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Economic Socio- dynamics

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With 4 Figures
and 4 Tables

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Introduction

Economics has changed considerably over the past decades. Our main goal is to challenge the mainstream economic theory by removing the principle of individualism from its foundation, at least in that version which fails to recognize the existence of the interests of society as such, and does thus exclude the role of the state as an independent market player, which seeks to realize these interests. We fully recognize the difficulty of our task and the ways in which our effort challenges an analytical tradition that canonizes this postulate as a principle of methodological individualism.

Adherence to this principle transformed into an ideological directive gave birth to a dualistic attitude towards the state. On the one hand one cannot do without it; on the other hand, any activity of the state contradicts the postulate of individualism. In trying to find a solution to this paradox, economists engage in a permanent search for the possibility of 'harnessing' the state, and James Buchanan even brings it down to 'a set of techniques, machine and artefact'¹. Being a passionate proponent of methodological individualism, this student of Frank Knight and stalwart of Knut Wicksell is pleased to repeat the tirade of the famous Swede: 'If for an individual citizen utility is equal to zero, the aggregate utility for all members of society will be also equal to zero only and to nothing else but zero'². The given formula seems so perfect to Buchanan, that he uses these actually one-hundred-year-old words of Wicksell as an epigraph to one of the sections of his Nobel lecture.

But is the real world so simple? According to the authors of a new version of the report to the Club of Rome, researchers from the Santa Fe Institute, engaged in the study of a mathematical theory of chaotic systems, have coined an elegant proverb: 'In theory, theory and practice are one and the same, but in practice, they are different'³. Actually, in traditional theory the utility of any good is determined by its utility to individuals. In practice, we also find goods which are of use to society as such but absolutely useless to an individual. In our book we cite numerous examples to confirm this thesis. Economic science 'doesn't want' to notice this so-

¹ Buchanan J.M., Tullock G. *The Calculus of Consent: Logical Foundations of Constitutional Democracy*. Ann Arbor Paperbacks, 1962 (Russian Edition: Nobel Prize Winners in Economics. James Buchanan. – Moscow, 1997, p. 49).

² Buchanan, J.M. *The Constitution of Economic Policy*. In J.D. Gwartney & R.E. Wagner (eds.). *Public Choice and Constitutional Economics*. Greenwich, Connecticut, 1988 (Russian Edition: Buchanan J.M. *The Constitution of Economic Policy*. // Nobel Prize Winners in Economics. James Buchanan. – Moscow, 1997, p. 210).

³ E. Weizsaecker, A. Lovins and H. Lovins. *New Report to the Club of Rome*

cial utility as yet. The reason is the same: unconditional loyalty to the principle of methodological individualism.

The contradiction between the traditional theory and practice is revealed in the following parable, told however on another occasion: 'Once, an elderly economist was taking a walk with his small, well-mannered granddaughter. Suddenly the girl saw a 20-pound note lying on the road. "May I take it?" she asked her grandfather and he answered, "Leave it, darling. If it were genuine, somebody would already have taken it."'⁴. Economists refuse to accept the existence of a utility that the market itself doesn't manifest, and continue to insist that any utility must be reduced to individual preferences. The viciousness of methodological individualism proper, which makes both theory and practice '20 pounds' poorer, is reflected precisely in the conceptual narrow-mindedness of the above 'economic grandfather'.

The original premise of the traditional market theory saying that interests of society as such cannot exist, is just a statement and nothing more. The common thesis on the conventional nature of assumption seems to be a rather lame argument here. No agreement on basic theoretical assumptions can be eternal, since both the real world and the idea of it change. The phenomenon of the canonization of the theory always threatens to transform the science into religion.

This happened not only to Marxism. Such disease also threatens modern economic concepts. We witnessed how neoliberal theory became a purely ideological doctrine hostile to any state interference. As for the postulate of individualism, it was absolutized only in the 20th century. Earlier it was a subject of discussions, current results of which formed a pattern resembling a swing of the pendulum.

