



**Research Network on Innovation
Réseau de Recherche sur l'Innovation**

**WORKING PAPERS
DOCUMENTS DE TRAVAIL**

N°5 / 2008

**THE (CONFUSING) ROLE OF CAPITAL IN SPECULATIVE
CAPITALISM—U.S.-STYLE**

Jim SAWYER

THE (CONFUSING) ROLE OF CAPITAL IN SPECULATIVE CAPITALISM—U.S.- STYLE

Jim SAWYER¹

ABSTRACT

Tightly connected to the U.S.-spawned global financial crisis of autumn, 2008, this paper considers the underlying doctrinal roots of speculative capitalism, including roots in the neoclassical profit lacuna. It examines recent precipitating events and proposes crucial changes to both doctrine and method in the social sciences. Among essential proposals is the policy prescription that government oversight will not change “pseudo-capitalist” outcomes, unless articulated tightly with what here is called “vision,” and which Michael Porter calls “strategy.”

© Réseau de Recherche sur l’Innovation, 2008

¹ James E. Sawyer is Fulbright-Nord Pas de Calais Regional Council Scholar (2008-09); Research Associate, Laboratoire de Recherche sur l’Industrie et l’Innovation (LAB.RII), L’Université du Littoral Côte d’Opale, Dunkerque; Associate Professor, Institute of Public Service and Center for Nonprofit and Social Enterprise Management, Seattle University, USA (on leave).

INTRODUCTION

Short-termism is a hallmark of contemporary, American-style speculative capitalism. Curiously, it runs contrary to the conceptualization of the competitive, profit-maximizing firm, operating within the short period. Marshallian analysis is the staple of sophomore-level instruction in microeconomics within U.S. universities. Short-termism not only suboptimizes profit, however, but within this analytical framework, social welfare also. When firms continuously “hold all their options open,” fixed capital is underutilized and therefore quasi-rent falls.

Presumably total financial gain from multiple placements of some quantity of speculative finance could be maximized using a “short-termist” strategy, but not without violating a fundamental assumption of doctrinaire capitalism. That is, the pursuit of self-interest is asserted to articulate universally with the attainment of the common good. Underutilization of “real” (non-financial) capital is inconsistent with social welfare maximization. Without this articulation, the moral authority of capitalism is lost on speculative, short-termist strategies.

The concealing of capital “use value” as a characteristic of the prevailing neoclassical paradigm has enormous implications for the inefficacious outcome of economic policy. Within the classical system, of course, the use-value of an asset could be traced.ⁱ A horse in the field, pulling a plow, for instance, would qualify as a productive capital placement. If the horse should be permanently removed from the field and tethered by the farmer’s door for the pleasure of his children, however, then “capital” would have been removed from productive use. That is, its use-value would have shifted from a capitalist controlled asset to one controlled by an individual qua rentier.ⁱⁱ

THORSTEIN VEBLEN ON CAPITALIST EXPLOITATION

Among the American Institutionalists, Thorstein Veblen is unique in his creation of an analytic framework into which use-value questions may be posed articulately. It is a framework that is useful—as a starting point—for the contemporary analysis of U.S. style speculative corporate capitalism. It is significant also to focus a lens on a contemporary U.S. practice, through a uniquely American analyst. I salute Thorsten Veblen as one with the prescient analytical abilities, literally, to frame our contemporary problem from his historical vantage point, over 100 years ago.

Quoting from *The Theory of Business Enterprise* (1904), “...the basis of capitalism has gradually shifted until the basis is now no longer given by the cost of material equipment owned, but by the earning-capacity of the corporation as a going enterprise.” (137) According to Veblen, often a going enterprise establishes its dominance through certain acquired attributes that confer upon it market power. “...the start,” says Veblen, “is commonly made with some substantial body of immaterial goods on which to build up the capitalization; it may be a franchise, as in the case of a railway, telegraph, telephone, street-car, gas or water company; or it may be the control of peculiar sources of material, as in the case of an oil or natural gas company, or a salt, coal, iron, or lumber company; or it may be a special industrial process, patented or secret; or it may be several of these.” (142) Once established, he observed in his day a tendency of the corporation to shift attention toward the acquisition of less tangible assets, including good will.

“Various items...are to be included under the head of ‘good will,’...including “such things as established customary business relations, reputation for upright dealing, franchises and

privileges, trade-marks, brands, patent rights, copyrights, exclusive use of special processes guarded by law or by secrecy, exclusive control of particular sources of materials. All these items give a differential advantage to their owners, but they are of no aggregate advantage to the community. They are wealth to the individuals concerned (sic) differential wealth; but they make no part of the wealth of nations.” (139, 140)

Veblen links the obscuring of use value to a growing separation of interests, between the capitalist on the one hand, and the community on the other. As a publically chartered entity, the implication is that the corporation should serve the community’s interest by succeeding at what it is chartered to do, rather than to become a pawn in the speculative financial dealings of the organization’s leader. “...the interest of the managers of a modern corporation need not coincide with the permanent interest of the corporation as a going concern; neither does it coincide with the interest which the community at large has in the efficient management of the concern as an industrial enterprise.” (157) Also, “...the point in question...is ...that...under...corporation finance the affairs of the corporation are in good part managed for tactical ends which are of interest to the manager rather than to the corporation as a going concern.” (162)

Other of Veblen’s observations are prescient, also, with regard to the recent U.S.-instigated, global financial crisis:

On abuses of information: “Partial information, as well as misinformation, sagaciously given out at a critical juncture, will go far toward producing a favorable temporary discrepancy...so enabling the managers to buy or sell the securities of the concern with advantage to themselves.” (156)

On transient equity ownership: “...a given block of capital, representing...a given industrial enterprise, may...change owners much more frequently than a given industrial plant...” (156) Further, “Their connection with the concern is essentially transient; it can be terminated speedily and silently whenever their private fortune demands its severance.” (159)

On securities manipulation: “They are also interested in making or marrying various movements of coalition or reorganization, and to this ulterior end it is incumbent on them to “manipulate” securities with a view to buying and selling in such a manner as to gain control of certain lines of securities.” (161)

On increased systemic risk related to securities manipulation: “...large-scale manipulation of vendible capital...commonly imposes(s) increased risks upon the business concerns....” (166)

THE PROFIT LACUNA, CAPITAL RELATIVISM AND FINANCIAL SPECULATION

My hypothesis—which runs somewhat parallel to Veblen’s—pertains to what I call “pseudo-capitalism.” That is, conventional policy practice in the U.S., and also the way in which we educate MBA and other business and economics students, is underpinned by incomplete and sometimes inaccurate theory. This provides an opportunity for rentiers to claim the reward of capitalists, but without provisioning historically sanctioned capitalist services including the full compliments of industry and skill, and risk-taking appropriate to stewardship responsibilities implied in the corporate charter. This tendency, pointed out particularly by Joan Robinson, grows out of the doctrinal profit lacuna that is also a capital lacuna, and a capitalist lacuna as well.

Building initially upon Veblen’s prescient analysis of over a century ago, then, I seek to make a case for what I call the doctrine of “capital relativism.” That is, in contemporary

wealthy societies, the character of capital is not absolute. Specifically, it is not a monetary sum although it may be summed in a monetary unit. Rather, the stock of capital exists relative to the outcome capital assets are intended to create. In democratic societies, therefore, the nature of capital assets is extrapolated from the social welfare function. Nothing is more important than clarity, by society, with regard to its intended outcomes, or ends. Harvard competitive analyst Michael Porter calls this “strategy.” In other words, contemporary capital must be anchored in comprehensive strategy, that in turn must be anchored in a clarity of societal vision. Without this now-essential link, “real capital” tends to become obfuscated with finance, and the representative innovator becomes increasingly likely to specialize in financial innovation.

The immediate quest, then, is to document the characteristics of pseudo-capitalism. A theory of pseudo-capitalism will be proposed, and finally, pertinent methodological issues will be scrutinized.

Distinction between financial innovation and product, service or process innovation, per se, is crucial. In considering financial innovation and its tendency to precipitate systemic instability, one thinks particularly of the work of Hyman Minsky and Charles Kindleberger. Here a summary relying upon Anastasia Nesvetailova (2007) emphasizes perspectives from Minsky and Kindleberger, also.

Historically, innovative financial manipulation in the United States is as old as Black Friday, 1869, when financier Jay Gould speculatively bought fiat currency printed to finance the Civil War, then cornered the market for gold in anticipation of popular calls for full convertibility of the near-worthless money. Sixty years later, at the vestibule to the Great Depression, Charles Ponzi perpetrated a fraudulent scheme in which he financed abnormally high returns on finance placed with him by paying so-called “investors” with revenue raised from other “investors” who followed behind. No real investment occurred, of course; it was entirely speculative financial fraud. All financial innovation, of course, is not fraudulent. Nesvetailova argues, however, the extensive use of financial innovation tends to increase the likelihood of “financial fragility,” therefore increasing the likelihood of ultimate crisis.

Financial innovation was essentially unknown in the early decades following the post-World War II creation of the Breton Woods international financial system, with fixed exchange rates tied to dollar guarantees underwritten by the U.S. Government (gold = \$35 oz). According to Guttman (1994) the first wave of U.S. financial innovation was associated with disintermediation during the mildly inflationary period of the early 1960’s. Government regulation imposed a lid on the rate of interest available to savers (Regulation Q) in traditional government-insured institutions. As savers left for higher rates in innovative, unregulated institutions, banks that had “lent long” for 30 year fixed rate mortgages, for instance, found it necessary to enter the unregulated market and borrow “short” in order to meet lending commitments.

Inflation associated with the Vietnam War presented a vastly increased challenge. Unable to meet its Breton Woods commitments to supply gold to foreign treasuries at the fixed dollar price, U.S. President Richard Nixon “floated” the dollar in 1971. Widespread privatization followed deregulation, launching the financial services industry. Indeed, Nixon’s action more than any other is identified with the industry’s creation.

