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(08) 2011 *Intellectum,* pp. 010-017

An ideological bubble

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The period of crisis is a time of realization and reflection- especially when, just like at the present juncture, the crisis is multileveled – not only economic but also moral, cultural and political. It is a period of controversies even for those who used to or strangely still side with the 'religious' doctrine of the free market.[1] But what exactly is the issue of controversies? Is it the 'golden boys' and the uncontrolled granting of mortgage loans or the whole ideological structure of the free market as it was theoretically justified?

What is under question now is the viability of the system itself, which has been imprinted on our conscience as something natural, 'un-historical', above politics, namely as something mythical.[2] Thus, in order to examine and interpret the present crisis in a rudimentary 'logical' way, one must dethrone the free market system (i.e. to reject the idea that this is an inevitable system, which just happens to walk on thin ice) and strip it from any cloak of naturalness, universality, scientificity and eternity.

The three main myths, upon which the ideology of the free market was founded, are the following: 1) man is a rational being 2) the invisible hand regulates the market and 3) the market is efficient. This essay will focus on one of the most significant mistakes of the economical theory, the myth of rationalism, which constituted the cornerstone of the conception of homo economicus, as well as of the Efficient Market Hypothesis. The

[1] For a better approach to the issue of the relationship between economy and religion, see Robert H. Nelson, Economics as Religion: From Samuelson to Chicago and Beyond, PENNSYLVANIA STATE UNIVERSITY PRESS, 2002.

[2] Roland Barthes, *Mythologies,*Kedros, Athens, 1979.

axioms, according to which human beings –while acting rationally– seek exclusively the maximization of profit and the market as a sphere of economic transactions is always balanced, proper and extremely efficient, were shaken to the core by the 2008 crisis. Therefore, we are not facing just a financial bubble, but an ideological one as well.

The Homo Economicus

According to the classical economic theory, the economic man is rational and solely cares for his personal interest. The idea of homo economicus was outlined by John Stuart Mill: "[Political economy] does not treat the whole of man's nature as modified by the social state, nor of the whole conduct of man in society. It is concerned with him solely as a being who desires to possess wealth, and who is capable of judging of the comparative efficacy of means for obtaining that end".[3]

Furthermore, this concept is often linked to Adam Smith and David Ricardo's ideas of the human being as an economic agent. According to the thinkers of the 19th century, man pursuits profit and tends to comply with the rules of economic logic. The pursuit of profit becomes an innate feature of human nature and this tendency is articulated by a discourse which projects that "every man is by nature prone to speculation ... No law prevails over profit... The profit is the core of the trade cycle".[4]

[3] John Stuart Mill, ESSAYS ON SOME UNSETTLED QUESTIONS OF POLITICAL ECONOMY, 2nd ed. Longmans, Green, Reader & Dyer, London, 1874, p. 97. Available in the website: http://www.efm.bris.ac.uk/het/mill/question.pdf

[4] Heilbroner Robert L., THE WORLDLY PHILOSOPHERS: THE LIVES, TIMES AND IDEAS OF THE GREAT ECONOMIC THINKERS, Kritiki Publications, Athens, 2000, pp. 51 and 453.

The homo economicus model has certainly suffered severe criticism from economic anthropologists, such as Marshall Sahlins,[5] Karl Polanyi,[6] Marcel Mauss,[7] Maurice Godelier,[8] who demonstrated that in traditional societies, people were making decisions about the production and exchange of products on the basis of the mutuality principle. In pre-capitalist economies, the motive for the production was not the personal interest but the fear of social condemnation, ostracism and the loss of social prestige and social status.[9]

One of the greatest discoveries of modern historical and anthropological research is that man's economic activity is ruled by his social relations. Human beings do not act in order to protect their personal interests, but their social status, social claims and social resources.[10] In reality, no one acts so rationally in one's constant struggle for the maximisation/minimisation of one's 'utilities and non-utilities', one's profits and costs.

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[5] Marshall Sahlins, *The Original Affluent Society* [in:] MARSHALL SAHLINS, STONE AGE ECONOMICS, Routledge, London, 2003, pp.1-40.

