

# FOUNDATIONS OF REAL- WORLD ECONOMICS

What Every Economics Student Needs  
to Know

Third Edition

John Komlos

Designed cover image: Guillermo del Olmo / Shutterstock

Third edition published 2023  
by Routledge  
605 Third Avenue, New York, NY 10158

and by Routledge  
4 Park Square, Milton Park, Abingdon, Oxon, OX14 4RN

*Routledge is an imprint of the Taylor & Francis Group, an informa business*

© 2023 Taylor & Francis

The right of John Komlos to be identified as author of this work has been asserted in accordance with sections 77 and 78 of the Copyright, Designs and Patents Act 1988.

All rights reserved. No part of this book may be reprinted or reproduced or utilised in any form or by any electronic, mechanical, or other means, now known or hereafter invented, including photocopying and recording, or in any information storage or retrieval system, without permission in writing from the publishers.

*Trademark notice:* Product or corporate names may be trademarks or registered trademarks and are used only for identification and explanation without intent to infringe.

First edition published by M.E. Sharpe 2014

First edition published by Routledge 2015  
Second edition published by Routledge 2019

*Library of Congress Cataloging-in-Publication Data*

Names: Komlos, John, 1944–author.

Title: Foundations of real-world economics : what every economics student needs to know / John Komlos.

Description: Third edition. | New York, NY : Routledge, 2023. |

Includes bibliographical references and index.

Classification: LCC HB171.5 .K643 2023 | DDC 330–dc23/eng/20220914

LC record available at <https://lccn.loc.gov/2022044709>

ISBN: 978-1-032-00484-6 (hbk)

ISBN: 978-1-032-00172-2 (pbk)

ISBN: 978-1-003-17435-6 (ebk)

DOI: 10.4324/9781003174356

Typeset in Interstate  
by codeMantra

Access the Support Material: [www.routledge.com/9781032001722](http://www.routledge.com/9781032001722)

# CONTENTS

<i>List of Figures</i>	xiii
<i>List of Tables</i>	xvii
<i>List of Illustrations</i>	xix
<i>Preface to the Third Edition</i>	xxi
<b>1 Welcome to Real-World Economics</b>	<b>1</b>
1.1 My Credo: It's Not the Economy—It's How People Feel in the Economy!	2
1.2 Humanistic Economics, the New Paradigm	4
1.3 A Primer on Blackboard Economics	5
1.4 A Paradigm Shift Is Long Overdue	7
1.5 Real-World Economics Is Superior	10
1.6 Simple Is for the Simple-Minded	10
1.7 "It's Only a Model!" Is Deceiving	11
1.8 Takeaways	13
Questions for Discussion	13
Notes	14
<b>2 The Evidence: Markets Are Neither Omniscient Nor Omnipotent</b>	<b>19</b>
2.1 Markets Are Not Created by Divine Power	19
2.2 Running the Economy "Hot"	20
2.3 The Downside of a High-Pressure Capitalism	20
2.4 Decline in Life Expectancy Reveals the Diminution of the Quality of Life	28
2.5 Markets Have Numerous Limitations	30
2.6 The "Achilles' Heel" of Markets	32
2.7 The Best Government Is Not the One That Governs Least	33
2.8 Morality Should Take Precedence over Markets	35
2.9 Economics Is a Social Science, Not a Natural Science	35
2.10 Ideology Is Unavoidable and Pervasive in Economics	36
2.11 Takeaways	37
Questions for Discussion	37
Notes	38
<b>3 The Nature of Demand</b>	<b>44</b>
3.1 The Post-Scarcity Economy	44
3.2 Tastes Are Endogenous, Contrary to Conventional Assumptions	44
3.3 Basic Needs Should Have Priority	49
3.4 The Invisible Hand Is Often Invisible Because It Is Not There	52
3.5 The Magic of Competition Is Not an Elixir	53

3.6	Consumerism Was Not Our Choice	54
3.7	The Market Has Hidden Magnification Mechanisms	56
3.8	Variations in Cognitive Endowment	57
3.9	Genetic Endowment Influences Human Behavior	57
3.10	Neuroeconomics Discovers Some Economic Secrets	58
3.11	Takeaways	58
	Questions for Discussion	59
	Notes	59
<b>4</b>	<b><i>Homo Oeconomicus</i> Is Extinct: The Foundations of Behavioral Economics</b>	<b>64</b>
4.1	Utility Maximization Is Anachronistic Economics	64
4.2	Optimization Is Impossible for Humans	67
4.3	The Imperfections of the Human Brain	67
4.4	Bounded Rationality Should Be the Default Model	68
4.5	Satisficing Is More Realistic than Optimizing	69
4.6	Biases and Wonders of Intuition	71
4.7	Heuristics Help Avoid Becoming Catatonic	72
4.8	Three Biases of the Human Mind: Framing, Accessibility, and Anchoring	72
4.9	The Utility Function Is Reference-Dependent	74
4.10	Prospect Theory Is the Future Foundation of Economics	76
4.11	Behavioral Economics Opens Up New Vistas	81
4.12	Takeaways	83
	Questions for Discussion	83
	Notes	84
<b>5</b>	<b>Taste-Makers and Consumption</b>	<b>87</b>
5.1	Interdependent Utility Function Should Be the Default Model	87
5.2	The Economy Is Embedded in a Society	89
5.3	The Culture Industry Has a Crucial Economic Function	90
5.4	The Ascendancy of Impatience	91
5.5	The Determination of Fairness Ought Not to Be Delegated to Markets	91
5.6	Justice Is More Important than Efficiency	92
5.7	The Rawlsian Just Economy	92
5.8	We Are Not Completely Selfish	93
5.9	The Distinction Between Positive and Normative Economics Is a False Dichotomy	94
5.10	Expected Utility vs. Realized Utility	95
5.11	Imperfect Information Is Ubiquitous and Crucial to Understanding the Real Economy	96
5.12	Signaling in Case of Imperfect Information	97
5.13	Time-Inconsistent Preferences	98
5.14	Takeaways	99
	Questions for Discussion	99
	Notes	100
<b>6</b>	<b>Oligopolies and Imperfect Competition</b>	<b>104</b>
6.1	Multinationals Instead of Mom-and-Pop Operations	106
6.2	The Illusion of Perfect Competition	107
6.3	Imperfect Competition: Oligopolies, and Monopolies	107
6.4	Prices Are Signals	111
6.5	Disequilibrium Is the Norm	114
6.6	Adverse Selection Is an Information Problem	115
6.7	Theories of Strategic Behavior	116

6.8 The Influence of Corporate Power: Economic, Political, and Social 116  
 6.9 Takeaways 118  
 Questions for Discussion 118  
 Notes 119

**7 Returns to the Factors of Production 123**

7.1 Marginal Theory of Everything 123  
 7.2 Labor Compensation Lags Far Behind Productivity:  
 The Steady Ascent of the Ominous Wage Gap 125  
 7.3 Earnings of Physical Capital 131  
 7.4 Human Capital in the Information Revolution 132  
 7.5 Other Forms of Intangible Capital 132  
 7.6 Institutions as Capital 133  
 7.7 Profit Rules 134  
 7.8 The Troubling Decline in Labor’s Share of GDP 135  
 7.9 Natural Resources Are Finite and Important 136  
 7.10 Poverty vs Affluence: The Stupendous Rise in Inequality 136  
 7.11 The Second Gilded Age of High Tech, High Finance, and Celebrities 139  
 7.12 Exorbitant Incomes Exacerbate Inequality 144  
 7.13 Welfare Does Not Grow at the Same Rate as the Economy 147  
 7.14 Relative Incomes Matter Most in Developed Societies 148  
 7.15 Ethics and the Skewed Distribution of Income 149  
 7.16 Takeaways 151  
 Questions for Discussion 152  
 Notes 152

**8 The Case for Oversight, Regulation, and Management of Markets 158**

8.1 Market Failure Is Ubiquitous and Ominous 158  
 8.2 The Principal-Agent Quandary 159  
 8.3 Moral Hazard Disrupts the Efficient Market Hypothesis 161  
 8.4 Transaction Costs Increase the True Price of a Product 161  
 8.5 Opportunistic Behavior Leads to Suboptimal Allocation 162  
 8.6 Regulatory Capture Is a Consequence of Rampant Inequality 164  
 8.7 Regulation in the Public Interest Is Essential 165  
 8.8 Morality Should Not Be Delegated to Markets 166  
 8.9 Exploitation Is Detrimental to the Social Fabric 167  
 8.10 Time and Space 168  
 8.11 Path Dependence or Sequential Decisions 168  
 8.12 Limits and Standards 171  
 8.13 Takeaways 171  
 Questions for Discussion 171  
 Notes 172

**9 Microeconomic Applications On and Off the Blackboard 176**

9.1 Minimum Wage Is Good for Workers and Good for the Economy 176  
 9.2 Price Controls Can Also Help 180  
 9.3 Monopsony: Bargaining Power of Firms in the Labor Market 181  
 9.4 Unions and Countervailing Power 181  
 9.5 The American Medical Association Is a Harmful Cartel 185  
 9.6 Redistribution Would Help 187  
 9.7 Takeaways 189  
 Questions for Discussion 189  
 Notes 190

<b>10 What Is Macroeconomics?</b>	193
10.1 Keynes, the Savior of Capitalism	193
10.2 Keynesian Fiscal Policy, the Steering Wheel of the Economy	196
10.3 Monetary Policy Is Also Essential	197
10.4 The Liquidity Trap Renders Monetary Policy Ineffective	198
10.5 Neoclassical Synthesis Was an Uneasy Compromise with Keynesianism	201
10.6 The Monetarist Counterrevolution	202
10.7 “Poor, Poor, Pitiful Macroeconomists”	203
10.8 Bailout Capitalism’s Modern Monetary Theory	205
10.9 The Production Possibilities Frontier	205
10.10 GDP Is a Misleading Measure of Welfare	207
10.11 Takeaways	208
Questions for Discussion	208
Notes	209
<b>11 Macroeconomics Part II</b>	212
11.1 Finagling with the Unemployment Numbers	212
11.2 The Natural Rate of Unemployment Is Not Natural at All	215
11.3 Economic Growth: When Is Enough Enough?	216
11.4 Growth Has Not Increased Life Satisfaction	217
11.5 Technological Change Is a Double-Edged Sword	218
11.6 Social and Economic Mobility	220
11.7 Complex Economies Evolve in Perpetual Disequilibrium	221
11.8 Missing Markets Are an Existential Threat	222
11.9 “There Is No Planet B”	223
11.10 Feminist Economics: If Women Counted	224
11.11 Takeaways	225
Questions for Discussion	225
Notes	226
<b>12 Macroeconomics Part III</b>	233
12.1 The Government Is an Integral Part of the Economy	233
12.2 The Challenges of Keynesian Fiscal Policy	233
12.3 Crowding Out Private Investment	235
12.4 The Ominous US National Debt	235
12.5 Taxes Are Good for Us	236
12.6 Trickle-Down Economics Is Bogus	237
12.7 The Scarcity of Savings	241
12.8 Wealth: the “Poor Ain’t Got None”	243
12.9 Inflation and Deflation	245
12.10 The New Wave of Industrial Policy	246
12.11 Takeaways	247
Questions for Discussion	247
Notes	248
<b>13 The Tsunami of Globalization</b>	252
13.1 The Theory of Comparative Advantage	253
13.2 The Effects of Tariffs on Welfare Are Complicated by Unemployment	254
13.3 Free Trade Is Not an Engine of Growth	256
13.4 Protection of Infant Industries	257
13.5 Unbalanced Trade Generates the Anguish of Unemployment	257

