place of trade unions.

Of particular notice is the discussion of the various parts of the economic cycle, and especially the classic factors of production, which are explained simply as labour, capital, natural resources and entrepreneurs. While these are straightforward definitions, there is little context for the discussion of

these factors. They are presented as parts of a system, each with a particular “remuneration”: wages, interest, rents and profit. The system is reduced to the mathematical dimension, and the formula of business is assumed: one’s profit is obtained after all the other factors have been paid off. Moreover, the various parties that need to be paid off have to be “controlled” by the entrepreneur (in fact, it is clearly stated as his role to do so). There is no discussion about how each of those factors gets prioritized, if at all, and given the social reality that capital is harder to access more often than not than labour, it gets the most attention (at least with natural resources, when you find them, one does not have to persuade them to play in the system). The fact that the abstract component of capital and the inanimate dimension of natural resources is made equivalent to the one component that actually drives the system, must be noted. The human dimension of economic activity is missing, and with it a necessary dimension that can reinterpret the relationship between the so-called “factors”.

As McCann notes, industrial production is still human, and because it relies upon human activity, it is naturally a cooperative activity. This has been largely obscured by “essentially unnecessary social conflicts” (McCann, 65). If we wish to restore a human understanding to our engagement of the production cycle, it is helpful to consider the phronesis of work and its purposes for human beings. John Paul II in his encyclical *Laborem exercens* provides some clarity in this regard, and can be the basis of a helpful critique of this educational approach, by his emphasis of the priority of labour over capital. This is not a partisan endorsement of socialism, as McCann carefully points out, but an observation of the necessary role that labour plays in creating capital.

Since the concept of capital includes not only the natural resources placed at man's disposal, but also the whole collection of means by which man appropriates natural resources and transforms them in accordance with his needs (and thus in a sense humanises them), it must immediately be noted that all these means are the result of the historical heritage of human labour.

This gigantic and powerful instrument--the whole collection of means of production that in a sense are considered synonymous with

"capital"--is the result of work and bears the signs of human labour  
(*Laborem exercens*, #12).

If we take this as a presupposition, then we must better illuminate for our learners the role that the various factors have. The first is to render them in human terms. Labour is not just an abstract piece of the economic puzzle, but it has a face. In this sense, the curriculum statement does make an effort to do this, and does so by explaining the concept of trade unions. But then, the role that unions play is defined in very narrow terms. There is no argument with the idea that unions “aim to protect the rights of workers”, “represent people at work”, “ensure that workers are treated fairly”, and “negotiate for better wages” (Dicks and Prozesky, 16). But when the role of trade unions is also stipulated to “draw attention to socio-economic issues such as poverty and unemployment”, it certainly appears to give them, and labour, by extension, the responsibility of dealing with these threats to human dignity, or at the very least of forcing other parties to deal with them. It is certainly unfair to assume that entrepreneurs, those holding capital and government don’t deal with these issues. But as Carrithers and Peterson point out, at university level, the study even of basic economics is often undertaken without the acknowledgement of ethical or moral frameworks; it is often assumed that the system of markets leads to social results if left to itself (Carrithers and Peterson, 376). This assumption filters down to the senior phase level of the curriculum.

An alternative approach is suggested by Gene Ahner in his idea of “stakeholder accountability” (Ahner, 10). Ahner is not the first to develop this, but presents a convincing argument that the framework of “stakeholder accountability” as opposed to “shareholder accountability” is more consistent with the idea of the common good, which can be the basis of social engagement for mutual benefit, as opposed to necessary competition. Stakeholder accountability posits the various “factors of production” as stakeholders in a business enterprise or a system, to which the entrepreneur is accountable. His objective is to marshal the interests of the parties in a way that meets the interests of the various stakeholders in a fair way. One can see that there are plenty of arguments for its greater sustainability, for if all the stakeholders are satisfied, and the enterprise operates more as a cooperative venture between the stakeholders, there will be less harmful confrontational outcomes, including debilitating strikes, longer-term investment of capital, and responsible stewardship of

natural resources. (It is simply to suggest in a new way the relationship of the cycle, but with the human dimension included in a way to reveal how the person affects and relates to people in real terms.)

## *Entrepreneurship*

### *Learning outcome 4: Entrepreneurial knowledge and skills*

The learner will be able to demonstrate entrepreneurial knowledge, skills and attitudes (RNCS-EMS, 44)

This outcome deals with entrepreneurship and the skills associated with it. The learning outcome for entrepreneurialism simply states that “the learner will be able to develop entrepreneurial knowledge, skills and attitudes.” In an encouraging turn, it emphasises the benefits to the common good that entrepreneurs perform, in their production of goods and services for society. They “are important to the development of a country” the curriculum states, “and can make an important contribution to sustainable economic growth”. Other benefits are cited, such as the contribution to the improvement of the standard of living as well as the possibilities of encouraging “communities to take pride in their uniqueness and environment, while making economic gains”. Finally, the learning outcome claims that the learner's entrepreneurial talent and potential will be unlocked and developed through learning about entrepreneurial activities and approaches.” (RNCS-EMS, 34).

While the outcome sets some hopeful expectations, it is at the level of assessment standards that we see what will really take place in the learner. Across all the levels of the Senior Phase (grades 7 through 9) the emphasis is exclusively on skills acquisition. For instance, the learner is said to “demonstrate entrepreneurial knowledge, skills and attitudes” when she, for instance, can generate business ideas through SWOT analysis, can develop a business plan, can advertise her venture, can differentiate between different forms of ownership, or can evaluate the financial viability of a business. For certain, all these things are important and essential for successful entrepreneurial leadership, but one can argue that they are not the only things.

One of the greatest vulnerabilities for the ethical dimension in business, or in any activity, for that matter, is compartmentalization: that is, when the

ethical dimension, indeed, the human dimension is considered extrinsically to the process or activity at hand, and often when one is forced to do so (i.e. government regulation). Regrettably, this tendency is often reinforced in the context of education and training when skills transfer takes place apart from the consideration of the human context in which the performance of said skills must operate. The learning objective for entrepreneurialism, with its emphasis on skills and methods reflects this tendency. Unless the instructor, on his initiative, chooses to situate a context, one cannot say whether the learner is equipped to consider the human dimension of entrepreneurial activity.

There is evidence that suggests that this approach is more the norm than the exception, and can have some dangerous consequences. Cornwall and Naughton in their study show how much of the literature on entrepreneurialism reduces success simply to terms of financial growth. Very little scholarly activity investigates the deeper meaning of what good entrepreneurship is. The authors refer to this tendency as “the illusion of technique” where success for the entrepreneur is measured simply as a function of the bottom line. The problem with this is that it leaves a potential entrepreneur a wide open field for so-called business opportunities which almost certainly will make a profit - like dealing in methamphetamines, or organising a prostitution ring. More often than not, the reasons why such opportunities will not be pursued by most folks is that they are unwilling to take the risks associated with it, like the arm of the law, or fellow competitors who expand market share by killing the competition (literally). These are egregious examples, but they illustrate how ethical concerns are usually externalised to the process, rather than an organic part of what it means to be a good entrepreneur. The question should be why it is not good entrepreneurial activity to be a drug pusher.

Cornwall and Naughton draw upon principles of Catholic social thought to suggest a new way of thinking about entrepreneurialism (and by extension the teaching of the subject) in such a way as to broaden its understanding. They suggest that there are three criteria for successful entrepreneurship, and by extension, the education of a successful entrepreneur. Firstly, one must master the technical aspects of the craft. Technical competence is non-negotiable reflecting the “entrepreneurial or instrumental habits of industriousness, diligence, ingenuity [and] frugality...without which the entrepreneurial process limps and eventually atrophies” (Cornwall and

Naughton, 71). On this point, the National Curriculum Statement is quite adequate, with its emphasis on various skills necessary for entrepreneurial success. In addition, however, attention is paid to what they call “the good of the person and the subjective dimension of work.” Critically, an understanding of the objective and subjective dimensions of work invites the human dimension that integrates the ethical dimension into the activities of entrepreneurship. The problem is that the evaluation of success simply as a function of productivity is an example of what John Paul II refers to as *economism*, a reduction of the human person to simply financial terms. In this type of thinking, a human being is simply a factor in production of goods and services, and her transcendent value is ignored. Entrepreneurship simply becomes a function of the material objectives of the entrepreneur, which results in a person reduced to a thing (Cornwall and Naughton, 63). Thus, the objective aspect of work is well understood, that of what the entrepreneur will accomplish. But what is not well understood (and what often fails to appear in the literature, as well as the learning outcomes in the Senior Phase curriculum), is the subjective dimension: how “are we changing through our work”? (Cornwall and Naughton, 63). That is, how is the entrepreneur-to-be developed, transformed into more of a human being, imparted with great dignity, because of his activity? This is a question that does not lend itself well to quantitative measurement, in the way that the financial bottom line does. It may be all well and good if one’s entrepreneurial efforts yield much financially, but if it takes place at great cost to the entrepreneur, in terms of her relationships or his reputation, one can argue whether such a success is sustainable in the long-term. John Paul II, in his encyclical *Laborem exercens*, puts it rather plainly:

Work is a good thing for man - a good thing for his humanity - because through work man not only transforms nature, adapting it to his own needs, but he also achieves fulfillment as a human being and indeed in a sense becomes "more a human being."

Without this consideration it is impossible to understand the meaning of the virtue of industriousness, and more particularly it is impossible to understand why industriousness should be a virtue: For virtue, as a moral habit, is something whereby man becomes good as man. [*Laborem exercens*, #9]

The emphasis on the quality of the person must also be considered in terms of the community to which this person belongs. Thus, the third criteria, the good of the community and the social order of work, must obtain. Again in *Laborem exercens*, John Paul II is acutely aware of how work is able to really shape a person for the better, but it can also be a form of oppression, even for those who are getting compensated. (*Laborem exercens*,#9). The term “the social order of work” implies that the entrepreneur does not work in some individualistic vacuum, but also in the context of a community; (as he is engaging in activity that is shaping him for the better by his efforts, he is also obligated to do the same for those who work for him) could be expressed more clearly. As Cornwall and Naughton put it, “*we perfect ourselves to the extent that we create conditions for other people to develop*. We cannot develop ourselves without developing others” (Cornwall and Naughton, 68-69). One should see that this is closely related to the idea in Catholic social thought of the pursuit of the common good. If the second criterion enables us to become more human, not just more technically competent, then this third criterion helps to promote the humanity of *others*. Successful entrepreneurs will see a robust bottom line, indicating that they are providing goods and services for their community, but will also realise personal development in their lives and relationships as a function of their activity, and will also create a space for those associated with their enterprise to grow and develop.

## Conclusion

This discussion is not an exhaustive assessment of the economics and business curriculum in South African basic education. However, it highlights the vulnerabilities of the way that the discipline is discussed, by presenting matters principally in a positivistic framework (the way things are) and failing to give a vision for how things should be (normative). In both cases, we assert that the activities of business are the ground for human activity and choices, and thus become the place for ethical decision making; unfortunately, this is markedly absent in the curriculum.

“Business needs to be put into the larger context of human living” Gene Ahner wisely observes. “It is the greatest point of disconnect between the business school” (where the positivistic, technical aspects of business is discussed) “and the humanities” (where the normative aspects get compartmentalised). It is the argument of this paper that the elementary

curriculum needs to reconceptualise business as a human activity, so that its undertakings help learners to think more ethically about it - and to see ethical considerations as intrinsic to the functions of economic education, and not a consideration after the fact.

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# **Ethical Challenges of the Current Economic System: the common good: access to global forums, distributive justice, management of the global commons and climate**

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MARILISE SMURTHWAITE

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Robert Kirkman (2010: 2), writing on *The Ethics of Metropolitan Growth* and referring to the financial crisis which began in 2008, said:

The unstated goal seems to be to return as quickly as possible to the way things were before the crisis, to get people to buy houses and cars again, to resume construction of subdivisions and strip malls. It strikes me, however, that the current financial and economic turmoil might also be the occasion for us to take a hard, critical look at the way things have been....

Kirkman is right. We do need to reflect on “the way things have been” because this in itself will show us some of the ethical challenges that face us in our current economic system. To examine these ethical challenges may well require us to question our assumptions about the person, the common good and the relationship between economics and human beings. Groody (2008:18) reminds us that:

In our current predicament, we are losing sight of people in the pursuit of profit, responsibility in the face of new freedom, and the common good in the search for self-interest....We have veered off course as a human family, and correcting today’s abuses requires more than

“market logic” if we are to overcome the economic polarities that negatively affect the global village.

Perhaps it is time to take seriously such views as those of the investment banker Ken Costa who contends that we need to move from “contract to conscience” and to reunite “the economic with the moral and indeed the spiritual dimension of being human” (2010:35), because the “root deficiency of the financial crisis was the erosion of moral and human spirit - it was a human failure” (2010:35).

Let us begin by briefly clarifying for ourselves what we might mean by an ethical challenge. For centuries we humans have asked questions about how best we should live. What is a meaningful life for the human person? What is good for our well-being? How do we organise society so that all can flourish? How best do we live together in community? Ethics considers what is right and good for humans and studies the conditions necessary for our well-being: it is really about the good, the self and the other and its aim is the good society. Therefore, ethics asks questions about the nature of the good and the nature of the human person. If we talk of an ethical challenge we are talking of those challenges which concern the good of the person. We are talking about those challenges which face us with questions of human dignity, of the common good, of justice and fairness for all. We are talking of those issues in our current economic system which challenge us to ask: How do we promote what Aristotle called eudaimonia: a term sometimes translated as “happiness” but really meaning “a life well-lived”; a life where every person reaches his/her potential as a human being. How do we ensure the common good?

So let us try to unpack at least some of the ethical challenges of our current economic system by looking at “the way things have been” with a critical eye.

It is well known that “the way things have been” in our global economic system, has been based on the assumptions and tenets of what is commonly called the neoclassical or neoliberal paradigm. In this paradigm we have forgotten that historically economics was part of ethics and have adopted instead an economics without ethics, where economics is a value free science which stresses concepts like ‘production’, ‘consumption’, ‘money’, ‘wealth’, ‘capital’, ‘competition’ and ‘scarce’ resources and

where market capitalism tends to be equated with the “truth” (McFague 2002: 121).

As Buarque (1993:77) has pointed out:

The problem is not that economists have not learnt their lessons well in the courses they attended; it is that they have learnt them much as a chemist learns what substances to mix to obtain sodium bicarbonate, without asking themselves why, what for, and at what cost. In studying their science as something unrelated to the realities of their countries, economists have lost the perspective for understanding the essence of the economic process and ...have become a species of cardinals of a church, whose brief is to set out the arguments that justify current dogma.

That dogma has fostered a perspective on human nature that is utilitarian: the person is seen as rational, *homo oeconomicus* (economic man) motivated by self-interest, making decisions to maximise pleasure and avoid pain. People are the agents of the economic process, but not necessarily its focus. We have ceased to concern ourselves with the common good. As Lutz (1999:2-3) has observed:

The very notion of the common good is not easily grasped in an intellectual community with a prevailing individualist liberalism.

The philosophy of a sound common good is based on the old republican tradition as practised by ancient Greeks and Romans and revived by Thomas Aquinas in the Middle Ages. This venerable tradition lasted in England until the eighteenth century when it was replaced by a new liberal creed, which has dominated political philosophy and economics ever since.

The notion that the common good will best be served by the operation of the free market system with minimal government interference, has been shown in reality not to be the case and this is well documented in the literature. Likewise the notion that economic problems will be best solved by promoting economic growth “generated by each individual’s pursuit of self-interest in a free market regulated by the forces of market competition” (Wilber 1991:212) has not yielded a solution to global poverty.

Therefore it seems to me, that “the way things have been” shows we have lost sight of the fact that economics does **not** exist for its own sake but should serve people. We have disregarded the fact that people are not merely economic units or merely rational economic beings: they are infinitely more complex beings, physical, spiritual, psychological and intellectual, whose economic needs reflect this complexity. We have lost sight of the dignity of every person and of the importance of an economic system being organised in such a way that the common good is served. And despite evidence to the contrary, we are loathe to believe that the needs of all persons are not best served by our current economic arrangements. It takes courage to face an ethical challenge of this magnitude: to ask again the questions about how best to organise economy so that it serves the needs of all persons, not just the few, to ask what assumptions about the human condition and how best to foster the good life for all we need to build into our economic system so that justice is served? Market economics is only one way of conceiving economy and as Mc Fague (2002: 121) has pointed out, our first step to seeing things differently is to realise that economics is not a “hard” science, but an ideology with an assumed anthropology and goal for the planet (summarized by greed and growth) and that there are other models (e.g. ecological economics). Or, as pertinently argued by Timothy Gorringer (2004: 90), “Economics is not fate. It can be changed”. Why? Because human beings make the decisions, decide on the policies, the changes, the rules of the game. We can use our rationality and our creativity to change “the way things have been”. But of course we need also to note, as Philippe Legrain (2010: 3) points out:

Powerful voices argue that little needs to change. The financial system may need a few tweaks here and there, but otherwise the world should go back to business as usual.

This brings me to two further sets of issues which seem to embody some of the ethical challenges of our current economic system:

- Issues relating to **power** especially power of the first world economies over the third world economies and of corporations over nation states;
- Issues relating to **consequences of the current economic model** most notably its unfair outcomes, its consequences for

the majority of the world's population (especially the poor) and for the environment.

*Issues related to power: First world versus third world/developing countries*

The current neoliberal global economic system has been based on certain **key features**, namely, export-led growth and production, trade liberalisation and deregulation, privatisation and finance capital. These features and the system per se have attracted considerable criticism as being imposed, often unfairly, by first world economies on third world economies to their great disadvantage. Furthermore, first world economies are seen as advantaged by the same system. They have, as it were, the power to declare the rules of the game for developing economies, but also the power to exempt their own economies from having to abide by the same rules.<sup>1</sup> Duchrow (2003: 28) and Gorringer (2004: 83) and others too, have observed that the world system is imperialist and, in Gorringer's view, exploitative and dominating over "less developed countries" and workers in general. State and ideological power (media, cultural institutions) is exercised such that the status quo in the globalised economy is maintained, a status quo which retains the power of the wealthy (first world economies) over the poor (third world economies). The mechanisms for this lie in the "key features" mentioned above. The insistence on these features as essential to participation in the global economy, likewise props up the status quo, and ensures the dominance of the powerful first world economies and their institutions. The origins of the system are well known as are its institutions: the World Bank, IMF etc., now criticized as undermining human creativity and disempowering people, especially the poor (see: Yunnis 2007:12-13). These institutions have been especially criticised for the structural adjustment programmes (SAPs) imposed on many third world countries and engendering the third world debt problem. Stiglitz (2002:17-8) notes how these financial institutions are "dominant players in the world economy", but their "economic prescriptions" based on free market ideologies have resulted in poverty for many and political and social chaos. SAPs have also failed to deliver sustained growth. Power, therefore, is vested in first world economies, less as nation states, and more by means of the institutions and organisations which have been spawned from their democratic ideology and neoliberal economic ideology

and praxis. This poses an ethical challenge at the macro-level: what structures can we develop in our global economic system to ensure power is not used to the disadvantage of the powerless? How can we structure the economic system so that all can participate in it and benefit from it? How do we ensure that people in every nation are empowered to do for themselves what they are able, rather than being deprived of the freedom of choice by centralising economic power and control and action in the hands of selected, largely first world bodies?

But it is not only the power of first world economies, their institutions and policies that are of concern and ethically challenging, but also the even greater power of corporations.

### *Issues related to power: Corporations over nation states*

Transnational or multinational corporations, have gained enormous power in the current dispensation, a power that has attracted much concern, criticism and outright opposition (McGiffen (2002:19; see also Groody 2008; Coleman and Ryan 2005, among others). Greater power to the corporations and less to the nation states is in fact one of the “key ingredients” of economic globalisation also referred to as *corporate globalisation*. Ironically, democracy, which makes economic freedom possible, has, in this respect, enabled the flourishing of the huge transnational/multinational corporations, to a point where they developed such great power that democracy seemed to have been replaced by “corporocracy” (Du Toit 2002:71). Again we are faced with what some call “a new era of imperialism dominated by the major super powers and the associated capital” whose ideology is grounded in neoclassical economics, the “supremacy” of western values and institutions, and property rights (Kelsey 2002:26). It is well known now that 51 of the largest economies in our world are corporations and 49 are nation states and that the top 200 corporations generate over one quarter of world trade. But, as Gorringer (2004:81) observes these 51` companies “are designed to serve less than 1% of the world’s people”, for in our global economy less than 1% of people own stocks and shares. In fact, he goes as far as saying corporations exist to serve shareholders and, despite their claims to serve humanity, are bent on profit making, “do not exist for ‘the common good’”

and are “wedded to injustice” as has been shown by criminologist John Braithwaite (1984) (Gorringe 2004: 82).

The power shift in favour of corporations poses an important ethical challenge. It is a shift which has been criticised as offending against the principle of subsidiarity by removing economic control from local and national levels and concentrating it at higher levels (The International Forum on Globalisation - IFG 2002). It is the corporations which are seen as both architects and beneficiaries of global governance, global trade, finance and investment which dominate our economic system. They have money and power and are therefore a major organising force, not only economically, but also politically and socially (IFG 2002:122-3). Furthermore, there are many documented cases of large corporations being found guilty of human rights abuses, directly or indirectly, worker exploitation and ecological mismanagement (think of the recent case of BP), to say nothing of the numerous recent corporate collapses and their consequences for ordinary people and indeed, for the entire world economy. Consequences of corporate activity for the environment will be dealt with later in this paper. As Korten (2001) notes, Adam Smith did *not envisage* multinational corporations with concentrated or monopoly power and minimum public accountability or legal liability - a true market economy would rather have human scale enterprises, honest money, local ownership, a democratic framework and maintain an efficient market function.

*Issues related to consequences: Unfair outcomes, their consequences for the majority of the world's population (especially the poor) and for the environment*

Let us turn now to the second group of ethical challenges which relate to the consequences of our current economic model both for people and for the environment. I will begin by considering the people and then move to environment, although these categories are not mutually exclusive. Ethicists and economists, as well as others, have noted that the neoliberal free market system cannot and does not function to ensure any kind of equitable distribution in the global economy. Its outcomes are, by nature, unfair. Markets are not neutral and they benefit some and not others (Du Toit 2002:78, (see also Riddell 1980:26-9). Our current economic system

presents us with many ethical challenges, but the need for greater economic justice globally and nationally is surely one of the most urgent. This challenge, acknowledged by both religious and secular writers and leaders<sup>2</sup>, is one which has become even more urgent since the advent of the latest world financial crisis.

As Hehir (1993:32) has observed, a just economy is one in which basic standards of welfare, as conceived by human rights theory and “the theory of social and distributive justice”, are achieved for each person. Yet in our globalised society, economic injustice is evidenced by the fact that “two-thirds of the planet live in poverty” (according to the World Bank cited in Groody 2008: 4) with more than a billion people living on less than \$1 a day, and nearly 2.7 billion living on less than \$2 a day. Our world has 45 million poverty-induced deaths per year, 93 million beggars, 100 million supported through garbage, 500 million who live close to starvation, 700 million who live in slums (see Groody 2008:5). Wealth distribution is even less equitable than income “with half of all wealth held by only 2 percent of the world’s adults” (Groody 2008:4)<sup>3</sup>. The figures are staggering, but what is more staggering, is that each figure represents a number of human beings suffering deprivation and marginalisation in a globalised society characterised by features like enormous technological development, sophistication and progress, by efficiency and by a free market ideology which purports to be the solution to relieving poverty. To quote from Groody (2008:5):

A cursory glimpse of the state of the world reveals that economic growth and income development have not advanced hand in hand with human development. As Nelson Mandela puts it, “Massive poverty and obscene inequality are such terrible scourges of our times - times in which the world boasts breathtaking advances in science, technology, industry and wealth accumulation - that they have to rank alongside slavery and apartheid as social evils”.

The challenge of the poor is surely one of the most urgent ethical challenges we need to meet. Pogge (2007) asks: why, given the well-known statistics on poverty and economic injustice, are Westerners not morally troubled. It is Western values which are dominant, yet despite all the moral norms and standards of this dominant Western civilization, this poverty continues. We need to question a way of organising our economic system based on notions of competition, self-interest, profit making,

economic growth, etc. as a means of ultimately contributing to the benefit of all in the society. For the evidence is that it has not done so and is unlikely to be able to do so. How do we ensure that basic human needs are met for all persons and that basic human rights are met for all persons in our globalised society? We are not saying globalisation causes poverty in a simplistic way for it is a complex phenomenon. But we should, at least, acknowledge the adverse consequences of this globalised economic model for the majority of people.