The decade of the 1970’s was also marked by the “recycling”—particularly by American banks—of so-called “Petrodollars” from oil-producing nations to developing nations. Gradually the financing of “capital flows” shifted ever farther, with foreign direct investment

in developing economies, being replaced, relatively, by an influx of so-called “hot money” controlled by managers of mutual funds, for example.

Nesvetailova points out that to bridge the arbitrage gap caused by disintermediation, U.S. banks relied on a variety of borrowed funds. Thus the industry’s strategy shifted dramatically during this transformation, from an historic one of asset management, to a new focus on “risk management” of liabilities, instead.

Boiled down, says Nesvetailova, the characteristics of the contemporary international financial environment that contribute to “financial fragility” are deregulation or liberalization, privatization including privatization of exchange rate risk, and financial innovation. Although none of these existed in present form prior to the floating of the U.S. dollar, Veblen reminds that the roots of the contemporary problem can be found in the dominant corporate culture of a century ago.

Regarding financial innovation, Nesvetailova distinguishes it specifically from conventional product, service or process innovation (16):

1. Due to the very nature of finance, money is exchanged for a future promise;
2. Financial innovation involves finding new ways of borrowing and lending, leading to the emergence of new financial institutions; and
3. These new credit instruments rely more upon investor’s expectations and less upon “underlying economic variables.”

In this new “debt economy” as it has been called, Nesvetailova describes the process of the management of risk, or financial engineering, as the quantification, management and trade in sophisticated, secondary financial instruments or derivatives, with portfolio positions in which “...price and risk exposures of various asset’s ...[are]...carefully weighted and projected into the future.” Theoretical approaches based in mathematics, such as the capital asset pricing theory (CAPT) or Black-Scholes option pricing model, have promulgated financial innovation including portfolio selection and diversification models, arbitrage trading and leveraging techniques. (20)

Nesvetailova also discusses other contributory characteristics to financial fragility:

- Technological innovation (e.g., the Internet);
- The shift from equity, toward debt financing through a growing pyramid of liability and risk;
- Dichotomization between individual choices and aggregate outcomes; that is, ethical bifurcation between the pursuit of self-interest and the attainment of the common good;
- Widespread use of leverage; massive volumes of debt, speculatively built up in pyramid-like fashion;
- Large systemic increases in liquidity, in innovation leading to creation of new credit instruments, and thus to over-borrowing; and
- Widespread (mis)perception that debt liabilities are profits (such as “Ponzi” schemes).

“Hyman Minsky was a pessimist,” the author observes. “He believed that as long as capitalism is governed by sophisticated financial institutions and inter-linkages, it is inherently, and unpredictably, unstable.” (7) Minsky argued that the source of financial fragility lies in the schism between the development of real profit opportunities on the one hand, and a growing pyramid of debt commitments on the other. Financial innovation coupled with globalization makes it “dangerously easy” for contemporary financiers to disguise their growing share of borrowing by portraying it, instead, as investment. Indeed, Nesvetailova observes, it is tempting to view the growing web of credit as a giant Ponzi

scheme, which Minsky once noted is the usual way of financing investment in capitalism (328).

On the plus side, the capacity to generate new credit instruments facilitates the dispersion of risk throughout the marketplace. The down-side, however, says Nesvetailova, is that

“...the new channels of borrowing lead to build-up of large structures of credit and thus, massive volumes of debt in a pyramid-like fashion. This tendency...is a major factor contributing to the present-day fragility of finance. Disturbingly, the effects of the liberalization of financial markets, as well as the nature of credit itself, translate...into crises of insolvency....” (4)

PSEUDO-CAPITALISM: RECENT EVIDENCE

In the midst of the global financial crisis of 2008, with political leaders and public policy makers pledging new government oversight and resources to stabilize and prevent further erosion, the Porsche/Volkswagen situation of late October is startling. What might be called “the VW caper” is a financial “high wire” act that ought to be occurring in a casino, arguably, rather than markets for publically traded securities of corporations producing essential goods and services. Surely it is the kind of initiative that further provokes financial fragility, and therefore it also increases systemic risk that is now being built up in some cases upon publically guaranteed credit.

In late October the New York Times reported for a brief moment Volkswagen became the most valuable company in the world, with share prices leaping approximately five-fold, creating market value in excess of the combined market values of Apple, Phillip Morris and Intel. This is how it happened. In one way it is entirely a contemporary event; in another, it is quite similar to the world of corporate speculation described by Thorsten Veblen one century ago.ⁱⁱⁱ

Volkswagen’s recent soaring value, say the authors, reflects what they call engineering of a financial, rather than an automotive sort. It came amidst a financial scramble when Porsche revealed it had increased its Volkswagen holdings to approximately three-quarters of VW’s voting shares. Hoping to control the company, Porsche had been building up a portfolio of VW shares, thereby driving up the price. Enter hedge funds seeking to “profit” from the possible disparity between the inflating market price and the so-called “intrinsic” price. By purchasing VW stock and selling it short, the hedge funds anticipated profiting handsomely, eventually pocketing the difference between the price at which they borrowed and sold the stock, and the lower price at which they later planned to repurchase, to repay the loans.

But Porsche’s revelation that its control approached 75 percent of voting shares sent the stock price on an abrupt but short-lived path skyward. Because the German State of Lower Saxony holds a 20 percent VW stake, the pressure on the remaining five percent of the shares was enormous, as hedge funds presumably rushed in to buy shares at extraordinary prices, in order to cover expiring positions.

With enormous sums at stake—potentially 10’s of billions of euros—commentators reported the spectacle has been riveting for Germans, but in the global economy, of course, financial implications extend far beyond the immediately visible German car makers and their employees. In the U.S. case, while Americans contemplate the implications of “bailing out” Wall Street institutions, the Volkswagen “extravaganza” may be especially unsettling.

Three U.S. hedge funds were reported among the short sellers: Glenview, Greenlight and SAC Capital. Shares of Morgan Stanley also tumbled initially on the day the story “broke” publically, but later made up ground. A Morgan Stanley representative indicated the firm had less than \$25 million in “exposure” to Volkswagen. Meanwhile, the New York Times reported the cost to insure debt rose for speculators in VW stock. For Goldman Sachs, credit default swaps widened 15 basis points, to 310, or \$310,000 per year to insure \$10 million in debt, for a 5-year period. Arguably the Porsche/Volkswagen caper is also about moral hazard, for instance, with U.S.-backed Wall Street institutions including Morgan Stanley and Goldman Sachs now “on the hook” for these sorts of spectacles.

For Porsche, this is not the first time it has booked “profit” from trading in Volkswagen stock. The New York Times reports that in 2007 it made most of its “profit” that year trading VW stock. This time, the estimated “profit” from the “stock deal” could be far greater. Most countries have laws prohibiting this sort of financial play, called by traders, a “corner.” Officials in Germany are reported to be reviewing the events for possible fraud, or for purposes of “plugging” the regulatory hole that made it possible. Even so, as Veblen would point out, the manufacturing character of neither company is served in the long run, and as Nesvetailova would point out, even if no speculative damage is done, financial fragility has expanded further, throughout the global system.

Meanwhile Lori Montgomery and Dan Eggen of the Washington Post (October 18, 2008) report the U.S. is borrowing at a rate that could undermine the nation’s economic security, with the numbers adding up fast, as much as \$1.5 trillion. It is not hard to imagine annual deficits in the near-term approaching 7 percent of GDP, or upwards of \$1 trillion, mainly to finance the U.S. bailout.

Regarding the “particulars” of what went wrong in the United States, Anthony Faiola, Ellen Nakashima and Jill Drew of the Washington Post (October 15, 2008) go back as far as 1998 searching for clues, to a meeting of President Clinton’s Working Group on Financial Markets. That meeting brought together Federal Reserve Chairman Alan Greenspan, Treasury Secretary Robert E. Rubin and Securities and Exchange Commission Chairman Arthur Levitt, Jr., among others. The adversary of the group was Brooksley E. Born, head of the Commodity Futures Trading Commission (CFTC), with an in-coming reputation as a tough, successful Washington D.C. litigator. Ms. Born’s persistent interest in the fledgling market for derivatives put Greenspan, Rubin and Levitt on the defensive. Said Michael Greenberger, Born’s director of trading and markets, and a witness to the 1998 meeting: “The industry had been fighting regulation for years, and in the meantime, you saw them accumulate a huge amount of stuff and it was already causing dislocations in the economy. The government was being kept blind to it.”

Born’s interest was not in commodity futures, per se, but rather, the class of derivatives linked to fluctuations in currency and interest rates. The Washington Post reports Born told a group of business lawyers in 1998 that the “lack of basic information” allowed derivative traders “...to take positions that may threaten our regulated markets or, indeed, our economy, without the knowledge of any federal regulatory authority.”

More recently, the real estate boom and easy credit led to even more complex securities and derivatives, linked to the inflated values of millions of units of U.S. housing. Derivatives, according to Born and the MFTC staff, encouraged more risk-taking. Typically “investors” inside and outside of the U.S. have gorged on mortgage-backed “investments,” then purchased “credit-default swaps” to hedge against losses rather than to post large loss

reserves. The global derivatives market, the Washington Post reports, reached \$530 trillion as of 30 June 2008, credit default swaps included, although the total at risk is estimated to be much smaller; \$2.7 trillion, or about 20 percent of GDP, according to the International Swaps and Derivatives Association.

Montgomery and Eggen report that the response to Born by Greenspan, Rubin and Levitt at the 1998 meeting was “swift and blistering.” They cited “grave concerns” which Deputy Treasury Secretary Lawrence Summers later described in Congressional testimony as “casting a shadow of regulatory uncertainty over an otherwise thriving market.” Later that summer, Alan Greenspan drove home his opposition. “Regulation of derivatives transactions that are privately negotiated by professionals is unnecessary...,” he declared. “Regulation that serves no useful purpose hinders the efficiency of markets to enlarge standards of living.”