[6] Karl Polanyi, THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME, Nissides Publications, 2001, translation by Kostas Gaganakis

[7] Marcel Mauss, THE GIFT, THE FORM AND REASON FOR EXCHANGE IN ARCHAIC SOCIETIES, Routledge, London, 2006

[8] Maurice Godelier, THE ENIGMA OF THE GIFT, University of Chicago Press, Chicago, 1999.

[9] A.J.H.Latham, Karl Polanyi: SOME OBSERVATIONS, University College of Swansea, International History Seminar, Institute of Historical Research, pp.2-3. Further descriptions of the function of pre-capitalist economies can be found in the work of Karl Polanyi, Conrad M. Arensberg, Harry W. Pearson, TRADE AND MARKETS IN EARLY EMPIRES: ECONOMIES IN HISTORY AND THEORY, Free Press, 1957, Karl Polanyi, THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME and Bronislaw Kasper Malinowski, ARGONAUTS OF THE WESTERN PACIFIC: AN ACCOUNT OF NATIVE ENTERPRISE AND ADVENTURE IN THE ARCHIPELAGOES OF MELANESIAN NEW GUINEA, George Routledge & Sons, 1922.

[10] Allan Carlson, THE PROBLEM OF KARL POLANYI, The Intercollegiate Review, 2006, pp.6 Karl Polanyi, THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME, pp.57

And no one is led to a decision solely by what one thinks of as personally useful or beneficial – one must choose from an accessible environment, is affected by the community, one's preferences reflect several means of social influence more or less random from an 'economic' point of view.[11]

According to Bourdieu, individuals carry their economic habits ('economicus habitus') into their economic activities, which link their future actions to their past experience. For Bourdieu, the concept of homo economicus describes "a kind of anthropological beast". That's why the human being acts logically rather than rationally in his economic activity.[12]

Furthermore, several economists, such as Thorstein Veblen,[13] John Meynard Keynes,[14] Israel Kirzner,[15] Herbert Simon,[16] criticized the concept of homo economicus as an agent that has perfect knowledge of macroeconomics and can make right decisions by predicting the future. The factors that define the decision-making process are the uncertainty and the bounded rationality. Consequently, the concept of the rational individual, who is fully aware of all the circumstances that influence his decisions, who in

[11] Kornilios Kastoriadis, THE RATIONALITY OF CAPITALISM, Ipsilon Publications, Athens, 1997, pp.38.

[12] Neil J. smelser, Richard Swedberg, THE HANDBOOK OF ECONOMIC SOCIOLOGY, Princeton University Press, 2nd edition, 2005, pp.18.

[13] Thorstein Veblen, *"Why is Economics not an Evolutionary Science?"*, QUARTERLY JOURNAL OF ECONOMICS, VOL.12, 1898, THE THEORY OF THE LEISURE CLASS (1899).

[14] John Maynard Keynes, Chapter XXVI, *"The Application of Probability to Conduct",* A TREATISE ON PROBABILITY, Cosimo, Inc. New York, NY, 2006, pp.313.

[15] Israel Kirzner, Chapter 2 *"The Entrepreneur",* COMPETITION AND ENTREPRENEURSHIP, University of Chicago Press, Chicago, IL, 1973, pp. 30-87.

[16] Herbert Simon, *Economic Analysis and Public,* Models of Bounded Rationality, V.I., 1984.

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other words attains the perfect information, is not encountered in the actual economic activity.

Although homo economicus is just a model – an unrealistic ideal type, it constituted the foundation of the assumptions that prevailed in the orthodox economics. Indeed, the greatest achievement of capitalism on a symbolic level was the anthropological mutation: the destruction of the previous social significances and the creation of homo economicus, who is led by the economic motive and tends to substitute all others.[17]

The Efficient Market Hypothesis

The myth of rationalism revived during the 1970s, after the Great Depression during the 1930s, which caused the total deprecation of the orthodox economists as well as the free markets. The Chicago School of Economics has been the Mekka of thought on issues concerning the free market economy. The professors of University of Chicago, with Milton Friedman as the most popular representative, argued that Keynes's theory, which highlighted the significance of state intervention in the markets, proved to be unsuccessful. According to the professors, it would be best if the fund management was carried out by the markets rather than the bureaucrats. The prevailing rhetoric was the following: the markets know better. They have the ability to diffuse the risk. They collect and circulate the information. They regulate universal economic issues with such speed and determination that no government can reach.[18]

[17] Kornilios Kastoriadis, THE RATIONALITY OF CAPITALISM, Ipsilon Publications, Athens, 1997, pp. 30-31.