To begin to meet this ethical challenge, we need to acknowledge the differences between theory and practice which reveals for us further ethical challenges.

Firstly, financial markets according to economic theory “tend toward equilibrium”: in practice this view of financial markets is inaccurate, given that, as Soros (2002:24-25) tells us:

...you operate with *imperfect understanding*, your actions have *unintended consequences* and that is why you do not reach equilibrium necessarily... If *financial markets* are *inherently unstable*, then stability has to be an objective of public policy.

The current financial crisis corroborates this view and its consequences are global, and are not merely confined to first world economies where the problem originated. While Adam Smith’s belief was that the free market should benefit all if each pursued his/her self-interest and if governments did not interfere in the workings of the economic system to stop it from working efficiently, the real world does not offer conditions such as ‘perfect information’ which is necessary in order for markets to work as envisaged by Adam Smith’s “invisible hand” theory. In reality, information is “asymmetric and imperfect” and hence markets cannot work ideally. This means we have periodic enormous amounts of unemployment and poor resource use. Markets do not and cannot work to produce a fair outcome of their own accord. In the market there are some winners, but many losers.

Secondly, we need to admit that globalisation’s “hypergrowth” and trade liberalisation have not meant that the increased wealth has “trickled down” and improved the lives of the poor. Rather, its benefits have mainly

trickled *up* (IFG 2002:21; see also Sethi 2003) meaning, at the very least, relative poverty is increased (Zamagni 2001:124)<sup>4</sup>. Hence, in the view of some, economic growth means a lack of social justice (Qin 2002: 89).

Thirdly, we need to remember that because the global economy has more or less done away with exchange controls, capital is not necessarily guaranteed to remain in the country where it is generated. In fact, as McGiffen (2002:20) notes:

...most of the profit made in developing countries finds its way back to the metropolitan North and into the bank accounts of TNC shareholders. The servicing and repayment of debt (which costs sub-Saharan African countries, for example, a fifth of their GDP each year) and the privatisation of resources (which results in foreign ownership and a fall in the share of wealth paid in wages) mean that far more capital flows out of poor countries than arrives in the form of direct investment or development aid.

The plight of these debtor nations, i.e. the third world developing and poorer countries, is a further ethical challenge and presents further evidence that our current economic system is not benefiting all, especially the poor. Pettifor (2002), among others, emphasizes that in the global economic context the domination of finance capital rather than industry capital is not accidental, but has occurred by design, as the result of policy making. It has brought with it debt for third world countries, which “acts as the key mechanism for the transfer of wealth from weak to strong; from debtor nations to international creditors” (Pettifor 2002:12). Duchrow (2003) argues this debt is not an economic problem, but a political tool to exploit and control debtor countries, where, for example, Africa is “being crucified” by neoliberal economic policies that result in unemployment and the worsening of work conditions among others. Groody (2008:6), too, notes that it is Africa which is “most deeply entrenched in poverty, with more than 50% of people living in “extreme poverty”, while Sachs (2008:31) notes that in 2005 the wealthiest country, the United States, had a per capita income of about 20 times that of those in sub-Saharan Africa, the poorest region then. To counter the poverty trap, means to devise “special policies and global efforts”. Poverty, while not inevitably the fate of certain countries, will not be solved by market forces alone (Sachs 2008: 31).

And this brings us to the nub of the problem.

In fact, the market needs to be guided and checked by "...human morality, collaboratively exercised, through political means" (Jenkins 2000:233). The working of our economic system lacks what Williams (1993a:924) has referred to as a "moral culture" to inform economic life and has been dogged by unethical business practice, human greed and a lack of concern for the common good. This was not the type of market economy envisaged by Adam Smith, who assumed a moral context rooted in those virtues found in the "Judaean-Christian vision" and "clearly articulated in his earlier treatise on ethics" (Williams 1993a:923)<sup>5</sup>. Such a view would ensure the market economy resulted in a "humane community" (Williams 1993b:13).

Our current system based on a 'value-free' economics, ignores the original moral motivation of Adam Smith's "invisible hand" theory where the rich would be led to help the poor (Jenkins 2000:46). Adam Smith proposed self-interest, not greed and would be "outraged" by those neoliberals who attribute to him the idea that "the market turns unrestrained greed into socially optimal outcomes" (Korten (2001:81). Duchrow (2003) believes greed has been systematised in the market. Korten contends "Greed is what the economic system being constructed by the corporate libertarians encourages and rewards" (Korten 2001:81). Some financial and economic commentators on the continuing global financial crisis and recession, have also suggested greed to be at the root of practices which resulted in financial collapse for a number of corporate institutions and a world-wide recession. In effect, as some have pointed out, greed is legitimised as a result of the profit focus within a "casino culture", where money makes money, work and fulfilment are irrelevant and ethics is "bypassed" (Agnivesh 2002:48)

Counteracting greed "calls for greater ethical vigilance and activism in the global community" (Agnivesh 2002: 46) where we have adopted an economic model which pays too little heed to people, resource consumption or to the ecological consequences of its actions and fosters excessive profit making as well as militating against a sense of community (Jenkins 2000).

Pope Benedict XVI (CV n. 9) notes:

The risk for our time is that the *de facto* interdependence of people and nations is not matched by ethical interaction of consciences and minds that would give rise to truly human development.

So let us turn now to **ecological sustainability** and the sustainability of the whole human community which is a further major ethical challenge and one which some contend is not given major priority in our current economic system (see McFague 2002:127ff). Today, there is growing concern over the commodification and privatisation of such natural resources as water and seeds and the implications that this has for the lives of the poor in particular. There is also considerable debate, and even wrangling, on the issue of climate change, as was seen in January 2010 at the Copenhagen Climate Summit. Geoffrey Sachs (2008: 5) has noted that the “world’s current ecological, demographic, and economic trajectory is unsustainable, meaning that if we continue with “business as usual” we will hit social and ecological crises with calamitous results”. He has also predicted that “the twenty-first century will overturn many of our basic assumptions about economic life” (2008: 3). Although we understood some 50 years ago that ecological resources had to be managed for the common good, we still need to find new, revitalised ways of global cooperation to ensure this happens. We know that there has been growing concern about a model of economy which is dependent on “the principle of perpetual growth” (Du Toit 2002:71), where resources are exploited to ensure continued growth (IFG 2002:28ff), despite the fact that these resources are finite, limited and not renewable. Public policies based on the principle of such growth exacerbate and accelerate “the breakdown of the ecosystem’s regenerative capacities and the social fabric that sustains human community” (Korten 2001:21) as well as further marginalizing the poor, who, in “the places they are forced to live, more often suffer the effects of contamination, toxic wastes, and even ecological disasters” (Groody 2008:117). In other words:

The consumer society is devouring the earth – its fish, its forests, its fertile land, its water. These basic goods, the foundations of life become scarcer year by year. Even clean, fresh, unpolluted air becomes scarcer.....Global warming, caused by CO<sub>2</sub> emissions from our vastly increased industrial activity, could make much more of the planet infertile...and drown great numbers of us (Gorringe 2004: 87-88).

I agree with Groody (2008:117), who says that it “is sobering to consider that if the environment goes, nothing else will matter, for we will no longer be a global home in which any human life can survive”.

Some, like Heslam (2004: 127-8), question whether the current system can in fact “ensure a sustainable environment” and suggest that a new “sustainable global capitalism” would be required. Others, like Robert Kirkman (2010: ch 2), point to our faulty thinking about environment, where we speak of *the* environment, instead of *our* environment, and where many conceive that environment is only about the “wild”, instead of understanding it is also about the whole of our complex shared and common environment. We should be asking whether our environment is a good place for humans to live and considering what Kirkman calls “two different problems of sustainability” (Kirkman 2010: 98): the non-renewability of fossil fuels and the consequences that burning these fuels has on climate, viz. climate change, which in turn begets further consequences for sustaining human life (Kirkman 2010:98).

Furthermore, while acknowledging the usefulness of scientific enquiry into areas like global climate change, we should not be taken in by the myth of scientific neutrality: there are and can be underlying values and assumptions which impact on how such scientific reports present and provide solutions to issues like climate change which may prevent us from taking timely action. Sachs has pointed out that we seem to be “paralysed” when it comes to taking action to ensure, for example, that we convert our global energy system which is currently causing climate change, to a more sustainable one which would both control such change and cost less than 1% of the annual world income. Sachs believes that there are solutions: the problem seems to be “implementing global cooperation to put those solutions in place” (Sachs 2008: 12).

### **Concluding remarks:**

The “way things have been” provides us with many ethical challenges. What is clear is that events since mid-2008, have catapulted us into a crisis situation: it is not difficult to note the gravity of the financial crisis when banks and corporations, thought to be “too big to fail”, request and are given massive government bailouts and when government must provide

“rescue packages” to shore up the economy to prevent total collapse. The cynic may well ask what has happened to the free market ideology when governments, who are supposed not to interfere in markets and the economy, are now asked to do exactly that, to prevent catastrophe. But cynicism is of little value for meeting the ethical challenges of our economic system and the crises, provoked, not least of all, by financial practices which were unsustainable and by unethical business practice in some of the world’s leading economies. As Benedict XVI (CV n.34) notes:

...the conviction that the economy must be autonomous, that it must be shielded from “influences” of a moral character, has led man to abuse the economic process in a thoroughly destructive way. In the long term, these convictions have led to economic, social and political systems that trample upon personal and social freedom, and are therefore unable to deliver the justice that they promise.

It is clear that the challenges posed by economic globalisation and by our current economic arrangements are not merely technical obstacles to be overcome by technical solutions. The destructive consequences of our current system and crisis for so many persons, demand ethical reflection and discernment in an environment where “the market imposes its way of thinking and acting, and stamps its scale of values upon behaviour” (Pope John Paul II 2001: Address to Pontifical Academy of the Social Sciences). As the Pope John Paul II (2001:28-29) observed:

We are seeing the emergence of patterns of ethical thinking which are by-products of globalisation itself and which bear the stamp of utilitarianism. But ethical values cannot be dictated by technological innovations, engineering or efficiency; they are grounded in the very nature of the human person. Ethics cannot be the justification or legitimisation of a system, but rather the safeguard of all that is human in any system.

Therefore, to quote Benedict XVI: “*The economy needs ethics in order to function correctly* – not any ethics whatsoever, but ethics which is people-centred” (CV: 45).

Economics and economic activity cannot solve all social problems through the simple application of *commercial logic*. This needs to be *directed towards the pursuit of the common good*, for which the political community in particular must also take responsibility...grave

imbalances are produced when economic action, conceived merely as an engine for wealth creation, is detached from political action, conceived as a means for pursuing justice through redistribution (CV 36).

We need, therefore to apply our minds and our creativity and our will as well as our hearts to working for changes to the current system which will ensure the common good and the dignity of all persons. This will take courage: what better virtue to meet our current ethical challenges for the benefit of all? Using our creativity, intelligence and capacity to provide ethical solutions to our current challenges and problems is therefore both likely and possible, given the heart and the will to do so.

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## Notes:

<sup>1</sup> See: Stiglitz, 2003b *The Roaring Nineties*, for detail on America's hypocrisy in this respect.

<sup>2</sup> We need to heed the many voices, from different and various academic and religious persuasions, noting the importance of preventing poverty which undermines human dignity, albeit advocating different means to accomplish this (see for example, the volume edited by Cramme and Diamond (2009), their own introductory chapter and especially chapters by Merkel (2009:38-58) "Towards a renewed concept of social justice"; and, in same collection, Miller (2009:23-37) "Social Justice versus Global Justice". Miller's view is that "Social justice should be defined in terms of personal autonomy, self-esteem and the capacity to open up life opportunities and make use of them –all desirable qualities of the good life"(Cramme and Diamond 2009:8). See also the latest encyclical of Pope Benedict XVI, *Caritas in Veritate*.

<sup>3</sup> As Schulz (2001:95) observed a decade ago:

*The globalisation process has been enormously uneven and has further widened the gap in global power and wealth. The assets of the wealthiest three individuals in the world now exceed the combined GNP of the forty-three least developed countries. Total income of the bottom 41 percent of the world's people is less than that reported by the 200 wealthiest individuals.*

<sup>4</sup> On the issue of poverty and globalisation see also Wade 2003:18-43

<sup>5</sup> See also Rothschild 2001:116 cited in Smith 2003:xvii in the introduction by A. B. Kruger; and Koprek 2002:120-121, who believes that Smith *was concerned* with morals.

# **New Directions in Economics and Ethics – Towards a new World Order**

## **New Directions in Global Financial Regulation and Governance**

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LAURENCE BOULLE

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### **Introduction**

This paper examines aspects of global financial regulation and governance in the post-GFC world. It makes particular reference to the option of establishing a World Financial Organisation (WFO) to provide for the global financial system what the World Trade Organisation does for international trade. Peter Boone and Simon Johnson raise the prospect of a WFO, en passant, in the recent London School of Economics survey on the Future of Finance,<sup>1</sup> as follows:

### **A Treaty for International Financial Regulation**

We should enshrine regulatory powers in an international treaty, similar to the World Trade Organisation for trade in goods and services, so that all nations are required to follow similar rules. This would make it harder for national legislatures and regulators to relax regulation, and so would reduce the ‘beggar-thy-neighbour’ costs imposed on others when one nation deregulates. It would also reduce the incentives for a ‘race to the bottom’ in regulation. The treaty would need to have simple rules, including large capital requirements. It would also need to have a body that monitored implementation, similar to the IMF or BIS today. This body would also need to have clear rights to impose new regulations so that rules can be modified to reflect changes in problems.

Against the background of general comments on the crisis and its aftermath the paper will consider and evaluate key points made in this extract. The consideration of a WFO option also has to be made in the context of other financial institutions in the global political economy which have emerged, and are emerging, out of the financial and economic crises of the past years.

Until the crisis in 2008-9 cross-border financial flows had been expanding at about 10% a year for the previous decade. While there has been much speculation over a new global architecture for this system very little of substance has emerged in the past three years. Much of the actual activity has been concentrated at the national level, and to a lesser extent at regional levels such as in the European Union. In this presentation there is an assumption that greater attention will have to be given to global institutions which are constructed with defined functionalities, by appropriate procedures and with suitable organisational structures to perform and enforce their functions. All this presupposes at least some diagnosis of what caused the crisis in the first place, as discussed in the following section.

This contribution brings a legal and institutional approach to bear on the complexities of international finance. All social discourse takes place in the shadow of norms of law as standards of legal rationality enjoy a privileged status in many social environments. The jurist Joseph Raz contends that legal systems are distinguished in part by their comprehensiveness - 'they claim authority to regulate any kind of behaviour' - and they claim supremacy over other normative systems in the same overall framework.<sup>2</sup> It is for this reason that law holds influence as a force for social change - if the law takes up a particular position on a normative issue it can be expected to influence to some extent the shape of other forms of social discourse.

However law's practical province is a limited one and is restricted to matters such as the allocation and distribution of authority, the constitution of public authorities, their powers and limitations, processes of decision-making and accountability, and the rights and duties of law subjects. In this it is less utilitarian than disciplines such as economics or politics and has a strong association with rule-based governance, epitomised by the Rule of Law doctrine. It is concerned more with means, in the form of

reasonable and rational procedures, and less with ends, on which it is inclined to defer to political and economic outcomes. Law in fact delegates to markets extensive areas of autonomous operation and itself sometimes mimics economic reasoning.

While law is central to the governance of global financial institutions and markets the current international legal regime in this area is a complex web of national laws and regulations. These emerge from nation states, from bilateral, regional and multilateral treaties, from international Organisations, decisions of international courts and tribunals, and from agreements and practices of industry bodies and transnational economic enterprises. As regards the form of regulation rules come in two varieties: positive rules which provide specific directives on rights, duties and procedures, so-called 'hard law'; and principles which express more malleable and abstract values or required conduct and their consequences, so-called 'soft law'. The former has a juridical quality and can be enforced, while the latter is more in the nature of a non-binding guideline, charter or code of conduct. At the global level legal regulation comprises significant elements of soft law which necessarily has only a limited impact on the dynamics of international finance.

## **Diagnosis before prescription**

In dealing with regulatory issues one might expect initially to diagnose the causes of the crises since diagnosis normally precedes prescription. Many professions of course prefer the converse arrangement. You will note that the references here are not to the 'global' financial or economic or social crisis as there might have been some hyberbole in this dramatic phrase - everything else is global, so why not the crisis? Its usage may have similarities with those pertaining to the 'World' wars or the 'World' baseball series' or a 'world-famous' local entertainment. In each case many countries or economies were or are relatively untouched by the 'world' feature - in the case of the GFC manufacturers in China, consumers in Indonesia, banks in Australia and exporters in Brazil were less affected by the so-called global event than were the headline economies. However, even in its non-global dimensions the crisis was a significant event which impacted on numerous states, corporations and individuals, and therefore created both an impetus and some political space

for restructuring the global economy. Whatever the causes of the crises they provided the occasion to reconsider the architecture of the global financial system.

To return to the crisis causes, the academic literature and popular media abound with theories on its sources: human greed, inadequate restrictions on the supply of credit, new financial instruments in which risk was difficult to assess, lack of regulatory intervention in housing markets, lack of controls on speculative aspects of the economy, deficiencies in the Bretton Woods institutions, inadequate regulation generally, and the absence of harmonization in prevailing national regulations. Each of these factors could be elaborated on in detail and there might be a measure of veracity in each. However, although they created propensities for the crisis in the global economy it is difficult to be precise about which were the precipitating factors. For example it could be argued that it was the effect of deregulatory measures in many areas of the economy which lead to the global liberalisation of financial markets and the removal of clear distinctions between retail and commercial banks, securities dealers and insurance providers. But sweeping generalisations might overlook nuances in the detail.

If the global financial system is not only a complicated but also a complex system then it is difficult to reduce it entirely to its analytical components. Here complexity theory might suggest that systemic approaches to diagnosis could overlook the significance of relatively minor occurrences. The ‘minor’ in this context has some magnitude. It comprises the failure of US authorities to bail out Lehman Brothers as they had done with other financial institutions ‘too big to fail’. Complexity theory would contend that a single phenomenon such as this, in the context of an inter-connected global financial system, could be the precipitating factor for a number of contiguous and contagious events which cumulatively made up the financial crisis. In popular culture this would be referred to as the ‘tipping point’. Whatever its contribution to our understanding of the crisis, complexity theory will make another appearance later in the piece.

There have of course been previous crises and previous attempts at financial reform. The IMF, the G-20 group of countries, the Basel Committee and the Financial Stability Board all preceded the GFC. There is contention over the extent to which they predicted and warned about the

crisis, but they certainly did not prevent its occurrence. However leaving aside the apportionment of blame conundrum, the crisis suggests several areas in which reforms are required many of which, given the assumptions of the globalisation project and the new reality of a multi-polar world, require some form of international involvement.

The ‘lessons learned’ from the GFC suggest that the following should be considered in a global financial regulation project:

- Removal of distorted incentive structures which encourage costly risk-taking.
- Implementation of capital adequacy and prudential requirements for banks and other financial institutions.
- Greater transparency for risk assessment purposes in financial instruments.
- Coordination of financial policy and laws to prevent cross-border arbitrage.
- Greater regulation and reliability among credit rating agencies.
- Transparency in and monitoring of banks and hedge funds.
- Funding of externality costs by financial institutions themselves and not by taxpayers.
- Accountability and monitoring of tax havens.
- Standardisation in accounting and auditing systems.
- Avoidance of new cycles of excessive risk-taking and deficit spending.
- Removal of implicit taxpayer subsidies for risky financial institutions.
- Discouragement of massive indebtedness by nation states.

More disputed areas of regulation would be issues along the lines of:

- Controls on the use of public funds to bail out defaulting financial institutions.
- The depoliticisation of the financial system.
- Development of a global ‘Tobin tax’.
- Management of the several layers of moral hazard.
- Adjudication systems for alleged breaches of international financial regulatory measures.

How to achieve the reforms and how to evaluate the contentious matters are considered in the remainder of the paper.

## **The current global mix**

The architecture of globalisation, or international economic law to be more prosaic, is a complicated one designed by many proverbial ‘committees’. Three of the main financial areas in the global economy are banking, securities and insurance but there are many related and interstitial areas which also require attention. In all areas of financial activity there are continuous evolutionary trends fomented by competition, scarcity and technology. There is considerable international regulation in all areas but not a great deal of consistency and both overlaps and gaps are evident. While it does not capture all the post-crisis changes in financial regulation the G-20 summit in 2009 issued a Declaration called ‘Strengthening the Financial System’. It included the following elements:

- Establishment of the Financial Stability Board with a strengthened mandate to succeed the Financial Stability Forum.
- Collaboration of the FSB with the IMF to provide early warning of macroeconomic and financial risks and actions needed to address them.
- Reshaping the regulatory systems of the G-20 countries so that authorities can identify and take account of macro-prudential skills.
- Extend regulation and oversight to all systematically important financial institutions, instruments and markets, including hedge funds.
- Endorsement of FSF’s principles on pay and compensation and firms’ corporate social responsibility.
- Improvements in the quality, quantity and international consistency of capital in banking systems and avoidance of excessive leverage.
- Actions to be taken against tax havens and banking secrecy.
- Improved standards and supervision of valuation and accounting systems.
- Extension of regulatory oversight to credit rating agencies through codes of practice, inter alia to prevent conflicts of interest.

These recommendations were superimposed on the fragmented existing set of regulatory institutions and their responsibilities. There is always a discrepancy between the form and operation of such international regulatory systems. However excluding for present purposes the IMF and World Bank, a regulator's view of the current state of international institutions in the global financial system is as follows:<sup>3</sup>

### **The Financial Stability Board<sup>4</sup>**

The Financial Stability Board (FSB) is at the centre of a wide range of institutions, multilateral and regional, governmental and industry-based, public and private, specialized and general. The former Financial Stability Forum evolved into the FSB in April 2009 in the wake of the challenges emerging from the GFC. It was 'mandated' by the G-20<sup>5</sup> to address vulnerabilities and develop and implement regulatory, supervisory and other policies in the interests of global financial stability. Its mission specified as follows:<sup>6</sup>

- Monitor and advise on market developments and their implications for regulatory policies.
- Advise and monitor best practices in meeting regulatory standards.
- Undertake joint strategic reviews of the policy development work of the international standards setting-bodies to ensure it is timely, coordinated, focused on priorities and addressing gaps.
- Set guidelines for and support for the establishment of supervisory colleges<sup>7</sup> and manage contingent planning for cross-border crisis management, particularly with respect to systemically important firms; and
- Collaborate with the IMF to conduct early warning exercises.

Membership of the FSB is in three categories with member-states<sup>8</sup> represented by their agencies dealing with finances, international organisations<sup>9</sup> and international standards setting-bodies and other groupings.<sup>10</sup> Contributing to the activities of the FSB are six bodies with specialist functions in different industries. This is now the central institution in the regulation and supervision of the global financial institution, operating with both other international financial institutions

and with national authorities in many states. Its presence poses a challenge for proposals on a new world financial authority such as a WFO.

### **The Bank for International Settlement<sup>11</sup>**

The BIS was established in 1930 by the Hague Agreement between its original parties Germany, the UK, France, Belgium and Japan, and the Swiss Confederation.<sup>12</sup> It is the oldest of the international financial institutions and is designed to foster cooperation among central banks and other agencies in pursuit of monetary and financial stability. It provides services exclusively to central banks and international organisations. Fifty-six institutions currently have rights of voting and representation at BIS general meetings.<sup>13</sup>

The major functions of the BIS are accomplished within a forum of central banks where they consider and make decisions regarding international finances. It serves as a cornerstone of monetary transactions between central banks, and as a trustee or agent in connection with international finances.

### **The Basel Committee<sup>14</sup>**

The Basel Committee on banking supervision enhances regular cooperation on banking matters.<sup>15</sup> It reinforces key supervisory issues with the purpose of increasing global banking supervision within the framework of exchanges of nationals' supervisory systems.<sup>16</sup> Since the financial crisis the Basel Committee has issued several proposals on capital adequacy, corporate governance, counter-cyclical capital buffer proposals, models for credit risk measurement and other aspects of global finance. Its proposals are not self-enforcing and require national authorities to implement them, which in practice many are in the habit of doing. However there has also been resistance to some Basel proposals and national economies compete with one another for financial advantage.

### **The International Association of Insurance Supervisors (IAIS)**

Established in 1994, the IAIS represents insurance regulators and supervisors from about 190 jurisdictions in nearly 140 countries, constituting 97% of the world's insurance premiums. It also has more than

120 observers. Its objectives include (1) cooperative improvement of the insurance industry at both national and international levels to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders; (2) the promotion of a well-regulated insurance market; and (3) contributing to stability in the global financial system.<sup>17</sup>

### **The International Accounting Standards Board (IASB)<sup>18</sup>**

In the past international accounting standards (IAS) were issued by the profession itself through the Board of the International Accounting Standards Committee (IASC). Since 2001 new standards have been known as the International Financial Reporting standards (IFRS) and have been issued by the International Accounting Standards Board (IASB). The IFRS standards establish the general rules of accounting on a global scale.