Anthony Faiola and Ellen Nakashima of the Washington Post (October 15, 2008) report the “second-guessing” started soon after the 1998 CFTC “brawl,” with the collapse later that year of Long Term Capital Management. LTCM was heavily weighted with derivatives and unable to cover nearly \$4 billion in losses. Even so, the official U.S. position did not change. Later, with Born replaced by a member of the incoming Bush administration, Republican Senator Phil Gramm of Texas opened a Congressional hearing on the subject with a call for “regulatory relief.” Gramm, more recently an adviser to 2008 presidential candidate John McCain, declared: “I think we would do well to remember the (Abraham) Lincoln adage that to ask a society to live under old and outmoded laws—and I think you could say the same about regulation—is like asking a man to wear the same clothes he wore when he was a boy.”

The President’s Working Group did ultimately produce some accommodation, however. Treasury officials put forward a self-regulation idea advanced through the Working Group’s November 1999 report, calling for pools of cash to be collected from financial firms and held as a cushion against losses. Federal oversight was proposed to insure the risk-management procedures of the private clearinghouse were followed; the proposal received legislative approval in late 2000. Another Congressional action one year earlier, however, created a “cross wind” against which even minimalist industry self-regulation faltered. Through the legislative co-sponsorship of Senator Phil Gramm, Congress passed the Gramm-Leach-Bliley Act in 1999, effectively dismantling the Glass-Steagall Act passed at the bottom of the Great Depression. That act had maintained a so-called “firewall” between commercial banks and other financial institutions including investment banks and insurance companies. An artifact of the 1999 deregulation was the diminishment of the federal government’s overall oversight role in the burgeoning financial services industry.

A manifestation of the laissez-faire deregulatory culture animating the Bush Administration was the gutting—and final dismantling—of the clearinghouse program created by the 2000 legislation under the jurisdiction of the Securities and Exchange Commission (SEC), more recently led by free-market advocate Christopher Cox. Faiola, Nakashima and Drew report the program’s ultimate nullification was driven by industry complaints of excessive regulation. Officials under Cox’s direction complained there was little they could do in the absence of a regulatory mandate with “real teeth.” Cox shut down the self-regulation program in the midst of international financial turmoil, on September 26, 2008, with a comment posted on the SEC’s website, “...the last six months have made it abundantly clear that voluntary regulation does not work.” Ideologically, Republicans had first argued for

industry self-regulation in lieu of full government oversight, to “stave off” oversight. Later, apparently the same chorus of voices dismissed self-regulation as ineffective, when crisis overtook rhetoric.

At a very direct level, the implosion of “Fannie Mae” (Federal National Mortgage Association) and “Freddie Mac” (Federal Home Loan Mortgage Corporation) offers a clear view of the sickening disintegration of unregulated U.S. financial institutions. Fannie Mae and Freddie Mac are government-sponsored enterprises chartered by Congress, but for many years, until most recently, they operated independently, with private equity “ownership.” A charter revision in 1954 provided “mixed” ownership with preferred stock held by the federal government and common stock, held privately.

Between 2005 and 2008, according to Charles Duhigg (October 5, 2008) of The New York Times, Fannie purchased directly or guaranteed indirectly at least \$270 billion in risky loans, more than three times as much as in all prior years. In 2000 Fannie launched a plan to buy \$2 trillion in loans from low-income, minority and risky borrowers by 2010, helping to supercharge Fannie's stock price and reward its top executives with tens of millions of dollars. When Daniel H. Mudd assuming leadership in 2004, it occurred in response to allegations of mismanagement and possible accounting fraud. Most recently, in response to the calamitous plunge of its equity, Fannie and Freddie were recapitalized on September 26, 2008, with a \$200 billion rescue by the U.S. Treasury, and with private investors essentially wiped out.

Shortly after he became chief executive, Duhigg reports, Mr. Mudd visited Angelo R. Mozilo, CEO of Countrywide Financial, then the largest mortgage lender in the U.S. Using public relations “leverage” derived from observing that Bear-Stearns, Lehman Brothers and Goldman Sachs had started bundling home loans and selling them directly to investors—bypassing Fannie and Freddie—Mozilo made the case for even more aggressive, riskier lending. “You need us more than we need you, and if you don't take these loans, you'll find you can lose much more,” Mr. Mozilo is quoted as saying to Mr. Mudd.

At the same time Freddie's private investors were pressuring it to take greater risks, and the housing regulators under Congressional mandate significantly increased Freddie's goals to serve more low-income and minority homebuyers. Later, says Charles Duhigg, “...according to two people present, Mr. Mudd told employees to “get aggressive on risk-taking, or get out of the company.” Mudd says he cannot recall that conversation. Employees, however, saw it differently. “Everybody understood that we were now buying loans that we would have previously rejected, and that for which the models were telling us we were charging way too little,” said a former senior Fannie executive.

THE IDEOLOGUES, CONTINUED

The New York Times points out that both sides of the political aisle had a stake in driving Freddie's risky, toxic business model. "I'm not worried about Fannie and Freddie's health, I'm worried that they won't do enough to help out the economy," the chairman of the House Financial Services Committee, Barney Frank, Democrat of Massachusetts was quoted as saying. "That's why I've supported them all these years—so that they can help at a time like this."

In his editorial assessments of the financial crisis, New York Times Op Ed columnist Thomas L. Friedman (October 19, 2008), chronicler of globalization and its evolution, has rendered a moral commentary on the financial devastation, and upon its "actors." Of particular interest here is his lucid assessment of "The Great Iceland Meltdown," in a story filed from London at the height of the crisis. Around 2002, Friedman observes, Iceland began freeing its banks from state ownership. Three banks, particularly, grew quickly and their combined assets rose tenfold in the following five years. This occurred, in part, due to an "above-market" rate of interest the banks offered. It turns out, he observes, that more than 120 British municipal governments, and other British universities, hospitals and charities, among others, had their deposits embargoed in the wake of the global meltdown that followed. Cambridge University had about \$20 million embargoed, while 15 British police departments including Kent had roughly \$170 million frozen in Iceland, according to The Telegraph, cited by Friedman.

So, he says,

"...think about it: Some mortgage broker in Los Angeles gives subprime "liar loans" to people who have no credit ratings so they can buy homes in Southern California. Those flimsy mortgages get globalized through the global banking system and, when they go sour, they eventually prompt banks to stop lending, fearful that every other bank's assets are toxic, too. The credit crunch hits Iceland, which went on its own binge. Meanwhile, the police department of Northumbria, England, had invested some of its extra cash in Iceland, and, now those accounts are frozen, it may have to reduce street patrols...."

Friedman's preeminent conclusion: "And therein lies the central truth of globalization today: We're all connected and nobody is in charge."

According to Eric Lichtblau, David Johnson and Ron Nixon of The New York Times (October 19, 2008): "In 2004, a senior F.B.I. official warned publically that a flood of fraudulent mortgage deals had the potential to become "an epidemic." Yet the next year, as public warnings about fraud in the subprime lending markets neared epic levels, the F.B.I. had the equivalent of only 15 full-time agents devoted to mortgage fraud. More recently the number has grown to 177, but the staffing level is still hundreds of agents below levels during the savings and loan crisis of the 1980's. After the September 11, 2001 terrorist

attacks, the Bureau shifted about one-third of agents in criminal programs, to intelligence duties. Over all, criminal cases brought to federal prosecutors dropped 26 percent in the seven years following. A data base maintained at Syracuse University shows an even steeper decline during the same period for F.B.I. prosecutions of white collar crime. The writers also report that

"...several former law enforcement officials said in interviews that senior administration officials, particularly, at the White House and the Treasury Department, had made clear to them that they were concerned the Justice Department and the F.B.I. (Federal Bureau of Investigation) were taking an anti-business attitude that could chill corporate risk-taking."

Meanwhile, the so-called "Oracle of Wall Street" has been facing intense scrutiny for his libertarian-oriented ideological leadership at the Federal Reserve. Under the title "Taking Hard New Look at a Greenspan Legacy," Peter Goodman of The New York Times (October 9, 2008) chronicles how as a professed libertarian, Alan Greenspan "...counted among his formative influences the novelist Ayn Rand, who portrayed collective power as an evil force set against the enlightened self-interest." Further, "What we have found over the years in the marketplace," said Greenspan, "is that derivatives have been an extraordinarily useful vehicle to transfer risk from those who shouldn't be taking it to those who are willing to and are capable of doing so," Mr. Greenspan told the Senate Banking Committee in 2003. "We think it would be a mistake to more deeply regulate the contracts," he added.

In an October 23, 2008 appearance before the U.S. House Committee on Oversight and Government Reform, a somewhat humbled former Federal Reserve Chairman acknowledged putting too much faith in the self-correcting power of unregulated markets and being blind-sided by unrestrained, even fraudulent mortgage lending. Since the Fed is charged with authority to prohibit deceptive lending practices, as well as control of the money supply, Mr. Greenspan left the Federal Reserve—and the American people—vulnerable on at least two fronts. Said Greenspan: "The modern risk-management paradigm held sway for decades...The whole intellectual edifice, however, collapsed in the summer of last year."

Edmund L. Andrews of the New York Times (October 24, 2008) reports Henry A. Waxman, chairman of the committee, probed: "'Do you feel that your ideology pushed you to make decisions that you wish you had not made?" Mr. Greenspan conceded: "Yes, I've found a flaw. I don't know how significant or permanent it is. But I've been very distressed by that fact." Greenspan refused to accept responsibility for the crisis, however.

Reporting on the new "G-20" meeting of world leaders in Washington D.C. on November 15, 2008, Glenn Kessler and Anthony Faiola of The Washington Post

(November 16, 2008) report consensus on the causes of the crisis including "...weak underwriting standards, unsound risk-management practices, increasingly complex and opaque financial products and consequent excessive leverage." No mention was made of the precipitating role of the United States. Participants agreed to submit their countries' financial systems to rigorous review by the International Monetary Fund, and urged new constraints on executive pay packages that "reward excessive short-term returns or risk-taking." Afterward, George Bush told reporters: "I'm a free market person."