Up to the middle of the 18th century – during the era sometimes called the 'Big-Men-Society, where an individual with outstanding capabilities, kindness, and intellect became an outstanding person carrying out a fair trial and fair reallocation'⁵, — the idea of 'enlightened despotism' or 'paternal monarchy' dominated: a wise and fair monarch was believed to use his power to serve the public benefit. Under such conditions, no interaction of an individual and state could exist. Since all rights were usurped by the state, an individual had not a single one. Therefore the question of harmony of public and individual interests could arise only when individual rights appeared.

Tough protectionist barriers in combination with severe governmental directions and regulations of economic activities doomed the European countries of that time to the continuous economic stagnation. An urgent need for economic growth conditioned the demand for and prompt success of ideas of economic liberalism, which were first expressed and systematized by Adam Smith in his system of natural freedom.

We would like to emphasize two essential circumstances. First, due to Adam Smith, an individual interest as a foundation for the mentioned system has been legitimated in economic theory. This is where an everlasting conflict between theoretical approaches to the economic interaction of an individual and state has

⁴ Ibid., p. 207.

⁵ Koslowski P. *Gesellschaft und Staat. Ein unvermeidlicher Dualismus*. Stuttgart: Klett-Cotta Verlag, 1982 (Russian Edition – Moscow, 1998, p. 272).

come from. Second, according to Adam Smith, an individual and state are not inherently hostile. It is only later that the notion of their everlasting antagonism was established, any weakening of one of them meaning strengthening of the other and vice versa. According to Smith's theory, the state was – without any ideological pressure – objectively forced out to the edge of social structure, since unimpeded realization of self-interest was considered sufficient for socium's normal functioning.

A social idea historian once noted precisely that philosophers of the 18th century, including Smith, 'in their concept of individualism didn't separate the demand for individual freedom from the striving, even with the state support, for maximum possible development of most individuals'⁶. We would like to emphasize that Smith, unlike some of today's neoliberals, was not hostile to the state. After a long period of domination of mercantilism with its regulations binding any individual initiative, he gave government a more adequate role. What he meant was simplification of government tasks, not its abolition – the latter was suggested by Johann Gottlieb Fichte, individualist philosopher, Smith's contemporary, who designated a purpose of each government 'to make the government unnecessary'⁷. Lack of opposition of an individual and state in Smith's theoretical model came from his teleological belief in predetermined harmony of common and individual interests. Smith's belief in harmony gave rise to optimism penetrating his entire system of 'natural freedom'.

The 19th century swung the pendulum away from the triumph of individualism. Rapid development of bourgeois relations provided a kind of renaissance for comprehensive theoretical paternalism, giving rise not only to the liberation of individual initiative, but also to mass poverty, this time in the form of 'organic state', 'Utopian' and 'scientific' versions of socialism. The main rebuke of socialists to adherents of the natural freedom system with its self-regulatory market mechanism was its indifference to the suffering of masses. As a result, various collectivist projects came into fashion, intending to relieve peoples from poverty and inequity with the help of total supremacy of social interest, which – voluntarily or involuntarily – denied individual interests.

Since then, a long period of continuous ideological conflict between individual and public interests started. Due to approximately equal spread of individualistic (Say, Rossi, Bastiat, Menger, Walras, Marshall, etc.) and collectivistic (Hegel, Saint-Simon, Fourier, Marx, Schaffle, etc.) orthodoxy, the main stream of economic thought could not take a distinct shape at the end of the 19th century; it was split into two parallel streams of opposite social and economic views.

⁶ Michel H. L'idée de l'état. Essai critiquesur l'histoire des theories sociales eu politiques en France depuis la révolution. – Moscow: Tipografia Tovarishstva Sytina, 1909, p. 383.

⁷ Fichte J. Einige Vorlesungen über die Bestimmung des Gelehrten. In: Michel H. L'idée de l'état. Essai critique sur l'histoire des theories sociales et politiques en France depuis la révolution. – Moscow: Tipografia Tovarishstva Sytina, 1909, p. 68.