The IASB is a privately-funded organisation comprising 14 board members who, through various committees and consultations, are responsible for setting up, promoting and developing the standards set up by the IFRS board. The Organisation's mission is to set accounting standards that best serve the public interest and create internationally-acceptable guidelines for financial statement reporting.

### **The International Auditing and Assurance Standards Board (IAASB)<sup>19</sup>**

This body was established in 1978, originally as the International Auditing Practices Committee (IAPC), and has published more than 30 International Standards on Auditing (ISAs) and approximately as many International Auditing Practice Statements (IAPSs) and other pronouncements on topics such as quality control. Over 126 jurisdictions are now using or incorporating ISAs into their national auditing standards.<sup>20</sup> IAASB comprises ten members, nationals of different IFAC countries, and nominated by IFAC member bodies, five members representatives from the forum of firms, non-practitioners and practitioners in both auditing and insurance, a full-time chairman and three public members who are non-practitioners.<sup>21</sup>

The mission of the International Federation of Accountants (IFAC), as set out in its constitution, is ‘to serve the public interest, strengthen the accountancy profession worldwide and contribute to the development of international economies by establishing and promoting adherence to high quality professional standards, furthering international convergence of such standards, and speaking out on public interest issues where the profession’s expertise is most relevant.’<sup>22</sup> During the crisis the IAASB developed a variety of publications such as staff audit practices addressing audit concern in consideration of the actual economic environment, and emerging practices issues having regards to the use of external confirmation in an audit of financial statements.<sup>23</sup>

### **The International Organisation of Securities Commissions (IOSCO)<sup>24</sup>**

As the name implies IOSCO has representation from securities regulators, or equivalent agencies, in member countries and membership extends to a wide range of economies.

The objectives of the Organisation are to provide a forum for cooperation in developing, implementing and promoting adherence to internationally recognised and consistent standards of regulation, oversight and enforcement to protect investors, maintain fair, efficient and transparent markets, and seek to address systemic risks. It also attempts to enhance investor protection and promote investor confidence in the integrity of securities markets, through strengthened information exchange and cooperation in enforcement against misconduct and in supervision of markets and market intermediaries.

Part of IOSCO’s functions involve the exchange of information at both global and regional levels on respective experiences to assist development of markets, strengthen market infrastructure and implement appropriate regulation.

### **Institutional saturation?**

All the above institutions operate within the same dominant economic paradigm and with belief in the self-equilibrating nature of financial

markets. This is not the opportunity to consider those economic principles and their continued validity. The question rather arises as to a global financial authority would fit into the above institutional mix, which also includes the IMF whose mandate was boosted by the G-20. More particularly if there is a body such as a WFO what functions might it perform vis-à-vis the Financial Stability Board. In terms of the latter question there are four main options:

- It could have a coordinating function in relation to the activities of existing financial institutions.
- It could have specific and exclusive over-arching authority over policy development in key financial areas identified by the G-20.
- It could have the ‘constitutional’ functions currently performed by WTO agencies, providing a forum for member states to negotiate relevant policy and a mechanism for resolving disputes among them.
- It could have a direct ‘government’ function exercised through a constituent body able to impose policies directly on member states, with executive and supervisory functions for their implementation and monitoring.

## **A WORLD FINANCIAL ORGANISATION**

What follows is an evaluation of aspects of the Boone/Johnson extract above:

### **1. Enshrinement of regulatory powers in an international treaty**

Institution-building in the contemporary world order operates at three traditional levels.

The first is the multilateral level which attempts to engage all countries in treaty-making exercises. It has succeeded in relation to many of the United Nations family of Organisations and to the World Trade Organisation in 1995. However multilateralism is not what it used to be and the failures of the Doha trade round over many years highlights the predicament. It is not only a question of the increased number of states participating in international negotiations, but the changing power relations and the

intensity of issues involved. This has led to many deviations from multilateralism, and in reality all such deviations are preferential and discriminatory in intent and effect.

The second is the regional level which has reached a new intensity in recent years given the difficulties with multilateralism. The high point of regionalism is found in the European community where legal imperatives from central agencies now enjoy juridical paramountcy in constituent nation states. Other forms of regionalism abound and there are now attempts to form 'meta-regionalisms', for example among the SADC, COMESA and the EAC.

The third is the bilateral level at which there has been exponential activity in recent times, particularly in relation to cross-border investment agreements. The majority of about 6000 international investment treaties in existence comprise bilateral agreements. Other bilateral treaties operate in trade, tax and other areas of economic activity.

Plurilateralism provides another option in international decision-making and is well-established in the WTO system. Essentially it involves the development of multilateral agreements which can be acceded to on an opt-in basis by other countries, as is the case with the Agreement on Government Procurement (AGP) in the WTO system. Plurilateralism has the advantage of short-term effectiveness in that few state commitments are required to establish a particular treaty; however for subsequent accession states there could be democratic deficit concerns based on their lack of involvement in the original agreement. The WTO itself has a 'single undertaking' rule which requires accessing states to commit to all the organisation's covered agreements to ensure membership.

Ideally a global financial authority modelled on the WTO with the objectives of providing long-term financial policy should be based on the principle of multilateralism. However given the challenges faced by the WTO in relation to multilateral decision-making there is little prospect of this materializing in the short term. The G-20 group of countries took initial decisions on a consensus basis but this involved only a small group of states, and even then its capacity to reach consensus dissolved after the crisis had retreated from its peak. Plurilateralism, despite its shortcomings, would be a more practical option for establishing a WFO.

## **2. Similar to the World Trade Organisation**

The WTO is the seminal multilateral rules-based institution in the global economy. Essentially the WTO provides a forum in which member states can negotiate agreements on trade and trade-related issues, as well as providing monitoring and capacity-building services. One of the strengths of the system is that over 150 countries have acceded to the WTO framework, the members of whom account for nearly 90% of global trade.

However, one of the paradoxes of the WTO system is that its most highly regarded aspect is the dispute settlement system, involving Panels and the Appellate Body determining whether member states' policy, laws or practice measures are compliant with their obligations under the covered WTO agreements. In past years there has been extensive activity in this body but a degree of atrophy in the WTO's rule-making function. The Doha 'development round' of trade negotiations has been in stalemate mode since 2006, partly because of the incompatibility of interests between the US and EU, on one hand, and emerging and developing economies, on the other. Multilateralism is always a problematic decision-making process in international law and is starkly reflected in the WTO. This is a problematic situation as a rule-making vacuum in any social system inevitably places strain on the dispute resolution processes as members seek new interpretations of outmoded rules. The adjudicative system is always decisive in that there is no longer any plenary second-guessing of DSU determinations – a consensus of all countries, including the successful party, is required to overrule a Panel or Appellate Body decision.

The WTO therefore provides a limited model for a WFO which would have to resolve the tension between rule-making and rule-adjudication experienced by the former.

## **3. Trade in goods and services**

Global finance has an inherent unpredictability as interest rates and exchange rates can never accurately reflect current economic conditions. As Anetole Kaletsky<sup>25</sup> argues,

...trying to create more perfect markets for financial products is often counterproductive because financial products exist to deal with uncertainty.

The extrapolation of the principles of liberalisation and market access from trade in goods and services to global finance overlooks some of the key differences between the two, differences which also manifest partly in the differences between goods and services. The 'real economy' in goods and services has tangible and transparent attributes not apparent in new financial instruments, hedge funds, private equity and portfolio investments, for which the regulatory systems used for the former might not be adequate.

In this respect the WTO, which focuses exclusively on goods and services, again provides a limited model for a WFO, apart from broad principles such as MFN and national treatment. The financial system has become infinitely more complex than traditional trade systems and involves more substantial issues of moral hazard.

**4. Harder for national legislatures and regulators to relax regulation, reduce the 'beggar-thy-neighbour' costs imposed on others when one nation deregulates and reduces the incentives for a 'race to the bottom' in regulation.**

One of the objectives of a global regulatory system is that it would make it more difficult for national legislatures and regulators to play hard and fast with regulations in pursuit of their immediate local interests. Regulations might be relaxed for protectionist purposes, to increase comparative advantage in key sectors, to respond to local political pressures, or because of local regulatory capture. Here the prisoner's dilemma, an aspect of complexity theory, comes into the picture as the first country to relax regulations may secure advantages for itself in the short term but its actions may lead to disadvantages to all players in the long term.

While there is sometimes a measure of exaggeration in 'race to the bottom' theories, differences among regulatory systems create arbitrage opportunities for transnational corporations, and exploitation of these opportunities

creates more short-term incentives for states to relax their regulatory systems. This can operate in taxation, currency exchange, banking, other financial institutions and all areas of finance in which there are short-term advantages in 'defecting' from global norms. This is a global moral hazard issue of a political nature which has torpedoed and sunk the global financial ship before.

In practical terms this implies that a WFO would have to enjoy compulsory and enforceable jurisdiction over policy and regulatory activities in individual nation states to prevent the prisoner's dilemma from being played out by states and regulators in a competitive environment. Here the WTO does provide an appropriate model as tariff bindings, once made by a state, cannot be modified to the disadvantage of trading partners without adverse potential consequences being visited on the defecting state by the organisation's dispute resolution bodies.

## **5. The treaty would need to have simple rules, including large capital requirements.**

This cryptic point is not addressed by the authors and requires some divination from the context of the paragraph in which it stands. It is clearly designed to redress the inadequacy of capital requirements and extensive leverage in banking institutions in the past. However it would be unusual for capital requirements to be included in treaty rules, given the need for these to be adjusted over time and given the need for some plurality of arrangements for different economies and different institutions within economies. Moreover capital adequacy is sound in principle but requires significant effort to put into practice and where a few small economies, such as an Iceland, are not compliant it can create deregulatory pressure in larger economies.

While the plea for simple rules is self-evident, rule simplification has eluded legislatures and executives over the years. In the context of international treaties there is a strong inclination to leave the language of provisions broad and ambiguous so that each side can present outcomes as favourable to constituents. This has the implication that meaning derives from the interpretations of those who interpret the provisions in their execution, administration or adjudication. The meaning of provisions, in

other words, is deferred until their implementation or enforcement. This suits political expediency but is problematic for the kind of specific regulation required in financial regulation.

**6. It would also need to have a body that monitored implementation, similar to the IMF or BIS today.**

The mandate of the BIS, and its group of ‘clients’ might seem restricted in comparison to those of a prospective WFO. Monitoring functions are necessary to prevent the prisoners’ dilemma scenarios referred to in point 4 above. Many social norms are self-enforcing and economic theory has argued the self-regulatory nature of markets. However, rules in all legal systems require monitoring, investigative, operational and policing functions. Normatively these functionalities should adhere to elementary principles of objectivity, proportionality, transparency and procedural fairness in their application. Dispute resolution and rule adjudication also denote principles of neutrality, objectivity and procedural fairness. However, while the administrative functionality, which is utilitarian in nature and needs and tolerates variability in operation, adjudication requires consistency over time and meta-norms in the form of fundamental rights which trump economic policy.

The WTO has a small secretariat which has little role in investigating and monitoring states’ compliance with their obligations. Greater institutional support is provided for dispute resolution system but this relies on individual states to prosecute complaints in terms of the DSU rules, with no independent authority to undertake this function. It again provides a limited model for monitoring and implementation functions in the enforcement of global financial regulation.

**7. This body would also need to have clear rights to impose new regulations so that rules can be modified to reflect changes in problems**

This requires a constitutional arrangement along the lines of the WTO to support a continuing governance role. There have been analyses of the WTO structures and procedures in terms of their constitutionalising

tendencies although there are several shortcomings in this notion. Nonetheless a WFO would require structures, division of powers and procedures similar to the WTO to enable it to perform ongoing regulatory functions. The difficulties alluded to in terms of multilateralism would require gradations of decision-making procedures for issues of varying significance and impact. However the reality of volatility in global finance indicates the need for responsive policy mechanisms.

## **Conclusion**

Davies and Green<sup>26</sup> suggest in relation to the current international system of regulation:

It looks extremely cumbersome, involving complex structures intersecting at many levels and locations,.. It is clear that, if we were starting afresh, we would not create the system we now have, with all its overlaps, underlaps and complexity.

The authors suggest that the following principles should guide the developing of a new order in which nation states pool specific areas of sovereignty in international institutions:

- Simplification – though few institutions or groups in this area ever die;
- Legitimacy – to take account of changing realities in the global economic order;
- Structure – in the sense of clear financial architecture with defined powers;
- Responsiveness – to new or changing financial entities such as Islamic finance, sovereign wealth funds or private equity.

If the global political economy were construed in terms of a nation state, it would not only lack institutional frameworks, but also suffer a significant democratic deficit. The more such a body assumed rule-making functions the more it would be necessary to address the deficit. Rule-making functions are a requirement in all areas of the global economy, trade, financial as well as investment, and auxiliary areas closely bound up with the economy such as competition and the environment. These are all self-

evident areas of policy-making in national states and require equivalents at the global level. Rule-making prescribes rules for economic behaviour, procedures for their enforcement and consequences of non-compliance.

New rule-making institutions, such as a WFO, with functions in financial governance require legitimacy either through their method of composition and accountability or through the effectiveness of their performance. In the long run the former provides more stability than the latter. The G-20 operated with a limited degree of democratic legitimacy but during its first year its policy imperatives attracted wide credibility because they were perceived as appropriate and appeared to be successful. However by mid-2010 there was little over-riding consensus as differing national interests attempted to predominate in the deliberations. As a consequence the latest meeting of the G-20 achieved little of substance and left the credibility of the institution damaged.

Legitimacy is not the only aspect which poses challenges for the concept of a WFO. Take the issue of public funds being used to bail out banks. One could argue that this constitutes a permanent risk as it encourages indebtedness and defaults which will be forgiven through government largesse. Moral hazard suggests that creditors should bear the risks not taxpayers. However when risk theory meets political reality the likelihood is that the latter will prevail and governments will not allow financial institutions to fail, other than in exceptional cases.

What would the lowest common denominator of the factors referred to above be for a WFO institution? In the first place it would be plurilateral in nature to avoid the endemic problems of plenary multilateralism. Secondly, it would have coordinating functions vis-à-vis the other institutions referred to above. Thirdly, it would involve a combination of soft and hard laws. Fourthly, it would require Rule of Law type procedures, and standards such as proportionality in regulation, full costing of externalities, and avoidance of moral hazard. Fifthly, it would require some administrative agencies to engage in monitoring and surveillance activities.

David Unterhalter has referred to the Bretton Woods project as having occurred at an idealistic moment in world history, and the same may be said for the 1995 WTO Agreements and to a lesser extent the London

meeting of the G-20. Current conditions might not provide the same idealistic moment for a WFO, particularly while the same economic paradigm continues to dominate. However, they may be auspicious for taking incremental steps in the direction of a world financial authority.

## Notes:

<sup>1</sup> Peter Boone and Simon Johnson, 'Will the politics of global moral hazard sink us again?' in the London School of Economics Survey, *The Future of Finance – And the theory that underpins it* (2009) 247.

<sup>2</sup> Joseph Raz, *Practical Reason and Norms* (OUP, 1999, 150)

<sup>3</sup> H Davies and D Green, *Global Financial Regulation – The Essential Guide* (Polity Press, 2008) 32-3.

<sup>4</sup> See <http://www.financialstabilityboard.org/members/links.htm>

<sup>5</sup> As reflected in the G20 Leaders' Statement a consensus emerged towards placing the FSF on stronger institutional ground than it had been:

[http://www.financialstabilityboard.org/publications/r\\_090402.pdf](http://www.financialstabilityboard.org/publications/r_090402.pdf).

<sup>6</sup> See remarks of Mario Dragui, Chairman of the FSF, at conclusion of London Summit, 2 April 2009. [http://www.financialstabilityboard.org/publications/r\\_090402.pdf](http://www.financialstabilityboard.org/publications/r_090402.pdf).

<sup>7</sup> Sub-bodies within the FSB for dealing with supervision of national authorities responsible for financial stability, in order coordinate national policies in the pursuit of global stability.

<sup>88</sup> Currently Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Mexico, The Netherlands, Republic of Korea, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, the UK and the US.

<sup>9</sup> These include the Bank for International Settlements (BIS), the European Central Bank (ECB), the European Commission (EC), International Monetary Fund (IMF), the Organisation for Economic Coordination and Development (OECD), **and** the World Bank.

<sup>10</sup> The Basel Committee on Banking Supervision (BCBS), Committee on the Global Financial System (CGFS), Committee on Payment and Settlement Systems (CPSS), International Association of Insurance Supervisors (IAIS), International Accounting Standards Board (IASB), International Organization of Securities Commissions (IOSCO).

<sup>11</sup> See <http://www.bis.org/about/index.htm>

<sup>12</sup> See The BIS in profile. <http://www.bis.org/about/profile.pdf>.

<sup>13</sup> The central banks or monetary authorities of Algeria, Argentina, Australia, Austria, Belgium, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, Chile, China, Croatia, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong SAR, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, the Republic of Macedonia, Malaysia, Mexico, the Netherlands, New Zealand, Norway, the Philippines, Poland, Portugal, Romania, Russia, Saudi Arabia, Serbia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Thailand, Turkey, the United Kingdom and the United States, plus the European Central Bank.

<sup>14</sup> See <http://www.bis.org/list/bcbs/index.htm>

<sup>15</sup> The Committee's members are from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the U K and the US.

<sup>16</sup> See <http://www.bis/>

<sup>17</sup> See <http://www.iaisweb.org/>

<sup>18</sup> See [http://www.ehow.com/about\\_4687975\\_international-accounting-standards-board.html](http://www.ehow.com/about_4687975_international-accounting-standards-board.html)

<sup>19</sup> International Auditing and Assurance Standards Board: A Brief History of its Development and Progress <http://www.ifac.org>.

<sup>20</sup> International and Assurance Standards Board Terms of Reference, Annual Report 2009 - [http://web.ifac.org/download/2009\\_IAASB\\_Annual\\_Report.pdf/](http://web.ifac.org/download/2009_IAASB_Annual_Report.pdf/)

<sup>21</sup> See above, note 13

<sup>22</sup> International Auditing and Assurance Standards Board Terms of Reference—March 2010 - [http://web.ifac.org/download/IAASB-Amended\\_Terms\\_of\\_Reference.pdf](http://web.ifac.org/download/IAASB-Amended_Terms_of_Reference.pdf).

<sup>23</sup> See above, note 12, p12.

<sup>24</sup> See <http://www.iosco.org/>.

<sup>25</sup> Anatole Kaletsky, *Capitalism 4.0 – the Birth of a new Economy* (Bloomsbury, London, 2010) 191.

<sup>26</sup> Note 3 above, Chapter 7.

# New Directions in Economics and Ethics: Towards a Systematic Relationship

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GERARD WALMSLEY

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## Preamble

In what follows *I will attempt to introduce a little philosophical foolishness into economics*. At the same time I will argue that philosophers are not the only ones to think in peculiar ways. I agree with Descartes that ‘nothing is so incredible that some philosopher has not proposed it’. Then I found they had strong rivals amongst the economists! This led me to realise that, along with my explicit inquiry into economics and ethics, I had to deal with another issue: how and how not to think like an economist. In order to respond to my main concern with integrating ethics and economics I found I had to reflect on economic ways of knowing and even to criticize them where their writings took on an Escher-like quality.

*Economists, I found, could also propose incredible things*. Keen (2001) claims that economists often invoke Escher-like assumptions and that:

[s]tandard economic diagrams are rather like Escher drawings, in which the rules of perspective are used to render scenes which appear genuine - but which are clearly impossible in the real, three dimensional world (2001: 15).

I came to the conclusion that it is these Escher-like assumptions that would frustrate any attempt to relate economics and ethics. Before deciding on new directions in ethics AND economics we may have to work out new

directions in economics itself - we have to look for something other than mainstream neoclassical economics.

Generally, I approached this inquiry from two directions: (a) *as a member of the general public*, as a consumer or victim of economic advice, and (b) *as a person with philosophical interests* led to take note of the philosophy of human nature, the theory of value, and the philosophy of science implicit or explicit in economic theory.

On this basis, I came to agree with various commentators that: (a) *economics is too important to leave to economists*, and (b) economics cannot insulate itself entirely from questions raised by neighboring disciplines or by members of the wider social and political community. Economics is “*not beyond the scrutiny of the broader population that has to live with the consequences of its advice*” (Smith 2010:304).

## **I Introduction: The scope of the inquiry**

My main topic is ‘new directions in economics and ethics: towards a systematic relationship’. Let me begin by defining my terms. By ‘*economics*’ I have in mind the economy, economic theory, policy and prescriptions, as well as business theory and practice. By ‘*ethics*’ I have in mind philosophical reflection on properly human action, that is, on intelligent, responsible and free action, including reflection on human nature and intentional human consciousness. However, the most problematic term is the conjunction: The real topic is ‘*economics AND ethics*’. I want to discuss *why* we need to bring the two sides into closer alignment and *how* this might be done.

Hence I have to refute the position that there is no conjunction. A common view, held unreflectively by many, and explicitly insisted upon by economic theorists is that there is no conjunction. I argue that this perspective is simply wrong - and dangerously wrong - as the recent global economic crisis shows. This moral scepticism is bound up with neoclassical economic theory. I shall argue that this need not be so: we need both intelligent economics and ethical economics and not just the ‘economic rationality’ of establishment theory.

My thesis is that a systematic link between economics and ethics can be found if we develop a deep enough account of the human being, if we appreciate the nature of the human person who is both an economic agent and a rational agent, and if we look more closely at actual economic performance (and not just at idealized models). Developing this deeper understanding requires what is technically called ‘intentionality analysis’. The term may be off-putting and unfamiliar, but it refers to our human capacity for self-reflection, the capacity by which we grasp ourselves as human persons. I argue that a sustained effort at self-attention as we perform in the economic and the ethical realms will throw light on their interconnectedness.

This need for this kind of reflection may be overlooked in mainstream economic thought. *I argue that mainstream economics is not reflective enough about its assumptions, about its status as a ‘science’, about the relationship of economic theory and economic practice, about the way economists are trained and about the relationship of economics to ethics.* And to give backing for this evaluation I offer a survey of contemporary critiques that support the claim. The need for new directions then becomes clear.

Many people may see no real need for new directions despite frequent complaints that economic theory is misguided in serious ways. My aim will be to show once and for all that there really is a problem with entrenched neoclassical economic theory. There are a range of problems which cannot be ignored or brushed off as they often are when encountered separately. I believe that too much is at stake to allow any easy dismissal. If economic theory undermines democracy and corrupt capitalism (Smith 2010) or if thinking like an economist undermines community (Marglin 2008), then attempts to evade the problems are irresponsible - criminally so according to one commentator.

However, I will also sketch out a number of positive openings for economic theory in relation to ethics. The survey of contemporary critiques already begins to point what the required new directions might be. Building on this I consider three developed alternatives to standard economic thinking: the methodological economics of Lonergan (1998, 1999), the humanistic social economics of Lutz (1999) and finally the integrative ethical economics of Ulrich (2008). In a single article it is

impossible to develop completely new alternatives, but a convincing case that such alternatives exist can be made.

## **II. The challenge of ethical scepticism**

In order to establish some kind of systematic relationship between economics and ethics I must overcome the challenge of a widespread and pervasive scepticism found in economists, businessmen, the general public, theologians and even philosophers. It is useful to indicate the different forms this scepticism takes as this helps us to work out how best to respond to it.

An extreme insistence on the separation of economics (or business) and ethics is found in *business leaders*. Apparently John D. Rockefeller said he would pay an annual salary of a million dollars to someone with the right qualities:

[The ideal employee] must know how to glide over every moral restraint with almost childlike disregard...[and have] besides other positive qualities, no scruples whatsoever, and [be] ready to kill off thousands of victims - without a murmur (Quoted in Solomon 1997:21).

Another example follows the same line in a more restrained way:

A friend recently said that running a business with a conscience is like driving with the brakes on (Hawken 1994:57).

In a further example we find a CEO when asked whether a conference for sales people should include a session on ethics replying: “*The sales meeting is supposed to be upbeat and motivational. And ethics is such a negative subject*” (Quoted in Maxwell 2003:7). Clearly some business people think there has to be a choice between being successful and being ethical.