Michael Mandel of *Business Week* (October 28, 2008) makes the case that Ben Bernanke, Chairman of the Federal Reserve and Henry Paulson, Secretary of the Treasury, may be treating the symptom rather than the cause of the problem. "What if we face a wrenching readjustment of the global real economy," Mandel asks, "rather than a crisis of confidence rooted in the financial system?" In fact, he observes, the current crisis also reflects a growing realization that global patterns of technology transfer, foreign trade and global finance are not sustainable. The reason, he says, connects to how American consumers finance their debt. Beyond over-consuming, Mandel observes, Americans have been borrowing at a time when real wages have been falling except for those holding advanced college degrees, since 2002.

The sub-prime mortgage collapse, he reasons, was only the first thing to break, like dominos falling on one another. Now, investors are studying every country, asking this question: "Is it 'sound' enough to survive if American demand for imports falls?" Mandel's conclusion is that U.S. policymakers should shift focus away from immediate concerns about investor confidence and focus instead upon the real goal of stimulating the creation of new goods and services the U.S. can produce and sell globally, sustainably. The bottom line regarding the U.S. economy, says Mandel: Focus upon innovation.

Also from *Business Week* (October 30, 2008) comes a prescient observation from Harvard competitiveness guru Michael Porter (October 30, 2008), that the U.S. lacks a long-term economic strategy—a coherent set of policies insuring competitiveness for the long haul. Strategy embodies clear priorities, observes Porter, and the American political system has become especially weak in recent years, reacting to current events piecemeal, such as the sub-prime lending-induced financial crisis. Both political parties have contributed in their own dysfunctional ways, by approaching economic strategy with long-held ideological biases rather than reaching across the political isle to embrace pragmatic policy positions to sustain the common good.

From the Republicans, says Porter, comes ever-repeated, simplistic, free-market jargon. Self-reliance is preached, he says, "as if no transitional safety net is needed." Some even argue passionately the U.S. should operate without a

strategy, he observes, for that would be loathsome "industrial policy." Indeed, for "fundamentalist" Republicans, Porter's call for strategy may be interpreted as akin to a call for "communist inspired socialism." Overall, he observes, "Republicans seem to think business can thrive without healthy social conditions." Democrats don't fare much better under the Porter microscope. They keep talking, he says, as if penalizing investment and economic success is reasonable strategy, and also defending obstructionist unions in areas like education, even as they resist initiatives to reduce litigation costs to levels of U.S. economic competitors. In short, he says, "They seem to think social progress can be achieved only at the expense of business."

"Efforts under way by both parties are largely canceling each other out." New structures are needed to govern strategically, and these initiatives will require consensus building through collaboration. Surely the in-coming U.S. administration has an historic opportunity to start differently, focusing upon the U.S. economic future, rather than merely dividing up the existing "pie."

DOCTRINE-INSPIRED MALFESENCE

Returning to the analytical contours provided by Thorstein Veblen, one must conclude the American problem of short-termism is not a new phenomenon. Veblen plotted how market power, often built up around a tangible asset, later shifts to the augmentation of financial wealth through the pursuit of intangibles such as good will, and then ultimately, securities manipulation. This evolution may bode poorly not only for the corporation, *per se*, but also, particularly, for the community in which the corporation resides.

Veblen implies that obfuscation is likely by "corporatists" regarding the primary moral hypothesis of capitalism, that the pursuit of self-interest by and through the corporation should articulate with a strong corporate-sustained common good, strong communities included. Certainly Veblen strengthens the historical case for oversight of markets and publically chartered corporations that operate within them. One is led to ask: After the passing of a century, why does the United States yet remain blind to ever-more sophisticated and toxic manifestations of what Veblen described cogently in 1904?

To begin, the world changes, but the way in which the world is believed to work, doctrinally, does not stay apace. Indeed, we tend to look in crises, to the solution that seemed to work in the last crisis, in this case the Great Depression (or arguably, the neoclassical synthesis of the early 20th Century). Then, however, industrial capitalism did not rely extensively upon sophisticated secondary financial markets, globalization, and technology capable of moving financial capital at the speed of light. Economists, also, tend to obfuscate on contemporary "real world" problems for which—all too often—their

prescriptions are doctrinally rather than pragmatically motivated. Also, none have had greater (subtle) influence on the early development of economic doctrine than 18th Century physicist Isaac Newton and mathematician Pierre-Simon Laplace. Too often the quest for "Laplacian determinism" has led many economists to think of themselves as "rocket scientists," although it would be difficult to convince citizens across the planet in 2008 that we know much about stable growth and increasing standards of living, much less rocket science.

The "political economist's religion" described by Keynes is badly tattered, as some hypothetical, contemporary Keynes might observe. Even so, the ideologues remain unwilling to relinquish their positions. Jeff Madrick (2005), Economic Editor at the New York Times, observes the American profession has become too comfortable with powerful interests, not unlike 19th Century Parisian artist's salons. Then, rules were promulgated to maintain standards, but also to exclude "up-and-coming artists" who chose to circumvent the salon's style. Thus, salon-related "norming" behavior enhanced visibility and prestige, and the wealth and power of its senior members. However, it excluded the interesting work of Impressionist challengers such as Monet and Cezanne. Unless the challengers complied with what Madrick decries as an enforced "paint-by-the-numbers" scheme, they had little hope their work might reach around the hegemony, into the hands of collectors and consumers. Certainly the cartel-like structures Madrick describes do not sustain innovation.

It is instructive to consider aspects of the contemporary U.S. economist's salon Madrick decries. The "drill" is well known among those who consider ourselves to be heterodox. It begins, in the United States, for instance, at the college sophomore level with departmental adoption of texts written by those once described by the media as "leading economists." Much later in the educational pipeline, graduate students learn—expediently—the set of salon-appropriate questions, and also the salon-approved methods for adjudicating those questions.

Response to the "French economist's salon" earlier this decade is sobering. In the "Autistic Economics" case, felicity for subject and mentors dissolved into loathing by many French graduate students departing economics for berths in fields considered by them to be more "real world-oriented," including sociology and political science. The "autistic" word choice is in no way casual. Presumably an autistic economist (struggling with Asperger's Syndrome, for instance) would be very good at math, but very poor at crafting complex, interactive policy solutions to real-world problems. Indeed, we might ask ourselves, has economics largely become an autistic profession? That is, are we

competent at building particularistic models (only), but autistic when it comes to crafting pragmatic strategies corresponding to how the world actually works?

Certainly the way the world works changes, but the way economist's salons think about how it works tends to ossify. JM Keynes reminded, for instance, that as mortals we tend to live uncritically, often out of the ideas of long-dead economists. And as TS Kuhn (1970) described, intellectual revolutions are precipitated by increasing fissures between reality, and the way reality may be perceived by the keepers of the "sacred flame." Thus, the economist's salon implied by Madrick may also function as an information cartel protecting the interests of its elite, even in the face of gathering doubt about the validity of its paradigm's truth claims. A salon may continue to dispense its conventional wisdom aggressively, in the style of the failing, curmudgeonly Wizard from the 1939 American fantasy film classic. Indeed, as economists, the make-believe land of the Wizard of Oz may be closer at hand than many may care to acknowledge.

The most recent Porsche-Volkswagen equity debacle certainly has an Oz-like quality. Hedge fund speculators in the United States suddenly experienced exploding, unanticipated risk resulting from selling short the stock of a German automaker. Another German car company speculates that trading in the stock of its competitor may earn more "profit" than building motor cars, at least in the present fiscal year. Meanwhile, American taxpayers who have been asked to "bailout" American banks, investment houses and insurance companies, for instance, look on with wondering disbelief about the cost to them of speculation by global-operating U.S. hedge-funds. All the while, these firms hire so-called "rocket scientists" to calculate trades that often constitute nothing more than rampant speculation in the context of Veblen's analysis. How can the common good be served, in any practical way, by such flagrant, egoistic and community-spoiling strategies?

I am reminded of my daughter's early debuts behind the wheel of the family car, at age 15 (then legal in the State of Washington). One family outing was particularly harrowing. While driving at normal speed, suddenly, precipitously, she bolted, passing, weaving her way through traffic, and then dropping back into orderly formation. To cries from the back seat for restraint, she replied, "I made it, didn't I?" Of course she made it—we, together with her—had made it, but it felt like we had made it "just barely." If you will, it felt a bit akin to what might be described out of Nesvetailova's lexicon as "motorist fragility." My analog to financial speculation—and financial fragility—relies upon this image. So long as every other driver behaved exactly the way my daughter calculated, she executed flawlessly and moved to the front of the line of cars. But, one wonders what might have happened, instead, had she miscalculated or

experienced sudden mechanical failure, or another driver had instantaneously overcorrected. Because she could neither appreciate nor calculate the risk, did not mean that risk and uncertainty were not involved. How many other lives were put in jeopardy by this egoistic, "rocket science" type of driving? And, should something have gone wrong, would my young daughter not have blamed the catastrophe upon the "stupidness" of some other driver—for not acting "rationally." In other words, it was OK in her mind to take on unreasonable risk, because she expected everyone else to drive risklessly—to play strictly by the rules.

To continue in this Veblenesque "frame," American-style corporate capitalism has become too much about "making a killing in financial markets," and not enough about "patient capital" -about actually making goods and services. U.S.-style speculative capitalism is about winning boldly; winning quickly. Who does not want to become an entrepreneurial "legend" among their peers? During the heady stock option days at Microsoft, I remember the words of a recently retired (at 45 years) colleague and friend. Microsoft in the 1990's, he observed, was a great company because one could work really hard, make a "bushel" of money, he said, and then quickly exit to enjoy the riches.

As Nesvetailova observes, "financial fragility" always includes a monetary exchange for a future promise. One can make a bushel of money, of course, by manipulating this future promise via any or all of three primary variables: Cash flow, durability, or rate of discount. For instance, if an entrepreneur can somehow raise market perception of value added, cash flow may improve dramatically. When discounted to present value, the results may be literally awe-inspiring. Seattle has seen perhaps thousands of fairly recent fortunes made in this manner, as the successful entrepreneur rushes to cash out market-capitalized net present value, and then swaggers onto a waiting yacht or other accoutrement of newly acquired wealth and power.