13.6	Import Certificates Could Eliminate the Trade Deficits	260
13.7	New Trade Theory	261
13.8	Takeaways	262
	Questions for Discussion	262
	Notes	263
<b>14</b>	<b>The Financial Crisis of 2008</b>	<b>265</b>
14.1	Preliminaries	266
14.2	The End of Boring Banking	267
14.3	Double Trouble: Greenspan's Bubble	270
14.4	Greenspan Saw Nothing, Bernanke Heard Nothing, and the Fed Said Nothing	272
14.5	The Minsky Moment: The Meltdown of 2008	274
14.6	Thirty-Two Causes of the Meltdown	276
14.7	Bailout Capitalism: The Crisis Obama Wasted	286
14.8	Obama's Tepid Stimulus	288
14.9	Nationalization of the Too-Big-To-Fail Banks as Pre-Privatization	289
14.10	Takeaways	291
	Questions for Discussion	291
	Notes	292
<b>15</b>	<b>Economists' Mistakes Lead to Right-Wing Populism Plus an Insurrection</b>	<b>299</b>
15.1	Four Tsunamis Pave the Path to Populism	299
15.2	"It's the Economy, Stupid"	300
15.3	Reaganomics Was the Gamechanger	302
15.4	The Destructive Forces of Globalization Amplified Reagan's Mistakes	305
15.5	After Reagan, Bush Sr., Clinton, and Bush Jr., Obama Adds Fuel to the Fire	308
15.6	From Reagan to Trump in One Generation	309
15.7	Takeaways	311
	Questions for Discussion	311
	Notes	312
<b>16</b>	<b>Hidden Racist Elements in Blackboard Economics</b>	<b>317</b>
16.1	Introduction to Covert Racism	317
16.2	The Descendants of Slaves Are Still at the Bottom of the Totem Pole	317
16.3	Alice-in-Wonderland Discrimination in Economic Theory	320
16.4	The Achilles' Heels of Real-Existing Markets Disadvantage Minorities	322
16.5	Time to Purge the Curse of Systemic Racism from Economics	331
16.6	Takeaways	333
	Questions for Discussion	333
	Notes	334
<b>17</b>	<b>The Covid-19 Pandemic Exposed the Need for a Black-Swan-Robust Economy</b>	<b>339</b>
17.1	An Economy in Disequilibrium Is Vulnerable	339
17.2	The Economic Crisis	342
17.3	Bailout Capitalism to the Rescue	344
17.4	The Goal of a Black-Swan-Robust Economy	346
17.5	Covid-19 Exposed the Deep Fissures, Endemic Imbalances, and Precarious Nature of the US Economy	347
17.6	Takeaways	348
	Questions for Discussion	348
	Notes	349

<b>18 Conclusion: Toward a Capitalism with a Human Face</b>	351
18.1 Summing Up: Imaginary vs. Real Markets	351
18.2 Eight Inconvenient Truths about a Dual Economy	353
18.3 The Gordian Knot: The US Economy Is Facing 16 Headwinds, Only One of Them Is Partly Fixable	357
18.4 Takeaways	361
Questions for Discussion	362
Notes	362
 <i>Index</i>	 367



# FIGURES

2.1	International comparison of the Happiness Index	21
2.2	Poverty rate among children below age 18, 2016	23
2.3	Cumulative income distribution, US, 2018	24
2.4	International comparison of Gini coefficients, 2018	25
2.5	Life expectancy at birth, 2018	31
2.6	Per capita health-care expenditures, US dollars, 2019	31
2.7	Life expectancy at birth vs health-care expenditures per capita	32
3.1	Conventional view of consumer sovereignty: tastes are supposedly exogenous	45
3.2	Tastes are determined within the economic system in the real world	46
4.1	Medicare Part D options confuse	70
4.2	What is the average length of these lines?	73
4.3	Context matters in case of ambiguity	74
4.4	Concave utility function implies risk aversion	75
4.5	Convex utility function implies risk seeking	76
4.6	Changes in utility and wealth of two investors according to the conventional model	77
4.7	The utility function defined on gains and losses in prospect theory of Behavioral Economics	77
4.8	Comparison of Cathy's and Susan's utility, according to prospect theory	78
4.9	Conventional comparison of two options	79
4.10	Experimental results conform to prospect theory: the case of two options	80
4.11	Conventional demand and supply analysis with negative feedback	82
4.12	Positive feedback loop causes asset price bubbles	82
5.1	The value today of receiving \$1 in the future	98
6.1	Production of a perfectly competitive firm in the short run	104
6.2	In long-run equilibrium of a perfectly competitive firm, profits disappear	105
6.3	Profit of a monopolist (without fixed costs)	108
6.4	Optimal profit of a monopolist	109
6.5	Corporate taxes as a percentage of profits	118
7.1	Index of the productivity-wage gap in the US	125
7.2	Cumulative gap between productivity and wages	126
7.3	Median annual income by gender (2019 dollars)	128
7.4	Men's hourly wages by education (2020 dollars)	129
7.5	Women's hourly wages by education (2020 dollars)	129

7.6	Share of labor income in GDP (%)	135
7.7	Distribution of household income by quintiles, US, 2019	139
7.8	Distribution of earnings in 2019 compared to Ford workers of 1914	139
7.9	Median household income by ethnicity (2019 dollars)	140
7.10	Trends in the share of total household income (%)	141
7.11	Changes in the share of total household income in three epochs	142
7.12	Growth of real after-tax household income, 1979-2018	143
7.13	Ratio of top group's income to the poor's income	143
7.14	Growth of welfare with relative incomes, 1979-2018	149
7.15	International comparison of inequality, 2018	150
7.16	Inequality is inversely related to happiness	151
8.1	The optimum level of freedom in an economy	164
8.2	Corporations invest heavily in order to tilt the playing field in their direction	165
8.3	Investment decision with perfect foresight two periods ahead is easy	169
8.4	Investment decision with perfect foresight one period ahead is also easy	169
8.5	With sequential decision, optimum technology A is no longer feasible	170
9.1	The minimum wage and unemployment in Seattle	177
9.2	McDonald's profit from Big Macs (without fixed costs)	178
9.3	An increase in the minimum wage transfers some profits to workers	179
9.4	The effect of a price ceiling on a monopolist (without fixed costs)	180
9.5	Profit of an oligopolist	183
9.6	Physicians per 1,000 population, 2019	185
9.7	The market for doctors with supply constraint imposed by the American Medical Association	186
9.8	Redistribution of income increases total utility of the society	188
10.1	US consumer confidence index, 1950-2020	195
10.2	Fluctuating demand during the Great Depression	195
10.3	Automobile production in the US, 1900-1970 (thousands)	196
10.4	The discount rate and the federal funds rate	198
10.5	Quantitative easing and GNP per capita	199
10.6	Velocity of circulation of M1	200
10.7	Production possibilities frontier with institutional constraint	206
10.8	Capacity utilization, all industries	206
10.9	Welfare and sickness over time	207
11.1	U-3, U-6, and the true unemployment rate (%)	214
11.2	The official unemployment rate and the natural rate (%)	216
11.3	Real GDP per capita and the population's happiness	218
11.4	Global warming	222
12.1	US national debt as percent of GDP	234
12.2	Investments as a percent of GDP and the Reagan tax cuts	238
12.3	US GDP growth per capita	239
12.4	US GDP: potential GDP, and the Reagan tax cuts	239
12.5	Average annual US federal government budget deficits	240
12.6	Trends in real wealth per household, 2020 dollars (millions)	243
12.7	Wealth distribution in the US, 1990 and 2019	244

13.1	The effect of tariffs on domestic production and consumption	254
13.2	US trade balance in goods and services, 2021 dollars (billions)	258
13.3	US trade balance as a percent of GDP	258
13.4	US accumulated trade deficits, 2021 dollars (trillions)	259
13.5	US imports as a percent of GDP	259
14.1	Price-to-earnings ratio of S&P 500 stocks	267
14.2	Ratio of US house prices to rents, to nominal median household income, and to the consumer price index, Index 1998 = 100	271
14.3	The Fed's interest rate and GDP growth	279
14.4	Real GDP and potential GDP, 2009 prices	288
15.1	The Gini Index of pre-tax income	303
15.2	After-tax income share of the top 0.1 percent	303
15.3	Number of high-income tax returns	304
15.4	Life expectancy trends in the OECD	306
16.1	Distribution of household income by ethnicity, US, 2019	318
16.2	Differences in income distribution relative to whites, US, 2020	319
16.3	The U-6 unemployment rate by ethnicity	320
17.1	Life expectancy at birth in the US	341
17.2	Covid-19 mortality rate per 100,000 population, November 26, 2021	342
17.3	The <i>real</i> unemployment rate, U-6, and U-3 during Covid-19	343
17.4	The official unemployment rate in selected countries, 2020 (%)	344
17.5	GDP per capita in five recessions	344
17.6	Real GDP per capita and assets held by the Federal Reserve	345
17.7	The Fed's assets and the official unemployment rate during Covid-19 by ethnicity	345
17.8	The S&P 500 Index and the assets held by the Federal Reserve	346
18.1	Unemployed who are excluded from the official unemployment statistics (millions)	354
18.2	Real median weekly earnings of part-time workers (2021 dollars)	354
18.3	US federal deficit (2021 dollars, billions, by administration)	358



# TABLES

1.1	The differences between humanistic and mainstream economics	4
2.1	The US homicide rate per capita as a multiple of the rate in selected countries, 2018	22
2.2	The US incarceration rate as a multiple of the rate in selected countries, 2018	22
2.3	Drug use in the US, 2019 (millions)	26
2.4	Number of adults who experienced a mental illness episode in the past year, 2019 (thousands)	27
2.5	Rate of change of the percent of adults affected by mental illness	27
2.6	The US drug overdose deaths as a multiple of the rates in selected countries, 2018	29
6.1	Profits of US oligopolies, 2020 (billion dollars)	110
7.1	Growth in productivity and real compensation, US, 1947-2021 (%)	126
7.2	Foreign trade surplus or deficit as a percent of GDP	128
7.3	Corporate profits in 2021 and selected profit per employee	134
7.4	Tax returns of the super-rich (2018 dollars)	138
7.5	Real household median income by ethnicity (2019 dollars)	140
7.6	Distribution of income in the US, 1967 and 2019	141
7.7	Real disposable household income in the US, 1979 and 2018	143
7.8	International comparison of CEO compensation	147
9.1	Big Mac price index (2010 dollars)	178
11.1	The <i>real</i> US unemployment rate, 2019	213
12.1	There is no relationship between economic growth and the top tax rate	236
12.2	Tax savings in 1985 compared to 1980	238
12.3	Happiness rank and average tax rates	240
12.4	Personal savings as a percentage of disposable income	242
12.5	Financial insecurity in the US, 2019	242
12.6	Wealth distribution in the US, 1990 and 2019	244
13.1	US trade with China (billions of dollars)	260
15.1	Trump's plurality in three Rust-Belt states in the 2016 election	301
15.2	Economic indicators for the Rust Belt, 2016	302
15.3	The annual rate of increase in the number of millionaires	304
15.4	Number of employees in US manufacturing	307

xviii *Tables*

16.1	Distribution of household income by ethnicity, US, 2020 (%)	318
16.2	The U-6 unemployment rate by ethnicity and education, 2021	320
16.3	The poorest neighborhoods in U.S., 2016-2021	329
17.1	The U-6 unemployment rate by education and ethnicity, September 2020 (%)	343
17.2	The U-6 unemployment rate by age and ethnicity, September 2020 (%)	343
18.1	Real median household income by education (2020 dollars)	355