Students in business studies apparently learn the lesson early (or bring it with them as part of modern common sense). Ahner (2007:2-5) provides the details. He reports that when asked how they could reconcile moral sensibility and business practice students replied: (a) I need to make a

living (I can't afford to be moral right now); (b) I try to do my own job in a morally responsible way (the company may be immoral and I may be pressured to compromise); (c) I won't do anything illegal (moral comes down to legality and staying out of trouble); (d) It's up to the government to regulate business (it is not my responsibility).

The next group to treat the separation are the *economists*. I briefly touch on their stance as I will return to it in more detail later. In neoclassical economic theory the strict separation is needed in order to defend the scientific status of 'positive economics'. For example, we find Lionel Robbins insisting that 'economics cannot pronounce on the validity of ultimate judgments of value' and John Hicks saying that a values-based economics is "a dreadful thing to accept" (Quoted in Lutz 1999:105).

*Philosophers* enforce the separation in their own way. Plato began the tradition by arguing that the state should keep its trading class as small as possible' and that "trade should be made over to a class of people whose corruption will not harm the state unduly". And Aristotle held that "no man could share in office who had not abstained from selling in the market for a period of ten years" (Both quoted in Ahner 2009).

These ancient philosophers certainly felt that economics and business were in tension with philosophical ethics. Modern philosophical ethicists often do not improve things much. Too often they present a spectrum of unrelated philosophical traditions and then apply them as abstract single lens principles to complex concrete situations including economics. The principles are then applied as simple corrective measures in business ethics case studies. There is little direct engagement and little effort at real integration. *So anyone seeking for new directions in economics and ethics receives little support from the philosophers as well as from the economists.* The philosophical ethics is often not foundational enough in that it stays at the level of over-neat theories that are not re-thought.

So we come to the *theologians*; to moral theology and Catholic social teaching as well as liberation theology and political theology. This stance also relates to some versions of secular social economics, including Marxism. The separation of economics and ethics takes the form of a tendency to see the need of ethics to critique business only in an extrinsic way, as Lonergan (1999:xxviii) judges:

As a general command, the moral precept of a 'just' or 'family' wage so stressed by the social encyclicals - in traditional Catholic teaching more a precept of charity than of justice - was extrinsic to the economic situation of businessmen and wage earners.

In other words, there is a gap between 'well-intentioned moral demands' and 'concrete exigencies'. *The unfortunate consequence was that Catholic business people who followed the teaching on a 'family' wage went out of business.* Similarly when liberation theologians or Marxists point out the negative effects of 'capitalism' they tend to call for distribution of wealth in isolation from any understanding of how it is created. In all these cases what is missing is the effort at understanding how the economy actually works which would allow constructive suggestions to replace moralistic or ideological judgments. As Lonergan says: "moral precepts that are not technically specific turn out to be quite ineffective" (1999:106n135). To that extent he agrees with the economist Samuelson who said: "in economics it takes a theory to kill a theory" (Quoted in Martin 2008:166).

The challenge is to overcome an apparently impossible dilemma. Lonergan sets out the dilemma vividly and tries to respond to it. In his *'Healing and Creating in History'* (1985:100-109; 1999:97-106) he considers the views of Bertrand Russell and Karl Popper on 'what is wrong with the world'. He finds that for Russell the problem is that human beings are "clever but wicked", while for Popper we are "good but stupid" (1985:100-101). For Lonergan the two views are equally inadequate for they amount to the same thing: *the separation of intelligence and goodness*. What we need then is to understand how the 'creativity' of intelligence can be linked to the 'healing' of a good will. The myth of the separation has to be overcome and a dynamic integration effected: we need more than a rigid economic rationality insisting on understanding itself as a hard science that has no room for ethics; we need more than an ethics that restricts itself to extrinsic corrections or moralizing. Lonergan (1999:105) makes two suggestions:

The first regards economic theorists; the second regards moral theorists. From economic theorist we have to demand, along with as many other types of analysis as they please, a new and specific type that reveals how moral precepts have both a basis in economic process and so an effective application to it. From moral theorists we have to demand along with their

other various forms of wisdom and prudence, specifically economic precepts that arise out of economic process and promote its proper functioning.

Lonergan asks for contributions from both sides and in effect calls for interdisciplinary collaboration between economically, well-informed, ethical theorists and ethically, responsible economic theorists. Meanwhile Lonergan makes his own contribution to this by applying his philosophy of self-appropriation to both ethical thinking and economic thinking. He offers a fuller account of human agency that shows how the required intelligence may be united to and preserved in an equally essential moral perspective. He reflects at length on how this applies to economics. He shows how both intelligent and responsible action is required to sustain economic process. But the desired integration is rarely attempted by most thinkers and the many reasons for this need to be examined.

### **III Why we need new directions in economics and ethics: The data on dissent**

In the following sections I want to establish the urgent need for new directions in economics and ethics. The prior task is to *rethink economics itself* in itself, for there are many aspects of mainline economic theory that marginalize or rule out ethical considerations from the start. The second task is to *rethink economics in relation to ethics*, once we have established that a relationship cannot be ruled out in advance. A number of recent critiques bring out the problematic aspects. *A survey reveals a discipline under pressure*. Dissident economists join with non-economists to question much of establishment economics, arguing that it has problems with its assumptions and with its self understanding as positive science, as well as with its relationship to ethics.

As we shall see the number of critiques of orthodox economics is growing. Some mainstream economists try to defend the established position. Coyle in: *The Soulful Science: What Economists Really do and Why it Matters*, argues that “economics gets an unfairly bad press” (2007:1). I am not so sure and tend to support Sam Keen who says that economists are: “*Mad, Bad and Dangerous to Know*” (2009).

Coyle tries to dismiss the criticism as the “popular unpopularity of economics” is out of date. She also uses the defense that “we already know all this” and have responded to it (2009: 2, 249). I would still maintain that the range of diversity in the criticism cannot be so easily dismissed. Even if economic theory has moved on, it remains true that much of what is questionable is still taught in ‘toxic textbooks’ and it remains true that too many economists continue to see economics as a ‘hard’ science rather than as a social science, and finally it is still true that ethics is marginalized. Moreover the common complaint is still heard that economists do not engage outsiders: they manifest “a dismissive attitude to deter reasonable questions” or retort with superficial responses that do not engage the issues raised (Smith 2010:305). Physicists make more effort to explain ‘string theory’ or ‘quantum mechanics’ than economists do to explain their theorems. Jonathan Aldred responds directly to the ‘economics has already changed for the better’ line. He argues that much of the cutting edge is even more unrealistic than the standard account it builds on. Furthermore he says that “unreconstructed unrealistic economics is not in decline” but continues as economics colonizes other areas. This is seen in contemporary political economy (2009:231-234).

It is for this reason that I give so much attention to the ‘*data on dissent*’. Something is wrong with the discipline and how it communicates. The number of critics grows and collectively echoes an earlier judgment ‘economics is a dismal science’. Any human science can become open to suspicion if it is divided ideologically or if it seems remote to real life concerns. According to Lonergan “the notorious instance at the present time is economics” (2004:302). A survey of positions reveals the reasons behind the suspicion and the reasons for rethinking economics.

### **III.1 The parallel with business studies: Ghoshal’s challenge**

My concern is to show that there is an urgent need to rethink mainstream economic theory, particularly in relation to ethics. Providentially the ground I want to cover has been mapped out in the neighboring discipline of business studies. In an extremely important article: ‘*Bad management theories are destroying good management practices*’ (2005), Ghoshal sets out the case concerning business studies. Ghoshal argues that bad theory in the form of: (a) a ‘pretension to knowledge’ or scientism that has reduced

the social science of business studies to a supposed ‘hard’ science, and (b) a ‘gloomy ideology’ involving pessimistic assumptions about human nature has invaded business schools. *This has led to the bad practices of treating both managers and employees as simply ‘maximizers of self-interest’ who cannot be trusted to do their jobs. Hence managers need obscenely inflated incentives to get them to do their job properly, whilst employees will only work properly if suitable surveillance mechanisms are in place. And because all this is taught to each generation of students in MBA programmes the bad practice is perpetuated.*

For Ghoshal the underlying problem is the denial of what he calls ‘intentionality’. Both the ‘pretence to knowledge’ and the ‘gloomy ideology’ may be traced to the suppression and truncation of human intentionality. More simply the problem lies in the failure to appreciate the full dimensions of intelligent and responsible action, the failure to recognising persons as persons. In this way Ghoshal provides me with a backdoor entry into the issues I want to raise, and he does this with a rhetorical intensity that may excuse a similar tone in my own presentation.

Ghoshal argues, firstly, that the pretence to ‘scientific’ knowledge has led to the “exclusion of any role for intentionality or choice”, the concern to make business studies a science involves “a firm belief in causal determination for explaining all aspects of corporate performance” (2005: 86). So “business is reducible to a kind of physics” where the role of managers is completely determined by economic, social and psychological laws. Causal and functional management theories squeeze out intentional explanation (2005:79). This inadvertence of intentionality then leads to a proliferation of uncritically adopted theories based on unnoticed epistemological assumptions. It also frustrates attempts to integrate theories in a way that would adequately deal with “phenomena of organised complexity” (2005:86), such as a business, a human being, human society, an economy, a global economy.

Without an appreciation of human intentionality and hence without an adequate epistemological perspective we cannot make sense of the “many different and mutually inconsistent theories” that explain the same phenomenon “often to very similar extents”. For we have no basis on which to weed out inadequate theories or combine promising ones. Hence,

“the choice among theories then falls very much on a scholar’s personal preference” (2005:86-87). Ghoshal (2005:87) warns us that:

Excessive truth claims based on extreme assumptions and partial analysis of complex phenomena can be bad even when they are not altogether wrong. In [this regard], social scientists carry an even greater social and moral responsibility than those who work in the physical sciences because if they hide ideology in the pretence of science, they can cause much more harm.

This is a very important assessment that may apply as much to economics as to business studies. It too has to deal with ‘phenomena of organised complexity’. In economics, as well as business, human intentions matter. The importance of the discussion so far may be seen in the way that a pretence to science already begins to marginalize morality, with serious effects on students:

Since morality, or ethics, is inseparable from human intentionality, a precondition for making business studies a science has been the denial of any moral or ethical considerations in our theories and, therefore, in our prescriptions, for management practice (Ghoshal 2005:77)

I suggest that by propagating ideologically inspired amoral theories, business schools have actually freed their students from any sense of moral responsibility (Ghoshal 2005:76)

And this permeates the curriculum:

In courses on corporate governance grounded in agency theory...we have taught our students that managers cannot be trusted to do their jobs...and that to overcome ‘agency problems’ management interests and incentives must be aligned with those of share holders by, for example, stock options as a significant part of their pay. In courses on organisation design, grounded in transaction costs economics, we have preached the need for tight monitoring and control of people to prevent “opportunistic behaviour” (Ghoshal 2005:75).

This leads us into the second issue raised by Ghoshal: the problem of the ‘gloomy ideology’. Here we consider more directly the (non) recognition of ethics in the social sciences. At this point the link to economics becomes explicit as Ghoshal traces the problems in business studies to the economic theory of the Chicago School of Economics, and to what

Friedman calls 'liberalism'. Here we encounter the problematic account of human nature found in 'liberal anthropology' in the alarming figure of the *homo economicus*. Ghoshal argues that psychology, sociology and economics, the disciplines in which business studies finds its roots, "have increasingly converged on a pessimistic view of human nature" (2005:82). He follows Friedman in calling this ideology 'liberalism' and characterizes it as the view that "the primary purpose of social theory [is to solve] the "negative problem" of restricting the social costs arising from human imperfection" (2005:77). That is, after assuming a pessimistic view of human beings as 'self-interested' we must go on to manage and control this or, as in economics, claim that market forces will do this.

This gloomy view of human nature informs research agendas and research methodologies, as well as the teaching curricula. We can now see that the exclusion of intentionality has huge implications. It results not so much in the exclusion of ethics as in the inclusion of a gloomy ethics and a reductionary account of complex human beings. We can see also, perhaps, why economics cannot be separated from ethics, for this gloomy ideology is at the core of economic theory. Mainstream economics has always worked with the model of people as rational self-interest maximizers - with the model of the *Homo Economicus* (Ghoshal 2005:82).

Ghoshal points out that the situation does not improve if we turn to behavioural economics or evolutionary ethics, if anything it is made worse. For we shift from rational self-interest to foolishness or irrationality and not to any 'other-than-self-interested' preference. The range of behaviour recognised is simply 'rational' or 'non-rational', an un-nuanced typology that continues to marginalize intentionality and which ignores the possibility of reflective intelligent and responsible action of reasonable agents.

We find, therefore, that despite claims to 'scientific' status and to being value-free, economics often insinuates values in the form of a gloomy ideology. Ghoshal (2005:83) argues that "no social science can be value free" and this applies particularly to economics:

While no social discipline makes a stronger claim to objectivity than economics, no domain of the social sciences is more value-laden in both

its assumptions and its language than economics and all its derivatives, including much of modern finance and management theories.

But because it focuses on approaches such as agency theory, social network theory, theories of social dilemmas that routinely exclude considerations of intentionality, economics does not realise the value-leadenness of its assumptions.

*The further consequence of the lack of self-reflective intentionality is that bad theory leads to bad practice.* In fact the bad theory becomes self-fulfilling according to Ghoshal. *In the first place when people are told that all human action is self-interested they may begin to put the theory into practice,* if only to protect themselves against all the others who really are self interested. *In the second place if you assume the theory and try to control self-interest by means of surveillance you might end up inducing self-interested behaviour.* For if responsible autonomy is denied it reasserts itself as irresponsible autonomy in protest. At this point absurdity in theory may lead to dehumanisation in practice (Isaiah Berlin suggests) as ruthless managers try to micromanage alienated employees (Ghoshal 2005:84-86; 79).

Interestingly, Ghoshal's hypothesis that bad theory and gloomy ideology can be self-fulfilling is both testable and has been tested - in economics! The cooperative behaviour of graduate students trained in microeconomic analysis based on the notion of self interest "*decreases significantly relatively to those peers trained in other disciplines*" (Moldavenau and Martin 2008:19).

Ghoshal says the solution in the first place is to "go from the pretence to knowledge to the substance of knowledge". This would involve allowing 'intentionality' explanations to take their proper place. It would involve seeking to relate "the different and contradictory facets of human nature and Organisational behaviour" e.g. other-regarding preferences and self-regarding preferences could be related. This would "vastly change our theory" (2005:85). Ghoshal also suggests that a more adequate theory would involve recognition of the wisdom of common sense. He even calls for "a scholarship of commonsense" (2008:82) and proposes "an epistemology of disciplined imagination". In addition he calls for theorists to be more self-reflective in attending to their assumptions and their

implicit epistemologies and ontologies, and asks for openness to a pluralism of methods (2005:87-88).

However, in the end, it is clear that Ghoshal is only able to gesture in the direction of a solution. He sees the need to do justice to ‘intentionality’ but has no detailed grasp of what ‘intentionality analysis’ might involve, or what its full implications might be for economics. In the end he has to admit “*we have made little analytical progress in the last 30 years on the positive problem [of recognizing other-regarding interests]*” - with ‘considerable cost to our students, companies, and to society” (2005:87).

### **III.2 The case of economics: First encounters with the ‘Dismal Science’**

We now need to consider the case of economics more closely. I begin with general observations from commentators who find in economics the same kind of problems that Ghoshal found in business studies. Following this I will consider in more detail how ‘the pretense to knowledge’, ‘the gloomy ideology’ and the tendency for ‘bad theory to lead to bad practice’ apply to economics. Finally I will outline the problems that economic theory has with ethical considerations.

Paul Ormerod has been a constant critic of what he calls ‘orthodox economics’. In *The Death of Economics* (1994; 1997) he finds “the whole basis of conventional economics is deeply flawed” (1999: v). His basic complaint is that “orthodox economics theory simply does not offer a proper account of the working of the economy of the West” (1999: vii). Part of the reason for this is that economics has gone off track by seeking “the status and prestige of the physical sciences” in a way based on an outdated model of science (1997: 9). Economic orthodoxy, trapped in an idealized mechanistic view of the world, is unable to respond adequately to present crises.

Ormerod complains that the mathematisation of economics gives an “air of scientific precision whilst hiding the implications of assumptions” (1997: 43). At the same time, it leaves even intelligent and interested members of the public unable to engage with the discipline that has a huge impact on

their lives: “A barrier of jargon and mathematics makes the subject difficult to penetrate for the non-initiate” (1997: v).

This mathematisation has an ideological function, according to Ormerod. Governments are expected to acknowledge the scientific status of economics and leave the markets free to be guided by the economist (1997:46). Note that the usefulness of mathematics is not denied. Rather the concern is that: (a) the tendency has been to use only the mathematics suited for a mechanistic world view or (b) the mathematics has been allowed to drive the economy rather than vice versa (1997:45). The mathematical model is allowed to overshadow the complexities of the real world economy. Ormerod finds, therefore, a pretence to science along the same lines as Ghoshal.

The insistence on scientific status is then shown to lead to unrealistic assumptions about economic agents. Economic theory holds that human agents influence each other only indirectly - for self-interested individuals do not relate to each other as social or properly personal beings (1997:ix). The assumption is that the behaviour of individuals can be ‘added-up’ to predict the working of the economy at the macro level (1997:206). The mathematics requires this. But Ormerod argues that this does not fit real-world behaviour. People do interact or cooperate. He points out how many disciplines recognising the interactions of different parts of a system or of different agents. Environmentalists and ecologists appreciate ‘the fundamental inter-dependence and complex feedbacks which exist in the world’s economies’ (1997:208).

Even physics recognises the relevance of non-linear mathematics for systems in which ‘the behaviour of the system as a whole can be sensitive to variations in the overall environment’ (1997:209). Such systems in the economy may have many more ‘solution paths’ than, for example, the mathematics of rational choice theory allows. Ormerod argues that economic historians intuitively understand how ‘the path which an economy follows can be very sensitive to a particular decision or set of decisions at a specific point in time’. And if certain paths are chosen there will be ‘no tendency for it to revert to a natural equilibrium’: the effect can ‘persist for decades’ (1997:209). In other words real-world economic process involves a dynamic interplay between economic agents and hence

their behaviour cannot be ‘added-up’ or expected to lead to an overall equilibrium state of the kind assumed by orthodox theory.

Recognition of the non-linear aspects of economic process forces us to rethink the question of ‘what kind of subject is economics’? Ormerod argues it is more like paleontology or cosmology than mathematics or physics. Like paleontology there is a single phenomenon and a single realm of facts to be investigated. Economics should build its theories around these facts ‘from the outset’, and it must respect real events and recognising how “from time to time external shocks are of crucial significance” (1997:211). Ghoshal would take a further step: we have to realise we are dealing with a social science and not a natural science. And this is also Ormerod’s final move.

Ormerod says he must state his final point in words for it is a question of moral value. He argues that the assumption of free market philosophies that there is no such thing as society “will prevent the creation of full employment regardless of the form which economic policy takes” (1997: 11). If it creates a huge and permanent gap between employed and unemployed this may also turn out to be a self-fulfilling prophecy: There will be no society for it has been destroyed.

The promotion of the concept that the untrammelled, self-sufficient, competitive individual will maximize human welfare damages deeply the possibility of ever creating a truly affluent cohesive society in which everyone can participate (Ormerod 1997:11).

Ormerod continues this line of thinking in: *Butterfly Economics: A New General Theory of Social and Economic Behaviour* (1998).

Marglin in: *The Dismal Science: How Thinking Like an Economist Undermines Community* (2008), takes up the final point made by Ormerod. He also characterizes the issues we are dealing with in terms of how economists think. For Marglin markets are important but the way we think about markets, the assumptions we make about markets, may be destroying community. The basic assumption that human beings are self-interested individuals seeking only how their unlimited wants may be maximized by rational calculation means that human relationships are

‘circumscribed and reduced by the market’ (2008:2). Instead of being at the service of the community, markets become its controller.

And economists facilitate this: “Economics is the enabler; economics provides the justification for building a world based on the market” (2008: ix). This influence of economics began before the Great Depression and continues, with even greater force in a more mathematical form, as each generation of students is inducted into standard economic thinking. The problem is that students then lose the ability to think of wider issues such as the community as a whole. “In the process, students are taught to put aside large questions, which inevitably take them beyond mathematics” (2008:x).

Moreover, students don’t even come with large questions as they have already been affected by the market themselves. They are focused already on ‘career advancement’. But these large questions cannot be avoided forever. They include such issues as the widening gap between rich and poor, the tension between efficiency and equity. And new questions continue to arise on the global level when we ask about “the cultural specificity of economic theory” (2008:xiii) - and how this might relate to the interventions of the World Bank or the IMF.

Marglin argues that if students merely master mathematical formalism without comprehending underlying economic process which involves human agents, or without appreciating the impact of economic theory and practice on wider social and cultural processes then community will be eroded. For this reason, he says, we need a “foundational critique of the kind that most economists and the discipline in its present form resist” (2008:56).

In his comprehensive account Marglin touches on all the problems raised by contemporary critics of economic theory and relates them to his central concern with the destruction of community. Like Ormerod he points to both cognitive and moral limitations in standard theory. So for example, he questions the ideology of algorithmic knowledge (2008:46, 116). This, he says, excludes the community as a source of knowledge: economic experts tend to act like doctors who do not listen to patients or as specialists who do not listen to general practitioners. This is a mistake for local knowledge can provide clues as to the bigger picture: it was the economic journalists

who discerned that the recent economic crisis was coming, while the theorists thought they knew better.

On the ethical side, Marglin argues that the assumptions of self-interest, individualism, of unlimited wants leads not only to an inadequate account of the human good, but also to an inadequate account of the reality and relevance of judgments of value (2008:68). This distorts human self-understanding because it overlooks the possibility of a development in which preferences are refined; it overlooks the possibility of a self-transcendence that allows us to apprehend objective values, especially the value of another person. The transformation of the vice of selfishness into the virtue of self-interest needs to be challenged (2008:96-112). Again an ideology is at work here, thinks Marglin. Assumptions about self-interest, individualism, unlimited wants as well as a certain model of the State are half truths received from the ideology of modernity or 'liberalism' (2008:38).

Also on the ethical side, Marglin goes on to critique the rigid separation of positive economics and welfare economics and the unreal separation of production and distribution that marginalizes ethical considerations (2008:173-197). Economists tend to think of themselves as being responsible for the 'size of the pie', saying they leave it up to politicians to determine the 'way the pie is sliced' - clearly putting more trust in politicians that most citizens would think is justified. For Marglin it is highly debatable whether this separation can be done so neatly: economics is inescapably 'political economics'. He notes the ultimate ethical problem of economic rationality and of the free market economy is that "enough is never enough" (2008:199-222).

This leads to a discussion of the "Economics of tragic choices" (2008:223). Here he explains how the third or developing world comes to carry the burden e.g. it is asked to import pollution as a way of supposedly alleviating its poverty (the request comes from World Bank CEO Lawrence Summers). This points to the final problem: the transformation of imperialism into economic globalism (2008:245; 264).

The most trenchant critic of establishment economics is probably Steve Keen in his: *Debunking Economics: The Naked Emperor of the Social Sciences* (2010) - he manifests the same kind of rhetorical intensity as

Ghoshal. Keen begins his critique by quoting Keynes on the need to escape from “habitual modes of thought and expression”, but argues that “Keynes’s own escape was incomplete” (2010:xii). Keen was originally educated into the Keynesian-Neo-Classical synthesis, but found that this education into economics was “little better than an indoctrination” (2010: xiii).

What puzzled him above all was that economists “refused to consider any criticism of economic theory” (2010:xiv). Then un-self-critical economists are uncritically followed by politicians all over the world who regard economic theory as the sole source of wisdom about the manner in which a modern society should be governed. The result is “the world has been remade in the economists’ image” (2010:xiii). This has negative consequences for the policies promoted seem, to many non-economists at least, to damage society rather than to enhance it: “virtually everything they recommend at least appear[s] to favour rich over poor, capitalist over worker, privileged over dispossessed” (2010:xiv). In other words this ascendancy of economic theory has not made the world a better place. “Instead it has made an already troubled society worse: more unequal, more unstable, and less “efficient” (2010:xiv). But why then do economists continue with a theory ‘which has been comprehensively shown to be unsound? And why do politicians continue to apply this economic toolkit to almost all social and economic issues? Keen (2010: xiv) finds the root problem lies in the education of economists:

I came to the conclusion that the reason [economists] displayed such anti-intellectual, apparently socially destructive, and apparently ideological behaviour lay deeper than any superficial personal pathologies. Instead the way in which they had been educated had given them the behaviour traits of zealots rather than of dispassionate intellectuals.