[18] Paul Krugman, *Who was Milton Friedman*, THE NEW YORK REVIEW OF BOOKS, February 15, 2007.

The University of Chicago and particularly the economist Eugene Fama formed a theory which is known as "Efficient Market Hypothesis, EMH".[19] This is a theory, according to which the current values of the stock prices reflect accurately and directly every relevant and available information. According to the hypothesis, this occurs due to the existence of many investors who think and act rationally and competitively, maximizing their utility and trying to predict the future prices of their portfolio securities.

Therefore, what this hypothesis declares is that stock markets are highly competitive and consist of numerous rational and informed investors, who seek to buy shares in low prices and sell them in a higher price, in order to maximize their profit. According to the Efficient Market Hypothesis, the variations of stock prices result from the new information and do not depend on any other factor, such as the retail investors' state of mind (optimism, pessimism, fear, greed), which cannot affect them.

The most essential hypothesis of the theory is the one which indicates that investors act rationally, aim at the maximization of their utility and have 'rational expectations', which they adjust as soon as they receive new information, being collectively aware of the significance of every available information. The rational investors are not systematically wrong in their estimations. Even in the case of wrong choices, these happen randomly and have no impact on the market balance. In other words, the market is always right.[20]

[19] For a more detailed description of the term see, Eugene Fama, *Efficient Capital Markets: A review of Theory and Empirical Work,* JOURNAL OF FINANCE 25 (2), 1970, pp. 383-417. Eugene Fama, *The Behavior of Stock Market Prices,* JOURNAL OF BUSINESS 38, 1965, pp. 34-105. Paul Samuelson, *Proof That Properly Anticipated Prices Fluctuate Randomly*, INDUSTRIAL MANAGEMENT REVIEW 6, 1965, pp. 41-49.

[20] Joe Nocera, *Poking Holes in a Theory on Markets,* The New York Times, June 5, 2009.

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The Efficient Market Hypothesis, which constituted the doctrine of economic science since the beginning of the 1970s, began to suffer some serious hits, when the economic psychology emerged with important representatives, Richard H. Thaler[21] from Chicago University and Robert J. Shiller[22] from University of Yale, who showed that the mass psychology, the herd behavior and human emotions have a huge impact on the stock prices, suggesting that, after all, the market is not that efficient. According to the economic psychology, the behavior of the human being is neither rational nor mechanical, but rather neurotic. The human being tends to follow the crowd, doesn't always succeed in planning his future and makes mistakes quite often. At this point, a quotation of Richard H. Thaler's interview in the Financial Times is worth being presented: "conventional economics assumes that people are highly rational- super-rational- and unemotional. They can calculate like a computer, and they have no self-control problems. Real people are not like that".[23] What is extremely interesting is that the new generation of economists, who declared the dominant belief that the market is rational and efficient, tried to scientificize, that is to use mathematics in order to prove its hypothesis. More particularly, the Efficient Market Hypothesis constitutes the field of application of the modern tools of econometrics and the 'random walk model' is the common mathematical expression of the abovementioned general hypothesis. In fact, the frequent use of math in

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[21] Richard H. Thaler, *The Winner's Curse: Paradoxes and Anomalies of Economic Life,* PRINCETON UNIVERSITY PRESS, Princeton, 1964. Richard H. Thaler, *Quasi Rational Economics,* RUSSEL SAGE FOUNDATION, New York, 1994.