# ILLUSTRATIONS

2.1	The market treats poor children cruelly. How will history judge us?	24
2.2	The market did not give Rosa Parks the option to sit anywhere on the bus	35
3.1	Starting analysis with adults is a major error of mainstream economics	47
3.2	Drink to contentment. Most people who drink colas do not look this sophisticated. One bottle has 41 grams of sugar. For a woman, the recommended daily intake of non-naturally occurring sugar is 25 grams! No wonder that two-thirds of American adults are overweight or obese	50
3.3	The Marlboro Man represents the macho rugged individualism of the dominant American ideology. Marlboro's supposedly transformative experience killed millions of men by causing cancer	51
4.1	Virginia Slims' successful marketing appealed to feminists by combining imagery of glamour, freedom, independence, emancipation, empowerment, slimness, and attractiveness. It increased smoking among teenage girls and killed hundreds of thousands of women. The message was designed to bypass the prefrontal cortex	65
5.1	Consumerism overwhelms. Madison Avenue makes consumption seem as though it leads to a good life. It does not. It often leads to frustration and indebtedness	88
5.2	What is one without a mansion and a yacht? The lifestyle of the superrich and super-famous includes conspicuous consumption. It is rampant at a time when tens of millions are deprived of the basic human right of a decent education and health care	97
7.1	Life would just not be the same if I had to travel on a commercial airline	138
7.2	You did not bleed on Omaha Beach (Normandy) on June 6, 1944. The least you owe to the memory of those who did is to leave the Earth as nice as you found it	145
8.1	Doctors for Camel exploit consumers' gullibility	167
9.1	United in unions, labor would have countervailing power and obtain a share of profits. Divided, it has none	182
11.1	Global warming is causing unconscionable damage to the environment	224
14.1	Blowing bubbles can be fun, but it's not good for financial stability	270
14.2	Brooksley Born was a hero, the Joan of Arc of US finance. Her attempt to save the system was torpedoed by Alan Greenspan, Robert Rubin, and Larry Summers	272

xx *Illustrations*

14.3	Wasted crisis, a mistake of historical proportions	287
15.1	The storming of the Capitol was an inexcusable blot on American democracy	300
15.2	Millions of families lost their homes because of the financial crisis, but the financiers who caused the crisis were not among them. Allowing this to happen is a severe blot on the Obama administration	308
15.3	Hillary's deplorables, disadvantaged in a hot economy, break into Congress to redress their grievances	310
16.1	Black Lives Matter Movement in the wake of the cold-blooded killing of George Floyd	332
17.1	One flag, one life. A small virus showed what a big mistake economists made by disregarding basic needs	340
18.1	Astronomical inequality generates white supremacist backlash	360
18.2	A humanistic economy is full of happy people	361



# PREFACE TO THE THIRD EDITION

We must grant to markets what belongs to markets—and retain for people what rightfully belongs to them.

—The author

The motivation for conceiving of the first edition of *Foundations* originated a dozen years ago in the wake of the financial crisis, as it became evident that mainstream economists, who dominated the profession, were caught utterly unprepared for it. They had to improvise to avoid a Chernobyl-like meltdown of the economy.<sup>1</sup> Like millions of others, Queen Elizabeth famously wondered in amazement “Why did nobody notice,” the coming of such a stupendous catastrophe?<sup>2</sup> It became obvious that we were witnessing the failure of “zombie neoliberalism”<sup>3</sup> and that a paradigm shift was desperately needed to face the challenges of the new century. The text focused “on the neglected issue of the discrepancy between current economic scholarship and the simplistic, methodologically flawed, outdated, and irrelevant economics we too often teach undergraduates.”<sup>4</sup> The aim was to reveal the mistaken theories, covert assumptions, overlooked facts, trivialized exceptions, and the accumulating evidence contradicting the mainstream canon.<sup>5</sup> The new paradigm proposed was “humanistic economics” or “capitalism with a human face,” a hybrid of the Nordic Model and of the social market economy.<sup>6</sup>

The message was well received. One reviewer pointed out that “this book is a must-read for anyone interested in reforming the discipline of economics to create a more just society and to promote human development.”<sup>7</sup> Another said that “everyone who teaches undergraduate economics should read *Foundations of Real-World Economics*.”<sup>8</sup> Another reviewer thought that: “it is trained mainstream economists, not introductory-level students, who should take the time to read, and reflect upon, this book.”<sup>9</sup>

Several translations<sup>10</sup> and scores of positive reviews later a new edition was necessitated by the turbulence of the intervening years. These brought into ever sharper focus that the neoclassical paradigm, based on Milton Friedman’s and Friedrich Hayek’s<sup>11</sup> ideology of market fundamentalism had led to policy failures of historic proportions.<sup>12</sup> The second edition included the topics usually covered in introductory economics courses plus an expanded discussion of globalization and the financial crisis.

The continual deterioration of the social and political order made three additional chapters necessary in this edition. Economics students should know about the economic causes of the unimaginable rise in populism; they should know how false economic theories led to fallacious

economic policies, thereby fostering a disillusionment among a large group of men left behind. Feeling mistreated, they revolted against entrenched elites and overthrew the establishment in 2016, a process that culminated in the ferocious Bastille-like uprising on January 6, 2021 (see Chapter 15).<sup>13</sup>

Moreover the Black Lives Matter movement made it difficult to ignore the plight of minorities usually overlooked in mainstream economic courses. In fact, Blacks and Hispanics practically never appear in Econ-101 courses. Students should also know that economics treats discrimination with kid gloves and learn about the appalling disadvantages of those born on the wrong side of the tracks. So, Chapter 16 examines the racist subtext hidden deep within the mainstream's canon.

Then came the Covid-19 pandemic and economists had to scramble again to meet the challenges of a high-impact low-probability event that challenged the very existence of millions of people. The lessons learned from the pandemic is that basic needs are much more important than economists were willing to acknowledge and that fail-safe strategies such as in airplane design should be incorporated into the economic canon so that the very existence of the economic system is not threatened periodically (see Chapter 17). With these three new chapters the student should be able to comprehend the current state of the economy and how we got to this point.

Some of the reviewers suggested that I mention who the intended audience is. I wrote the book for *anyone* who wants to gain essential understanding of how a *real* market economy works and how it can be transformed so that it becomes inclusive. Humanistic economics puts the human element at center stage rather than inanimate abstract concepts like gross domestic product. How do people feel in the economy becomes the key issue rather than how much people earn in the economy. So obviously this should be interesting for students taking introductory courses but also includes their professors who are open-minded enough to notice that mainstream economic theory does not work well in the real world and are looking for alternative ways to approach the subject. The audience also includes graduate students who are looking for new topics and ideas to explore. They will find the extended footnote references useful. This could be helpful at the start of a research project. As several reviewers mentioned, this is an "honest" rendering of the economy without equivocating or trying to whitewash the dual nature of the real-existing economy. It does not focus on theoretical markets but on real-existing ones. Although several reviewers criticized the hundred-dollar words I use, I was able to use the textbook successfully in introductory courses.

The thesis of this volume is that the only way out of the West's current dilemma is through a paradigm shift toward a Capitalism with a Human Face.<sup>14</sup> Humanism means that the economy should work for everyone and not only for the select few. This can be accomplished only if we discard the failed assumptions of mainstream economics and instead of analyzing imaginary markets, we base our theories on evidence gleaned from the real world. Consequently, the book has been used also as a counterweight to conventional economics textbooks so that students gain pluralist insights about the actual economy.

Such a comprehensive paradigm shift will not be easy since there is a political world-view behind the mainstream's interpretation of the discipline and vested interests with deep pockets supporting the status quo. Nonetheless, we must discard a failed ideology,<sup>15</sup> because as long as our minds are trapped in the dogma of neoclassical economics, sketched eloquently on academic blackboards, we will be unable to attain a society in which everyone is flourishing.

## Notes

- 1 John Cassidy, "After the Blowup. Laissez-Faire Economists Do Some Soul-Searching—and Finger-Pointing," *The New Yorker*, January 11, 2010.
- 2 Dimitris Chorafas, "Queen Elizabeth II and the Economists," in *The Changing Role of Central Banks* (Palgrave Macmillan, 2013), pp. 15-36.
- 3 Neoliberalism advocates for free-market capitalism, deregulation, and small government. Felicia Wong, "Build Back Better Meets the Spooky Season: Zombie Neoliberalism Creeps into the Negotiations," Roosevelt Institute, October 21, 2021; Thomas Palley, *Neoliberalism and the Road to Inequality and Stagnation: A Chronicle Foretold* (Edward Elgar, 2021).
- 4 Benjamin Balak, "Book Review" of the second edition, *Political Studies Review* 19 (2021), 3: NP3-NP4.
- 5 Tony Lawson, *Essays on the Nature and State of Modern Economics* (Routledge, 2015).
- 6 Julie Nelson, *Economics for Humans*, 2nd edn. (University of Chicago Press, 2018); Torben Andersen et al., *The Nordic Model: Embracing Globalization and Sharing Risks* (The Research Institute of the Finnish Economy, 2007).
- 7 Rhys Manley, "Book Review," *Journal of Human Development and Capabilities* 21 (2020), 2: 209-210.
- 8 Michael Ash, "Book Review," *Basic Income Studies* 15 (2020), 2.
- 9 John Foster, "Book Review," *Economic Record* 95 (2019), 311: 514-516.
- 10 Translated into Chinese, German, Hungarian, Romanian, and Russian.
- 11 Milton Friedman, *Capitalism and Freedom* (University of Chicago Press, 1962); Milton Friedman and Rose Friedman, *Free to Choose* (Harcourt Brace, 1979); Friedrich Hayek, *The Road to Serfdom* (University of Chicago Press, 1944).
- 12 Adair Turner, *Economics After the Crisis: Objectives and Means* (MIT Press, 2012); Assaf Razin, *Understanding Global Crises* (MIT Press, 2014), p. 5, suggests that most theorists consider the pre-crisis consensus a mistake.
- 13 Donald Trump's inciting pre-insurrection speech: <https://www.rev.com/blog/transcripts/donald-trump-speech-save-america-rally-transcript-january-6>.
- 14 Samuel Bowles and Wendy Carlin, "What Students Learn in Economics 101: Time for a Change," *Journal of Economic Literature* 58 (2020), 1: 176-214.
- 15 Anonymous, "Efforts to Modernise Economics Teaching Are Gathering Steam," *The Economist*, March 20, 2021.



# 1 Welcome to Real-World Economics

Earth provides enough to satisfy every man's need, but not every man's greed.  
—Mahatma Gandhi

The financial crisis and the Covid-19 pandemic illustrated vividly how markets often go hay-wire; yet, mainstream textbooks remain unchanged, failing to convey the fundamental flaws and Achilles' heels of the free-market system.<sup>2</sup> These limitations resulted in so much accumulated frustration with a system that skewed its benefits to a select few and left too many people far behind, scrambling to eke out a bare existence, that it culminated in the rise of far-right populism and a threat to democracy itself. Yet, academics and politicians continue to sing the praises of abstract markets as if they had descended straight from heaven while maintaining a conspiracy of silence about the fact that without extravagant government bailouts the whole capitalist system would have collapsed. In a panic, only central banks could print trillions of dollars or euros to avoid utter calamity.