Keen sets out to develop an alternative. He backs up his rhetoric in detail. Having had limited success in addressing economists he addresses “those people who feel that they have been effectively silenced by the economists” (2010:xv), his aim being to show that the economic orthodoxy does not hold the intellectual high ground.

The central question then is: ‘Why have we handed over the running of the world to economists?’ Why do we let economic theory sweep aside the

criticism of the ‘multitude’, whether G8 protestors in Seattle or labour unionists, or ecologists? If the wide acceptance of economic theory has not made the world a better place, more equal and stable, and if we go from crisis to crisis then why continue with the same kind of thinking? There may be government responsibility to consider - there always is. But, with some reason, many non-economists wonder if these crises also result from following the advice of economists (Keen 2010:2). And economists such as Stiglitz, an insider who was Chief Economist and Vice-President of the World Bank, supports this. He holds that smart economists often use unsmart economics because they do not have the firm grasp of the big picture e.g. the crisis in the Russian economy where “economists typically had little knowledge of the history or details of the Russian economy and didn’t believe they needed any” (Quoted in Keen 2010:2-3).

Keen rejects, then, the claim that economic theory is “*a body of generalisations whose substantial accuracy and importance are open to question only by the ignorant or the perverse*” (Robbins 1932; Quoted by Keen 2010: 4). There are now plenty of economists who, over a century, have argued that “economic theory is replete with logical inconsistencies, specious assumptions, errant notions, and predictions contrary to empirical data” (2001:4). Keen (2010:4) concludes:

When their critiques are collated, little if anything of conventional theory, remains standing. Virtually every aspect of conventional theory is intellectually unsound; virtually every policy recommendation is just as likely to do general harm as it is to lead to the general good.

Keen has something to offer for everyone. He provides an informed critique that examines economic theory “from first principles” without the short-cuts that he finds ‘in the vast majority of conventional economic texts’ (2010:13). His account lays out the topics that any serious education in economics must provide. For those who have an intuition that the claims of economic theory are problematic he provides an explanation of how they were arrived at and why indeed they may be questionable.

Finally the voice of Paul Krugman adds weight to the above criticism. I extract these comments from an interesting chapter of: *Beyond Establishment Economics: No Thank you Mankiw*, entitled: ‘The Shocking

Candour of Economics Professors' (Anderson and McShane, 2002: 65-78):

Why did the magic economy go away?... But let me cut to the chase: the real answer is that we don't know. There are a lot of stories out there. Most of them, including the ones that have achieved the widest currency, are dead wrong on logical or factual grounds. There are some less popular stories that could be right, but if you are honest with yourself, you will admit that nobody, yourself included, knows which if any of these stories is right.

In America's system, professors of economics get tenure and build the reputations that give them other academic perks by publishing, and so they publish immense amounts - thousands of papers each year, in scores of obscure journals. Most of those papers aren't worth reading, and many of them are pretty much impossible to read in any case, because they are loaded with dense mathematics and denser jargon.

It's easy to be cynical about the motivations of the people who write these papers. You don't progress as an economics professor by solving the real problems of the real economy...Instead you progress by convincing your colleagues that you are clever. In an ideal world you would demonstrate your cleverness by developing blindingly original ideas or producing definitive evidence about how the economy actually works [but few can do this and so another approach is taken]...thus the most popular economic theories among the professors tend to be those that best allow for ingenious elaboration without fundamental innovation - ways to show that you are smart by putting old wine in new bottles, usually with fancier mathematical labels.

### **III.3 Questioning the basic assumptions of the gloomy ideology of economics: self-interest/ supply and demand/ scarcity and competition/ universality of markets and the totally free markets**

The plausibility of basic assumptions is normally a crucial factor in establishing a theory. How plausible are the basic assumptions of mainline economic theory? I consider first the most important set of assumptions which have to do with self-interest and which lie at the heart of a gloomy ideology. The discussion is then expanded by taking a historical perspective on assumptions of supply and demand, scarcity and competition and the scope of the free market. These reflections lead to the

conclusion that the status of economic theory as a ‘science’ has to be reconsidered.

Economics draws strongly on the ‘gloomy ideology’ that Ghoshal talked of, and in fact, may be its source. All critics of neoclassical economics focus on the core assumption of self interest: the assumption that ‘the best social outcome results from all individuals look after their own self-interest’. According to this assumption, “the market will ensure that the welfare of all is maximized” (Keen 2010:23). However, most popular critiques are only concerned to resist that gloomy suggestion that human beings are all selfish all of the time. Many people would like to think they are at least sometimes selfless: altruism is a possibility at least.

I would like to add that the ‘bad ethics’ is linked to ‘bad science’. The real difficulty with the assumption is that it will not do what the theory wants it to do: ground a theory of consumer demand that will allow us to talk about the welfare of society as a whole. If people really are self-interested then we cannot work out how to maximize social welfare for self-interest is subjective. And if the theory of demand is problematic the basic teaching of conventional economic may not hold: the familiar supply-demand framework becomes problematic also.

At this point economists agree that their model of human nature is ‘economical’. It leaves out some aspects of our nature. However, they claim that nothing essential is left out (given their purpose). They claim that: (a) ‘treating individuals as self-interested hedonists captures the essence of their economic behaviour’ and (b) “the collective behaviour of society can be derived by summing the behaviour of this self-interested multitude” (2001:23). But Keen argues that this has not been proved and in fact cannot be proved, even if economists pretend otherwise. The reason for this is that it is impossible to ‘add-up’ the satisfactions linked to the consumption of multiple commodities by multiple consumers and so impossible to explain the overall demand. For personal satisfaction is subjective and cannot be summed up.

This becomes clear if we consider the possibility of changes in income distribution e.g. one person is fired and another hired. Then the person hired can afford to consume what the other person can no longer consume. But then a different person is satisfied, possibly to a greater degree. The

total satisfaction is then changed - so 'social welfare' is changed, assuming that society is the aggregate of more or less satisfied individuals. As income distribution does keep changing the total 'social welfare' cannot be calculated in the manner the theory assumes. (Note that there is no real 'society' on this model, so the terms 'social welfare' or 'welfare of society' are ambiguous - we are not talking about improving the welfare of each and every person but only of the aggregate. The aggregate welfare - the GDP - can rise even if the welfare of most can decrease, for a few very satisfied rich people can load the balance).

To respond to this difficulty, orthodox economists had to show somehow that a change in income distribution did not alter 'social welfare' as understood in terms of the aggregate of satisfactions. They proposed an ingenious (but unbelievable) solution. They assumed that: (a) all people have the same tastes, and (b) tastes and preferences do not change as income changes (or throughout life). Hence it does not matter if one person replaces another in the consumption process: overall satisfactions remain constant. In effect, Keen argues, this means: (a) there is only one representative person to consider - or many clones, and (b) there is only one commodity - or different commodities given the same satisfaction (2010:24). For Keen these are *bizarre assumptions*: clearly people have different tastes and clearly tastes differ as increase in income allows people to acquire further tastes or tastes change as people develop. Incredibly many economists still continue to accept and teach these bizarre assumptions, without any discussion as to their unreality, says Keen. Others are coming to a different conclusion:

The idea that we should start at the level of the isolated individual is one which we may well have to abandon. We may well be forced to theorize in terms of groups who have collectively coherent behaviour (Kirman 1989, Quoted in Keen 2010:48).

If such a crucial assumption as 'self-interest' is so problematic the whole theory becomes questionable.

Other assumptions begin to seem questionable if we take up a historical perspective. Geoffrey M. Hodgson provides a strong challenge to standard theory in his: *How Economics Forgot History: The Problem of Historical Specification in the Social Sciences* (2001). Hodgson challenges abstract

economic theory generally, arguing that in losing contact with history, including its own history, economics loses contact with real world phenomena and with real world economic institutions. This lack of history leads to distorted views of supply and demand, scarcity and competition and the nature of the market as well as of the discipline as a whole.

Hodgson's reflections as a whole constitute an inquiry into the nature and status of economics as a 'science'. He calls his inquiry a 'meta-theoretic' investigation and situates it at the borderline between economics theory and philosophy. *The basic argument is that attention to history allows economics to rethink its status and its basic notions.* Unfortunately the lack of appreciation of history leads the discipline to lose sight of how it came to accept the prevailing ideology that economics is a 'hard' science rather than a social science.

In abandoning its former historical orientation, economics as a whole was radically transformed. It lost its emphasis on the study of real, social-economic systems, instead to become a deductivist exploration of 'individual choice' (Hodgson 2001:xvi)

The lack of historical sensitivity not only results in a mistaken understanding of the status of economics, but also to a distorted understanding of many basic market notions. Hodgson first of all questions the 'myth of universal markets'. History reveals, he says, that 'exchange' is not confined to 'markets'. He also shows that markets change considerably over time, in character, scope and importance (2001:244-45). This at least puts a break on any imprecise use of the term 'market'.

Similarly history shows that 'supply' and 'demand' are not fixed abstract universals. Production is universal in economic process but not as 'supply' - understood as willingness to sell at a specific price. Consumption is likewise universal, but not as 'demand' - understood as goods for which there is willingness to purchase at a definite price. Rather supply and demand are 'measures of exchangeability' expressed in some kind of price mechanism. So any proper use of these theoretical terms should relate them to real world phenomena in market based economics - and to actual production and consumption (2001:276-77).

Scarcity and competition are also found to be notions that must be used carefully and in context. There are many kinds of capital and they are not all 'scarce' in the sense of being quantitatively finite. Social capital and intellectual capital differ from material capital: when intellectual capital is used it can be enlarged rather than depleted - it can expand as it is practiced. If this is so then it may be too narrow to define economics as the allocation of scarce means and resources to given wants or ends (2001: 78). In fact the way opens for rethinking economics as the study of the providing of the means of human life, by the intelligent use of resources that may or may not be scarce. Unfortunately the 'yearning for universal principles prevents any deconstruction of the standard notion of "scarcity"' (2001:278).

Similarly the concept of competition is found to have an inflated status. History does not support 'the presupposition of universal competition in the face of scarcity'. Even where there is 'competition' of some kind, this "does not necessarily result in hostile uncooperative or greedy behaviour" (2001:279).

Though Hodgson criticizes what he considers to be abstract pseudo-universals he realises that 'meta-theoretic' terms of some kind are needed to explain the overall phenomenon of economic process. The challenge is to methodologically relate general terms to particular events without losing contact with the real world. We need to develop a range of dynamic frameworks that do not allow abstractions to hide real world phenomena.

This takes us back to questions about the status of economics: *What exactly does economics study? How adequate is it to real world phenomena?* Hodgson argues that we can avoid misleading abstraction if instead of taking economics as "the science of individual choices" we take it as "the study of the social structures and institutions governing the production, distribution and exchange of the requisites for human life". In other words "economics should be the study of all providing institutions" (2001:346). This fits earlier conceptions of economics leading up to Marshall. And it has not been totally lost sight of by more recent economists.

Political economy or economics is the study of mankind in the ordinary business of life; it examines that part of individual and social action which

is most closely connected with the attainment and with the use of the material requisites of well being (Alfred Marshal 1949)

Economics, then, is an effort at rational inquiry into those institutions through which man provides himself with the means of life and experience (J. Fagg Foster 1981)

[Economics is the study of] the workings of social institutions which bind the economic system together: firms, markets for goods and services, labour markets, capital markets, and the banking trade and so on (Ronald Coase 1997)

*This position has the advantage of relating all the aspects of production, market process and financial services.* Hodgson points out that taking economics as the analysis of the providing institutions of a civilized society and a market economy may be found as far back as Alfred Amon. Unfortunately Lionel Robbins, in the same period (around 1930), was insisting that economics was the study of ‘the law of choice’, a view that academic economics took over (Hodgson 2001:347). So a historical viewpoint leads us to discover *a crucial turning point* in the development of economics: at this stage a social science began to turn into a natural science. I will come back to this story in more detail shortly. Meanwhile, outside the academy the prevailing view was that economics was the study of the actual workings of the economy and not a study of ideal constructs. In other words, economics should be, what it once was, a political economics! Hodgson is clear on his own position: economics should be: (a) the study of institutions (thesmology), (b) the study of the markets (agorology), and (c) the study of the political economy of capitalism or democratic capitalism.

Finally, Hodgson calls for a rethinking of economics and a rebuilding of the social sciences at the methodological and philosophical level. I include this element of his account as it leads us neatly into the next topic: the (possibly unfortunate) turn to science in economic thought. Hodgson (2001:354) says:

The reinvigoration of the social sciences requires above all a methodological awareness, particularly concerning the meaning of theoretical explanation and the scope of empirical inquiry.

That is to say, economics needs to reinvent itself as all disciplines need to do at times. Whitehead makes the general case. In every area of study it is important to critically revise our modes of abstraction. Philosophy makes a contribution towards the health of society in this respect for philosophy is the critique of abstractions. Any civilization or any discipline, such as economics that cannot escape its current abstractions “is doomed to sterility after a very limited period of progress” (Quoted in Hodgson 2001:355).

Hodgson argues that the role of philosophy in relation to other disciplines is to provide a “meta-theoretic framework that can inform and nurture new theories”, or to bring out the relevance of theories retrieved by historical research. The social sciences, however, may not have been making sufficient use of philosophy or history, he thinks. (Hodgson 2001:355).

[I]t is on this philosophical terrain that the social sciences are currently at their weakest. Philosophy is too frequently omitted from the compulsory curriculum of the social sciences. Many students learn economics and sociology without knowledge of the philosophical problems involved in theory construction [and without appreciation of the epistemological complications]. Today...there is an alarming degree of philosophical illiteracy among social scientists that hinders creative and intellectual development.

There may be a need therefore for a philosophical component to economic studies, a need for the ‘intentionality analysis’ that Ghoshal pointed towards. And for Hodgson this goes hand in hand with the need for a consideration of “the history of ideas and the study of economic history” (2001:355). Together philosophy and history would enable a more nuanced and dynamic view of basic economic notions and a rethinking of the whole discipline. This again would let in the ethical.

### **III.4 The pretence to science: Is economics a pseudo-science?**

The question of the ‘scientific status’ of economics has already been raised. What kind of discipline is economics? How well does it reflect real world phenomena? We now need to examine the ‘scientific turn’ in economics, focusing on the mathematizing of the discipline. *I shall argue that, to some extent, the way mathematics was invoked tended to pull it away from real-world economic process.* This evaluation has been made by a number of commentators. If the assessment is well-grounded the need for a corrective becomes clear.

The critique of ‘scientism’ in economics is forcefully presented by Geoff Davies (2004) in *Economia: New Economics Systems to Empower People and Support the Living World*. He develops many of the themes already treated. For example he considers ‘economics systems’ in relation to deeper levels of our society and humanity. And he writes for a general audience who might appreciate an emphasis on “integration and synthesis”, or who need help in engaging “the armies of jargon speaking experts who defend the current regime” (2004:xi). But his focus is on the status of economics as a scientific discipline. He (2004:xi) argues: (a) that economics is a pseudo-science that is completely inadequate to real world economic process, and (b) that real world economic process involves interacting economic agents, situated in a wider social-political-cultural process as well as an ecological context. Hence, economics needs to develop a methodology that goes beyond mathematics to consider real world process with its complex feedback structures rather than idealized models devised with the requirements of mathematical simplicity in mind. Internal connections and feedback processes may be more important than the aggregate of isolated individual actions (Davies 2004:4).

I shall not go into detail on the ecological dimension of his position as I think Davies overshoots human feedback systems and goes too quickly to a consideration of ecological systems. I focus on his critique of economics as a pseudo-science and how the mathematical reformulation of the classical thought of Adam Smith and Jeremy Bentham turned economics into a pseudo science. Davies gives his own version of a much told story.

According to Davies the origin of the ‘pseudo-science’ is said to be found in the work of such economists as Leon Walrus (1834-1910), Stanley Jevons (1835-1832), Vilfredo Pareto (1848-1923) and Alfred Marshal (1842-1924). The shift involved an explicit assumption of ‘social atomism’. On this view macroeconomic outcomes could be predicated by assuming economic agents were individualistic maximizers of self-interest, just as the macroscopic properties of a hot gas could be predicted by making assumptions about the nature of isolated atoms.

Partly inspired by the examples of early versions of statistical theory, a few mathematically inclined economists of the nineteenth century conceived a grand vision: to construct a quantative theory of economics

based on a very simplified picture of how people behave in the context of economics (Davies 2004:32).

A little cynically, Davies says that this theory was attractive to the mathematically inclined theorists because it gave them new mathematical challenges, whilst it was attractive to the rich who were encouraged to think their selfishness was now a virtue (2004:34).

Davies maps out the ‘scientific turn’ from Walrus to Friedman, suggesting that if economics was a science it was a very different science to the physics to which it compared itself. *The peculiarity of economics as a science may be seen first in the work of Walrus, who explicitly compared his theory to Newton’s theory.* He claimed that “the pure theory of economics is a science which resembles the physic - mathematical sciences in every respect” (Quoted in Davies 2004:37).

However, Walrus seemed to have a very poor understanding of science. He overlooked the difference between Newton’s theory, which has been repeatedly confirmed as corresponding with the real world, and his own, which remained an unverified assertion. And he confuses physical and mathematical science. He talks of the physico-mathematical sciences as utilizing a ‘rational method’ as opposed to an experimental method. He says that after drawing their basic concepts from experience they leave experience behind to construct “a priori the whole framework of their theorems and proofs”. They go back to experience, he claims, not to “confirm” their framework but only to “apply it” (2004:37). Davies sees this as simply bad science. Not only does it confuse mathematics and physics, but it implicitly reduces the social sciences to natural science. He paraphrases Walrus as saying: “Economists don’t need to test their predictions against reality because they already know their assumptions and logical deductions to be correct” (2004:37).

*Davies finds the same thing in Jevons, another founder of neoclassical economics.* Jevons says that the ultimate laws of economics are known to us immediately by intuition or at any rate are furnished to us ready made by other mental or physical sciences. He continues, (Quoted in Davies 2004: 9, 37)

[We make] simple inductions on which we can proceed to reason deductively with great confidence. From these axioms we can deduce the laws of supply and demand, the laws of that difficult concept, value [utility], and all the intricate results of commerce...[our] method is as such sure and demonstrative as that of kinematics or statics, nay, almost as self evident as are the elements of Euclid.

The slippages from mathematics to science to logic are clear, at least to observers from other sciences.

Davies moves forward to show that the same outlook continues in the twentieth century. Thus we find Nobel prizewinner Gerard Debreu telling us how ‘primitive concepts of economic analysis’ are represented by a mathematical object: “*an axiomatized theory substitutes, for an ambiguous economic concept, a mathematical object, that is subject to definite rules of reasoning*” (Quoted in Davies 2004:38). Again questions about the status of the discipline emerge. Is economics a mathematical or a scientific discipline? Is it a social or a natural science?

The confusion was taken forward, and *perfected* almost, by Milton Friedman’s infamous contribution. Friedman (1953) seems to admit that the assumptions of economics are incredible and unverifiable, but then suggests that their unrealism doesn’t matter because economic theory is to be judged not by its assumptions but by its predictions. He makes extreme claims (Quoted in Davies 2004:69):

Truly important or significant hypotheses will be forced to have ‘assumptions’ that are wildly inaccurate descriptive representations of reality, and in general the more significant the theory the more unrealistic the assumptions.

This seems at best a crude *instrumentalism* that denies science offers any explanation of how the real world is; science is simply a way of predicting future quantifiable observations. All we really know is what our instruments can measure. This allows us to manipulate the world but not to understand it as it ‘really is’. This is not only bad science, it is bad philosophy. Friedman misinterprets the nature of hypotheses and theories. He takes a good hypothesis to explain much on the basis of the little it abstracts from concrete reality. But he seems very confused about the nature of a hypothesis or theory. The aim of a hypothesis is to bring order

to messy facts and to anticipate some order within the facts. But this does not mean making wild guesses. A good hypothesis is meant to explain as much as possible about observed behaviour *without leaving out essentials*. So if we are investigating the ‘law of the falling body’ as Galileo did, we need to search out the essential features and discern how they are related: we ‘abstract’ or identify as essential ‘speed’ and ‘time’ and ‘distance’. At the same time we disregard aspects of the data that we find to be inessential: we disregard ‘air friction’ which can be shown to be inessential or negligible. What we do not do is make wild assumptions that add or impose something extra on the given phenomenon (Keen 2001: 150-154). Friedman is confusing ‘negligibility assumptions’ with ‘essential assumptions’.

An unfortunate consequence, says Davies, of Friedman’s account is that he is read as saying that *assumptions don’t matter* as long as the deductions are rigorous. But the rigorous deduction only focuses any inaccuracy in the assumptions: wildly unrealistic and inaccurate assumptions led to wildly inaccurate theory and to extremely bad practice. And much of neoclassical theory seems to consist of adding wildly inaccurate assumptions: *everyone has the same set of preferences; preferences do not change with change in income; preferences concerning certain commodities do not change as new commodities become available; buyers and sellers have all the information they need; obtaining the information does not take time or effort or cost anything; in the stock markets everyone has perfect knowledge of future markets*.

To further illustrate the disconnect with reality, Davies offers an interesting account of an encounter between prominent physicists and economists at the Santa Fe Institute (1987). The aim was to cross-fertilize the disciplines by inter-disciplinary dialogue about complexity. But a meeting of minds was not forthcoming. The physicists were impressed by the mathematical ability of the economists but “startled by their lack of reference to the real world” (2004:73). The economists, they thought, were often: “*not looking at what the models were for*”: *their test was not the match with reality but with what other mathematical economists were doing*” (2004:74). In this regard, Davies finds that even when mainline economists do find a mismatch between theory and the real world they are often too terrified to state this clearly “lest their colleagues realise what they are saying”. So for example we might find researchers saying something like this: “*The only*

*way out of this situation is to jettison explicitly the programmatic central core that has been so carefully preserved throughout the many paradigmatic shifts". According to Davies what they should have been saying is this: "Our precious theory doesn't work. We have to start again. Cleverly dressing up old assumptions will not do. We have to test our theory against reality" (2004: 61).*

And for good measure Davies gives an example of how an overly mathematical approach cannot deal with real world process. He argues that the markets are so dynamic that standard economic mathematics cannot deal with them. It assumes that a free market will automatically move to a balanced equilibrium, which can be treated mathematically. But this is impossible, says Davies, given: (a) the nature of a learning curve, and (b) the effect of the economy of scale on production. A learning curve means that the first firm to apply new technology normally establishes an advantage. And a large firm normally learns faster given that it can take advantage of larger experience. It is possible that a firm can experience runaway growth and come to dominate the market, "Witness Microsoft" (2004:13). Davies concludes that "*modern economies are not in equilibrium or anywhere close to equilibrium*" (2004:13). Constant change is the norm. So multiple equilibria have to be coordinated and managed by constant intelligent and responsible interventions. This is even more evident if we recognising all the social and political feedback loops that relate to the economy, and if we recognising developing and even volatile preference changes, or if we realise we have to balance short and long term considerations, and finally if we have to manage market fluctuations due to stampede reactions. We reach the startling conclusion that: "*neoclassical theory has nothing to tell us about how a modern economy works*" (2004: 39).

The pretence to science is explored further by Yves Smith (2010) in: *Econned: How unenlightened self-iInterest undermined democracy and corrupted capitalism*. She adds considerably to the critique of economic theory and financial theory, providing convincing detail drawn from first hand knowledge of the markets. The critique is strong but Smith justifies this by pointing to the disastrous consequences of establishment economics. She argues that the economic profession, acting like a group of sorcerers' apprentices, has brought chaos to the economy and to people's lives. Economics has been blinded by seeking for the status of a natural

science and this has distorted social science (2010:29). Neoclassical economics has allowed: “*the triumph of simplistic maths over messy facts*” (2010:92).

Smith argues that overconfidence in supposedly ‘scientific’ theory leads to a “drunk under the streetlight syndrome” where mathematical convenience drives theory instead of actual phenomena. Smith adds to the story already told by Davies by pointing out how Keynes interrupted the development of neoclassical economics by allowing a role for government. *In effect Keynes was playing closer attention to concrete economic phenomenon and contradicting the neoclassical assumptions about a self-righting economy.* But, unfortunately, neoclassical theory moved quickly to domesticate Keynes by removing any elements that did not fit mathematical economics. He was marginalized by the approximation of his argument for government intervention to socialism or even communism. In addition he was read more in summary than directly. Generally he was misrepresented and neoclassical thinking reasserted itself. In this John Hicks contributed to the misreading of Keynes whilst the role of Paul Samuelson was important in the revival of neoclassicism:

The effort to remake economics as a science and use mathematics-based exposition got a considerable push forward from Paul Samuelson, the first American Nobel Prize Winner in economics (Smith 2010:38).