If paired with "market-to-market" accounting, the results within an organization can be profoundly rewarding to the "early players," such as those in the well-documented collapse of Enron. There, Jeffrey Skilling (now serving a 24 year prison term) promoted a particular financial innovation known as the "Gas Bank." As Peter Elkind and Bethany McLean (2004) explain, Skilling's "legerdemain" freed Enron from holding production and transportation assets. Enron could simply own a portfolio of contracts that allowed it to control tangible resources, as needed, acquired through trading in sophisticated markets. This, of course, served in lieu of tangible supplies and a tangible distribution system. For Skilling, the realms of production and finance were thought to have become interconnected—even seamless—through financial innovation. ^{iv}

Profitable operation of the Gas Bank required, among other Skilling financial innovations, the legitimatization and adoption of "market-to-market" accounting. Skilling insisted on market-to-market as a condition of coming to Enron from his prior lucrative consultancy with McKinsey and Company. Under conventional GAAP principles (Generally Accepted Accounting Principles), an asset's value on the company's books reflects initial assumptions over its life, even if the underlying economics eventually change. Revenues and therefore profits flow in from contracts—including forward contracts for the delivery of natural gas—and are booked as they come in the door, quarter by quarter, year by year. But in market-to-market, at Enron, estimated changes in asset value (e.g., the net present value of the estimated income stream over the asset's life) were booked immediately, often virtually "exploding" asset value. This allowed Skilling—in the first year of multi-year contracts—to book the entire estimated appreciation over the asset's life. (39) Until Enron, the principal use of market to market had been among traders. At Enron, however, it became a tool to "game" the natural gas business—producers, consumers, investors and employees, all.

A metaphor may be useful here, based upon the market to market accounting concept. Its use is not descriptive of accounting rules, per se, but of an entrepreneurial thought process—perhaps similar to my colleague at Microsoft. Paired with a clearer understanding of the dynamics of pseudo-capitalism, the concept behind market to market may help economists—I believe—understand and perhaps better appreciate the speculative power of an innovative business strategy that can be capitalized, and then sold in its entirety.

Suppose, for metaphorical illustration only, I purchase a desktop printer for my computer. The seller is able to book a transaction—and therefore profit—each time I order a printer cartridge, since the contemporary business model is to sell the customer ink, over time, rather than to include the printer's full cost at the time and point of sale. Suppose, then, my printer company uses a "market-to-market strategic way of thinking," as an illustration. Estimated ink usage over the printer's life, then, might be metaphorically "booked" as "latent" profit at the time I take delivery. The speculative profit stream would assume such things as intensity of use, and the likelihood I may purchase ink from vendors who attempt to "reverse engineer" the printer company's proprietary ink technology.

In the mind of the metaphorical, speculative entrepreneur, the goal is to cash out. What the "printer entrepreneur" would need to show a potential buyer of his business plan is a viable revenue projection, based in this illustration upon the revenue stream of a "representative" user (me), discounted

to present value. Extending beyond this simplistic printer and ink example, this is the animus, I believe, of U.S.-style, speculative corporate capitalism. It is about "cashing out," much more than it is about producing and selling "stuff" through the deployment of patient capital.

CONCLUSION

To conclude, then, we must return to the question of why policy analysts, educators and politicians, crucially, remain "blind" to this sort of Veblenesque pseudo-capitalism? The response to the American odyssey of pseudo-capitalism begins with the profit lacuna spoken of clearly, initially, by Joan Robinson. Because this lacuna does not define what the relatively greater reward should be for the capitalist beyond the rentier, neoclassicism therefore is a doctrine without a theory of profit. Of course, without a profit reward, practically, there is no capitalist (as distinct from rentier), and therefore no capital, as distinct from asset placements by rentiers.^v

With no particular reward for the capitalist, then, beyond the reward available to the rentier, the logic of a pseudo-capitalist looks something like this. In anticipation of two strategies, the less-costly (opportunity cost) strategy is typically chosen and ultimately—hypothetically—may lead all capitalists to act as pseudo-capitalists. To the extent this occurs, then "patient capital"—and with it the Marshallian, capital-conserving short period—may be sacrificed even as resulting societal outcomes are diminished.

Doctrinaire capitalism has evolved, from laissez-faire capitalism, through so-called mixed capitalism, to what may now be called "relative capitalism," I believe. This is due to the nature of choice in contemporary, wealthy societies. Thus we come, immediately, to Porter's argument for strategy. Macro-strategy, as Porter implies, requires a clear, unified vision. Those activities in complex, contemporary society that move closer to strategic vision, then, become designated as capital, I argue. Those that do not become so designated are merely rentier strategies, worthy of receiving a "normal" profit which in the Marshallian long period is just sufficient for asset-holders to maintain those assets in their present use.

Economic profit, then, is here defined as the differential required to attract the quality and quantity of resources essential to attain Porter's strategic vision. A higher profit reward is essential, of course, differentiated from the reward to pseudo-capitalist rentiers, via tax, regulatory or other incentives. An example of a negative incentive directed at nonproductive asset "hoarding" behavior, for instance, would be the so-called "Tobin Tax," after Yale economist James Tobin. As proposed, the hypothetical tax could function as an excise tax

on cross-border currency movements of so-called "hot money," to reduce financial "churning" by speculators, particularly.

Perhaps a "Veblen-esque" moral incentive could be added, also. Publically chartered corporations at renewal could be tasked to describe how their actions and strategies enhance the common good. As with the Sarbanes-Oxley Act aimed at U.S. corporate accounting fraud, significant governmental oversight would be required. An ultimate and profound challenge to such a scheme, of course, is that in a world of "capital relativism," society must decide what is wanted before corporations can deliver effectively. In an increasingly global world, also, the broadening significance of "community" will ultimately test the limits not only of the international community, but of the boundaries of the nation state.

Finally, one must reflect on our somber responsibilities as educators. No longer is it sufficient to promote corporate strategy as value-neutral. No longer is it rational or ethical to teach subjects including game theory or the marginal productivity theory of finance without instructing students in the ethical implications of using these tools as corporate strategy.^{vi}

OBSERVATIONS ON ECONOMIC METHOD

Francis Bacon (1561-1626) is credited with the discovery of the scientific method; a rather linear process of moving from hypotheses about how the world works, to the design and execution of empirical experiments, to the redesign of hypotheses based upon empirical findings. A crucial assumption of classical liberalism, of course, is rationality. Berkeley linguist George Lakoff observes, however, that human beings aren't as rational as the Western philosophical tradition asserts. There are various empirical and nonempirical reasons for Lakoff's claim, and some lie within the domain of aggregate social choice.

Among these has been a virtual explosion of wealth, facilitating a previously unthinkable diversity of preferences. Related, also, is what Daniel Kemmis (1990), former Mayor of Missoula, Montana, calls "practice." He means, I believe, the common tasks that hold us together as communities and nations. Commonality of practice, for instance, no longer tightly binds together Montana, or the United States, as it once did on the American frontier. Kemmis describes "barn-raising" from his childhood, during the 1950's. Then, diverse segments of the community still came together—to observe and to learn skills from one another, to toil together, and to tolerate one another, also—in order to build the massive structures required for livestock to survive the harsh Montana winters. Generations before, he observes, Montana communities came together in similar manner not just to build barns, but houses, also, for without tight community cooperation, even human beings would perish. As author and political leader, then, he laments the dwindling sense of practice that alters the shared reality of community in Montana, and elsewhere. Kemmis's concept of practice, I believe, holds profound significance for economic methodology, also. In sum, wealthy societies no longer "practice" together, in comparison with earlier.

Another crucial methodological consideration pertains to the "salons" of Jeff Madrick's description. These information cartels tend to ossify intellectual structures,

particularly paradigms. What logically “comes next” in a paradigmatic sequence, therefore, may relate more to the structure of salon “thought control” and social conditioning, than to the presumed rationality of independent human discovery. Cartelized social “norming” holds profound implications not only for the methodology by which questions are adjudicated, but even more profoundly, for the very selection of what constitutes salon-appropriate questions.

For these and other reasons, Heterodox economists typically set themselves apart from the neoclassical mainstream, often with disdain for the thought homogeneity imposed by the structure of the prevailing paradigm, and therefore potentially deadening effects upon the ideal of free intellectual inquiry. Between the neoclassical and heterodox perspectives occurs a strategic “dance” that a contemporary Francis Bacon would be hard pressed to comprehend.

Over the past quarter century neoclassical advocates of the conventional capitalist paradigm have engineered a resurgence of laissez-faire-style public policies, particularly in the United States. Challengers to this Political Economist’s Religion have been beaten back or otherwise marginalized by advocates of so-called free-market economic policies, sometimes clamoring for a form of societal regulation through market-based institutions, sometimes even relying upon what “agnostics” might oppose as forms of Laplacian determinism.

Eventually, if challengers are to prevail against this laissez-faire resurgence popularly described as neoliberalism—according to the perspective of Antonio Gramsci (1986) — either they must demonstrate the prevailing paradigm is without foundation, or alternately, they must pose philosophical syntheses of greater importance and significance. Many of neoliberalism’s challengers become exhausted in pursuit of the former, when the paradigm’s primary vulnerability is with the latter. This methodological statement derives from Gramsci’s perspective about posing competing philosophical syntheses.

MIT urban planners Donald Schön and Martin Rein offer a perspective that articulates with Gramsci’s. Their work addresses policy-related conflicts in which the parties observe common empirical realities, but attach different interpretations, meanings and emphases in order to dismiss antagonists. They define a metacultural frame as pertaining to the broadly shared beliefs, values, and perspectives through which a particular culture gives meaning to its thought and action.

Informed by Karl Popper (1962) on the nature of scientific propositions and their essential, innate potential for falsification, and by Thomas Kuhn (1970) on the nature of scientific revolutions, through the lens provided by Schön and Rein it may be impossible empirically to falsify the metacultural frame of an opponent. This may be particularly true in diverse, wealthy societies with little uniform practice, such as those observed by Daniel Kemmis. In the sense of Gramsci, then, the particular opportunity for challenging neoliberalism is to demonstrate that its metacultural frame is inconsistent with the resolution of the most intractable contemporary problems.