Under the severe economic depression of 1930s, their conflict reached its apogee in the first half of the 20th century, as the scale started to incline to collectivistic structures embodied in Russia (total socialization of property) and Germany (total socialization of people). Due to John Maynard Keynes, however, the theoretical tradition of economic liberalism laid by Smith began to revive. Having ascertained the chronic deficiency of effective demand, which no one could make up but the state, Keynes urged the latter to fight with a 'bias towards saving' inherent in individuals and stimulate consumption and investment using the targeted budget and monetary policy.

Keynes put forward a completely heretical thesis of necessity to 'establish centralized control in spheres mainly under private initiative. A state should control inclination to consumption partially by creating a proper tax system, partially by fixing an interest rate, and perhaps by other means'⁸. For all that, he did not doubt the viability of market economy in general and private property in particular. He wrote, 'Establishment of the centralized control necessary for ensuring full employment will certainly call for considerable expansion of traditional government functions. But opportunities for private initiative and responsibility will remain ample'⁹.

Thus at a new historical stage, Keynesianism turned out to be a concept that first confirmed the viability of a market as an economic mechanism, and, second, brought 'peaceful' (à la Smith) interaction of individual and social interests back into market theory. This aspect of Keynesianism should be emphasized, since at the end of the 20th century, some researchers were close to reckoning Keynes among socialists¹⁰. Actually, the essence of the Keynesian revolution was limited to complementation of a market's 'invisible hand' by a state's 'visible hand'. But still in the last quarter of the 20th century, the individualistic paradigm took the upper hand and again pushed the state to the edge of the social system.

We should stress that contemporary proponents of liberal economic doctrine didn't significantly advance in their perception of the role of government in a market economy. Adam Smith's thesis is at best reproduced today, i.e. two hundred years later, in saying that 'the economy needs no more of the state than is necessary.' At worst, we are faced with another slogan, 'The less state, the better for the economy.' In both cases a theoretical explanation for the criteria of interventionism is missing. However, if there was no obvious need for such substantiation in Smith's system of "natural freedom," today – when the powerful and systematic intervention of the state is firmly integrated into reproductive processes of any developed market economy – it seems absurd to limit oneself to the total critique of

⁸ Keynes J.M. *The General Theory of Employment, Interest and Money*. London, Macmillan, 1936 (Russian Edition – Moscow, 1993), p. 428.

⁹ *Ibid.*, p. 430.

¹⁰ See, for example, Howard K., Zhuravlyova G. *Principles of Economics of Free Market System*. — Moscow, 1995, p. 278.

the state, based on the purely ideological statement that 'any governmental activity is an evil imposed by some persons on other persons.'¹¹

Antistatism, established in the mainstream under the motto 'Back to Smith,' is rightfully associated with the names of Friedrich Von Hayek and Milton Friedman, who expressively described imaginary and real horrors of state interventionism. It is due to their works that the thesis of inherent stability of the market mechanism of self-regulation (malfunctioning due to state interference alone) returned to neoclassical theory. This 'Manichaeian' approach to the state (its treatment only in categories of good and evil) leaves no chance for an adequate interpretation of agents of contemporary economy.

Expansion of state activity, being an indisputable fact, requires an explanation 'without anger and prejudice,' regardless of whether it is excessive or not. However, the neoliberal doctrine seems to ignore this requirement, limiting itself to antistatist philippics of a normative nature. In this sense, neither numerous examples given by Friedman, nor severe Von Hayek's warning of dangers for liberty add to this explanation. The next attempt to resolve the 'damned' issue and settle a conflict between reality and its theoretical image was made by representatives of the institutional stream of economic thought.

Here, we should single out James Buchanan, one of the founders of the constitutional economic theory, in which the growing state influence still remains a strong allergen, but not every case of governmental interference arise protest. Buchanan considers theoretical grounds for 'correct' intervention from purely individualistic positions. According to the principle of methodological individualism, he allows any positive action of the state only if it corresponds to a unanimous decision of individuals regarding the goals which can be reached by them within a group.