Though Samuelson was seen as Keynesian in fact he says he instinctively rejected Keynes because he was so steeped in neoclassical mathematical economics. In effect he fostered the reemergence of the neoclassical paradigm, frustrating the establishment of a new paradigm more fitted to the actual phenomenon of trade, to the facts of unemployment, and to the workings of international finance. Hence, according to Leontief, another leading economist and Nobel Prize winner, *those who were interested in how the economy really works were marginalized.* The discipline came to convince itself that “telling stories in a mathematical form rather than a purely verbal fashion somehow comes closer to establishing their validity” (2010:42).

Smith gives an example of the way the Arrow-Debreu theorem on equilibrium was given a prominent place in economic theory. This is seen as the most influential work in recent economic literature, according to

Smith. Some take it as a confirmation of Adam Smith's invisible hand theory. The theorem shows that there can be a set of prices at which all goods can be bought or sold at a certain point in time, and which would 'clear the markets'. That is to say there would be no unfilled orders and no unsold goods. Unfortunately we again encounter the problem of 'unrealistic' assumptions. The theorem holds only under extreme conditions: all buyers and sellers have perfect information; no buyer and seller is big enough to influence prices; 'forward marketing' for all future time periods is possible. Smith (2010:47). comments with strong feeling:

What follows from the Arrow-Debreu is *absolutely nothing*. Arrow-Debreu leaves you just as in the dark about whether markets will clear in real life as you were before reading Arrow-Debreu. And remember, this paper is celebrated as one of the crowning achievements of economics.

This brings us back to Friedman. For Smith, Friedman's argument that good theories require wildly inaccurate assumptions amounts simply to a "get out of reality free" card (2010:47). Real science keeps to the essentials of the concrete phenomena and abstracts from the inessential conditions. On the contrary, says Smith, neoclassical economics adds substantial and unreal conditions such as perfect information or rational agents with super computational and cognitive capacities (2010:47-48).

Smith sees that the mathematical approach has become 'hard-coded' into economics to the extent that analytical rigour, as understood in mathematics, now overshadows empirical relevance as physics understands it: "The result is that we now understand almost less of how actual markets work than did Adam Smith or even Leon Walrus" (Blaug, Quoted in Smith 2010:54). Mainstream economics tries to dismiss the criticism by saying it is dated. Economics, it points out, includes information asymmetry economics or behavioural economics and 'progressive' work in game theory, as well as more general empirical work. Smith is not convinced. She agrees with Blaug who points out that game theory, for example, deals with "predictable outcomes only in one-off, cooperative settings, on a trivial subset of the real world of commerce' (Quoted in Smith 2010:54). Game theory considers only ideal strategies, not the strategies that people actually use - which may be reasonable in their own way. And to claim that things have moved on either, misses the point or claims too much. What it misses is the core criticism that a social

science is being distorted. It claims too much because the standard theory is still being taught. Meanwhile the data that is admitted is limited to what Smith (2010:60) calls “clean data” in sufficiently large quantities: *But restricting inquiry to where the information can be tackled statistically, as opposed to the infusion of qualitative factors, severely limits study.*

For Smith, the “drunk under a street light” methodology is still at work. Quantative research methods are heavily favoured over qualitative or historical methods. The use of qualitative methods to cross-check or complement quantitative method is minimal or forbidden. Apparently when one researcher wanted to investigate ecological limits to growth he was told his career would be ‘nasty, brutish and short’ if he continued (Aldred 2009:232). Similarly when Truman Bewley, a Yale economist, wondered why wages did not fall in a recession, he was frowned upon because he used an interview method of research - interviewing business people (Aldred 2009:229) He decided not to teach the method to students because it “would ruin their careers”. Should we conclude as someone did that: “Mathematics brought rigor to economics. Unfortunately it also brought mortis”! At the very least we have to ask for “a reasoned and complete explanation of why economists believe what they believe” (Smith 2010:305) about the ‘scientific’ status of economics: need it rule out ethics?

### **III. 5. Theory and practice in economics: Does bad economic theory lead to bad business practice?**

*In theory there is no difference between theory and practice; in practice there is!*

Ghoshal claimed that bad business theory leads to bad business practice. Does economic theory work in the same way? I shall argue that this may be the case. I suggest that economic theory and business practice are often only tenuously linked and that the link may be more ideological than methodological. Because economic theorists are ‘blinded by science’ they may not pay enough attention to actual business or financial practice. This, arguably, leaves them with fewer resources to check “the whirlpool of speculation” that according to Keyes swamps “the steady stream of enterprise”. Meanwhile business practice may selectively invoke economic

theory and use the ideology of the free market to rationalize bad practice. The theorists keep to the idealized world whilst those in business and finance establish a much messier world and one messier than it need be.

Keen begins his account of the dysfunctional relationship between economics and business by noting that “economic theory has seen off many attacks, not because it has been strong enough to withstand them, but because it has been strong enough to ignore them” (2010:311). This is because: (a) the economy continues to operate and develop whether or not the prevailing theory is valid, (b) economic theory about the free market is often ideologically useful to business. I would add: (c) because politicians are always looking for advice about the economy and continue to seek advice from those they take as specialists whether they understand it or not.

The situation may be provocatively summarized in this way. Economic theory and business practice are linked tenuously at the level of ideology: the ideology of the free market or the ideology of democratic capitalism. Mathematical economists explain the free market by adding up the actions of free individuals. By assuming a certain model of free, rational, self-interested agents these economists become able to do their calculations in freedom from the messy facts. Meanwhile business men take the ideology of the free markets to mean that markets should be free from government interference. This allows them to go about their messy business without interference. And governments are intimidated by economic experts into agreeing to deregulation. The gap between economic theory and business practice is well expressed by John Kay (Quoted in Anderson and McShane 2002: 74) of the London School of Business:

If you ask most businessmen what they think economics is about, their answer will be economic forecasting. They do not think very much of economic forecasting - although they go on thinking they need to and so they do not think very much of economists. Every day they are concerned to analyze their costs - which is done by their accountants. They determine their prices - this is the responsibility of their marketing departments. They need to interpret the business environment they face - the task of their corporate planners and strategic advisors. The economic input into any of these functions is minimal.

The scene is set for disaster as the economic theorists working in the theoretical stratosphere are not alert to signs of danger on the ground. The businessman on the ground may have a short term perspective whilst constantly being tempted to immediate profits. The middlemen, the politicians, have a great responsibility because they follow the economic advice of the theorists uncritically or get too close to the business side, thus losing their oversight responsibility. Interestingly the most balanced perspective may be provided by economic journalists who have some grasp of economic theory and some awareness of conditions on the ground. Certainly a case can be made for saying that they came closest to recognizing the emergence of the housing crisis and the global crisis (St Amour 2010). Whether that is so or not it is clear that economic theory and business practice are linked in peculiar ways. For example there is the problem of deregulation.

The false confidence [that economic theory] has engendered in the stability of the marked economy has encouraged policy-makers to dismantle some of the institutions which initially evolved to try to keep its instability within limits. ‘Economic reform’, undertaken in the belief that it will make society function better, has instead made modern capitalism a poorer system: more unequal, more fragile, more unstable (Keen 2010:311).

Keen argues that if the damage done by economists had been brought about by warlords, by weapons rather than bad policy, the economists would have found themselves at the International Court of Justice. He has in mind the failed Russian experience with the market economy. Keen wonders how much has to go wrong before the need for serious and drastic rethinking is recognised. The Great Depression, he notes, led Keynes to turn economic theory upside down, but this work was quickly domesticated by Samuelson and others. Will the present global crisis force a paradigm shift or will economic theory “continue to function as a surrogate ideology for the market economy” (2010:34).

Interestingly Keen seems to have predicted the present crisis. He said (in 2001) that such a crisis “has been well and truly put in train by the cumulative processes” that he had criticized. He had in mind the processes leading the finance markets to get the price of assets wrong and the processes which lead to stock market crashes, all of which depend on the “*efficient market hypothesis*” which he regards as flawed (2010:312; 214;

243). The peculiar and destructive relationship between theory and praxis comes out clearly here.

The efficient market hypothesis suggests that stock markets can accurately price stocks in terms of their possible (but unknown) future earnings. “Economists have assured the world that the stock market’s valuations reflect the true future prospects of companies” (2010:214). *Given this assurance business people are encouraged to carry on speculating without appreciating the extent of the risk.* Economists don’t emphasize that the hypothesis relies on the bizarre assumptions already mentioned, such as the assumption that all investors have equal access to credit or that investors have correct expectations of future prospects of companies. *Keen notes that this amounts to saying investors are God.* Since they are not, he finds that “there is no way the stock markets can be efficient” (2010:215). Clearly speculation can overvalue assets, bubbles can form, and ridiculous valuations can be made. But business people continue to indulge in bad practice for the sake of immediate profits, with the rationalization that economic theory supports them. “By promulgating the efficient market hypothesis...economic theory has encouraged the world to play a dangerous game of stock market speculation” (2010:256).

*Keen also examines the way economic equilibrium theory prevents us from understanding why real markets crash.* The emphasis on theoretical equilibrium takes us away from concretely changing realities and so we do not see how economic or financial practice can destabilize the real economy. Economic theorists can seem to ignore the fact that concrete processes take place in time. They think, says Keen, that in the long run we can treat the economy as if the dynamic process would end up in a state of static equilibrium. But concrete diverges from equilibrium and does not set up forces that bring the economy back to equilibrium as many commentators have pointed out (2010:165-166), and concretely we always have to deal with disturbances in the present. As Keynes (2010:177) says:

But this long run is a misleading guide to current affairs. In the long run we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again.

*In other words, a static economy is imaginary. We live in and suffer a changing economy and we have to deal with it NOW. Economics then should deal with dynamism: it should deal with rates of change in demand, or rates of change of supply, or rates of change of prices, and rates of changes of outputs or of unemployment (2010:177). But this is not sufficiently appreciated.*

[T]he core ideological beliefs of economists are bound up in the concept of equilibrium. As a by-product of this economists are driven to maintain the concept of equilibrium in all manner of topics where dynamic non-equilibrium analysis would not only be relevant but frankly would be easier. This obsession with equilibrium has imposed enormous costs on economics (2010:177).

If economies are actually dynamic then economic theory may mislead economic and business practice when it suggests that we can operate as if economies head towards a static equilibrium. According to Keen, various kinds of non-equilibrium thinking show that economies are clearly dynamic: *fractal market hypotheses, inefficient market hypotheses, and the financial instability hypothesis* (2010:243). They show that financial practice can “destabilize the real economy” (2001:17). Standard efficiency market theory tries to attribute stock market volatility to external factors. *Keen replies that market volatility is due to its own ‘internal dynamics’.* Non-equilibrium thinking indicates this. The three theories just mentioned “support the argument that unless finance markets are *institutionally tamed*, capitalism will remain subject to potentially catastrophic *breakdown*” (2010:243). Economies are dynamic and we need to recognise what this implies. “The real question is whether we can control such an unstable system - whether we can constrain its instability within acceptable bounds” (2010:187).

*We have a better chance of doing this if we look more closely at how real economies actually work.* We need to identify the real variables of economic process and we need to look closely at the workings of the providing institutions of our economy. We need to consider the interplay of production, business and financial practice more directly. A whole range of new approaches in economic thinking from methodological economics to humanistic social economics to market economy theorizing seem to be realising this.

Yves Smith (2010) also takes this line. She argues that the ideology of a totally free market, apparently justified by economic theory, has led corporations to become “less restricted in their pursuit of profit”, and financial services to pursue “unenlightened self-interest”: hence “the industry has become systematically predatory” (2010:4). In many ways this behaviour is rationalized by the theory.

Idealizing the rational aspect of business decisions means refusing to notice behaviour that is predatory, destructive, criminal or simply stupid. Believing that risk is manageable through mechanical systems has required not just unrealistic assumptions, but also willful blindness to clear signs of danger (2010:5).

Bad theory leads to bad practice when an uncritical use of neoclassical economic theory leads to an increase of risky behaviour. Economic theory encourages banks and financial services to dominate the economic process. According to Smith the orthodox ‘free market’ theory is taken as a justification for “an overly powerful and self-interested financial services industry” to act as an end in itself (2010:27). But the invocation of a (totally) free market ideology may be simply a way of ruling out intervention and regulation.

In other words, “free market” ideology with its libertarian idealism, has in fact produced a Mussolini style corporatism. And until we learn to call the resulting looting by its proper name, it is certain to continue (2010:7).

In all this the real world conditions of production and selling and of wider social process are left behind. *The ideal of rational self-interest leads to the ‘science of rational choice’, which then allows or justifies a dominant role for banking and finance in the market, often with disastrous results.* Unfortunately, says Smith, the economic theorists who designed the failed policies and the financiers who caused the crash are never held accountable and the dominance of ‘economic rationality’ is not challenged at its source (2010:6). Nor is the way that financial losses are shifted from the public poor to the private rich in unjust bail out procedures insufficiently challenged. Economics and Finance are made ends in themselves instead of being servants of the whole community. Meanwhile the politicians, as we have said, give up their oversight function when they are co-opted by the financial system.

How should we respond to this? We have to realise again that economics and finance are too important to leave to economists and business people. “We need to implement economic policies that treat finance as the hand-maid of commerce, not just as its master” (2010:6).

If our economic system is to harness the self-interest [and the other-interest] of individuals to achieve the general good, it must be supervised within a democratic society and responsive to criticism by the outside voices of those who are not unafraid to think independently (2010:5)

In this regard Stiglitz makes an interesting comment. Markets are needed but they do not work well on their own; they need to work with governments and NGO’s and a variety of stakeholders (2010:xii). The tricky thing is to work out the details. By this I mean working out a more adequate account of human agency, a better understanding of the schemes of recurrence set up by human cooperation that constitute the good of order, a better understanding of the ways in which all the concrete providing institutions relate to each other, and a better understanding of how the social and political and cultural realms relate to the economic realm. I shall touch on these issues again in a later section.

As a final comment on the ideological relationship of theory to practice, I note Ghoshal’s (2005:79) juxtaposition of the views of Friedman and Isaiah Berlin on this matter:

Few trends could so thoroughly undermine the very foundations of our free society as the acceptance of a social responsibility other than to make as much money for their stockholders as possible. To try to reduce the behaviour of individuals to that of impersonal social forces [for financial structures] not further analyzable into the conduct of men who...make history...is a form of false consciousness of bureaucrats and administrators who close their eyes to all that proves incapable of quantification, and thereby perpetuate absurdities in theory and dehumanisation in practices.

### III.6 How (not) to think like an economist: The (mis)education of economists.

If the criticisms already mentioned have some validity to them, then why do we not change the assumption of self-interest or the view of economics as ‘the science of rational choice’, why continue with the fixation on equilibrium, why hold fast to the model of economics as a positive science and not a social science? *Some argue that the reason is that economic education does not encourage change.* A much repeated criticism of establishment economics is that students of economics are more indoctrinated than educated into the discipline. The established position is never challenged because of what is taught and how it is taught. Inadequate textbooks leave little room for new directions. Hence they are characterised by some as ‘toxic textbooks’. Any search for new directions must take this into account.

We have already seen how for Marglin “students are taught to put aside large questions” which cannot be handled by quantitative means alone (2008:xiii). Marglin realises his criticism could be dismissed as out of date, in the manner of Coyle (2001:2). But he responds by saying that “the enterprise of economics is better characterised by the content of elementary texts than what goes on at the frontiers of economic theory” (2008:5) - even if the ‘leading edge’ was really advancing the discipline. Marglin says that the texts continue to promote, without sufficient qualification, the idea that markets are good for people. He finds this in both conservative texts such as Mankiw’s: *Principles of Economics* (2004), the largest selling text, and also in liberal texts such as Krugman and Well’s: *Microeconomics* (2005).

Keen (2010:5) says much the same thing. He found his own economic education “little better than indoctrination” and he sees each new generation of economic students being educated the same way:

Most introductory economic textbooks present a sanitized uncritical rendition of conventional economic theory, and the courses in which these textbooks are used do little to counter this mendacious presentation.

The result is that economic students are insufficiently literate and insufficiently numerate. They are *insufficiently literate* because they miss out on the history of the economy and production. They are *insufficiently numerate* because they are taught mathematics by economists who teach mathematics in their own way e.g. a way focusing on linear mathematics and not non-linear mathematics or complexity theory.

In the same way as Marglin, Keen (2010: 15) also argues that textbooks are important despite possible advances at the margins:

Economics is a moving target, and the outer edges of the theory sometimes bear little resemblance to what is taught at undergraduate level. I concentrate upon the fare served up to undergraduates, rather than the rarified extremities of new research - mainly because this is the level at which most economists operate, but also because the work done at the theoretical 'cutting edge' takes as sound the foundations learnt during undergraduate days.

Undergraduate students learn the basic theory as if there were no complications and certainly, no contradictions. This is done deliberately in some cases:

Bryan Caplan argues that initially undergraduate should be kept in the dark...advising fellow academics not to mention the assumptions or limitations behind textbook economics, and to tell their students, 'I'm right, the people outside this classroom are wrong, and you don't want to be like them, do you?' (Aldred 2010:227).

This may continue down the line. Even if the difficulties are eventually introduced they are minimized and what are really contradictions are underplayed as 'modifications'. Eventually problems recede into the background as students get more and more familiar with the established system which eventually they will teach in the same way (Keen 2010:27). I do not dismiss Keen's argument for I have found the same thing in philosophy. Students are indoctrinated into a restricted horizon - they absorb the 'standard account', say, of 'knowledge as justified, true belief' only to end up teaching it relatively unchanged themselves. And so we find that inadequate textbooks economics continues to be taught and to be used with disastrous consequences. Stiglitz linked the crisis in the Russian economy directly to this. He told World Bank personnel that "an excessive

reliance was placed on textbooks economics” and argued that textbook “economics may be good to teach American students, but it may not be so good as a basis for economic advice” (Quoted by Janet Guttman, Washington Post, Thursday, November 25, 1999: E1, E16).

Bruce Anderson and Philip McShane take up the problem in: *Beyond Establishment Economics: No Thank-You Mankiw* (2002). With Stiglitz they hold that brilliant people create bad policies because “these smart people did not learn smart economics”, and with Mark Lavoie they find that “pressures to conform to the orthodox canons are exerted from the very start, with the imposition of well known and voluminous first year university textbooks” (2002:5). There are “schemes of culture, research ideology, publishing etc. that close out challenges to orthodoxy” (2002:6). They are particularly concerned with the underlying epistemology of economic thought and with the lack of self-reflection in students. Hence they devote an interesting chapter to ‘Thinking like an Economist’. This is in direct response to Mankiw (2005) who has a chapter on this topic. They find Mankiw has a lot to say about models and graphs but little to say about thinking as such e.g about how best to understand the role of assumptions and theories. Their basic claim is that economists need to ask more often: ‘What am I doing when I am knowing-in-economics?’ or ‘What is the status of the economic science I am developing?’ They seek to motivate economists to operate at the level of self-reflection or of ‘intentionality analysis’ instead of dogmatically learnt theory.

On this topic, I cannot omit mention of an ongoing discussion amongst ‘real world’ or ‘non-autistic’, dissident economists concerning what they call ‘toxic textbooks’ - the main example of which they take to be Mankiw’s: *Principles of Economics* (2004). Toxic Textbooks are those which perpetuate the misconceptions about how economies and markets work (Fullbrook 2009). At the same time they omit real difficulties with established theories. They indoctrinate students into the myths of an established orthodoxy: myths about self-interest, market efficiency and the invisible hand. They disguise the ideology as hard science. And because of this they helped to bring about the global crisis, indirectly at least. The real-world economists hold that the best way to reform economics would be to reform the curriculum. A more pluralistic approach would be needed: Neokeynesianism as well as Neoclassicism; some serious economic history; an examination of providing institutions and financial institutions;

some relevant philosophy of the kind argued for by Nussbaum in: *Not for Profit* (2010).

Alternatively, as a minimum, we could put this warning on standard textbooks:

WARNING: This economics textbook is not suitable for use on real planets that face ecological limits. Application of the ideas, implicit values and analytical tools found in this textbook, without high levels of scepticism and caution, can result in an overheated atmosphere, greater difficulty surviving and widespread misery. Other species may experience extinction. Some conflicts with commonly accepted human values are suitable for use in imaginary worlds only or for historical study (Toxic Textbooks: Facebook Site).

Finally I finish with a serious suggestion. There is clearly room for an ‘economics studies’ programme or an ‘economic literacy’ programme for those who are not aiming at becoming professional economists. A programme that is academically demanding, that communicates the core of economic theory, but which does not require a high level of training in mathematical formalism is possible. And such a programme could even communicate a solid appreciation of what the necessary and proper use of mathematics can contribute - without demanding a huge investment of time in mathematical training. I argue that such an education is ever more vital. It is required by future politicians, by business leaders or trade union leaders and by concerned citizens. When students leave university one of the most pervasive influences they will encounter will be economic forces. Economic literacy taught as a social science or as part of the humanities will help them to prepare for this.

### **III.7 The economizing of ethics: Responding to ethical scepticism**

In this section the ethical dimensions of the need for new directions in economics, and hence in economics and ethics together, are considered. The need for ethics and morality seems evident given the recent global crisis which brought great hardship for many, and which was no accident. I will argue that to appreciate what went wrong involves a close examination of economic thinking, in a way allows us to tease out its linkages with ethical thinking. The moral scepticism found explicitly in

mainstream economic thought needs to be challenged. My argument will be that the same lack of reflection that led to a misunderstanding of the ‘scientific’ status of economics also leads to the exclusion of ethics. The economizing of ethics is due to a lack of self-reflection. The fundamental issue again is how and how not to think like an economist in the real world.

The general need for a consideration of ethics in relation to economics is well brought out by Stiglitz in: *Free Fall: Free Markets and the Sinking of the Global Economy* (2010). Stiglitz argues that the scale of the crisis shows we cannot go back to business as usual; he vehemently rejects the denialism of those who say ‘accidents happen’ and the crisis was simply that (2010:xx). His own position is that the markets are indeed important but “they don’t work well on their own”: economies “need a balance between the role of governments - with important non-market and non-governmental institutions” (2010:xii). He also says we cannot simply follow the experts who, in any case, often “provided the intellectual armor that the policy-makers invoke in the movement toward deregulation” (2010: xvii). Stiglitz also says the problem is systemic: it involves both mainstream theory and the action of overpowerful financial agents (2010: xix). Finally, he (2010:xx-xxi) says that questions of responsibility arise, so the systemic problem has ethical dimensions.

Among the long list of those to blame for the crisis, I would include the economics profession, for it provided the special interests with arguments about efficient and self-regulating markets.

The crisis makes it clear that a rethinking is required and that there should be a role for ethics in this, and even economists may need to recognise this; the “crisis exposed not only flaws in the prevailing system but also flaws in our society [and ethics]” (2010:284). A near-death experience, such as the global crisis forces us to “re-evaluate priorities and values” (2010:274). The ethical dimensions are evident in a direct way, for people in business were taking advantage of others and sold manifestly ‘toxic products’. This forces us to reflect as what kind of society we want and how the economy and our business practice fit into this (2010:275). Do we fit the economy to society or vice versa? Too often we let the market shape us so that “many come to value what the markets are valuing” (2010:277).

Stiglitz argues that the global crisis exposed a ‘*moral deficit*’ in the economic world. This was clear in the practice: multiple cases of deceptive accounting; self-deception in the calculation of risk; repackaging of toxic produces; and the ‘moral depravity’ of a setup that systematically pumps money from the bottom of the pyramid to the top (2010:279). Yet financial institutions absolve themselves of responsibility. It is not up to them, they say, to decide what is right or wrong. That is up to the lawmakers and politicians. Yet they spend huge amounts of money trying to get the legislation they want. They know they want to act in morally dubious ways and seek legal protection. They ignore consequences they know to be bad - like cigarette companies knowingly increasing addictive products.

However, this ‘moral deficit’ is also found in economics and economists. For they ignore or evade the ethical dimensions systematically linked to their theories. Unfortunately Stiglitz seems to dilute his critique here. He says that economics, “unintentionally provided sustenance to this lack of moral responsibility” by allowing a “naïve reading” of Adam Smith to suggest market participants could ignore moral issues (2010:281). *I argue that economic theorists have done more than this.* They have insisted on a radical separation of ethics and economics in order to uphold the scientific status of their discipline. Or they have insisted on a rigid separation of ‘positive’ economics and ‘welfare’ economics. At the same time they have imported surreptitiously an ‘ethic’ of self-interest into their ‘science of rational choice’. This is then taught in MBA and PPE programmes. Stiglitz correctly sees there is a systemic problem but fails to see it involves a problem of systematically relating economics and ethics.