Of course, a popularly held metacultural frame is none other than the “conventional wisdom,” so named by John Kenneth Galbraith. Indeed, the challenge of deconstructing the conventional neoliberal wisdom begins with sorting out the difference between how the world is perceived to work by neoliberals, from the way in which it is perceived to work by elements of the heterodoxy, for instance.

At times of crises such as these, the nature of economic inquiry may be subjected to added critical reflection. Therefore during crises the grip of a prevailing salon may become loosened somewhat. For instance, consider the conventional wisdom regarding the alleged homogeneity of output.

This paper has questioned implied capital homogeneity, arguing that in contemporary, wealthy societies, capital may exist particularly within the eye of the beholder. Output homogeneity (GDP), also, may be “coming to crisis,” to use Joan Robinson’s phrase. Public financial stimuli in the United States are now being parceled out according to an evolving process of “picking the winners,” and therefore by default, picking the losers, also. To wit, the American automobile industry may now be confronting a shift in public sentiment regarding clean emissions and fuel efficiency. If auto companies are to receive public funding, then, should it not come with a stipulation, for instance, that unlimited production of SUV’s no longer is compatible with the evolving U.S. standards of social welfare? If so, then the contribution to GDP of one dollar’s worth of SUV output no longer may be homogeneous with one dollar’s worth of fuel-conserving, environmentally sustaining automotive technology.

Nuances such as these—in Francis Bacon’s time—would have been irrelevant to widely “practiced” concerns for raising the “global human condition.” How, then, it is pondered, may the Baconian methodology of inquiry be modified to accommodate the increasingly crucial perspectives of Antonio Gramsci, Daniel Kemmis or Schön and Rein?

To illustrate, I live near a former military airport, near Seattle, which is adjacent to the seacoast community of Mukilteo. It is the site of the Boeing factory that produces and launches the 747, among other models. Over the years, the larger community has accepted Paine Field as a “general aviation” airport, serving Boeing and private, noncommercial air traffic. Large housing developments appeared in recent decades in response to implied public consensus that buying a home near Paine field could be a good investment. Upper middle class communities including Mikilteo have evolved to cater to life styles in which significant airport noise is verboten. Now, however, prominent commercial interests nearby are challenging this fragile consensus about the use-character of Paine Field, to promote their version of economic development, based upon the economic interests of their coalition.

As the long held airport consensus has been called into question, and thus weakened, each side in the increasingly vocal, intractable dispute has begun to marshal arguments and evidence. As would be expected, each side now spends significant amounts to retain economic consultants to address various airport-related issues, from their ideological vantage point. For my neighbors, key issues pertain to a future potential decline of residential property values incipient to living near a busy airport, and the potential stress upon students in schools built around the airport, among others.

In this environment, Francis Bacon’s rather linear process of empirical inquiry appears to be of little value to either side. The dialogue is now much more sophisticated, reminiscent of Gramsci, and Schön and Rein. Thus, there is a distinct tendency to hire economic consultants with viable “scientific” credentials who can marshal arguments and evidence to diminish the viability of the position held by one’s adversary. Indeed, older residents, particularly, express frustration that there seems to be no way to gain clear answers for resolving the impasse. The contemporary process is much “messier,” also because previously

disenfranchised voices now find new means to make themselves recognized and heard, politically.

What is to be made of the evolution of so-called economic “science” amid these kinds of “not in my back yard” (NIMBY) political and cultural clashes? Are these types of questions about whether there will be commercial aviation at Paine Field, similar to whether automakers in the United States should build substantially fewer SUV’s? I believe so.

Briefly and rather simplistically, steps in the so-called “scientific” process are becoming—practically—quite differentiated from the methodologies by which most of us prepared to become professional economists, one, two, three or more decades ago. Now, contrary to the elegance of Baconian method, the emerging methodology, in the parlance of Gransci, and Schön and Rein, looks like this. First, one takes control of (meta) problem identification; then second, one dismisses opponents espousing dysfunctional, self-interested questions and solutions; and third, one replaces or modifies opponents’ paradigms with ones that are more workable and also friendlier to one’s own salon.

“Deconstruction,” then, becomes an enormously important part of this nouveau method, and indeed it looks a great deal like the character of a political campaign, such as the recent one between John McCain and Barak Obama. That is, the preeminent characteristic of this kind of “sparing” between Paine Field commercial air service aficionados, one the one hand, and the “save our communities” faction on the other, comes down to “unpacking” or disaggregating the arguments and evidence of one’s opponent, then recasting those in a public relations “frame” that strengthens perceptions within the media of one’s position while simultaneously weakening the frame of one’s opponent. Also known as “deconstruction,” this strategy derives practically in the U.S. from a method of literary criticism that gained traction among liberal academics, particularly since the 1980’s, under the name “French Theory.”^{vii}

Among the manifold ethical issues accompanying the actual “doing” of this type of social science, I am reminded of the context in which I teach “deconstruction” strategies at Jesuit Seattle University, from which I am on leave. That style, I believe, emphasizes at least the following characteristics:

1. Humanistic, compassionate respect for one’s opponent.
2. Revelation rather than concealment of one’s own value frame, including assumptions.
3. Discovery of the value frame of one’s opponent.
4. Distinction between scientific propositions and nonscientific ones, according to criteria of “falsifiability,” along the methodological line of Professor Popper (1962).
5. Quest for a deeper humility, in the sense of Mark Blaug (1956) and Gunnar Myrdal (1954), defined here as tolerance not only for imperfection in one’s opponent, but for imperfection in one’s self, also.

* * * * *

Readers of economic historian Mark Blaug (1996) may be particularly interested in the evolution of his commentary on methodology pertinent to some of the topics discussed here. Full text is available in the notes for readers so interested.

1. Sorting out scientific hypotheses in psychology, from nonscientific ones, is also extraordinarily challenging. Non-mainstream psychology considers concepts such as the id, ego, sublimation, etc. from Freudian Theory (Sigmund Freud) that lie completely beyond the realm of falsifiability. In Blaug’s note on this (698), perhaps there is a touch of humor

regarding the limits of method: “At any rate it would be fair to say that the status of the falsifiability criterion in economics is about halfway between its status in psychoanalysis and its status in nuclear physics.”^{viii}

2. Tangential to the argument that the economics profession should reflect a certain amount of professional humility, Blaug (599) quotes Gunnar Myrdal (1954) regarding the “vagaries” of so-called “disinterested social science.”^{ix}

3. The refurbishment of Walrasian static equilibrium occurred in the 1950’s and 1960’s, particularly at the hand of American mathematical economists including Paul Samuelson, among others. Given dominance in the latter half of the 20th Century, then, it is no wonder, expresses Blaug, that contemporary, elementary textbook analysis is so poor “...in the analysis of technical change, the growth of big business, the causes of the wealth and poverty of nations”^x

4. Particularly with regard to the absence in contemporary American principles textbooks of a dynamic theory of entrepreneurship and innovation, Blaug (445-447) connects the work of Knight (1912) and Schumpeter (1947) with a lacuna also caused in part by the profession’s myopic focus on static equilibrium.^{xi} “So long as economic analysis is preoccupied with the nature of static equilibrium,” observes Blaug (444), “...there is simply no room either for a theory of entrepreneurship or a theory of profit...”^{xii}

5. Perhaps among all of Blaug’s (576-577) comments, there is none more heartening, methodologically, than his observation “...in the near future ...some kind of interdisciplinary science of politics and economics...will rescue welfare economics from the theoretical blight to which it has fallen victim.”^{xiii}

Bibliography

Andrews, Edmund L. “Greenspan Concedes Error on Regulation.” The New York Times, October 24, 2008. Access:

<http://www.nytimes.com/2008/10/24/business/economy/24panel.html?scp=1&sq=Greenspan%20Concedes%20%20October%2024&st=cse>

Bator, F. “The Simple Analytics of Welfare Maximization.” American Economic Review, 1957.

Bellais, Renaud. “Post Keynesian Theory, Technology Policy, and Long-Term Growth.” Journal of Post Keynesian Economics, 26 (2004): 419-440.

Blaug, Mark. Economic Theory in Retrospect 5e. Cambridge, 1996.

Bogle, John C. The Battle for the Soul of Capitalism. New Haven and London: Yale University Press, 2005.

Chartered Financial Analysts (CFA), Center for Financial Market Integrity. "Asset Manager Code of Professional conduct," 2005.

Chartered Financial Analysts (CFA), Institute for Corporate Ethics. "Breaking the Short-Term Cycle," 2006.

Clark, John Bates. The Distribution of Wealth. London: Macmillan & Co., Ltd., 1899.

Clower, Robert. "Reflections on Science . . . and Economics." Intermountain Economic Review. 5 (1974).

Conference Board, Corporate/Investor Summit Series. "Revisiting Stock Market Short-Termism," 2006.

Cusset, Francois (English translation by Jeff Fort). French Theory: How Foucault, Derrida, Deleuze, & Co. Transformed the Intellectual Life of the United States. Minneapolis and London: University of Minnesota Press, 2008.

Dealbook. "Porsche's Clever Corner in VW Stock." The New York Times, October 31, 2008.

Access:

<http://www.nytimes.com/2008/10/29/business/worldbusiness/29volkswagen.html?ei=5070&adxnlnl=1&emc=eta1&adxnlnl=1226253870-YLPF3mCUtVWxpY5qk6+fww>

Dertouzos, Michael, Richard Lester and Robert Solow. Made in America: Regaining the Competitive Edge. Cambridge: MIT, 1989.

Dougherty, Carter. "VW Shares Plunge, a Day After Surge." The New York Times, October 29, 2008.

Access:

<http://www.nytimes.com/2008/10/30/business/worldbusiness/30volkswagen.html?scp=1&sq=Dougherty,%20Carter%20October%2030,%202008&st=cse>

Duhigg, Charles. "Pressured to Take More Risk, Fannie Reached Tipping Point." The New York Times, October 5, 2008.