The doctrinaire approach to the teaching of economics is illustrated by the arrogant assertion that, "we know that markets work." That was hardly evident in 2008 or in 2020. In reality, they only do so within an appropriate *institutional framework*, with appropriate government *oversight*, and they not only work inefficiently frequently but tend to tip the stream of benefits toward a few insiders.<sup>3</sup> Hence, we should explore and delineate clearly the circumstances that prevent real markets from working as well as their theoretical counterparts and suggest remedies for their failings.<sup>4</sup> The ideological commitment to "*market fundamentalism*," which led to the excessive reliance on markets in public policy, has brought us to our current precarious political and social polarization. I hope the present volume will rectify this misconception and improve the understanding of real-existing economies by presenting a real-world perspective as opposed to the fantasy world of mainstream textbooks.<sup>5</sup>

Alan Greenspan's post-meltdown confession that he made a ghastly error in believing in—and aggressively preaching—market deregulation demonstrates vividly the miscalculations of the fundamentalist approach to economics. Congressman Waxman asked if he had been wrong; Greenspan responded:

I made a mistake in presuming that the self-interest of organizations, specifically banks ... were such that they were best capable of protecting their own shareholders and equity in the firms .... The problem here is [that] something which looked to be a very solid edifice and indeed a critical pillar to market competition and free markets did break down and ... that ... shocked me. I still do not fully understand why it happened.<sup>6</sup>

History is replete with people caught unaware by such ideological blinders. Greenspan made two *inexcusable* mistakes in that short statement: (1) inanimate abstractions like firms cannot have self-interest. They have employees who have their own self-interest in mind and the interest of those employees and the interest of the owners of the firm are often not well aligned (see Section 8.2). (2) Moreover, a bank's management cannot assess the impact of their activities on the rest of the financial system, since they only see their own balance sheet, not those of other banks. The oversight of the whole system was Greenspan's responsibility. Only he could assess the *systemic risks*: how the bankruptcy of one bank and the default on its obligations create a cascade of defaults throughout the financial system (see Section 14.1).<sup>7</sup> Systemic risk arises because the banks are interlinked.<sup>8</sup> So, Greenspan was negligent in abrogating this responsibility.

Congressman Waxman continued: "You had an ideology .... this is your statement: 'I do have an ideology. My judgment is that free competitive markets are by far the unrivaled way to organize economies.'" Greenspan's answer was not very convincing: "Yes, I found a flaw ... in the model that I perceived ... how the world works." Waxman: "In other words, you found that your view of the world, your ideology, was not right." Greenspan: "Precisely. That's precisely the reason I was shocked."<sup>9</sup>

Greenspan should not have been shocked. One did not need a PhD to realize that housing prices were off the charts and that it made no economic sense because incomes were not increasing (see Figure 14.2). It would not have been difficult to realize that increasing demand was not logical without an increase in incomes. Yet, Greenspan and Benjamin Bernanke, his successor in 2006, chose to ignore this critical evidence, since they were blinded by their ideology that markets were infallible. *Ideology immune to empirical evidence becomes dogma*. So, they were trapped by their own ideology.

## 1.1 My Credo: It's Not the Economy—It's How People Feel in the Economy!<sup>10</sup>

My worldview is progressive, democratic, and *humanistic*.<sup>11</sup> Instead of focusing on production and consumption, I concentrate on *how flesh-and-blood people feel in the real-existing economy*.<sup>12</sup> That is a crucial difference because mainstream economics equates consumption with well-being, which is easily refuted (see Chapter 2). Instead, humanistic economics aims to improve the *quality of life* and to restructure the economy to increase *life satisfaction* for everyone because there are better ways to measure well-being than in terms of money. The goal should be to catch up to Finland in educational attainment, to Switzerland in happiness, to Norway in longevity, and to Denmark in equality, rather than growing the economy.<sup>13</sup> These countries have demonstrated how to improve human flourishing, so they can provide guidance. All students (graduate and undergraduate) must know this.

*Economic analysis should begin with empirical evidence*, as the natural sciences, rather than with assumptions.<sup>14</sup> Evidence should be at the core of the discipline since "economics is supposed to be an inquiry into the world, not pure thinking."<sup>15</sup> Hence, it should not rely on axioms and derive theorems based on them using deductive logic. Instead, it should start with data, and build theories based on that evidence using inductive logic. It should also be open to *falsification*,<sup>16</sup> but it holds these axioms with such religious faith that they become doctrine and are therefore insensitive to evidence contradicting them.<sup>17</sup> Yet, human beings are not inanimate objects whose trajectory can be described accurately by mathematical formulas. Unlike planets,

they can and do change direction. Isaac Newton, one of the greatest scientists, admitted as much in 1720: "I can calculate the movement of the stars, but not the madness of men."<sup>18</sup>

We need theories that are valid not only on academic blackboards<sup>19</sup> but also in concentrated areas of poverty like Cleveland's 44115 zip code area (with a median household income of \$15,034).<sup>20</sup> Mainstream economic theory does not work so well there as it does on Park Avenue in New York City (10282 zip code) (with a median household income of \$250,000)—four times the national median.<sup>21</sup>

Instead of revering income, humanistic economics stresses values that enhance human dignity and promote *mass flourishing*.<sup>22</sup> "Flourishing can be understood as a state of living in which all aspects of a person's life are good, including, ... happiness and life satisfaction, physical and mental health, meaning and purpose, character and virtue, and close social relationships."<sup>23</sup> Flourishing can be promoted by universal healthcare, universal educational opportunities from kindergarten through college, guaranteed basic needs, minimal stress, and a widespread safety net. Those are the basic ingredients of a *thriving society*.

Humanistic economics also advocates the minimization of pain and anxiety. *Homo oeconomicus*, the idealized construct of mainstream economics, feels no pain or stress or anxiety. Conventional economics assumes that utility cannot become negative. Hence, the current economic system treats the anguish of disadvantaged groups with an indifference that borders on negligence. These include children attending dysfunctional schools in dysfunctional neighborhoods growing up in dysfunctional families, the working poor who are unable to find their bearings in the new economy transformed by the IT revolution and globalization, those trapped in a culture of poverty, or displaced union workers experiencing downward social mobility. They are sentient beings and ought not be treated like inanimate objects without feelings.

The quest for the good life is as old as philosophy itself. Aristotle argued 2350 years ago that the essence of a good life was understanding the world around us. This book is about understanding the fundamental nature of today's economy as it actually works rather than the way it is *imagined* in academic classrooms. Change should start with understanding. My focus is on how real human beings actually live and feel. An abstract concept like the Gross Domestic Product, the total output of an economy, is a number that does not reveal how people feel in that economy. Hence, *GDP should not be equated with welfare* (see Section 7.13).

Moreover, we should be aware of the tyranny of averages, because average income or average GDP per capita are not the same as life satisfaction actually experienced by human beings living in that economy. Those statistics conceal how the income or GDP is distributed in the society which is crucial to understanding how much welfare is being generated. The increasingly uneven distribution of income is crucial, since it created much disaffection and consequently has become a potent political force ripe for manipulation (see Chapter 15).<sup>24</sup>

The pre-Covid-19 common wisdom was that "the economy is in good shape."<sup>25</sup> However, this was a major mistake because (1) it is a misuse of averages and completely disregards the distribution of benefits; and (2) what really matters is if the people living in the economy are in good shape. Gallup polls indicate that this is not the case in the US (see Chapter 2).<sup>26</sup>

Furthermore, I believe that our starting point should not be Adam Smith's *Wealth of Nations* (1776), but his *Theory of Moral Sentiments* (1759), in which Smith asserted forcefully that we possess an innate empathy toward our fellow human beings.<sup>27</sup> Moreover, *ethical principles of fairness* are part of our nature.<sup>28</sup> We ought not expunge these notions from the economics canon. Hence, I believe that mass flourishing can be achieved only in a *just society*, one in

which compassion is more important than efficiency (see Section 5.7).<sup>29</sup> Even arch-conservative Republican Alan Greenspan, an ardent advocate of free markets, realized that the perception that the economy is *just* is an essential prerequisite of sustaining Capitalism:

[y]ou cannot have the benefits of capitalist market growth without the support of ... virtually all of the people; and if you have an increasing sense that the rewards of capitalism are being distributed unjustly, the system will not stand.<sup>30</sup>

Well, he was right, it was not standing very firmly on January 6, 2021.

## 1.2 Humanistic Economics, the New Paradigm

Humanistic economics is not an oxymoron. It implies that a more just capitalism is possible, embedded in a truly democratic society that enables people to live their daily lives with less anxiety, less conflict, less inequality, less insecurity, less manipulation, less pain, less poverty, less stress, less uncertainty, no unemployment, and less fear that their lives could spiral out of control in the next recession. This *Capitalism with a Human Face* would also increase ethical behavior, increase educational attainment, increase the health of the population, increase intellectual satisfaction, allow more leisure time, enable people to love and respect one another, improve social relationships, and enable the attainment of a moral life easier.<sup>31</sup> This is not utopian theorizing. It has been largely achieved in Switzerland, in Scandinavia, and is close to the social-market economy of Germany and Austria, and to the welfare states of other Western European countries.<sup>32</sup> These countries have the highest quality of life in the world.<sup>33</sup> My constructive agenda is to demonstrate that humanistic economics should be the new paradigm for organizing our economic thinking. By emphasizing that consumption ought not to be the goal of a meaningful life, humanistic economics differs fundamentally from the mainstream (Table 1.1). Human beings are *not* “economic agents.” The mainstream’s emphasis on income often conflicts with human values. “Capitalism with a human face” would enable everyone to live fulfilled lives. John Maynard Keynes said as much:

Table 1.1 The differences between humanistic and mainstream economics

	Humanistic economics	Mainstream economics	
1	Start of analysis	Evidence	Axioms
2	Begins with	Children	Adults
3	Logic used	Inductive	Deductive
4	Sister disciplines	Included	Excluded
5	Human Psychology	Behavioral	Rational
6	Mathematics	Minimal	Extensive
7	Markets	Just	Free
8	Government’s role	Substantial	Minimal
9	Pain/stress	Minimize	Omitted
10	Utility function	Interdependent	Independent
11	Goal	Quality of life	Consumption
12	Distribution	Important	Unimportant
13	Basic needs	Paramount	Omitted
14	Relative income	Important	Omitted
15	Opportunity	De facto	De Jure
16	Power	Important	Omitted
17	Species	Homo sapiens	Homo oeconomicus



I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life.<sup>34</sup>

The common wisdom erroneously equates economic growth with rising living standards (see Section 7.13). However, surveys categorically contradict this proposition. The growth fetishism disregards not only the pollution it causes but also other negative externalities associated with growth, such as stress and insecurity. Furthermore, focusing on growth disregards the distribution of its benefits: economic growth has not benefited the destitute, the uneducated underclass, or the underemployed. *Despite 250 years of economic growth since the Industrial Revolution, discontent is more widespread than ever* because income has concentrated at the top 1 percent. It is amazing how much dissatisfaction the \$23 trillion US economy produces (see Chapters 2 and 15).<sup>35</sup> In 2019, merely 55 percent of US adults considered themselves “thriving” while the rest were “struggling” (41 percent) or “suffering” (4 percent).<sup>36</sup> This economy is inefficient at producing contentment for some 150 million of its citizens. Consequently, by disregarding the distribution of income and the stress generated by the economic system, free-market aficionados have led us astray.