The challenge of moral scepticism or moral oversight in economic thinking has to be met. *It is clear that economics finds it difficult to make room for ethics.*

Elementary economics, as it has been taught for decades, rejects the normative character of social economics in principle as incompatible with science, the factual analysis and scientific apparatus of the so called “positive economics” (Lutz 1999:104).

We find, as we have seen, Lionel Robbins insisting that economics “cannot pronounce on the validity of ultimate judgments”. More

alarmingly, we find Gunnar Myrdal saying the “economist should leave the making of evaluative premises to the politicians”. We noted John Hicks’s comment that “a values-based economics is a dreadful thing to accept”. Then there is the terrible Friedman who argues that “about values, we can only fight”. And finally, there is Kenneth Arrow:

Kenneth Arrow, too, agrees that an objective social good, independent of individual desires, does not exist, and he endorses the “nominalist temperament” of contemporary academia in which the existence of a social idea is relegated to the meaningless (Lutz 1999:105).

*Generally what is denied is any possibility of making a principled judgment of value.* The remote basis for this stance is Hume’s argument for a rigid fact-value or is - ought distinction: values such as ‘wickedness’ are said to correspond only to some sentiment or feeling in us. Kant does improve things much when he separates feelings from universal rational principles generated by a purely rational will. Economists do not seem to realise that the rigid Humean distinction is now being strongly questioned (Putnam 2002). Hence they marginalize ethics until some crisis forces ethical issues to the foreground. Some critics find their insistence on values-neutrality ‘quaint’ but, I shall argue, their stubbornness and rigidity has harmful consequences.

The inadequacy of the rigid separation is indicated by the incredible lengths to which economists go in order to translate moral phenomena into their ‘amoral’ scientific framework. For example they notice that people sometimes appear to be altruistic but explain this away. Generosity is “a taste for the perception of the welfare of others”. Religious-based concerns for others are really about “great retirement benefits” or “afterlife consumption”. Ghoshal gives other examples - “justice is important only because it leads to the avoidance of waste” according to Richard Posner. This has been said to be “a dim observation of a brilliant man”. On the same level is Gary Becker’s “theft is harmful only because it diminishes productivity” (Ghoshal 2005:79).

A developed response to such moral scepticism is given by Jonathan Aldred in his: *The Skeptical Economist: Revealing the Ethics Inside Economics* (2009). Aldred argues that the exclusion of ethics is fostered by “black box economics” and “veto economics”. Black box economics hides

principles that are inescapable moral in character e.g. “Employees are essentially selfish, and should be managed accordingly” or “The value of life can be measured in monetary terms”. While seeming to exclude ethics, economic theory tends to import its own values (or to rule out values in favour of preferences). Aldred argues that economic theory imposes a “web of belief” that affects human life “beyond our economic lives as consumers and workers” (2009:4). At the very least this shows that we cannot neatly separate ethics and economics.

Many people recognise this. They reject the veto economics which claims that the ‘inescapable economic logic’ of experts should be accepted without questions. For example, they see how the call for ‘efficiency’, which calls for producing the same valued outcome with few resources or less effort, really means the same effort with lower wages or fewer workers. They realise efficiency is not an ethics-free concept (2009:5). They have good reason for opposing particular forms of globalisation. They know quite well that unlimited free trade has undesirable consequences. They reject, therefore, Diane Coyle’s rule which states that “where common sense and economics conflict, common sense is always wrong”. And they reject the extreme claim of Bryan Caplan that those who do not accept the conclusions of establishment economics are simply too stupid to understand the ‘invisible hand’ theory. Aldred (2009:226) comments:

But remarkably, nowhere in his book does he seriously contemplate the possibility that ordinary people may have good reasons - such as different ethical starting points - for reaching different conclusions to economists. The public need not be foolish, irrational or ignorant.

In this way Aldred tells us that we should not let ‘economic rationality’ automatically trump ethical thinking. We should resist economic imperialism: “the trend for orthodox economics to invade other ways of thinking and attempt to colonize them” (2009:97). When such colonization is allowed the world is changed to suit the theory and the theory becomes a self-fulfilling force. Economists may argue that they need a simple model of human nature because without it “the mathematics underpinning economic analysis becomes unmanageable” (2009:224). But they do not appreciate the ethical implications: making the mathematics manageable in

this way leads to treating them as if they were manageable and in fact makes them manageable to some degree.

Apparently some academics find no problem with this. Richard Posner, Gary Becker and Robert Fogel have promoted an ‘economics imperialism movement’. The aim is to apply economic theory about rationality to transform education, history, sociology, anthropology, political science, criminology and even law; according to Posner, “building on such cherished notions as utility maximization, opportunity cost, scarcity, the law of demand and other such concepts, reduces all human sciences to economics” (Lutz 1999:161). The danger here is that a limited view of the human person will be allowed to engineer social institutions to fit the theory. This is one reason why Frank Knight’s is correct to suggest that “there is no more important prerequisite to clear thinking in regard to economics than is recognition of its limited place among human interests at large” (Lutz 1999:161). We need a better account of economics and a better account of ethics to go with it.

Aldred has a final point. Economic theory assumes rational self interest but does not apply this universally. It is readily applied in political economy to bring out the self-interest of politicians. This is the reason for arguing against a totally free market and for a non-interventionist state. But what of economists themselves - are they also self-interested? And are they proposing a theory of self interest out of self interest? They may claim that they are looking at the workings of the economy objectively. But then cannot other stakeholders operate on the basis of intelligence, including normative ethical reflection?

Economic rationality is constantly tempted to take over every area of life. R.W. Fevre explains in: *The Demoralization of Western Culture* (2000) how economic thinking prefers to reduce other kinds of thinking to itself rather than admit it is limited or that it has to rethink the nature of economics. In this economic rationality is like ‘common sense’. Here common sense is understood as the tendency to generalize out of limited contexts, to insist on the familiar, even if it leads to contradictory results - Too many cooks spoil the broth; many hands make light work. Economic thinking can do this by seeing all human action in terms of quantifiable self-interests. They overlook the possibility of genuine cooperation in the production of material goods; they do not consider the possibility of well

grounded judgments of value; they do not recognising the good or order or the common good as such. Economic rationality thinks one-dimensionally and cannot appreciate that some situations are so complex they have to be approach from different sides: they may need inter-disciplinary consideration. It may be that an ethical perspective can even alert us to intellectual alternatives e.g. by helping us to see the plausibility of taking economics as the study of providing institutions in the way Hodgson suggests. But why is this not recognised?

Ben Fine, in his article: *'Economics and Ethics: Amartya Sen as a Point of Departure'* (2004), suggests a reason for the blind spots in economic thinking that echoes Ghoshal's call for increased reflection in this area. Fine asks why economics is so poor at ethics. He lists six interrelated reasons that sum up much of the argument so far.

In the first place, the rigid distinction between positive and normative economics reflects an uncritical reliance on the fact-value distinction that other disciplines are rethinking. Then there is neglect in the area of methodology, which makes it unlikely for economics to "interrogate its own ethical and other foundations" (2004:96). A third problem is that economics has neglected its own history and hence its previous linkages with ethics. A further problem is the isolation of economics from other social sciences which might have alerted it to ethical issues. Unfortunately, rather than learning from them, economics prefers to colonize them, exporting such elements as rational choice theory to the social sciences and to political science. The fifth reason is that "mainstream economics has always been and is now almost absolutely intolerant of heterodox economics from which ethical differences might be teased out" (2004:96). Economics has a strong disciplinary border which is well policed. The final reason is the most important:

Sixth, in sum, with method, methodology, history of economic thought, interdisciplinarity, and heterodoxy sidelined to marginal status, this has meant that economics is extraordinarily lacking in circumspection around the (ethical) meaning and implications of all its standard concepts, such as production, consumption, utility and the market (2004:96).

This is precisely the difficulty Ghoshal (2005) raised regarding business studies. The same lack of reflexivity in economics rules out any space for

ethical considerations, whilst at the same time ensuring a narrow self-understanding that may distort the discipline.

To sum up this long discussion: the account of all the problematic areas of standard economic theory, the whole spectrum of ‘economyths’ (Orrell 2010) gives evidence that a major rethinking is called for. We need a new paradigm in economics itself that will open it up to new ways of relating with ethics. How can economics be thought so that the ethical questions are seen to emerge naturally rather than being limited to external correctives? How can ethical thinking respect the integrity of economic process whilst subsuming it into ethical reflection on human life? We must now turn to the positive task of sketching out what the new directions.

#### **IV. The search for solutions: Possible new directions in economics and ethics**

If there is a single point that sums up the last section it is this: “*It Doesn’t have to be Like This*” (Legum 2002). These assumptions of orthodox economic theory need not be accepted; economics need not be thought of as a hard science; the relationship between economic theory and business practice can be revisited; economic education can be different - economics need not be divorced from ethics. There are clear alternatives to mainstream neoclassical economics, some of which have been briefly pointed out. Keen lists alternatives as basic approaches to economics: Austrian economics, post-Keynesian economics, Sraffian production based economics as well as complexity theory-based economics or evolutionary economics (2010:300).

My treatment and listings of alternatives will differ because I am interested in the philosophical under-pinning of economic thinking and in its relation to ethics. Hence, I consider:

- (a) The need for a more explanatory grounding of economic methodology in the conscious intentionality of intelligent and responsible agents;
- (b) The need for an economic approach that explicitly relates economics to society;
- (c) The need to integrate ethical thinking and economic thinking in a more direct and systematic way.

I consider in turn methodological economics, social economics and integrative ethical economics. These positions argue in different ways that economics naturally opens up to ethics if it is more adequately appreciated as a social science. To these three we could add social market economics, another tradition of economic thinking that overlaps with both social economics and with Catholic Social Teaching.

#### **IV.1 Methodological economics: Intentionality analysis and macro-economic dynamics**

There is a strong case for taking Lonergan as a source of new directions in economics and ethics. His credential may be quickly established. In his major works: *Insight: A study of Human Understanding* (1992), and: *Method in Theology* (1971), he provides in great detail the ‘intentionality analysis’ that Ghoshal (2005) was looking for. At the same time his: *Towards a New Political Economy* (1998), and his: *Macroeconomic Dynamics: An Essay in Circulation Analysis* (1999), testify to the seriousness of his sustained reflection on economic process. Lonergan could be seen as giving philosophical backing to Catholic Social Teaching on economics.

To refer to a work like *Insight* may seem to import a lot of philosophy into a discussion of economics and ethics. But Lonergan insists that “in constructing a ship or a philosophy, one has to go the whole way; an effort that is incomplete is equivalent to a failure” (1992:7). For Lonergan going the whole way means going behind theories to their generating base. He offers a philosophy of self-appropriation which invites us to grasp conscious human thinking and acting more deeply. For him, ‘intentionality analysis’ involves simply a sustained reflection on our intellectual and responsible operations. He provides “a compelling analysis of intentionality” (Little 2009), a compelling account of the human person who is attentive, intelligent, reasonable and responsible, that is relevant to every area of life and every field of study. The promise he gives (1992: 22) is:

Thoroughly understand what it is to understand and not only will you understand the broad lines of all there is to understand, but also you will possess a fixed base, an invariant pattern, opening upon all further developments of understanding.

Every discipline must at some stage and to some degree have recourse to this level of reflection. Only at this level, Lonergan claims, can a discipline grasp its own character and identity and scope and method. Only at this level can we go beyond a merely empirical level or a merely theoretical level to a full integration of theory and practice. And only at this level can we cross over into other disciplines appropriating their generating principles. Lonergan claims that self-appropriation, understanding one's understanding, provides a balanced epistemology, a comprehensive metaphysics, a basis for interdisciplinary cooperation and also an ethics. At this level,

The many sciences lose their isolation from each other; the chasm between science and common sense is bridged ... [and] an ethics results from knowledge of the compound structure of one's knowing and doing' (1992:23).

Little shows how this applies to business studies in his: *Lonergan's Intentionality Analysis and the Foundations of Organisation and Government: A Response to Ghoshal* (2009). Here I want to consider the significance of Lonergan's thought for economics. Everything he says about our cognitive capacity and our moral consciousness applies to economics. We appreciate best what we are doing in our economic activity and our economic thinking if we ground them in our intentional consciousness. While it is impossible to give more than an outline of Lonergan's overall position, we can begin to appreciate its implication for economics.

#### **IV.1.1      Intentionality analysis and human economic agency**

As we have seen, one of the aspects of orthodox economic theory is its gloomy ideology that reduces human beings to *homo economicus* in order to justify treating economics as a natural science. Here I argue that Lonergan's intentionality analysis *provides an alternative and better account of human economic agency and at the same time it reveals why social sciences differ from physical or natural sciences*. Lonergan argues that any adequate economics must be a "social economics", "guided by

observant, intelligent, reasonable and responsible agents” (Martin 2008: 84), for this is what intentionality analysis reveals us to be.

The difference between Lonergan’s approach and that of mainstream and Marxist economic methodology centers mainly on *Lonergan’s emphasis on the role of intelligence*, the corresponding intelligibility of economic process, and moral economic agency in the pursuit of the good of economic order (Martin, 2008:85).

To recognise intelligence and moral responsibility makes it impossible to see economies as mechanical. *It leads to a very different interpretation of the ‘invisible hand’ metaphor.* It either shows there is no ‘invisible hand’ automatically maximizing social welfare, or it leads us to discover what in reality really corresponds to the metaphor - the actual explicit intelligent cooperation of human agents.

In the first place ‘intentionality analysis’ and self-appropriation on the basis of heightened self-awareness and sustained self-reflection reveals the artificiality and inadequacy of the model of human beings as rational, maximizers of self-interest. The model loses all credibility by comparison with the account of the human agent based on self-attention. By drawing attention to full human agency, to the possibility of empirical, intelligent, reasonable and responsible, personal self-possession, *Lonergan makes it very difficult to take seriously the truncated model of human agency found in much economic theory.* This model appears simply pre-Copernican, and the economic science based on that model seems Ptolemaic. Recognizing Lonergan’s fuller account of human agency involves a challenge to, and transformation of, standard accounts of economic agency.

Lonergan, therefore, criticizes the metaphor and its role as “a principle of progress” in Adam Smith’s thinking (Lonergan 2004: 368). For Smith the aggregate of individual actions will lead to a positive outcome – collective welfare. But Lonergan holds that Smith, in handing over the motivation of capitalist process to enlightened self-interest, brings in a principle of decline. The problem is that ‘self-interest’ too quickly is linked to ‘profit maximization’.

What the self-interest of the capitalist must have is profits, for the alternative to profit is loss, and sustained loss means bankruptcy. In such a context, enlightened self-interest easily comes to mean really

profitable self-interest. And when the mathematical economists draw up their design for utopia, the best of all possible worlds is seen to result from maximizing profits.

In this fashion an ambiguous term betrays capitalist enterprise into complicity with the forces of decline. Profit as a criterion encourages the egoism of individuals and of groups; individual and especially group egoism is a bias that generates inattention, obtuseness, unreasonableness, or social irresponsibility; what initially appeared to be a 'scientifically' efficient and efficacious motivation has turned out to be an engine of decline (2004:368-369).

Against this, Lonergan argues that from his perspective the metaphor corresponds to "conditioned series of more or less probably emerging and surviving schemes of recurrence" that are found at all levels of reality : the genesis of atoms or the evolution of animal species or to human history. This is his philosophy of emergent probability, which attempts to explain the "many-layeredness" of reality. At the human level, an added factor comes in. Here "human ingenuity puts together natural and human resources to bring about institutional and, in particular, economic schemes of recurrence" (2004:368). The economy is precisely that: *a scheme of recurrence leading to the production and distribution of goods which involves human cooperation.*

Among such schemes, are capitalist enterprises; new harmonious fitting despite their independent origins appears the work of an 'invisible hand' but really results because human insights into concrete situations continue a process that runs through the whole of nature (2004, 368).

I would add that the economic schemes also come about and are preserved or supported because human moral consciousness grasps the common good to be attained by cooperation. Progress is the result of conscious and intelligent and responsible cooperation of human agents who know what they are doing, and who know if they do what they should not. *So the invisible hand is not invisible, it can grasp other hands, and also it can slap you in the face and may need to be rapped over the knuckles at times (for economic agents can be less than fully attentive and intelligent and responsible).*

At the same time the status of economics as a social science would be explained. The limitation of positivism and instrumentalism stand out if

we understand how intelligence can grasp the imminent intelligibility of economic process. A moderate realism could be grounded in the ‘data of consciousness’ that Lonergan points to. Insight is understood as grasp of imminent intelligibility and judgment is found to involve a grasp of the sufficiency of evidence to affirm the truth of an insight. Science is found to originate in the intelligent questions of concrete phenomena. A fuller appreciation of the human subject allows a better grasp of the scientific object.

The recognition of the human subject as consciously intelligent and responsible opens up a space for a distinct social science. It points to the need to consider human behaviour precisely as a mixture of attention and inattention, intelligence and failure to be intelligent, as reasonable and unreasonable and finally, as responsible or irresponsible.

With this fuller sense of economy agency, Lonergan’s concept of human behaviour and its use in social scientific analysis also clearly runs far way from the mainstream economic anthropological concept of ‘economic man’ in its consideration of cultural values and the exigency of human reason (Martin 2008:95).

On Lonergan’s position the social sciences must pay attention to conscious acts of meaning, to purposeful action and intelligent grasp of situations. They must consider meaningful, intentional, intelligent and responsible activities and hence also, when appropriate, take into account personal reports of economic agents.

If economics insists on the status of ‘natural science’ it will adopt a reductionary account of human agents: it will require them to act as if they were less than human and treat them as less.

[The] emphasis on modeling itself on natural science with its focus on prediction rather than explanation results in an inhuman science that does not provide people with precepts for living. In other words, by modeling itself positivistically on natural science (more exactly, its emphasis on prediction and quantifiability adopts more the methodology of mathematics), and economics as now constituted fails to be the normative prescriptive science it should be (Martin 2008:100).

Standard neoclassical economics can be prescriptive. But the prescriptions can only seem to come out of a ‘black box’ for most people. And if

human behaviour is treated as predictable in the same way as the behaviour of atoms, or as merely statistically probable events, then the prescriptions will be presented as dictates that do not require an intelligent response. Human economic 'agents' will really be treated as passive subjects to be managed. Hence Lonergan says: "The link between the human science and its application will not be human; it will be subhuman" (1990:363-64). By contrast, his own account recognises properly human agency:

Lonergan's account of economics as a social science not only recognises the potential ability and responsibility of economic science to issue precepts, but also the ability of economic agents to use their intelligence and responsibility to carry out these precepts (Martin 2008:102).

This has implications for how we understand the common good:

The economic good of order, however imperfectly realised is present predominantly in mixed-market economics, turns out to be much more complicated and *intentional* than Adam Smith's 'invisible hand' that magically transforms self-interest into the 'common good' (Martin 2008:107).

On this new economic theory, one has to take into account agents who are able to "*choose on the basis of values and not satisfaction*" (Martin 2008:103), and agents who intelligently work out their roles in relation to the productive process. Thus, for example, wage negotiations should ideally be intelligent and responsible because there is no automatic 'price mechanism'! Negotiations should be judged by the way they facilitate or obstruct the productive process and by the way they affect the way in which the potentialities of nature are transformed into a standard of living judged to be worth seeking. Intelligent and responsible direction of the economy and intelligent and responsible participation in the economy are required, especially if we seek a democratic capitalism. This outlook also recognises the role of society and social institutions without losing sight of personal agents. It does not replace a liberal free market with a Marxist command economy.

## IV.1.2 The new science of macroeconomics: Circulation analysis

*The recognition of intelligent and responsible economic agents changes our perspective on economic process.* It leads to a better grasp of the intelligibility and functioning of economic process itself because it directs our attention to what concretely happens - to what people do as they cooperate in economic schemes. *The object of economic inquiry becomes clearer.* For Lonergan the aim is not simply to predict changes in aggregates of individual behaviour such as the GDP, or overall price levels, or overall profits or other quantitative measurements. The aim is rather to understand and explain economic process and its concrete manifestations such as differences in income distribution, levels of unemployment, the cycles of booms and slumps, the impact on wider human welfare, in order to promote the ongoing service to the common good through a better understanding of the process.

Lonergan sought a theoretical understanding of the productive process as a whole and of the commercial and financial schemes that sustain it, and allow it to develop (St Amour 2010:63).

Lonergan set out to develop a better account of economic ‘science’ more suited to identifying the imminent intelligibility of economic process. He explained this new science of macroeconomics in terms of circulation analysis: the mutual conditioning of production cycles and money flows.

Lonergan began by arguing that all sciences involve the identification and relating of the *significant variables* that explain the phenomenon under enquiry. The core variables account for the way things are. But what are the significant variables for economics? *Lonergan’s response to this question may constitute his most important contribution to economic theory.* Lonergan argues that the significant variables are not what standard economic theory takes them to be.

Standard theory focuses on ‘things’ in relation to us, on particular goods and particular quantities of money such as prices and profits. At the same time standard theory considers a single circuit between households that pay for goods and firms that produce them (Mankiw 2004:23; Krugman and Wells 2006:31). By contrast, Lonergan points out variables that were overlooked or misunderstood (Lonergan 1999:55, 177-202; Anderson and

McShane 2002:111). He concentrates on the cycle of cooperation constituting the *production of capital goods* and the cycle of cooperation *producing consumer goods*. For him, the economic process as a whole is constituted by the relationship between two mutually conditioning cycles.

The single circuit of exchange is commonly presented in standard text books:

Economics typically recognises only one “circuit” of exchange, between households and firms. That is, money flows to households in exchange for services performed. This simple model is capable of being extended to incorporate finance and government sectors, plus foreign trade (Martin 2008:121).

However, this overlooks the fact that the different cycles of production, capital and consumer cycles, have their own price levels, quantity or rate of production, accelerations and decelerations in any given time period. Lonergan argues strongly that attention to these cycles gives a better understanding of the economy as a whole. These are the significant variables to be monitored, related and modified if necessary.

Lonergan’s economic analysis attempts to show that these basic and surplus “circuits” of production are crucial because they interact with each other toward either: (1) economic growth and a higher and more equitable standard of living for all or else, (2) economic contraction and a lower overall standard of living. Circuit analysis seeks to understand the normative dynamics of the interaction between production, exchange and finance within each circuit, and between the two circuits. Only in this way can economic agents possess the understanding to making timely and enlightened economic decisions (Martin, 2008:121).

Only in this way do we know ‘what’ we are talking about when we are doing economics. Lonergan argues that the single-circuit model is merely *descriptive* while his two-circuit model is *explanatory* in that it relates two features or basic variables in a way that throws light on the economic process as a whole. For example, it can show how changes in the production cycle of capital goods can ‘accelerate’ the production cycle of consumer goods. And it can explain how the two cycles must be balanced in different ways at different times of an economic expansion or contraction. This is comparable to the shift from a common sense

perspective on a falling body (it goes ‘faster and faster’) to Galileo’s explanatory account of the relation between speed and time and distance.

The distinction between consumer and producer goods is not original to Lonergan. *But what is original to Lonergan is the way he draws attention to two distinct dynamic cycles and explains their interaction and systemic interrelationship.* The production of capital goods does not directly affect the standard of living. But it does accelerate the production cycle of goods that do enter the standard of living. And the two cycles must be kept properly balanced e.g. profits in relation to capital goods must be modified according to the overall stage of an economic cycle in such a way as to allow the cycle to continue. One consequence of this is that the profit margin on the capital goods side at the beginning of a new cycle of production may have to be moderated as the consumer side experiences an expansion. If high profit margins are kept, few can afford the goods, and then the consumer side is not able to invest in the capital side and the whole system collapses.

This relationship may be of great importance. Hence Paul St Amour (2010: 63) says:

I believe it is fair to suggest that Lonergan’s differentiation of “the economy” into two interrelated circuits will eventually prove at least as important to economics as William Harvey’s differentiation of pulmonary and systematic circulation has been for medicine.

Lonergan’s analysis of how the cycle of capital goods production process interacts with the cycle of consumer good production is completed by allowing room for what he calls ‘*redistributive functions*’. These include the functions performed by governments, banks and financial systems as well as by welfare Organisations of different kinds. This completed account offers an intelligible image of the whole dynamic process of the economy which is much more explanatory than the standard ‘circular-flow’ diagram. It more readily communicates ‘what’ we mean by the economy and by economic inquiry. This distinctive framework of circulatory analysis throws light on many aspects of economic process. One application in particular catches St Amour’s (2010:38) attention:

One reason I consider Bernard Lonergan an important economist ... is that he makes a remarkably interesting and significant claim, supported

by cogent arguments and a compelling theoretical model, that economic slumps and neither necessary nor inevitable slumps result from a failure to intelligently and responsibly adapt financial practice to the requirements of the underlying productive process.