Access:

<http://www.nytimes.com/2008/11/02/business/02global.html?ei=5070&emc=eta1>

Eisinger, Jesse. "Long and Short: Retailers Discount Sales Stats." Wall Street Journal, June 7, 2006.

Elkind, Peter and Bethany McLean. The Smartest Guys in the Room. New York: Penguin, 2004.

Faiola, Anthony, Ellen Nakashima and Jill Drew. "What Went Wrong?" Washingtonpost.com, October 15, 2008.

Access:

<http://www.washingtonpost.com/wp-dyn/content/article/2008/10/14/AR2008101403343.html?referrer=emailarticle>

Friedman, Thomas L., Op-Ed Columnist. "The Great Iceland Meltdown." The New York Times, October 19, 2008.

Access:

<http://www.nytimes.com/2008/10/19/opinion/19friedman.html?ei=5070&emc=eta1>

Galbraith, James K. "The Predator State." Mother Jones. May/June 2006.

Galbraith, John Kenneth. The Economics of Innocent Fraud. Boston and New York: Houghton Mifflin Company, 2004.

Goodman, Peter S. "Taking Hard New Look at a Greenspan Legacy." The New York Times, October 9, 2008. Access: <http://www.nytimes.com/2008/07/02/business/02jobs.html?ex=1215662400&en=039c78c0643112f0&ei=5070&emc=eta1>

Graham, John R., Campbell R. Harvey and Shiva Rajgopal. "The Economic Implications of Corporate Financial Reporting." Journal of Accounting and Economics, 40 (2005): pp. 3-73.

Gramsci, Antonio. Quaderni del carcere. Cited in Harcourt, G.C. Controversies in Political Economy. New York: NYU Press, 1986; p. 106. Passage on "The Intellectuals" read at the memorial service for Piero Sraffa, November 1983.

Johnson, Carrie and Ben White. "Conditions Still Ripe for another Enron." The Washington Post, February 12, 2006.

Jost, John T., Jack Glaser, Arie W. Kruglanski and Frank J. Sulloway, "Political Conservatism as Motivated Social Cognition." Psychological Bulletin 129 (3): pp. 339-375.

Kessler, Glenn and Anthony Faiola, "World Leaders Agree to Seek Major Reform." Washingtonpost.com, November 16, 2008. Access: <http://www.washingtonpost.com/wp-dyn/content/article/2008/11/15/AR2008111500902.html?referrer=emailarticle>

Keynes, J.M. "The General Theory of Employment." The Quarterly Journal of Economics. 51:2 (1937): pp. 209-223.

Knight, Frank H. Risk, Uncertainty and Profit. Boston and New York: Houghton Mifflin Company, 1921.

Kuhn, Thomas S. The Structure of Scientific Revolutions. Chicago: University of Chicago Press, 1970.

Lakoff, George. Moral Politics: What Conservatives Know That Liberals Don't. Chicago: University of Chicago Press, 2nd Edition, 2002.

Laperche, Blandine, James K. Galbraith and Dimitri Uzunidis. Innovation, Evolution and Economic Change. Cheltenham, UK and Northampton, MA, USA: Edward Elgar, 2006. See Forward, JKG, p. xiii.

Leijonhufvud, Axel. On Keynesian Economics and the Economics of Keynes. New York: Oxford University Press, 1968.

Lichtblau, Eric, David Johnston and Ron Nixon. "F.B.I. Struggles to Handle Financial Fraud Cases." The New York Times, October 19, 2008. Access: <http://www.nytimes.com/2008/10/19/washington/19fbi.html?ei=5070&emc=eta1>

Mandel, Michael. "Mandel: It's Not a Crisis of Confidence." Business Week, October 28, 2008. Access: http://www.businessweek.com/bwdaily/dnflash/content/oct2008/db20081027_860032.htm

Madrack, Jeff. "The Bias in Academic Economics: The Economics Salon" in John Kenneth Galbraith and the Future of Economics, Blandine Laperche and Dimitri Uzunidis, eds. London: Palgrave Macmillan, 2005.

Marx, Karl. *Capital: A Critique of Political Economy*, volume 3, Library of Economics and Liberty, 1894. Access: <http://www.econlib.org/library/classics.html>

McWilliams, Gary and Kara Scannell. "Profit Tweaking May Lose Favor After Enron Trial." Wall Street Journal, February 16, 2006.

Minsky, Hyman. Stabilizing and Unstable Economy. New Haven: Yale University Press, 1986.

Montgomery, Lori and Dan Eggen. "Spending Surge Pushing Deficit Toward \$1 Trillion." Washingtonpost.com, October 18, 2008. Access: <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/17/AR2008101703368.html?referrer=emailarticle>

Myrdal, Gunnar. The Political Element in the Development of Economic Theory. Cambridge: Harvard University Press, 1954.

Nesvetailova, Anastasia. *Fragile Finance: Debt, Speculation and Crisis in the Age of Global Credit*, London, Palgrave Macmillan, 2007.

Nocera, Joe. "A Defense of Short-Termism." The New York Times, July 29, 2006.

Popper, Karl R. Logic of Scientific Discovery. New York: Basic, 1962.

Porter, Michael. "Capital Disadvantage: America's Failing Capital Investment System." Harvard Business Review (Reprint 92508) September-October 1992: pp. 65-82.

Porter, Michael. The Competitive Advantage of Nations. New York: Free Press, 1990.

Porter, Michael. "Why America Needs an Economic Strategy." Business Week, October 30, 2008. Access: http://www.businessweek.com/magazine/content/08_45/b4107038217112.htm

Rappaport, Alfred. "The Economics of Short-Term Performance Obsession." Financial Analysts Journal, Volume 61 (2005): pp. 65-79.

Robbins, Lionel, Ed. The Common Sense of Political Economy. London: Lowe and Brydone, 1933.

Robinson, Joan. Economic Heresies. New York: Basic Books, 1971.

Sawyer, James. E. "Doctrinal Roots of Short-Termism" in Powerful Finance, Blandine Laperche and Dimitri Uzunidis, eds. London: Palgrave Macmillan, 2008.

Sawyer, James E. "La Recherche et L'enseignement en Economie Sont-ils Devenus Autistes?" in Les Universités et L'Innovation. Henri Jorda, Ed. Paris: L'Harmattan. 2007.

Sawyer, James E. "Reframing Capitalism" in John Kenneth Galbraith and the Future of Economics, Blandine Laperche and Dimitri Uzunidis, eds. London: Palgrave Macmillan, 2005.

Sawyer, James E. Why Reaganomics and Keynesian Economics Failed. London and New York: Macmillan and St. Martin's, 1988.

Schön, Donald A. and Martin Rein. Frame Reflection: Toward the Resolution of Intractable Policy Controversies. New York: Basic, 1994.

Schumpeter, Joseph. Capitalism, Socialism and Democracy. London and New York: Harper and Brothers, 1947.

Story, Louise, Michael J. de la Merced and Carter Dougherty. "Panicked Traders Take VW on a Wild Ride." The New York Times, October 29, 2008. Access: <http://www.nytimes.com/2008/10/29/business/worldbusiness/29volkswagen.html?ei=5070&adxnll=1&emc=eta1&adxnllx=1226253870-YLPF3mCUtVWxpY5qk6+fww>

Veblen, Thorsten. The Theory of Business Enterprise, New York, Charles Scribner's Sons, 1904. Access: http://www.brocku.ca/MeadProject/Veblen/Veblen_1904/Veblen_1904_06.html

Viner, Jacob. "Mr. Keynes On The Causes of Unemployment." The Quarterly Journal of Economics. 51:1 (1936): pp. 27-33.

Wicksteed, Phillip H. An Essay on The Coordination of the Laws of Distribution. London: Macmillan & Co., 1894.

Notes

ⁱ Marx (1894) approached this phenomenon in Volume III of *Capital*. Capital is not a simple magnitude, Marx observed, but a "relation of magnitudes." Marx's observation lies within his framework (M—C—M'), where money is loaned as "financial capital." (V.XXIV.1). its use value, then, is to acquire more money. (V.XXIV.2). "It is not until capital becomes money-capital," Marx observed, that it can assume the form of a commodity, whose self-expanding faculty has a definite price, which is quoted in the current rate of interest. (V.XXIV.5) crucially, "For money is precisely that form, in which the distinctions of commodities as use-values are concealed,...." (V.XXIV.6)

ⁱⁱ Note in the simple classical system, the heroic nature of Say's tautology. If planned saving by capitalists is equal to planned investment, then the net rate of removal of productive capital into nonproductive asset use must be zero.

ⁱⁱⁱ Story, Louise, Michael J. de la Merced and Carter Dougherty. "Panicked Traders Take VW Shares on a Wild Ride." The New York Times, October 29, 2008. Carter Dougherty. "VW Shares Plunge, a Day After Surge." The New York Times, October 29, 2008. Dealbook. "Porsche's Clever Corner in VW Stock." The New York Times, October 31, 2008.

^{iv} Jeffrey Skilling believed the highly regulated—then deregulated—natural gas industry that operated precipitously through boom and bust cycles could get out of its predicament by creating a Gas Bank. By the late 1980's, 75 percent of natural gas transactions in the U.S. occurred on the spot market during a frantic few days at the end of each month. The problem for producers, particularly, was its inherent uncertainty. It was risky for pipelines to contract to deliver a steady supply of gas to industrial customers at a price that insured a profit. Enron Gas Marketing was created to provide a steady supply over extended periods to customers willing to pay Enron a hefty risk premium. Eventually it contracted with customers not even connected to Enron's pipeline. According to McLean and Elkind, it was the first serious effort to diminish the level of risk for all players in natural gas transactions. Enron, the bank, captured profits between its "buy" and its "sell" prices. Through hedging, Enron conceived of a balanced portfolio of contracts—that is, contracts to sell at a given

price were exactly offset by contracts to buy at the same price. Thus, regardless of spot market prices, Enron would already have fixed its risk and locked in its profit margin. Customers were enthusiastic, but suppliers were reluctant, sensing the opportunity cost of selling their gas low, then watching an appreciating resource creates wealth for a broker. To attract sellers, Skilling offered to cash out suppliers from long-term contracts by loaning them the net present value of the contracts up front. In effect, say the authors, Enron's business plan effectively freed the natural gas industry from the physical qualities of the resource it supplied. Instead of seeing a commitment to deliver gas as something requiring a pipeline, instead Enron conceived it as a financial commitment. It was a whole new way of conceptualizing the business, one that required less capital, at least theoretically, and also would produce more stable pricing and more flexibility for customers.