Another important issue is that humanistic economics considers *de jure* equal opportunity insufficient for a *just economy* without *de facto* equal opportunity. Wealth is a privilege because it provides opportunities to those who possess it. Babies born into poor families have less chance of living a fulfilled life than those born into wealthy ones. Hence, their future development diverges, depending on their initial endowment. Such random allocation at the start of life cannot possibly be the basis of a good society. Our goal ought to be to create a just society in which children have *de facto* equal opportunity, not just in theory, and those who are born at a disadvantage can be compensated by society for their initial bad luck (see Section 5.7).<sup>37</sup>

The aim of this volume is to provide a critical framework that helps us understand the actually existing economy—and how the mistakes of the conventional canon have landed us in our current divisive predicament (see Chapter 15). The book also provides a guide to a humanistic economy to which we should aspire and serves as a counterweight to conventional textbooks which instill in students full confidence in the benefits of the free-market system. Such confidence is unwarranted. After all, markets are human inventions; they do not deserve our blind faith. So, this book advocates a new paradigm: *Capitalism with a Human Face*.

### 1.3 A Primer on Blackboard Economics

“What do George Akerlof, Kenneth Arrow, Daniel Kahneman, Paul Krugman, Thomas Schelling, Herbert Simon, Robert Shiller, Joseph Stiglitz, Richard Thaler, and Oliver Williamson have in common?” would make a great Econ-101 question except for the fact that the contributions of these Nobelists are typically omitted from mainstream textbooks or relegated to obscure footnotes. Instead of emphasizing their critical ideas, these textbooks hype a free-market nirvana whose validity does not extend beyond the classroom.

Hence, millions of students taking Econ-101 fail to grasp essential aspects of *real-existing* markets in the hyper-globalized world of the twenty-first century. Rather, they learn a caricature of the economy at a level of abstraction that creates a fantasy world and distorts their vision: how inefficient! These textbooks perpetuate a stereotype that markets are efficient, thereby

automatically leading to a blissful life. The students fail to grasp that these are abstract hypothetical markets in Alice-in-Wonderland economies, not in the real world. Conventional textbooks sing praises to the immense achievements of the market system, disregarding inconvenient evidence contradicting their claims like the skyrocketing “*deaths of despair*” by the underprivileged, the millions in jail who were rejected by the legal labor market, or the inequality-fueled rise of populism against the entrenched elites who control the system.

Super rationality reigns in this utopian kingdom inhabited by *homo oeconomicus* with sufficient brain power to know every detail of the economy and are therefore not satisfied with anything less than *maximizing their welfare*. These consumers possess perfect understanding of the nuances in contracts in small print; they have perfect foresight from the beginning of their lives onward and are not inhibited by the challenges of information overload because information is available freely, instantaneously, and a cinch to understand. They are neither manipulated nor tempted, so they have complete control over their desires. They avoid bouts of irrational exuberance. Welcome to the *pseudo-science* of mainstream economics.<sup>38</sup>

Theirs is a caricature of human nature and of real-existing markets. The mainstream overlooks emotions and that habit and the unconscious mind play a substantial role in our decisions (see Chapter 4). Thus, it overlooks the path-breaking work of Sigmund Freud on the unconscious mind which is not only a source of many of our desires, but frequently comes into conflict with our rational thoughts.<sup>39</sup> Overlooking this leads economic policy makers astray. After all, if people are rational, there is no need for *consumer protection* from predatory mortgages. Yet, much of our reasoning is rationalizing our unconscious thoughts. By putting an enormous faith in the power of reason, mainstream economics reveals its *pre-Freudian* essence.

Moreover, in the mainstream’s fantasy world there are no brands, so goods have no quality dimension, and product choice becomes a no-brainer: two slices of generic pizza, or three? There are no traps, no false promises, no stress, so buyers need not be on their guard in this idyllic economy. There are no regrets, no need for human judgment or intuition, no emotion, no real uncertainty, hence no mistakes, and no need to worry about lawyers’ fees or other enforcement or transaction costs. Indeed, there is no society at all, no children, no gender, no glass ceilings, no class, hence no lower class, no power, hence no power imbalances, and neither space nor race, and hardly any time dimension. In this imaginary world consumers are not swayed by advertisements or by other people’s consumption.

Producers also inhabit this make-believe economy. They also know everything about consumers’ wants and their demand for the firms’ products, so they can maximize their profits with ease. Actually, the textbook firms are Mom-and-Pop operations, not modern multinational corporations. They are so small and there are so many of them that they are *price takers*; they must accept the market price, unable to influence it at all (see Chapter 6). This “*perfect competition*”<sup>40</sup> is still the default model although obviously “most industries are now dominated by a small number of large firms.”<sup>41</sup> There are no shareholders in these models or board of directors, no CEOs who maximize their own income rather than that of distant shareholders (see Chapter 8). These firms do not advertise to persuade consumers to buy their products, much less collude with others, deceive, or game the system.<sup>42</sup> Lobbyists are an extinct species, so there is no political process that can serve the interests of the high and mighty.<sup>43</sup> Problems are posed in terms of a single decision without antecedents and without fundamental uncertainty and without further implications in subsequent periods. In fact, time hardly plays a role in this static world since sequential decisions are neglected.<sup>44</sup>

Laws are in place, so we can disregard how they came into being or what advantages they provide to those already influential. Laws are not broken, and people do not take advantage of their counterparty's lack of information and hence there are no enforcement costs for contracts. So, oversight would be a waste of effort. Everything runs smoothly—there are no opportunities to finagle, no conflicts, let alone wars. Basic needs have given way to benign wants. Free markets are efficient, hence above morality, so questioning their *laissez-faire* premise would be a waste of ethical scruples. However, the mainstream fails to note that this is also a value judgment implying that efficiency is more valuable than sustainability, justice, reducing stress, or eliminating poverty.<sup>45</sup> Hence, questions of fairness are supposedly superfluous.

Moreover, the system is in perpetual *equilibrium*, meaning that supply equals demand in all markets; so, there is no need to worry about bubbles or crisis. Well-being is measured in terms of money, but there are no rich or poor so there is no hunger, therefore the system is democratic: one dollar, one vote. The fact that some consumers own more dollars than others is their birthright, so there is no need to waste time discussing that in reality some do have many more votes. These are the basic elements of *positive neoclassical economics*, at least on the blackboard. But there is nothing positive about the axioms upon which these propositions are based and the inconvenient truth is that they are based on value judgments and have little to do with the actual economy as it exists today full of too-big-to-fail banks and supranational mega-corporations with global reach who operate mostly above democratic oversight. Actually, the canon hides the fact that free markets have never ever existed in the real world because they cannot possibly exist in a social vacuum.<sup>46</sup>

The mentality of conventional economists is rooted in the much simpler Smithian world of the eighteenth century without its moral sensibilities.<sup>47</sup> That is like trying to understand atomic physics with Newton's laws instead of quantum mechanics. Hence, the dominant *neoliberal economic theory is anachronistic*—inadequate to meet the challenges of the crisis-ridden world of the twenty-first century. "Ivory tower" economists are experiencing a paradigm paralysis that blocks their ability to evaluate their canon critically.<sup>48</sup> They are inflexible, unable to think outside of the abstract framework they have created because alternative perspectives are inconceivable to them. They refuse to give up the simplistic assumptions of an imagined economy inhabited by implausible super-rational agents—*Übermenschen*—Supermen—devoid of emotion, without any sense of community, whose only identity is that of being consumers, or producers with hardly any interaction among them.<sup>49</sup> In contrast, humanistic economics is about flesh-and-blood people.

## 1.4 A Paradigm Shift Is Long Overdue

Our long-range goal should be to provide a thorough empirical foundation for the discipline, while our proximate goal is to demonstrate that the mainstream canon is woefully misleading and therefore a paradigm shift is absolutely necessary away from the current dominance of neoclassical economics and toward humanistic economics.<sup>50</sup> For economics to be relevant, it must become more realistic and work for the benefit of Everyman and not only for the top 1 percent.<sup>51</sup>

Today, economic policy is of paramount importance. The White House has the Council of Economic Advisers and the National Economic Council; the legislative branch's Congressional Budget Office has 235 employees; the Department of Commerce has the Bureau of Economic Analysis with 500 employees; the Bureau of Labor Statistics employs 2,500; the Bureau of the

Census also collects economic data and employs 5,600 people. So, lots of effort is expended on understanding the economy. Hence, it behooves us to discard false theories.

Mainstream economics has been unable to create an inclusive economy in which most people felt good about their life.<sup>52</sup> Mainstream economics steered us straight into the biggest economic crisis in 75 years, and the political crisis was not far behind (see Chapters 14 and 15).<sup>53</sup> Mainstream economics misjudged the severe impact of globalization on the lives of low-skilled workers (see Chapter 13). Mainstream economics misunderstood the impact of inequality on the social and political systems. These errors add up to an extraordinary set of policy blunders.<sup>54</sup> Hence, a paradigm shift is long overdue.<sup>55</sup> That is the proximate reason for writing this book. Without these blatant blunders I would certainly not have done so.

Instead of chasing the elusive “American Dream” in a “treadmill” economy with a few winners and many losers, we should focus on creating a more *harmonious economy* with a creative, decent, dignified, enjoyable, satisfactory, secure, sustainable, and peaceful life, one that is not based on excessive consumption, instant gratification, and cutthroat competition—one that is less materialistic.<sup>56</sup> For the first time ever, we have the possibility of achieving a quality of life that eluded our predecessors without struggling to achieve ever more material goods.<sup>57</sup> That is the essence of *humanistic economics*.

The emphasis on competition in economics is based on *Social Darwinism*—the survival of the fittest. Supposedly, competition brings forth more of the best products and best performance. But we already have enough material goods. We no longer need to strive for more. What we need more of is contentment. We could all live comfortably, given our level of productivity. Materialism is insatiable and therefore ultimately cannot satisfy because it just makes us want more. Rather, we need to rein in our appetite, our greed, and have a mindset that is less concerned with success measured by money and status and be able to enjoy more of what we already possess.<sup>58</sup> Instead of growing the economy, we need psychological, spiritual, and moral growth. However, for that, we need a new economic paradigm appropriate for the twenty-first century. The Canadian Institute of Wellbeing defines well-being thus:

The presence of the highest possible quality of life ..., focused on ... good living standards, robust health, a sustainable environment, vital communities, an educated populace, balanced time use, high levels of civic participation, and access to and participation in dynamic arts, culture and recreation.<sup>59</sup>

In short, well-being is not identical with GDP or income (see Section 10.10).<sup>60</sup> A good life in Capitalism with a Human Face should include the *minimizing* of anxiety, inequality, insecurity, pain, poverty, stress, unemployment, and *maximizing* ethics, intellectual satisfaction, health, leisure time, social relationships, love, respect, and a moral life.<sup>61</sup> President Jimmy Carter implied as much:

[T]oo many of us now tend to worship self-indulgence and consumption. Human identity is no longer defined by what one does, but by what one owns. But we have discovered that owning things and consuming things do not satisfy our longing for meaning.<sup>62</sup>

However, his warning fell on deaf ears: “[Carter] totally ignored the fact that the country’s dominant institutions—corporations, advertising, popular culture—were instrumental in promoting and sustaining the hedonistic ethic.”<sup>63</sup>

The reader should not misunderstand. I am not advocating abolishing markets or creating an immense leviathan and am resolute about protecting freedoms enunciated in the Universal Declaration of Human Rights. However, I have a wider conception of liberty than libertarians.