St Amour shows (2010:62-66) how Lonergan's account of economics may usefully be compared to the discipline of medicine, a more appropriate model than physics:

- Just as anatomy studies the organism as a whole, economics studies the dynamic economic processes of capital and consumer production and their associated financial flows;
- Just as physiology considers the functions of anatomical structures, so the demand and supply functions of the economy are in focus;
- Just as medicine identifies the standard by which health is measured, so macroeconomic dynamics identifies the conditions for long-term sustainability in terms of the relationship of consumer and capital production cycles;
- Just as pathology identifies what frustrates health, so a proper understanding of circulation analysis helps to diagnose what goes wrong in recessions and slumps, e.g. mistaken expectations of continued high profits that lead firms to behaviour that frustrate later expansion;
- Just as sound medical knowledge can promote healthy living, macroeconomics, circulation analysis, if widely understood, can show when either high profits or high wages are inappropriate.

#### **IV.1.3 Integrating ethics and economics**

In effect Lonergan has provided a new analysis of economic process that indicates where ethical considerations are appropriate. But he does this without ineffective moralizing. He insists on the *integrity of economic theory* as an empirical and intellectual discipline because “moral precepts

that are not technically specific turn out to be quite ineffective” (1999:106n135). But he also shows how we can construct a ‘technically viable’ alternative to the mainstream positions that allows a space for ethics.

[Lonergan] wished to determine how moral precepts can be derived from the imminent intelligibility of economic processes themselves and, in the process, establish both economic understanding and moral responsibility as *intertwined and constructed for proper economic functioning* (Martin, 2008:166).

Lonergan is clear that we must have an accurate understanding of economic process. However, the process involves cooperating agents and requires a willingness to implement the process in order to bring about the common good (or what contributes to the common good). You have to be alert, you have to have perspective, you need medium and long term goals, you need moral commitment, you need balanced judgment, and you need informed sympathy and informing or enlightening sympathy.

Lonergan claims that if moral precepts grounded in proper economic analysis are understood and people are morally inclined or can be persuaded to follow them in a cooperative effort for the common good, the economy could be guided intelligently, intentionally and democratically (Martin, 2008:167).

To the extent that it addresses only self-interest, and to the extent that it packages its prescriptions in mathematical terms or economic jargons, neoclassical economics denies stakeholders the information and understanding they need to participate intelligently in the economy. *Democratic economics is only possible if economic science communicates to stakeholders in a way that enables them to intelligently apply economic understanding to their own concrete situation, rather than being dictated to by ‘black box’ and ‘veto’ economics.*

## **IV.2 Social economics**

A second indication of new directions in economics and ethics is found in Mark A Lutz’s: *Economics for the Common Good* (1999). This presents humanistic social economics as a *genuine alternative*. In mainstream

economics Lutz argues that economics and ethics are linked as both are concerned about what is valuable in social life.

Accordingly, Lutz criticizes the mainstream for precinding from questions about the social good. He finds this reflected in students of economics in a startling way. When asked what they needed most to succeed in their discipline, they replied: (a) “being good at problem solving” and (b) “excellence in mathematics”. Meanwhile the least chosen answers were: (a) “having a broad knowledge of the economic literature” and (b) “having a thorough knowledge of the economy” (1999:1). Lutz reads this as meaning that these students had no idea of what the economy was for e.g. promoting the health of the ‘socioeconomic’ whole or the health of the ‘socioeconomic organism’. Why was this? It is because mainstream theory taught them to approach economics scientifically and “to keep clear of any contact with social values”. He complains (1999:2):

What counts are carefully conceived models constructed with analytical and mathematical rigor. How much longer can the social fabric tolerate the doctrines and medicines of an economics orthodoxy that appears inept at coming to grips with the socioeconomic problems people contend with every day?

The question is what are the credible alternatives? Lutz offers as a promising alternative a humanistic version of ‘social economics’. Social economics broadly conceived may be taken to include Catholic Solidarity Thinking, the Austrian School of Economics, even Neo-Marxist as well as Feminist Economics and Environmentalist Economics. Lutz advocates a humanist social economics going back to Sismondi (1773-1842), which focuses on human dignity and the common good or human welfare in the broadest sense. The outlook is well summed up by Schumacher in: *Small is Beautiful: Economics as if people mattered* (1973), (clearly this is close to Catholic Social Teaching, but Sismondi was wary of religious approaches as they tend to be parochial, he thought).

So what exactly is social economics?

An economics exploring the principles on which production of good and services can be undertaken such that human welfare in its broadest sense is maximized (Lutz 1999:2).

Immediately this involves two aspects: (a) the recognition of “a common good that gives direction to social science in general and to economics in particular” and (b) a role for a social dimension in economic analysis and thought. In addition, it involves: (c) recognition of the self or person who relates to other persons in society and who is able to make judgments of value, and (d) an insistence that ethics and economics are naturally related as both refer to values and social life. These elements, absent in orthodox individualism, once recognised “suggest a critical re-examination of the way mainstream economics treats matters of methodology, rationality and efficiency” (1999:2).

*The first element is recognition of the common good.* This is not easy to fit into neoclassical liberalism - it is even denied by people such as Bentham for whom the interest of the community is nothing more than the aggregate of the interests of individual members. Social economics affirms the possibility of a collective purpose, of a good of order or a good of participating in a collective effort, and of goods that only this cooperation can bring about.

*The second requirement is a recognition of society:* There is such a thing as society. Failure to recognise this would imply that economics is not aimed at the maximum-possible, properly-human welfare (it would aim at a quantitative aggregate that is of no direct significance for anyone). To aim at integral, human welfare would be to recognise that human beings are related, that economic process and material values related to wider social process and values, as well as to recognising questions of distribution and justice or equity.

*The third requirement of social economics is that persons are basic values.* In fact, it is really the person who underlies the common good and social “philosophy ultimately hinges on the concept of the self” (1999:9). This advances beyond liberal atomism in which other people can only have instrumental value. It also points to a deeper view of human agency, for persons are intelligent and responsible beings who can make judgments of value. This rejects the neoclassical model of human beings as bundles of preferences.

Although it is true that people are born with certain distaste and preferences that remain fairly stable, it is important to note that personal

values are not at all like tastes. They are more often something about which we [can] argue, something that is amenable to rational persuasion and very much affected by our own experience is the social economic universe (1999:13).

Furthermore, persons are essentially rational and social: social agents are persons who “value persons and evaluate institutions as to their responsiveness to people” (1999:6). Given this, economics should not treat persons as simply ‘acquisitive consumers’ but as related citizens cooperatively participating in the common good.

*Fourthly, social economics is characterised by its insistence that economics and ethics are naturally related.* Lutz comments (1999:5):

It is strange that economics and ethics have been kept apart for so long. Both disciplines deal with what is valuable and both refer to the same social life.

Lutz suggests that it is possible that Kantian ethics contributed to the separation of economics by insisting on the separation of feelings and moral obligations. This allowed Smith to consider happiness as something private. Everyone knows what is best for themselves. But he also thinks we can assume they will rationally maximize their interests, which allows a public science of personal material interests.

Ever since Kant and Smith society has come to accept these as two separate domains: happiness, guided by the principle of economic rationality, and ethics, based on the principle of moral personality (1999:5).

Social ethics tries to overcome the divide and to integrate ethics and economics. This would involve showing there is “social mediation in the formation of individual preferences” (1999:5). This would show that happiness is not merely a private affair, even in regard to material goods. This mediation is evident once we recognising the good of persons. Persons influence each other and, more important, are values for each other and persons together construct and participate in the good of order and together originate the public good.

In the social economic position, ‘economic rationality’, as understood in mainstream economics, will be in tension with social and moral intelligence. Maximizing self-interest will not maximize human welfare in the broadest sense. For that, we have to deal with person as persons. Also, questions of redistribution of wealth, questions about the social consequences of free flowing capital, and about ecology cannot be avoided. The key question arises:

What is the basic purpose of both the economy and economics as a discipline? An ever growing average income or an adequate provisioning of all persons, so as to increase the quality of life? (1999: 15)

This is the right question to ask. It enlarges the perspective and shows how problems generally conceived in a narrow way as purely economic (whatever that means) have to be considered from wider social and ecological perspectives. Then, new questions arise about welfare economics, about economic rationality and about corporate business practice and the global markets and finally, ecology:

- How can economics be “a positive science uncontaminated by ethical judgments” and yet provide “meaningful guidance to the public policy maker”?
- Is economic rationality “logically overambitious and humanly impoverished” and does it need to take note of non-algorithmic rationality in order to accommodate qualitative human judgments?
- Does the standard criterion of efficiency need to be subordinated to social values that call for material sufficiency for all along with respect for human dignity?
- Should economics not keep more closely in view the limits of cost benefit analysis, the growing gap of rich and poor, the impact on the environment and the need for sustainability, the consequences of globalisation? (1999:x-xi)

The social economic perspective is a valuable complement and challenge to the mainstream. It pays attention to the details – the impact of economic practice on the quality of human life - much like Catholic social teaching. The focus on the common good, dignity and ecology, allows important questions to be raised. To recognise the contribution of social economics requires a much wider historical perspective than is usual. We begin to appreciate the interesting connections between Catholic social teaching, social economics, social market economy and even Marxist social and economic thought. But more may be needed - a more direct engagement with standard consensus, the development of a detailed and convincing alternative economic theory that Samuelson calls for. A more technically viable alternative is needed. At present social economics seems a secular parallel to Catholic social teaching. Both need to develop a more detailed alternative theory that covers all the elements treated by mainstream theory.

#### **IV.3 Integrative economic ethics: Towards a civilized market economy**

As a final example of a possible new direction in economics and ethics, I consider Peter Ulrich's: *Integrative Economic Ethics: Foundation of a Civilized Market Economy* (2008). As with social economics, the basic unity of ethics and economics is affirmed. *But here the ethical side is worked out in more detail and Ulrich makes a much greater effort to integrate ethical normativity and economic normativity.*

The distinctiveness of this approach comes out when we see the way in which Ulrich, as well as criticizing the 'logic of the market' or 'economism', also criticizes much of applied ethics and business ethics for being merely a 'corrective' to 'economic rationality'. From this point of view business ethics comes in too late as damage control. The ethics does not function as a preventative factor or as an inseparable aspect of economic activity (2008:ix). To that extent, business ethics is similar to social economics and Catholic social teaching which function as 'protest' ethics after the event.

Integrative economic ethics aims at a much closer relationship between the ethics and the economics. It begins by pointing out the ambiguities in

‘economism’ which in effect, reduces ‘ethics’ to economics. Economism argues that we should aim at improving the ‘well-being of all’, therefore we should accept the neoclassical position in its entirety. Hence, economic rationality and cost-benefit thinking, the logic of the market, should be given normative primacy. This “strangely anonymous and coercive logic” should then be allowed to pervade the whole of life as well as the theory and practice of modern market economics. *But this only follows, say Ulrich, if we allow economism to trade on an ambiguity about the meaning of ‘well-being for all’.* This ambiguity allows it to obscure important intuitions about the nature of a good society.

[The logic of the economy] occasionally contradicts our intuitions and governing ideals about the good life and just ways of living together in a well ordered society of free and equal citizens (Ulrich 2008:1).

I would argue that economism contradicts our intuitions about the good life frequently not occasionally. Ulrich himself points out how the logic of the market condemns many to permanent unemployment, others to immense burdens and disempowerment. It leads remorselessly to a greater gap between rich and poor. It has no problem if only a small elite get richer: that’s just the way the markets work. And all this is at an ecological expense that has become permanent.

In this way, it incessantly improves ‘productivity’, or what we regard as productivity yet it still fails to provide everyone with what is minimally necessary for a life worthy of a human being at a national, let alone, at a global level (2008:1).

Economism then measures the good life in a one dimensional perspective - the GDP perspective. A narrow model of economic rationality overshadows a fuller reasonableness that grasps what is necessary to be at the service of life (2008:2). We need a more adequate account of economic activity and its purpose. For the logic of the market economy is ‘evidently not the whole truth about economic reasonableness’ (2008:2).

Ulrich’s position is this (2008:1):

Economic activity based on division of labor is a societal process designed to satisfy the human need to preserve and sustain the quality of life. It seems to be in the nature of things that a rational social form of economic activity must be oriented towards the service of life.

More fully, we can say that economic activity is designed to contribute to and to help *sustain the quality of life as a whole*. It produces goods that directly supply our needs; it provides the conditions for social and cultural goods to develop. In this way, it serves the good of the whole person - of all the people who produced it! But this perspective on economic activity is not implemented. Economic activity frequently does not operate at the service of life. Indeed it undermines human life and makes human life serve it.

The need for a fundamental reorientation in regard to economic process and an ethically well-grounded containment of the market economy is growing (2008:2).

We need to realise that:

Not the market but citizens finally deserve to be free in modern society. The market economy must, therefore, be civilized in a literal sense (2008:2).

This is the background, says Ulrich, for the “recent call for the new interdisciplinary field of economic ethics” (2008:2). For we need more than ‘containment’. We need to ask and answer the following question:

*How is economic rationality, as forced on us by the inherent logic of the markets, to be firmly linked with ethical reason, by which we mean the normative logic of the reciprocal relationship between free human beings?* (2002:2)

This linking will be difficult because a ‘pure’ economics has developed which “imagines it is “value free” and no longer has a place in its axiomatic for ethical categories” (2008:2). And economists, though they may as citizens be concerned about some development in the real world economy, are unable in their theory to comment reasonably on the *evident divergence between the logic of the market and the ethical logic of interpersonal relations* that applies also to economic situations. “What is more, contemporary economics is ... more a part of the problem than a sound base for its solution” (2008:2).

The reason for this is that it is locked into an idealized model of the market system that cannot accommodate human needs and social concerns. It can even argue against demands for justice and the service of life that does not fit its logic.

*Thus we come to the main systemic problem:* Economic logic is locked into its ideal model and tries to compartmentalise ethics or keep it at bay; meanwhile ethics or business ethics works out its principles prior to engaging the economic context and so can only bring fixed, abstract principles that are ‘external’ to economic process and which can function only as a corrective - both sides need to be re-thought and they may need to be re-thought together.

A rational ethics of economic activity can be satisfied neither with applied ethics nor with normative economics [from economism]. Its core concern is an integrative approach which literally ‘*thinks together*’ the ethical rationality claim and the economic rationality claim instead of simply juxtaposing them symptomatically (2008:80).

The normative claims of the market, based on its legitimate integrity as a discipline, have to be linked to the equally legitimate integrity of ethical normativity. We have to go beyond juxtaposition or oscillatory integration and certainly beyond the reduction of one to the other by moralizing, on the one hand, or market fundamentalism, on the other.

Integrative economic ethics sees its fundamental task, first of all, in clarifying the categorical relationship between ethical and economic rationality and in solving the problem of their systematic mediation (2008:2).

For Ulrich, this development of integrative economic ethics will enable the implicit ethical dimensions of modern economics to become explicit. It will show that any explanation of how to “deal “economically” with limited resources, in view of a multiplicity of human needs” cannot avoid questions about the ends which justify the actions prescribed. In other words, integrative economic ethics will reveal the ‘hiding places’ of the normative aspects of economics.

Ulrich’s project seems of the highest importance. The aim at a real integration is commendable. *However, at present, I am not sure how*

*successful the project will be in the end.* I am not sure if he goes back far enough to find the realm at which economics and ethics reconnect or if he focuses sufficiently on concrete economic and ethical performance.

*It is true that Ulrich gives us a good example by starting with a phenomenology of human morality.* This essential step is often overlooked. At the same time, however, I am not sure if he has given a fully adequate account of the human act or of the good of the human person. He discusses the ‘idea of a good person’ but not the person as a good. I find him sticking too close to Kohlberg’s model of moral development which, in my view, lacks reference to an adequate theory of the concrete good. This may be due to the Kantian aspect of Kohlberg’s thought or to the influence of Kant on Ulrich. This at least is the first aspect of this thought that I would take issue with. Still the phenomenology that Ulrich does provide is very detailed and can be engaged with profit.

*The second aspect of his thought I would take issue with is his treatment of the development of ‘rational ethics’.* This strikes me as relying too much on Kant and on the expansion of Kantian thought in the discourse ethics of Habermas. Again what I find lacking is a substantial account of the good and hence an inadequate account of the human agent who responds to the good. The integration to be effected is between ethical action and economic action. Kant may not be able to bridge this gap and may even be said to deny such a bridge is possible. Ulrich thinks he can make use of Kant. But in order to do this he must focus on ethical rationality in terms of offering a justification for choices made. He thinks this focus on justification as the common ground with economics. I am not sure that this line of integration will work out. The assumption is this:

Regardless of the interpretation of the concept we use, rationality is an orientational idea enabling sensible people to justify their preferences for a particular action and to discover how they ought to act reasonably (2008:89).

On the basis of this assumption about rationality we can take rational economic activity as being concerned with: (a) the determination of “ethically rational (legitimate) purposes and principles of economic activity in view of possible alternative uses of limited resources” and (b) the “technically rational (efficient) use as means in regard to clarified

purposes” of these resources, “while observing the condition of legitimacy”. In other words, we are dealing with ‘political economy’, so ‘pure’ economic rationality is merely “one half of economic reasonableness” (2008:89-90). The other half is ethical, legitimacy reasonableness.

*I wonder if the emphasis on ‘justification’ may distort the account of the ethical dimensions.* I do not think that Kant, who separates rational principles from felt needs, can bridge the gap - he may even establish it as permanent. This does not mean I adopt a utilitarian stance for this emphasis on concrete consequences does not lend itself to a theory of obligation, which seems to be a necessary element in ethical theory. I would look for a bridge between deontology and utilitarianism and *I would look for the bridge in the human agent who can make judgments of values as well as of facts.* Ulrich may be able to align rational principles from ethics and economics to some degree in his ‘political economy’, but I am not convinced that he can show how concrete human action in the world economics and business may be integrated with concrete human action in social and personal life. However, Ulrich’s rich and detailed exposition makes a substantial contribution to any future discussion on these issues.

*A particularly important lesson to be learnt from his discussion is that the ethical side has to be rethought as well as the economic side.* Not every ethical perspective is adequate to an integration with economics. No single lens or single-principle ethics will suffice to bring about a real integration, certainly not Kantian deontology alone or utilitarianism alone. We need to consider the concrete human agent and how properly human acts of intelligent and responsible human agents respond to the complex concrete good. Few ethical traditions and methods are ‘person-centred’ in this sense. Either they stick at the level of abstract principles and so underplay the concrete agent, or they have a ‘thin’ notion of the person, as does Kant. Alternatively they consider consequences of actions, but focus on the material dimensions rather than higher values. Even where there is a consideration of the idea of the good person, as in virtue ethics, the concrete good of the person, as the ‘original and originating value’ (a term used by Lonergan), is not considered. An adequate account of human nature, an adequate theory of the human good, and an adequate account of moral obligation need to be combined if an effective dialogue with economics is to be possible. The window shopping approach of laying out

the spectrum of standard abstract ethical theories and then applying them one by one to case studies in ‘business ethics’, will not suffice. There is room for a prolonged discussion between philosophical ethics and social economists here.

## **V. Concluding Remarks: Integration of economics and ethics by intentionality**

*So where are we now?* I hope to have made clear that new directions in economics, and in economics and ethics, are needed and that some steps have been made in the right direction. The need for new direction in economics should have been made clear in the account of how economics can tend to pretend to the status of a hard science. I have argued that economics needs to expand both its methodology and its perspective in order to deal with real world economic process.

It seems clear that a range of complementary methodologies is called for: social economics in its humanist mode, integrative economic ethics which seems to link up with social market economics, and what I have called methodological economics. Along with the approaches such as Post-Keynesianism or Sraffian economics or evolutionary economics, mentioned by Keen (2010), these provide resources for a paradigm change. A new pluralistic approach to economic education is made possible.

The ethical dimension comes to the surface and new directions in economics-and-ethics are brought out when we consider the ends of economic action: not just ‘efficient’ production that contributes to an aggregate ‘social welfare’, but a *wider provisioning* of the material supports of civilized life that offers something to each and every person in a real society of related human beings.

The notion of the *common good* applies here. The good is concrete and the common good should be a good for each and every person. The *good of order*, in which all participate and in which all share, resonates with the idea of economics as a study of the providing institutions of a civilized society. And the notion of the good of order seems to link up with the recognition of the economy as involving two cycles of production that mutually support each other, with some help from redistributive agents and

institutions. Once we understand the nature of the economy as a complex cycle of recurrence, involving many participants, we see the need for intelligent and responsible agency (to the extent possible) at every level of the process - whether individual and social and organisational. This cannot be simply taken for granted. We are responsible in particular ways for this dynamic good of order and not just for immediate profits or individual gain. The ethical dimensions emerge out of the concrete economic order. Questions of personal honesty and transparency are important, but so are questions of responsibility to institutions as a whole and questions of responsibility for the wider economic order. Multinationals, CEO's, managers, workers and unions, governments and all stakeholders have to act with intelligence and responsibility.

To go further along the path of integration will require a serious effort at the right kind of reflection. However, together the new methodological and systematic approaches discussed above indicate that progress is possible. And a whole lot of other paths open up. Wider reading adds to the impression that a new paradigm is possible and is actually emerging. A basis for a new search for the common good is suggested in: *Building a World Community: Globalisation and the Common Good* (Baudot 2001). Ahner provides a good illustration of how business can be rethought in his: *Business Ethics: Making a Life, Not a Living* (2007). Hawken points to wider dimensions in: *The Ecology of Commerce: A Declaration of Sustainability* (1994). Kasser alerts us to the negative side of a totally free market in: *The High Price of Materialism* (2010). The need for new ways of thinking about economics and business is indicated by Moldoveanu and Martin in: *The Future of the MBA: Designing the Thinker of the Future* (2008), though I do not think they go far enough in recognising how we can go beyond the limits of algorithmic thinking and recognising the ethical. We see, according to Hardt and Negri, that the new political order of globalisation constitutes an Empire (2000), that can and should be resisted by the: *Multitude* (2005). Peters considers the wider common good in her: *In Search of the Good Life: The Ethics of Globalisation* (2004). With these developments in mind we might be able to think of economics as Coyle does in: *The Soulful Science: What Economists Really do and Why it Matters* (2007); the 'dismal science' can be reborn as a 'soulful science'. But there will be no real advance without serious dialogue and collaboration.

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**NICHOLAS ROWE** is Head of Humanities and Education at St Augustine College. He is a historian by training, specialising in the intersection between imperialism, race and Christianity in the Atlantic World. In addition, he works in community development, social reconciliation and peace-building.

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**LAURENCE BOULLE** studied at the Universities of Stellenbosch, London and Natal and became an academic after four years of legal practice. He is currently Director of the Mandela Institute and Professor of Law at the University of the Witwatersrand, Johannesburg, and Professor of Law at Bond University in Australia. He specialises in international economic law, mediation and alternative dispute resolution and his books on these topics have been published in seven countries. Among his recent publications are *The Law of Globalisation* (Kluwer Law, The Netherlands, 2009) and *Mediation: Principles Process Practice* 3 ed (LexisNexis, Sydney, 2011). Laurence has practised as an accredited mediator for over 20 years in Australia and South Africa. He is a Research Fellow at the Helen Suzman Foundation.

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## **About St Augustine College of South Africa**

The idea of founding a Catholic university in South Africa was first mooted in 1993 by a group of academics, clergy and business people. It culminated in the establishment of St Augustine College of South Africa in July 1999, when it was registered by the Minister of Education as a private higher education institution and started teaching students registered for the degree of Master of Philosophy and Doctor of Philosophy.

It is situated in Victory Park, Johannesburg and operates as a university offering values-based education to students of any faith or denomination, to develop leaders in Africa for Africa.

The name 'St Augustine' was chosen in order to indicate the African identity of the College since St Augustine of Hippo (354-430 A.D.) was one of the first great Christian scholars of Africa.

As a Catholic educational institution, St Augustine College is committed to making moral values the foundation and inspiration for all its teaching and research. In this way it offers a new and unique contribution to education, much needed in our South African society.

It aims to be a community that studies and teaches disciplines that are necessary for the true human development and flourishing of individuals and society in South Africa. The College's engagement with questions of values is in no sense sectarian or dogmatic but is both critical and creative. It will explore the African contribution to Christian thought and vice versa. Ethical values will underpin all its educational programmes in order to produce leaders who remain sensitive to current moral issues.

The college is committed to academic freedom, to uncompromisingly high standards and to ensuring that its graduates are recognised and valued anywhere in the world. Through the international network of Catholic universities and the rich tradition of Catholic tertiary education, St Augustine College has access to a wide pool of eminent academics, both locally and abroad, and wishes to share these riches for the common good of South Africa.