It is hardly necessary to prove that such an approach to valuing real (not desirable) collective (state) decisions in the majority of cases does not correspond to reality. To present a variety of state activities as a result of consensus among all society's members means neither more nor less than to create another Utopian model.

It seems that the prolonged opposition of the state and individual in the economic theory has ended, and Francis Fukuyama's dream has come true. The pendulum stopped at the point of 'complete' triumph of individualism, proclaimed a gospel truth.

This is what became the main irritant for us, this is why we feel discomfort. Of course, one should feel greatly obliged to Ludwig Von Mises, Friedrich Von Hayek and James Buchanan, who (like Adam Smith in his time) used their powerful intellectual and moral potential to serve individual liberty, opposing any oppression of an individual by society. But still, aversion to state tyranny must not impede the development of the theoretical notion of *socium*, including its economic system.

¹¹ Mises L. von, *Liberalism in the Classical Tradition*. – Irvington on Hudson, New York, 1985, p. 57.

We clearly see the demand for and necessity of modernizing the postulate of individualism, particularly where the interests of society as a whole cannot be reduced to those of its individual members. We are in fact faced with a blatant contradiction between the general declaration that a modern market economy is 'mixed,' and a jealous and suspicious response to any attempts to limit methodological individualism as a governing principle. This contradiction cannot be solved within the framework of existing theoretical models. We are convinced that a 'mixed economy' is a practical projection of an as yet undeveloped economic theory of the 'third way.'

As James Buchanan put it, '...two "great alternatives," *laissez-faire* and socialism, are dying, and we can hardly expect their revival.'¹² On the threshold of the 21st century the need for an economic theory of the 'third way' became a categorical imperative. We hold that the concept of economic sociodynamics presented here constitutes the core of this theory. Having studied the evolution of the last three centuries of economic theory and modern economic practice, we have established the following pre-requisites for the above concept, the formulation of which is of the utmost importance.

First, we find many situations in which the market obviously does not function and the state must correct its 'failures.' After analyzing these cases, we conclude that they cannot in every case be motivated by individual interests. Other reasons also exist that induce the authorities to take action independently and even in spite of the interests of individuals. It is precisely these reasons that attract our attention.

Second, in observing the expansion of the zone of state involvement, we fail to sufficiently find convincing explanations of how these actions are related to the preferences of individuals. Despite sophisticated analytical contributions (such as the 'free rider problem', 'prisoner's dilemma', 'veil of ignorance', 'obedience paradox', etc.), this problem is not solved by those trying to identify an individualistic source of state intervention. In fact, the contradiction between the dominant trend in economic science toward minimizing governmental activities and increasing the role of the state in economic life even within developed market economies is becoming more acute. We believe that the specific interest of society, which differs from any aggregate of individual preferences, lies behind it.

Third, previous attempts to define and include this social interest in market models have obviously been insufficient. The social welfare function (A. Bergson, P. Samuelson), two utility functions (H. Margolis) and other similar constructions are nothing more than attempts to fit social interest into a 'Procrustean bed' of the postulate of individualism. By using this approach, everything is reduced to individual preferences, which supposedly embrace any social interest. That is why these models are unsuited for the analysis of society's specific needs.

Fourth, Richard Musgrave's attempts to integrate the concept of 'merit goods' into traditional market theory added doubt as to the universality of the postulate of

¹² Buchanan J. *The Limits of Liberty: Between Anarchy and Leviathan*. Chicago: The University of Chicago Press, 1975 (Russian Edition: Nobel Prize Winners in Economics. James Buchanan. — Moscow, 1997, p. 430).

individualism. The more than forty-year old discussion of the goods and services 'deserving' governmental support has produced two regularly reproducing points. On the one hand, society's specific needs (*merit wants*), which differ fundamentally from individual interests, are the object of analysis. On the other hand, we witness endless attempts to level this specificity with the aid of an individualistic argument for their existence. By analogy with biblical topic, we can say that during the same forty years the people of Israel managed to learn freedom again, modern economists managed neither to find meritocrats' place nor to reject this theory. Evidently, everything is not as simple as some authors, trying to explain any phenomenon exclusively from the individualistic standing, believe. A thorough study of the critical sources on meritocrats merely testifies to the assumption that the interests of society as such do exist.