*Freedom* is more than the absence of legal restraint to act. Crucially, it has to encompass Amartya Sen's notion of *capability*: the *ability* to act.<sup>64</sup> It includes the "freedom from want" and the "freedom from fear" emphasized by President Franklin Roosevelt: "Liberty requires opportunity to make a living—a living decent according to the standard of the time, a living which gives man not only enough to live by, but something to live for."<sup>65</sup> That includes, furthermore, the ability to live without the anxiety generated by a high-stress economy, so we should not have to worry about our job or pension disappearing, being defrauded, or paying medical bills or college tuition. The UN's Declaration of Human Rights includes these freedoms:

Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control.<sup>66</sup>

My conception of a good life also includes the freedom to live without the feeling of relative deprivation from seeing the lifestyles of the profligate rich and famous. One should also be free to develop one's personality autonomously rather than having it imposed by media magnates and influencers. In addition, developing one's character without the interference of the profit motive of multinationals is an essential aspect of true freedom.<sup>67</sup> We would then not be inculcated from the get-go with the fundamental elements of consumerism.

Furthermore, I also believe that many markets work well some of the time, and a few markets work well most of the time, but *no market works well for long without adequate oversight*. This is a crucial insight. So, we must verify if specific markets at a specific time really accomplish what is expected of them and, if not, we should improve their performance so that we can function better in them. I am an enthusiastic supporter of those markets that enable individuals to exercise their creativity, autonomy, and individuality without psychological manipulation or coercion and without interference from influencers peddling conformity, and predatory lenders fishing for gullible people, but my support is contingent on *empirical verification*. We should not ignore evidence contradicting the orthodox canon. If markets are suboptimal or even harmful, we must retain the right to reform them. This is also the essence of humanistic economics. Crucially, we, the people, should remain the masters of markets, and not vice versa.<sup>68</sup> Moreover, their benefits should be widely dispersed. So, markets are not above moral judgment.

Actually, there is a continuum of socio-economic systems, ranging from market fundamentalism to socialism. I advocate finding that constellation of institutional arrangements at the golden mean between the two extremes that can provide a fulfilled life for all. However, I do not believe that we need to "grow the economy" to achieve this. Rather, we should create a fairer economy that can sustain future generations, eliminate discontent, and minimize insecurity and *minimize suffering*, mental and physical.

Ernst Schumacher, a pioneer environmental economist, had a similar vision: "The most striking thing about modern industry is that it requires so much and accomplishes so little. Modern industry seems to be inefficient to a degree that surpasses one's ordinary powers of imagination."<sup>69</sup> By being "inefficient," he meant that the economy generates so little life satisfaction despite high average income and despite using so much resources. He continued: "the aim should be to obtain the maximum of well-being with the minimum of consumption." Thus, our goal should be to improve our sensibilities and *consumption skills* so that we can improve our lives by obtaining

more gratification with less consumption.<sup>70</sup> That is, become smarter, more autonomous consumers immune to instant gratification.

## 1.5 Real-World Economics Is Superior

The recognition is increasing that “the progress of economic science has been seriously damaged,”<sup>71</sup> because “[m]odern economics is sick. Economics has increasingly become an intellectual game played for its own sake and not for its practical consequences for understating the economic world.”<sup>72</sup> Consequently, there is a widespread effort to reform the discipline. This includes “Rethinking Economics,”<sup>73</sup> an international movement committed to “building a better economics.”<sup>74</sup> On the 500-year anniversary of Martin Luther’s 95 *Theses*, it posted “33 Theses for an Economics Reformation” on the entrance of the London School of Economics, arguing that “within economics, an unhealthy intellectual monopoly has developed.”<sup>75</sup> The manifesto is practically identical to humanistic economics.<sup>76</sup>

Similarly, the editors of the journal *Capitalism and Society* are explicit in their criticism of the “otherworldly neoclassical school ... using mathematics to model unrealistic assumptions”:<sup>77</sup>

Today’s established economics—the economics dominant in classrooms, banks, and governments—misconceives the modern economy. This disconnect has consequences for how we understand history, how we make policy, and how we view capitalism. Its explanations fail and mislead at important junctures in modern history. Until economics is grounded on the basic character of modern economies ... it limits and distorts our view.<sup>78</sup>

However, the groundswell of rejection of mainstream models has not been adequately represented in academic classrooms or in policy.<sup>79</sup> There is a veritable iron curtain protecting the power centers of neoliberal ideology that maintain its dominance in all top journals crucial for promotion and admittance into departments that shape the future of the discipline.<sup>80</sup> Even today most research papers published in prestigious journals begin with unrealistic assumptions.

No less an authority than Nobelist, Joseph Stiglitz, declared—prematurely in 2009—that “neoliberalism as a doctrine, market fundamentalism is dead.”<sup>81</sup>

This September has been to market fundamentalism what the fall of the Berlin Wall was to communism. We all knew that those ideas were flawed, that free market ideology didn’t work; we all knew that communism didn’t work, but these were defining moments that made it clear that it didn’t work ... America really has a system ... of corporatism corporate welfarism ... under the guise of free market economics. And it is that mixture, which was fundamentally flawed, incoherent, was intellectually bankrupt from the beginning, that has been shown not to work.<sup>82</sup>

Nonetheless, the popular textbooks remain unchanged. This is hardly a benign oversight. It has immense consequences, since it influences the media, political discourse, and the mindset of the voting citizenry. No wonder that many believe, “much of what economists do nowadays is a waste of time.”<sup>83</sup>

## 1.6 Simple Is for the Simple-Minded

The argument that a simple overview suffices to lay the foundations in Econ-101 before students learn more sophisticated aspects of the discipline, is blatantly false. It sells the students

far too short. Oversimplification leads to the distortion of reality beyond recognition, deceives students, and blends into indoctrination. If the straight-talking Nobel Prize-winning physicist, Richard Feynman (1918-1988) were still with us, he would concur that such caricatures should not persist in academia. In his 1974 commencement address at the California Institute of Technology, he beseeched students to practice “scientific integrity,” “utter honesty,” and to “lean over backwards” so as not to “fool ourselves.”<sup>84</sup> I believe this holds also for teachers of economics. Economists should be held to the same ethical standards as other professionals.<sup>85</sup> From the start, students must learn about the limitations of real markets as opposed to theoretical ones for four reasons:

1. Half-truths do not belong in academia: not in the beginning or at the end of a program; omitting crucial aspects like Herbert Simon’s theory of satisficing or behavioral economics is not living up to Feynman’s standard of being “utterly honest.”<sup>86</sup>
2. It is much more efficient to learn economics properly the first time than to have to correct it subsequently. It is extremely difficult to unlearn something once one is socialized into accepting the main tenets of the discipline without learning about their real-world limitations. The human mind is not so flexible: once the neural networks are in place, they are tedious to rewire.<sup>87</sup>
3. The more “sophisticated” ideas of imperfect markets are not so complicated and can be taught successfully at the introductory level. Neglecting them, dubbed “imperfections” or “frictions,” and focusing instead on perfectly competitive markets distorts economic theory to such an extent that students leave the course “convinced of the righteousness of neoclassical economics and the necessity of deregulation and the reduction of taxes,” i.e., with a fundamentally misleading caricature of the real existing economy.<sup>88</sup>
4. Most students of Econ-101 do not continue to study economics; so, they never learn the more nuanced models and are therefore convinced for the rest of their lives that markets work perfectly well without government interference. This influence played a substantial role in political developments by supporting an ideology tilted toward the free-market worldview. Thus, students should not be deceived and the distinction between theoretical and actual markets clarified from the start. Admittedly, instructors are expected to cover a considerable amount of material in Econ-101. Nonetheless, quality ought not be sacrificed for quantity: it is more important that students are not deceived and get a balanced view of the real-existing economy.

## 1.7 “It’s Only a Model!” Is Deceiving

The reliance on mathematics in economic models does not make economics into a rigorous science because the methodology has many drawbacks.<sup>89</sup> These include “sins of omission”: complex social and political processes cannot be captured accurately in a few equations. Consequently, many relevant issues are omitted, which leads to “narrow methodological biases,” and “epistemological insularity,” the isolation from other social sciences.<sup>90</sup> Simple models are unrealistic conceptualization of a complex economy with thousands of variables and interacting components. So, simplification renders many models harmful, as became obvious during the 2008 crisis.

Consider also that some critical issues can only be approximated. Obviously, extreme inequality can destabilize a democratic political system, but the precise relationship between the two

variables cannot be described mathematically. Yet, if economists omit political destabilization from their thinking about inequality, they are committing a critical error. Thinking about such issues requires approximation based on intuitive judgment. Teachers are doing their students a disservice if they allow them to leave their classroom without understanding that the political implications of such issues as inequality.

Because of such systematic oversight, simplified blackboard models are applied casually to real-world situations erroneously and lead to *disastrous* policies. The perfectly competitive model, the workhorse of mainstream economics, is invariably misapplied because it is irrelevant in today's economy (see Chapter 9). This is an immense flaw because it led to destructive policies. For example, Greenspan's and Bernanke's application of simple Econ-101 textbook models to the complex financial sector, while ignoring the warning signs before 2008, had catastrophic consequences (see Chapter 14). Similarly, economists omitted in their mathematical equations the ominous political forces that were unleashed by globalization, with similarly disastrous results (see Chapter 15).

Hence, the economics profession is responsible, in the main, for how ill-informed the public, the media, and politicians are about real-world economics. Economists have failed miserably to "bend over backwards" by clearly explaining the limitations of blackboard models. It is insufficient to mention the assumptions at the beginning of the semester and assume that the students remember them years later when they assume responsible positions by becoming newspaper editors, radio commentators, small-town mayors, or political activists, and choose among political candidates based partly on dubious economic models, remembering that free markets are supposedly efficient.<sup>91</sup> This failure has immense deleterious implications for society and its political system. Hence, we must clarify when *blackboard models are not applicable to real-world phenomena*. Without such emphasis most textbooks fail to provide adequate guidance to understanding the real-existing economy.

Thus, the deficiencies of Econ-101 have become a powerful political force as citizens become vulnerable to simplistic sound bites: "competition will lead to growth," "the free market is efficient," "lowering taxes will create jobs," "government is not the solution to our problems, government is the problem,"<sup>92</sup> "we are adults, we do not need consumer protection." To avoid such stereotypical political slogans becoming common wisdom, academics must avoid half-truths before the students are indoctrinated into thinking that competitive free markets miraculously provide the answers to all real-world economic problems.

Yet, economists often argue that unrealistic models are acceptable if their predictions are useful. However, mainstream economics fails miserably in this respect. For instance, typical models predicted that our life satisfaction would increase as real per capita gross national product rose by a factor of 3.5 in the US since 1950. Yet, that prediction is falsified by the inconvenient truth that the share of adults who are happy remained unchanged in the intervening half-century.<sup>93</sup> If anything, it has declined. Hence, the importance of money is obviously overvalued by economists.

Yet another example is Greenspan's prediction that deregulation would increase the efficiency of the financial sector, but that prediction was falsified when financial markets imploded in 2008. Similarly, Bernanke predicted that the subprime mortgage problem would not "drive the economy too far from its full employment path."<sup>94</sup> Yet, this Princeton star macroeconomist was dead wrong: two years later the official unemployment rate reached 10 percent, and the actual unemployment rate was closer to 17 percent.<sup>95</sup> Economists also predicted that



globalization would increase prosperity. Instead, it increased the number of have-nots and provided fodder for populism. Economists blundered by predicting that a financial crisis would not occur although there were enough warnings that people in authority disregarded.<sup>96</sup> Despite these mistakes there is no rush to scrap falsified theories in order to put economics on the right track in order to avoid such blunders in the future.