^v See bibliographic references for the author.

^{vi} Consider the so-called Least Cost Rule of the marginal productivity theory of resource demand. "A firm is producing a specific output with the least-cost combination of resources when the last dollar spent on each resource yields the same marginal product." A corollary is that one dollar's worth of any asset should receive the same high rate of return as one dollar's worth of any other asset. Otherwise, the financial asset holder may reduce opportunity cost and therefore increase portfolio yield by replacing lower yielding assets with higher ones.

But this ostensibly rational dictum at the level of the individual or organization too often becomes reified and dogmatized, and prescribed as a path of rational action for entire societies. For instance, consider how pseudo-capitalist behaviors may emerge within a contemporary economic environment in which trillions of dollars are traded electronically each day in global financial markets and few factories are more than a day's airplane ride away from the global markets they serve. In this environment a product may be designed, financed, produced and marketed in entirely different countries. Here, industrial capitalists who choose to do so may morph conveniently into postindustrial pseudo-capitalists.

This transformation is described by beginning with the dictum that one dollar's worth of any asset P should receive the same rate of return as one dollar's worth of any other asset C, where P and C denote pseudo-capitalist and capitalist assets, respectively. For instance, we begin with the capitalist holding C and the pseudo-capitalist holding P. Soon the capitalist may be motivated to morph into a pseudo-capitalist because he recognizes the opportunity cost of holding C is the extra skill, industry and risk-taking that s/he perceives to go uncompensated. The unmitigated pursuit of self-interest may ultimately lead all capitalists to act as pseudo-capitalists. To the extent this occurs, then societal outcomes are reduced by the value of the extra contributions indicative of the difference in social product between the capitalist class and the rentier class.

^{vii} See, for instance, Francois Cusset's French Theory: How Foucault, Derrida, Deleuze, & Co. Transformed The Intellectual Life of the United States, translated by Jeff Fort (University of Minnesota Press (2008)). Cusset argues that "During the last three decades of the twentieth century, a disparate group of radical French thinkers achieved an improbable level of influence and fame in the United States." Even outside of the academy, French Theory "...had a profound impact on the era's emerging identity politics while also becoming...the target of right-wing propagandists."

^{viii} "A few words about a subject like psychoanalysis will show that the difficulties of applying the falsifiability criterion are not confined to economics. Is psychoanalysis a science or merely a psychic poultice for the rejects of industrial civilization? If it is a science, are its leading concepts—the Oedipus Complex; the division of the mind into id, ego and superego; sublimation; repression; transference; and the like—falsifiable? Despite the fact that psychoanalysis is now almost a century old, there is still very little agreement on these questions either among analysts or among critics of psychoanalysis. In one sense, the situation in psychoanalysis is much worse than economics. At least economists do agree that economics is a science and that its principles must ultimately stand up to scientific testing. Psychoanalysts, however, sometimes argue that what Freud tried to do was not to explain neurotic symptoms in terms of cause and effect but simply to make sense of them as disguised but meaningful communication; psychoanalysis is, therefore, an art of healing and must be judged in terms of its success in curing patients. Even so, there has been surprisingly little research on psychoanalytic 'cures', and, of course, it is difficult to see how psychoanalysis could cure patients if its interpretations of

neurotic behavior did not somehow correspond with reality. At any rate, it would be fair to say that the status of the falsifiability criterion in economics is about halfway between its status in psychoanalysis and its status in nuclear physics.”

^{ix} “...in Myrdal’s words, ‘a “disinterested” social science’ has never existed and, for logical reasons, cannot exist.’ When we sort out the various meanings that such assertions carry, they reduce to one or more of the following propositions: (1) the selection of questions to be investigated by economics may be ideologically biased; (2) the answers that are accepted as true answers to these questions may be likewise biased, particularly since economics abounds in contradictory theories that have not yet been tested; (3) even purely factual statements may have emotive connotations and hence may be used to persuade as well as to describe; (4) economic advice to political authorities may be value-loaded because means and ends cannot be neatly separated and hence policy ends cannot be taken as given at the outset of the exercise; and (5) since all practical economic advice involves interpersonal comparisons of utility and these are not testable, practical welfare economics almost certainly involves value judgments. (Blaug) Oddly enough, all of these assertions are perfectly true but they do not affect the orthodox doctrine of value-free social science in any way whatsoever.”

^x “Walrasian static equilibrium analysis was refurbished, a process which reached even greater stages of refinement in the 1950’s and 1960’s. Despite valiant attempts to dynamise microeconomics, large parts of modern economics remain steeped in a static general equilibrium framework. No wonder then that the elementary textbook of today is rich in the treatment of consumer behavior, the profit-maximizing decisions of business firms (in short-run equilibrium behavior, the profit-maximising decisions of business firms (in short-run equilibrium), the theory of wages, the theory of interest, the theory of international trade, etc., but poor in the analysis of technical change, the growth of big business, the causes of the wealth and poverty of nations, and the theory of entrepreneurship.

This is the more remarkable in that this virtual consensus about the unimportance of entrepreneurship has been seriously questioned on at least two notable occasions in the twentieth century. The first occasion came with the publication of Frank Knight’s *Risk, Uncertainty and Profit* (1921), and acknowledged but little read classic of modern economics.”

^{xi} “Ten years before the appearance of Knight’s book, the young Schumpeter had contributed a wholly different view of the economic problem in *The Theory of Economic Development* (1912). In this book, entrepreneurship and its connection with dynamic uncertainty is placed at the centre of economic inquiry. Schumpeter developed his argument by constructing a model of an economy in which technical change of any kind is absent. Such an economy, he contended, would settle down to a repetitive and perfectly routine economic process in which there is no uncertainty about the future. Hence, there would be no profits in such an economy and, more-over, even the rate of interest would fall to zero. In short, competitive long-run stationary equilibrium as visualized in traditional theory rules out both profit and interest. Schumpeter’s claim that only technical innovations and dynamic change can produce a positive rate of interest has been hotly disputed...but at the expense of considering his associated views on innovation and enterprise...Schumpeter traced all economic change to innovations and identified the innovator with the entrepreneur. The entrepreneur is the source of all dynamic change in an economy and the capitalist system for Schumpeter cannot be understood except in terms of the conditions giving rise to entrepreneurship.

Nevertheless, Schumpeter never managed to get away from the concept of the entrepreneur as a heroic adventurer and even his discussion of innovations is too much focused on the introduction of dramatic novelties with far-reaching consequences—the steam engine, the automatic loom, the railways, the automobile, etc.—losing sight of the fact that so much technical progress consists of small, cumulative improvements in something like the combustion engine or the zip fastener.

Sumpeter’s influence on entrepreneurial theory has been overwhelming and subsequent writers on entrepreneurship have usually defined their own position by contrasting it with his. In the meanwhile, however, mainstream economic theory has continued to neglect Schumpeter’s writings on entrepreneurship as it continues to neglect (Frank) Knight’s theory of profits because neither fits in with static equilibrium analysis. The theory of entrepreneurship has however been given a new lease of life by the modern Austrian

School, descending from Ludwig Mises and Friedrich Hayek. Thus, a student of Mises, Israel Kirzner, has recently sought once again to persuade his fellow economists that the properties of disequilibrium states deserve as much attention as those of equilibrium states. Disequilibria are due to inter-temporal and interspatial differences in demand and supply and hence give rise to unrealized profit opportunities. The essence of entrepreneurship, for Kirzner as much as for Cantillon, consists in the personal alertness to such potential sources gain.

Unfortunately, the new Austrian theory of entrepreneurship reduces entrepreneurship to any kind of arbitrage and in so doing wipes out most of the crucial questions that have been traditionally posed about entrepreneurship. ...But perhaps we have now said enough to show that the theory of entrepreneurship begins where marginal productivity theory leaves off; there is more to distribution than is dreamed of in the static analysis of factor pricing.”

^{xii} “So long as economic analysis is preoccupied with the nature of static equilibrium under conditions of perfect competition, there is simply no room either for a theory of entrepreneurship or a theory of profit as the residual income claims of persons who assume the risks associated with uncertainty. What the older classical economists had called ‘profits,’ or what Marx calls ‘surplus value,’ is now said to be ‘interest’ and of course perfect competition produces a positive rate of interest even in stationary equilibrium. But a permanent, positive residual over and above wages and interest can only be the result of constant technical progress disrupting the stationary state and the new economics had little to say about the circumstances governing technical progress.”

^{xiii} “Bergson proposed that we evaluate welfare changes by means of a ‘social welfare function,’ that is, a social indifference map ranking different combinations of individual utilities according to a set of explicit value judgments about the distribution of income. Unfortunately, it is not clear whether these are to be the value judgments of economists, the legislature, the electorate, or any other specified group of persons,... And of course, it is these differences in the value judgments of different persons and groups that constitute the bugbear of welfare economics....Nevertheless, the true function of welfare economics is to invade the discipline of applied ethics rather than to avoid it....The purpose of welfare economics should be to influence the social consensus by making explicit the goals and objectives of different policies and by demonstrating the consistency or inconsistency of particular means—ends relationships...recent work of such economists as Arrow, Black, Downs, Buchanan and Tulloch on public choice and the ‘calculus of consent’ runs precisely along these lines. It raises the possibility of the emergence in the near future of some kind of interdisciplinary science of politics and economics that will rescue welfare economics from the theoretical blight to which it has fallen victim.”