[22] Robert J. Shiller, *Market Volatility,* MIT PRESS, 1990. Shiller Robert, George Akerlof, *Animal Spirits,* PRINCETON UNIVERSITY PRESS, Princeton, 2009

[23] David Orrell, ECONOMYTHS: TEN WAYS ECONOMICS GETS IT WRONG, John Wiley & Sons Canada, Canada, 2010, p.111. Reference in the interview: *"Long View Part 3,Real People's Economics"*, FINANCIAL TIMES (online video), 29 April 2009. Online: http://video.ft.com/v/62681182001/Apr-29-Long-View-Part-3-Real-people-economics

economics during the second half of the 20th century can be ascertained in the total number of pages that were published each year in the most important journals of the field.[24]

This fact is of great importance because the axiom of scientificity attributes a valid basis to the theory, a theory which, we should not forget, constituted the guide of governmental economic policy and did not remain in the narrow context of the academic community. The legalization of modern orthodox economics derives from Science. According to Milgram, who engaged in the circumstances and the terms of obedience to authority to the point, what guarantees that the order will be seriously taken into consideration and won't be resisted to is that it is presented as a part of a scientific process. Whatever takes place in the experiment is suggested and legalized by Science.[25] As Milgram puts it, "the idea of science and its acceptance provides the primordial ideological legitimacy of the experiment".[26]

[24] Gerard Debreu, "*The Mathematization of Economic Theory",* AMERICAN ECONOMIC REVIEW*,* March 1991, Vol.81 No.1, p.1-7. Since 1933, when they started getting published, until 1959, these magazines were Econometrica and the Review of Economic Studies, and their contents manifest the reduction of printed pages from the high level over 700 pages in1935 to a lower level of under 400 pages in 1943 and 1944. However, 1944 signaled the point of departure of a period of explosive development, during which Econometrica and the Review of Economic Studies bound with the International Economic Review in 1960, with the Journal of Economic Theory in 1969 and with the Journal of Mathematical Economics in 1974. In 1977, these five magazines were publishing the total amount of 5000 pages. During 1944-1977, the contents were almost doubled every nine years.

[25] Yannis Stavrakakis, *"Peripheral Vision: Subjectivity and the Organized Other: Between Symbolic Authority and Fantasmatic Enjoyment"*, ORGANIZATION STUDIES, 29(7), 2008, 1037-59.

[26] Stanley Milgram, OBEDIENCE TO AUTHORITY, Harpercollins, New York, 1974, p.142

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The increasing use of mathematics in economics certainly caused the criticism of significant economists such as Friedrich Hayek, [27] and John Meynard Keynes,[28]who contemplated that human behaviour cannot be systematized and interpreted by the language of mathematics. The criticism of mathematization of economics emphasized mainly the following points: the axioms of mathematical economics do not correspond with real world behaviour, the number of the empirically testable hypotheses generated by mathematical economics is small compared with the volume of mathematical economic analysis, much of the economics is not naturally quantitative and therefore does not lend itself to mathematical exposition, the translation of the description of economic processes from a natural language to mathematics can be naïve and illegitimate, there is no objective way to gauge whether mathematical economics is more precise than less mathematical economics, and last, because of all the above problems, mathematics is often an unnecessary adornment to economic discovery about the real world, but serves other purposes.[29]

The most recent movement against the tendency of mathematization and the subsequent restriction of alternative methods of economic issues approach began in 2000 with an online petition declaring that neoclassical economics, or for one their uncontrolled application in tutoring or research, ended up “autistic”. The students named their movement “Post-Autistic Economics” and they soon triggered a national discourse in France. Almost 200 French economists welcomed this protest, which accused economics of being a fantasy world immersed in “pathological” false scientific

[27] Friedrich Hayek, *“The use of knowledge in society”,* THE AMERICAN ECONOMIC REVIEW, 35 (4), September 1945, pp.519-530.

[28] John Meynard Keynes, GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY, 297.

[29] Clive Beed, Owen Kane, “*What is the Critique of the Mathematization of Economics* ”, KYKLOS 44 (4), 1991, p.583.

mathematics and opposed to the rational "novel writing" of orthodox economics, because it ignores the factors that often define the behaviour of homo economicus. The ideas of "heterodox" economists were collectively published via the journal Post-Autistic Economic Review (http://www.paecon.net).[30] In June 2001, 75 economists from 22 countries met in Kansas and composed the Kansas City Proposal,[31] which criticized the fact that the orthodox economics set aside the cultural, social, political, moral and historical dimensions of the economic process.[32]