In sum, the failure of economic theory to provide reasonable predictions to the major challenges of our time is essentially a travesty. The argument has been falsified innumerable times that economists can predict accurately even with unrealistic models. Thus, the conclusion is warranted that:

mainstream economists nowadays might not be particularly good at predicting financial crashes, facilitating general prosperity, or coming up with models for abating climate change, but when it comes to establishing themselves in positions of intellectual authority, unaffected by such failings, their success is unparalleled. One would have to look at the history of religions to find anything like it.<sup>97</sup>

Why this is the case is the subject of this volume.

## 1.8 Takeaways

The financial crisis of 2008 and the subsequent rise of populism demonstrated the failure of economic theories to grasp the full implications of their policies in the real world. In mainstream classrooms, markets are described as self-regulating institutions that work efficiently without government oversight. However, the devastation of the crisis, together with the upswell of discontent associated with a level of inequality not seen since the Robber Barons of a bygone era demonstrated convincingly how economists were blindsided by events. Theirs was not a minor error but a failure of historic proportions.

Trumpism captured the frustration of the electorate with free-market principles that dominated policies since the trickle-down theories of Reaganomics. Two hundred counties flipped from Obama to Trump in the 2016 election because of the anxiety linked to *downward social mobility* and the devastation that mismanaged globalization brought to the Rust Belt, to small towns, and to rural America.

Yet, textbooks remain unchanged, failing to convey the fundamental shortcomings of the free-market system as well as the ways in which social, political, and economic processes are intertwined. This chapter points to the weaknesses of the current economy and argues that only “Capitalism with a Human Face” can lead to a flourishing society.

## Questions for Discussion

- 1 Do you agree with Alan Greenspan that everyone has an ideology?
- 2 What is your ideology and how does it compare to the ideology of a typical American?
- 3 Do you think that the assumptions made in economics textbooks about the behavior of individuals and firms are sufficiently realistic to be appropriate and useful in their application to the real world, or do you think that they are oversimplifications?
- 4 Do you think that a value-free economics is possible?
- 5 Do you think it is useful to distinguish between basic needs, wants, and conspicuous consumption?

## 14 *Welcome to Real-World Economics*

- 6 Do advertisements or fashion trends influence your consumption habits?
- 7 Do you think that ethical considerations are as important as economic efficiency?
- 8 Do you think that consumerism should be the dominant culture? What about instant gratification, keeping up with the Joneses, conspicuous consumption?
- 9 Do markets always function well and increase our quality of life or do they frustrate many and exclude some?
- 10 Can you think of instances when you were disappointed by a salesperson, or deceived, or defrauded, or someone took advantage of your lack of knowledge or experience?
- 11 Does society have the right to control market activity?
- 12 Do you expect professors to follow Feynman's admonition to be "utterly honest"?
- 13 Are you more satisfied with your life than were your parents or grandparents?
- 14 Do you think that reducing the conspicuous consumption of the rich through higher taxes would improve the supply of public goods such as schools and infrastructure in the United States?
- 15 Do you know someone who voted for Donald Trump? Why did he/she vote for him?

## Notes

- 1 In the public domain. <https://www.reuters.com/article/us-gandhi-works/gandhi-works-to-go-public-60-years-after-his-death-idUSTRE50418A20090105>.
- 2 Diane Coyle, *What's the Use of Economics? Teaching the Dismal Science After the Financial Crisis* (London Publishing Partnership, 2012); Bradford DeLong, "Economics in Crisis," *The Economists' Voice* 8 (2011) 2: 1-2; David Colander, "Why Economics Textbooks Should, But Don't, and Won't, Change," *European Journal of Economics and Economic Policies: Intervention* 12 (2015), 2: 229-235; Joseph Stiglitz, "On the Market for Principles of Economics Textbooks: Innovation and Product Differentiation," *Journal of Economic Education*, 19 (1988), 2: 171-182.
- 3 Robert Nelson, *Economics as Religion: From Samuelson to Chicago and Beyond* (Pennsylvania State University Press, 2002).
- 4 Dani Rodrik, *Economics Rules: The Rights and Wrongs of the Dismal Science* (Norton, 2016).
- 5 Ariel Rubinstein, "Comments on Economic Models, Economics, and Economists: Remarks on Economics Rules by Dani Rodrik," *Journal of Economic Literature* 55 (2017), 1: 162-172.
- 6 "Waxman to Greenspan: Were You Wrong?" YouTube video, 5:05, posted by "NancyPelosi," October 23, 2008; [www.youtube.com/watch?v=txw4GvEFGWs](http://www.youtube.com/watch?v=txw4GvEFGWs).
- 7 This was pointed out by Daniel Kahneman, "Reflection on a Crisis," @ 18 minutes. <https://www.youtube.com/watch?v=LjGl6bZF6zs>.
- 8 Javier Bianchi, "Overborrowing and Systemic Externalities in the Business Cycle," *American Economic Review* 101 (2011), 7: 3400-3426.
- 9 "Waxman to Greenspan: Were You Wrong?" op. cit.
- 10 Paraphrasing Bill Clinton's campaign slogan of 1992.
- 11 Mark Lutz and Kenneth Lux, *Humanistic Economics: The New Challenge* (Bootstrap Press, 1988); George Brockway, *The End of Economic Man: An Introduction to Humanistic Economics* (Norton, 1991); Wilhelm Röpke, *A Humane Economy: The Social Framework of the Free Market* (Henry Regnery, 1960).
- 12 Reema Patel et al., *Building a Public Culture of Economics* (RSA, 2018); <https://www.thersa.org/>; Joe Earle et al., *The Econocracy: The Perils of Leaving Economics to the Experts* (Manchester University Press, 2016).
- 13 Giorgos Kallis et al., *The Case for Degrowth* (Polity Press, 2020); Kate Raworth, *Doughnut Economics: Seven Ways to Think Like a 21st Century Economist* (Chelsea Green Publishing, 2017).

- 14 "Our criticism of the accepted classical theory of economics has consisted not so much in finding logical flaws in its analysis as in pointing out that its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world." John Maynard Keynes, *The General Theory of Employment, Interest and Money* (Macmillan, 1936), Chapter 24.
- 15 The mainstream is guilty of "cultural barbarism," and "historical ignorance." Deirdre McCloskey, *The Secret Sins of Economics* (Prickly Paradigm Press, 2002).
- 16 Karl Popper, *Conjectures and Refutations: The Growth of Scientific Knowledge* (Harper & Row, 1963); Donald McCloskey, "The Rhetoric of Economics," *Journal of Economic Literature* 31 (1983), 2: 482-504.
- 17 Eugene McCarraher, *The Enchantments of Mammon: How Capitalism Became the Religion of Modernity* (Harvard University Press, 2019).
- 18 Wikipedia, "South Sea Company."
- 19 Nobelist Ronald Coase dubbed unrealistic models "blackboard economics." *The Firm, the Market, and the Law* (University of Chicago Press, 1988), p. 19.
- 20 Median income is that of the typical household. Half are below and half are above the median.
- 21 "Income by Zip Code," <https://www.incomebyzipcode.com/search>.
- 22 Edmund Phelps, *Mass Flourishing: How Grassroots Innovation Created Jobs, Challenge, and Change* (Princeton University Press, 2013), p. 273.
- 23 Tyler VanderWeele, "On the Promotion of Human Flourishing," *Perspective PNAS* 114 (2017), 31: 8148-8156; <https://www.pnas.org/content/114/31/8148>. <https://opportunityinsights.org/>; Harvard has a program in human flourishing: <https://hfh.fas.harvard.edu/>; Yale offers a course on the good life: <https://news.yale.edu/2021/04/14/how-gain-sense-well-being-free-and-online>.
- 24 Heather Boushey, *Unbound: How Inequality Constricts Our Economy and What We Can Do about It* (Harvard University Press, 2019).
- 25 Martin Feldstein, "The U.S. Economy Is in Good Shape," *The Wall Street Journal*, February 21, 2016; <https://www.wsj.com/articles/the-u-s-economy-is-in-good-shape-1456097121>.
- 26 Gallup, "U.S. Life Evaluation," [www.gallup.com/poll/151157/life-evaluation-weekly.aspx](http://www.gallup.com/poll/151157/life-evaluation-weekly.aspx); <https://news.gallup.com/poll/315614/record-drop-life-ratings-partially-rebound.aspx>.
- 27 Vernon Smith and Bart Wilson, *Humanomics: Moral Sentiments and the Wealth of Nations for the Twenty-First Century* (Cambridge University Press, 2019).
- 28 "How selfish ... man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it." Adam Smith, *The Theory of Moral Sentiments* (A. Millar, 1759), I.I.1.
- 29 Amartya Sen, *The Idea of Justice* (Penguin, 2010).
- 30 "Alan Greenspan on Income Inequality," YouTube video, posted by "johnklin," September 28, 2007, @ 2:36. [www.youtube.com/watch?v=oqx88MyUSck](http://www.youtube.com/watch?v=oqx88MyUSck).
- 31 Zero unemployment is also advocated in William Dugger and James Peach, *Economic Abundance: An Introduction* (Routledge, 2009).
- 32 Peter Hall and David Soskice, *Varieties of Capitalism* (Oxford University Press, 2001).
- 33 Of the nine happiest countries in the world five are in Scandinavia. The others are Switzerland, the Netherlands, Austria, and New Zealand. [https://happiness-report.s3.amazonaws.com/2020/WHR20\\_Ch2\\_Statistical\\_Appendix.pdf](https://happiness-report.s3.amazonaws.com/2020/WHR20_Ch2_Statistical_Appendix.pdf); Figure 7. The ranking of the most livable cities is similar: <https://world-happiness.report/ed/2020/cities-and-happiness-a-global-ranking-and-analysis/>.
- 34 John Maynard Keynes, *The End of Laissez-Faire: The Economic Consequences of the Peace* (Hogarth Press, 1926).
- 35 Richard Easterlin, "The Economics of Happiness," *Daedalus* 133 (2004), 2: 26-33.
- 36 Gallup, "U.S. Life Evaluation," op. cit.
- 37 Some people are luckier in the choice of their parents than others. John Komlos, "Income Inequality Begins at Birth and These Are the Stats that Prove It," *PBS Newshour*. [www.pbs.org/newshour/making-sense/plight-african-americans-u-s-2015/](http://www.pbs.org/newshour/making-sense/plight-african-americans-u-s-2015/).