Fifth, after reading a number of books on economics and related disciplines we have come to the conclusion that economic theory itself is unable to provide an answer to the question we are interested in. Almost every attempt to prove or disprove the assumption that any public interest is reduced to individual preferences ends up with a discussion of basic postulates, raising philosophical issues and transgressing the boundaries of economic theory. We mean the basic notions of *socium*, multitude of individuals forming it, and its structure. There is also a vivid contradiction between the modern understanding of *socium* and the postulate of individualism. We believe that canonization of this postulate is similar to an attempt to solve this contradiction, 'squeezing' the society structure into a strictly limited individualistic room. Therefore, the view from the point of social philosophy strengthens confidence in the necessity of modernizing the postulate of individualism.

Having formulated five major reasons that encourage us to carry out the theoretical research, we should mention one other. We could be reproached for superficiality or even worse for ingratitude, if in this introduction we said nothing about the philosophical foundation for the concept of economic sociodynamics and did not mention in this regard the influence of Ilya Prigogine's works on our understanding of *socium*. His postmodernist vision of the universe has altered our own picture of the world. We have realized that the growth of entropy and a system's tendency towards equilibrium are not the only trend. The real intrigue in the dynamics of all physical and social systems consists in the counterpoint of NECESSITY and CHANCE. Determinism in the equilibrium formation exists parallel to stochastic processes of its destruction. The dominance of equilibrium is only one more assumption of traditional economic theory.

We proceed from more universal notions of society seeing it as a multitude of individuals in constant change and fluctuation, who act independently and in various groups. Here all sociodynamic processes reflect both negative and positive reverse interdependences and are described on the basis of an original analogue of Prigogine's theorem: if obstacles appear in the way of an equilibrium, the stationary state of the *socium* corresponds to minimal entropy, and the energy of disturbance is transformed into interest inherent to the social system as a whole; the latter thus adopts a new qualitative level.

In other words, any disruptive impetus observed in society on a daily and hourly basis (such as changes in the environmental situation, an increased need for education, science, culture, growing differentiation in the population's incomes, a decline in the competitiveness of a branch which is important for a country, simply the development of a new product or technology, etc.) generates two consequences. In the first case, fluctuation is suppressed, a new equilibrium emerges and the disruptive energy is absorbed by the dynamics of individual preferences. In the second case, the fluctuation energy does not dissipate in new individual biases; it, instead, is preserved, even encouraging the formation of societal interest as such.

The first situation obviously is merely a specific case of economic sociodynamics. If a negative reverse interdependence is observed (the mechanism of the 'invisible hand' is attributed to it alone), then entropy increases, the energy of disruption decreases, fluctuations become less intense and disappear. Under conditions of a competitive market and the reducibility of needs, changing demand generates a corresponding supply reaction, and a new market equilibrium arises. If the phenomenon of positive reverse interdependence gives birth to increased fluctuation and their energy rises, new qualities arise in a social system, and an interest of society as such is formed which fails to be reflected in individual preferences. It is clear that this aspect of the dynamics of the socium, as well as its transposition to new levels of complexity, fundamentally contradicts with the postulate of individualism.

Doubting that this basic assumption, customary for economic theory, is well-grounded, we want to express our active disagreement with canonization of the principle of methodological individualism whether by Ludwig Von Mises, Viennese patriarch, or James Buchanan, our contemporary from Virginia. No eternal truths exist in science. And we believe that the time has come to revise the postulate of individualism. It is here that we find additional opportunities for development of economic theory. One of these opportunities is reflected in the concept developed by the authors of this book, which aspires to become the core of a 'third way' economic theory.

* * *

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