The use of mathematic models can surely prove useful, but according to the historian of economic thought Geoff Harcourt, "always pose the economics of an issue first, and then see whether some form of mathematics may be of use in solving the problems thrown up".[33] The economist and mathematician Edward E. Leamer agrees: "The great economists involved in this principle because they were interested in the social problems and they thought of economics as a tool for addressing and solving them." "But the discipline has become more and more model-driven. A mathematician is uninterested in the problem. He's interested in the degree of difficulty of the proof, or the surprise

[30] There is a lot of material that accompanies the whole tendency of changing the method of economic analysis in the 2001 issues. I quote some of the most typical article titles: André Orléan, "*Humility in Economics"*, Edward Fullbrook, "*Real Science is Pluralist"*, Tony Lawson, "*Back to Reality",* The Cambridge 27, "*Opening Up Economics"*, Paul Ormerod, "*Beyond Criticism"*, Steve Keen, "E*conomists Have No Ears",* Ben Fine, "*An Extraordinary Discipline"*, Michael A. Bernstein, "*Rethinking Economics in 20th Century America"*, Jason Potts and John Nightingale, "*An Alternative Framework for Economics"*.

[31] An International Open Letter to all economics departments, "The Kansas City Proposal", 13 August 2001. "The field of economic analysis must be expanded to encompass the following: a broader conception of human behaviour, the recognition of culture, the consideration of history, a new theory of knowledge, an empirical grounding, expanded methods, interdisciplinary dialogue".

[32] Peter Monaghan, "*Taking on `Rational man",* THE CHRONICLE OF HIGHER EDUCATION, JANUARY 24, 2003

[33] Geoff Harcourt, "*A Good Servant but a Bad Master*", POST-AUTISTIC ECONOMICS REVIEW, Issue No.6, 8 May 2001.

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nature of the theorem. Those value systems are fine in mathematics, but they're very destructive in economics".[34]

Jeremy Grantham, one of the most significant British investors stated that "in their desire for mathematical order and elegant models, the economic establishment played down the role of bad behaviour – not to mention 'flat-out bursts of irrationality'".[35] Newton puts it with the most accurate way: "I can calculate the motion of heavenly bodies, but not the madness of people".

The most crucial difference between science and economics is rather the relative role of concepts, equations and empirical data. Classical economics is built on very strong assumptions that quickly become axioms.[36] However, the most dangerous of all is the fact that these certainties replaced even the empirical observation. In contrast to the economists, scientists are always suspicious of axioms and their models. If the empirical observation is not compatible with this model, then one either ignores it or corrects it. Unfortunately, such kind of healthy scientific revolutions haven't occurred in economics, where ideas have been established and have taken the form of doctrines that "dominate" both academics and decision-makers of governments and financial institutions.

Conclusion

A whole generation of orthodox economists with almost religious devotion accepted a theory, which has a fundamental error in its core: the principle of rationalism. But, if people complied with certain principles of rationalism, then they should use and

[34] Peter Monaghan, "*Taking on `Rational Man",* THE CHRONICLE OF HIGHER EDUCATION, JANUARY 24, 2003

[35] Joe Nocera, "*Poking Holes in a Theory on Markets",* THE NEW YORK TIMES, June 5, 2009.

[36] JP Bouchaud, "*Economics needs a scientific revolution*", REAL-WORLD ECONOMICS REVIEW, Issue No.48, 2008.

respond rationally to every available information, make necessary calculations and be aware of all possible future events. And, naturally, if the economic agents acted rationally, then there would be no room for bubbles - that is irrational reactions of the market. [37]

The Information Technology bubble and the recent real estate bubble, which was the beginning of the circle of failures in economic theory and practice – and the closure is nowhere yet to be found – damage the supposed omniscience and efficiency of the free market, indisputably proving that markets are not efficient, humans tend to be over-focused in the short-term and blind in the long-term, and errors get amplified through social pressure and herding, ultimately leading to collective irrationality, panic and crashes.[38] Free markets are wild markets. It is naive to look for signs of rationalism in their agents and functions.

[37] Shiller Robert, George Akerloff, *Animal Spirits*, Princeton University Press, Princeton, 2009, p. 12

[38] JP Bouchaud, "*Economics needs a scientific revolution*", REAL-WORLD ECONOMICS REVIEW, Issue No.48, 2008.