- 38 YouTube video, "Richard Feynman on Pseudoscience," <https://www.youtube.com/watch?v=tWr39Q9vBgo>.
- 39 Sigmund Freud, *The Unconscious* (Penguin Classics, 2005), first published as *Das Unbewußte* in 1915.
- 40 Perfect competition occurs when there are a very large number of buyers and sellers so that no one can influence the market price of a homogeneous product. There are no barriers to entry into the industry. No one has market power, so everyone is a price taker, accepting the market price.
- 41 John Harsanyi, "Games with Incomplete Information," Nobel Lecture, December 9, 1994.
- 42 David Cay Johnston, *Free Lunch: How the Wealthiest Americans Enrich Themselves at Government Expense and Stick You with the Bill* (Portfolio Books, 2007).
- 43 David Cay Johnston, *Perfectly Legal: The Covert Campaign to Rig Our Tax System to Benefit the Super-Rich—and Cheat Everybody Else* (Portfolio Books, 2003).
- 44 Joan Robinson, "Time in Economic Theory," *Kyklos* 33 (1980), 2: b219-b229.
- 45 Jeffrey Sachs, *Building the New American Economy: Smart, Fair, and Sustainable* (Columbia University Press, 2017).
- 46 William Dugger, "Dugger's Theorem: The Free Market Is Impossible," *Journal of Economic Issues* 39 (2005), 2: b309-b324.
- 47 "[T]he basic psychological assumptions on which mainstream (neoclassical) economics is based—though they have long since been disproved by actual psychologists—have colonized the rest of the academy, and have had a profound impact on popular understandings of the world." David Graeber, "Against Economics," *The New York Review of Books*, December 5, 2019.
- 48 Ha-Joon Chang, *23 Things They Don't Tell You About Capitalism* (Bloomsbury Press, 2011); Philip O'Hara, "Principles of Institutional-Evolutionary Political Economy – Converging Themes from the Schools of Heterodoxy," *Journal of Economic Issues* 41 (2007), 1: 1-42; see also the journal *Real-World Economics Review*.
- 49 Stephen Marglin, *The Dismal Science: How Thinking Like an Economist Undermines Community* (Harvard University Press, 2010).
- 50 Thomas Kuhn, *The Structure of Scientific Revolutions* (University of Chicago Press, 1962).
- 51 Robert Reich, *Saving Capitalism: For the Many, Not the Few* (Knopf, 2015).
- 52 Edmund Phelps, *Designing Inclusion: How to Raise Low-End Pay and Employment in Private Enterprise* (Cambridge University Press, 2003).
- 53 Irene van Staveren, *Economics After the Crisis: An Introduction to Economics from a Pluralist and Global Perspective* (Routledge, 2015).
- 54 Michael Sandel, "Populism, Liberalism, and Democracy," *Philosophy & Social Criticism* 44 (2018), 4: 353-359; here p. 354.
- 55 Steven Keen, *The New Economics: A Manifesto* (Polity, 2021); Sam de Muijnck and Joris Tieleman, *Economy Studies: A Guide to Rethinking Economics Education* (Amsterdam University Press, 2021); Geoffrey Schneider, *Microeconomic Principles and Problems: A Pluralist Introduction* (Routledge, 2019); Robert Samuelson, "It's Time We Tear Up Our Economics Textbooks and Start Over," *Washington Post*, June 23, 2019; Gerald Friedman, *Microeconomics: Individual Choice in Communities*, 4th edn. (Kendall Hunt Publishing, 2018); Andrew Mearman et al., "Whither Political Economy? Evaluating the CORE Project as a Response to Calls for Change in Economics Teaching," *Review of Political Economy* 30 (2018), 2: 241-259; The CORE Team, *The Economy: Economics for a Changing World* (Oxford University Press, 2017), <https://Core-Econ.Org/the-Economy/?Lang=En.>; Anonymous, "The Teaching of Economics Gets an Overdue Overhaul," *The Economist*, September 23, 2017; Stuart Birks, *Rethinking Economics: From Analogies to the Real World* (Springer, 2015); Jamie Morgan, "Necessary Pluralism in Economics: The Case for Heterodoxy," *Royal Economic Society Newsletter*, no. 167, October 2014, pp. 16-19; <https://www.res.org.uk/uploads/assets/uploaded/d0f470de-3d71-40db-92aa8d77b543b361.pdf>; Rod Hill and Tony Myatt, *The Economics Anti-Textbook* (Zed Books, 2010); see also *International Journal of Pluralism and Economics Education*.

- 56 B.F. Skinner thought that a good life was “a life of friendship, health, art, a healthy balance between work and leisure, a minimum of unpleasantness, and a feeling that one has made worthwhile contributions to one’s society.” Wikipedia, “B.F. Skinner.”
- 57 Amartya Sen and Martha Nussbaum, *The Quality of Life* (Oxford University Press, 1993).
- 58 In Pope John Paul II’s socio-economic encyclical, *Centesimus annus* (1991), both private property and the organization of labor unions are included among a variety of fundamental human rights.
- 59 “What Is Wellbeing?” <https://uwaterloo.ca/canadian-index-wellbeing/what-wellbeing>.
- 60 Joseph Stiglitz et al., *Mismeasuring Our Lives: Why the GDP Doesn’t Add Up* (New Books, 2010); Marc Fleurbaey and Didier Blanchet, *Beyond GDP: Measuring Welfare and Assessing Sustainability* (Oxford University Press, 2013).
- 61 Zero unemployment is also advocated in William Dugger and James Peach, *Economic Abundance: An Introduction* (Routledge, 2009).
- 62 David Shi, *The Simple Life: Plain Living and High Thinking in American Culture* (University of Georgia Press, 2007), p. 272.
- 63 Ibid.
- 64 Amartya Sen, *Rationality and Freedom* (Harvard University Press, 2002).
- 65 Franklin D. Roosevelt, “Speech Before the 1936 Democratic National Convention,” Philadelphia, June 27, 1936.
- 66 Article 25 (1948); [www.un.org/en/universal-declaration-human-rights/](http://www.un.org/en/universal-declaration-human-rights/).
- 67 This is congruent with the classical conception of liberty: “Society cannot exist, unless a controlling power upon will and appetite be placed somewhere; and the less of it there is within, the more there must be without. It is ordained in the eternal constitution of things, that men of intemperate minds cannot be free. Their passions forge their fetters.” Edmund Burke, *Letter to a Member of the National Assembly* (Dodsley, 1791), pp. 68–69.
- 68 This was also demanded by the “Occupy Wall Street” movement.
- 69 Ernst Schumacher, *Small Is Beautiful: Economics as If People Mattered* (Harper Torchbook, 1973).
- 70 Tibor Scitovsky, *The Joyless Economy: An Inquiry into Human Satisfaction and Consumer Dissatisfaction* (Oxford University Press, 1976); Harvey Leibenstein, *Beyond Economic Man: A New Foundation for Microeconomics* (Harvard University Press, 1976).
- 71 McCloskey, *Secret Sins*, op. cit.
- 72 Mark Blaug, “Ugly Currents in Modern Economics,” *Options Politiques*, September 1997, pp. 3–8.
- 73 [www.rethinkeconomics.org/](http://www.rethinkeconomics.org/).
- 74 Dani Rodrik, *Economics Rules: The Rights and Wrongs of the Dismal Science* (Norton, 2016); Samuel Decker et al., *Principles and Pluralist Approaches in Teaching Economics: Toward a Transformative Science* (Routledge, 2019); Frank Stilwell, *Political Economy: The Contest of Economic Ideas*, 3rd edn (Oxford University Press, 2011); Jeffrey Madrick, *Seven Bad Ideas: How Mainstream Economists Have Damaged America and the World* (Vintage, 2015); “Heterodox Economics Newsletter,” <https://www.heterodoxnews.com/HEN/home.html>; Jonathan Aldred, *Licence to Be Bad: How Economics Corrupted Us* (Allen Lane, 2019); Paul Krugman, “The Dismal Science,” *The New York Times*, September 25, 2014; The International Confederation of Associations for Pluralism in Economics, <https://icafe.org>.
- 75 Andrew Simms, “The New Reformation: 33 Theses for an Economics Reformation, December 12, 2017, <http://www.newweather.org/2017/12/12/the-new-reformation-33-theses-for-an-economics-reformation/>; David Boyle and Andrew Simms, *The New Economics: A Bigger Picture* (Earthscan, 2009); Editors, “What’s Wrong with the Economy—and with Economics?,” *The New York Review of Books*, March 14–15, 2015; the CORE Team, *The Economy*, op. cit.
- 76 The Institute for New Economic Thinking has similar aims: <http://www.ineteconomics.org>; <https://economicpluralism.org/>; <http://othercanon.org/>; <http://nature-economy.de/>.
- 77 Michael Lind, “The Strange Career of Paul Krugman,” *Tablet*, November 22, 2021.

18 *Welcome to Real-World Economics*

- 78 [www.degruyter.com/view/j/cas](http://www.degruyter.com/view/j/cas).
- 79 Bart Nooteboom, *Uprooting Economics: A Manifesto for Change* (Edward Elgar Publishing, 2019); Jamie Morgan, "The Contemporary Relevance of a Cambridge Tradition: Economics as Political Economy, Political Economy as Social Theory and Ethical Theory," *Cambridge Journal of Economics* 40 (2016), 2: 663-700.
- 80 Lorenzo Ductor et al., "On the Influence of Top Journals," *Cambridge Working Papers in Economics* CWPE2029, 2020; James Heckman and Sidharth Moktan, "Publishing and Promotion in Economics: The Tyranny of the Top Five," *Journal of Economic Literature* 58 (2020), 2: 419-470; Kevin Hoover and Andrej Svorenčik, "Who Runs the AEA?" Duke University CHOPE, Working Paper 2020-12.
- 81 YouTube video, "Joseph Stiglitz - 'Market Fundamentalism Is Dead,'" November 10, 2008. [www.youtube.com/watch?v=x\\_2Tv2GPs0](http://www.youtube.com/watch?v=x_2Tv2GPs0).
- 82 Ibid.
- 83 Deirdre McCloskey, "The Trouble with Mathematics and Statistics in Economics," *History of Economic Ideas* 13 (2005): 85-102.
- 84 Richard Feynman, "Cargo Cult Science," *Engineering and Science* 37 (1974), 7: 10-13.
- 85 George DeMartino, *The Economist's Oath: On the Need for and Content of Professional Economic Ethics* (Oxford University Press, 2011); Wilfred Dolfsma and Ioana Negru, *The Ethical Formation of Economists* (Routledge, 2021); Kenneth Boulding, "Economics as a Moral Science," *The American Economic Review* 59 (1969), 1: 1-12.
- 86 Herbert Simon, "Rationality in Psychology and Economics," in Robin Hogarth and Melvin Reder (eds.), *Rational Choice: The Contrast Between Economics and Psychology* (University of Chicago Press, 1986); Amos Tversky and Daniel Kahneman, "Judgment under Uncertainty: Heuristics and Biases," *Science, New Series* 185 (1974), 4157: 1124-1131.
- 87 B.F. Skinner, *Science and Human Behavior* (Free Press, 1965), pp. 62-71.
- 88 Rhys Manley, "Book Review," *Journal of Human Development and Capabilities* 21 (2020), 2: 209-210.
- 89 Paul Romer, "Mathiness in the Theory of Economic Growth," *American Economic Review: Papers & Proceedings* 105 (2015) 5: 89-93; Erica Thompson and Leonard Smith, "Escape from Model-Land," *Economics*, 13 (2019), 40: 1-15.
- 90 George Akerlof, "Sins of Omission and the Practice of Economics," *Journal of Economic Literature* 58 (2020), 2: 405-418; Marion Fourcade et al., "The Superiority of Economists," *Journal of Economic Perspectives* 29 (2015), 1: 89-114; here p. 91.
- 91 Daniel Saunders, "The Impact of Neoliberalism on College Students," *Journal of College and Character* 8 (2007), 5: 1-9.
- 92 Ronald Reagan, Inaugural Address, January 20, 1981, <https://www.presidency.ucsb.edu/documents/inaugural-address-11>.
- 93 Richard Easterlin, "Happiness and Economic Growth – The Evidence," in Wolfgang Glatzer et al. (eds.), *Global Handbook of Quality of Life* (Springer, 2015), pp. 283-299.
- 94 YouTube Video, "Bernanke Was Wrong." [www.youtube.com/watch?v=INmqvibv4UU&t=2s](http://www.youtube.com/watch?v=INmqvibv4UU&t=2s).
- 95 St. Louis Fed, series UNRATE and U6RATE.
- 96 "The collapse of the housing bubble will lead to a loss of between \$1.3tr and \$2.6tr of housing wealth," Dean Baker, "The Run-up in Home Prices: A Bubble," *Challenge* 45 (2002), 6: 93-119.
- 97 Graeber, "Against Economics," op. cit.