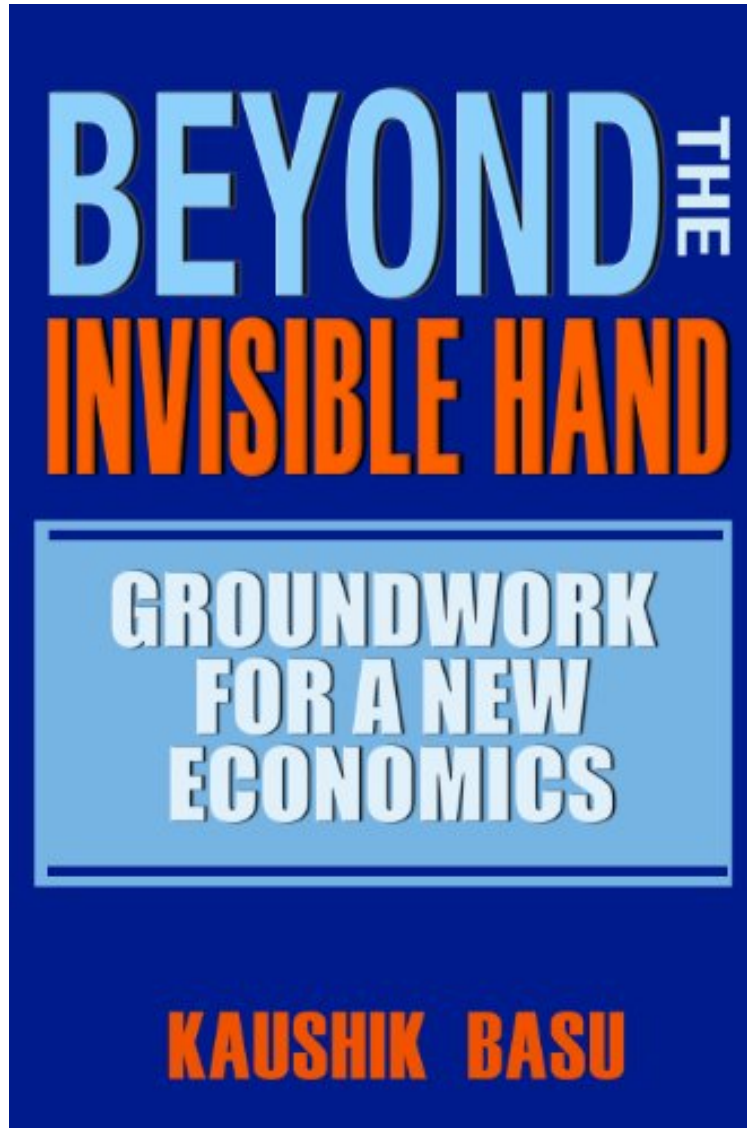


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## Beyond the Invisible Hand: Groundwork for a New Economics

*Kaushik Basu*

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**Kaushik Basu : Beyond the Invisible Hand: Groundwork for a New Economics** before purchasing it in order to gauge whether or not it would be worth my time, and all praised Beyond the Invisible Hand: Groundwork for a New Economics:

0 of 0 people found the following review helpful. A Masterful Tour de Force of Economics By Ravi Morey Kaushik Basu, the chief economist at the World Bank, had produced a masterful tour de force. He investigates in exquisite detail the reasons for the failures of conventional economic thinking and the need for a radical alternative. I highly recommend this book for anyone seeking radical changes in the current global economic order. My only criticism is that I find his faith in the possibility (however remote) of creating a society where the principle "from each according

to his ability, to each according to his needs) to be touching but naive. Such a society may be possible with cyber beings but is certainly not possible with human beings. The whole history of the twentieth century stands as testament.

0 of 1 people found the following review helpful. A modern view of economics. By Edoardo Angeloni Basu sustains the economic theory of Adam Smith, that is the invisible hand theory. It is the usual polemic between welfare and free market. The author uses literature arguments, particularly about Kafka and Saramago, for describing the bureaucratic aspects of the modern State, where the individual man is lost. The game theory is ruled by the preferences model, but so this follows from the existence of social norms around the traditional culture. That produces an economy where we have an equilibrium following the Pareto conditions.

14 of 15 people found the following review helpful. Thoughtful and penetrating synthesis of humanism and economic theory. By Herbert Gintis. As Basu says in the final chapter of this thoughtful and penetrating volume, *Beyond the Invisible Hand* "tries to lay the groundwork for a manifesto, but cannot pass for one." Basu stands clearly and firmly in two traditions. The first is progressive humanism, for which the goal of social policy is to create conditions that promote the well-being and dignity of all morally worthy citizens of all countries. I am sure some will violently disagree with this goal, for instance asserting that the goal of social policy is protecting property and ensuring contracts, but I consider Basu's dream no more controversial than the goal of eliminating infectious diseases. The second tradition is that of standard economic theory, in the tradition of Adam Smith's *Wealth of Nations*, and as taught and practiced in virtually every institution of higher education around the world. Small minds that cherish progressive humanism respond to economic theory (called "the dismal science" because the realities it models render humanist ideals difficult to attain) by rejecting the theory without serious critique. Small minds that cherish modern economics respond to progressive humanism (called "bleeding heart liberalism") with contempt rarely associated with serious critique. The virtue of Basu is that he is a very large mind. This book is his attempt to adjudicate humanism and modern economic theory. Why bother? Because, says Basu, economic theory has truths that are essential to recognize if we are to build decent societies, but economic theory alone cannot formulate the conditions for the good life. There are three points in Basu's argument. The first is that economic theory models only one, albeit very important, dimension of economic life: buying and selling on markets. "In reality," Basu notes, "human beings choose not just from budget sets but also from the many other things that they can do." (25) They also barter, perform charitable acts, help family and friends, volunteer for social service, form collusive alliances (crony capitalism), spread rumors, conceal transactions, misinform consumers, offer bribes, and kill or otherwise neutralize enemies. Basu stresses that such actions are simply disjoint from market interactions, but actually facilitate or undermine the role of markets in promoting social and individual welfare. This quote is just so accurate that it deserves special mention: "Successful societies rely on individual honesty and integrity, appropriate codes of behavior, the ability to communicate, and the possession economy-friendly social norms much more than economists have been willing to concede." (43) It follows from this that we require an economic theory that jointly models market competition and social norms (see my book, *The Bounds of Reason*, Princeton 2009). Basu's second point is that laws are focal points that coordinate human behavior, and they are nothing more than that. This is a very deep point, and seems counter-intuitive. For instance, suppose a law is passed limited the speed on a certain road to 65 mph. Then a motorist will obey the law because a police officer might otherwise issue him a costly citation. But why will the police officer do this? He does so because, in turn, he will be punished by his captain if he does not issue speeding tickets. But why with the captain punish him? He does so because... and so on down the line. Basu's point is that if we remove the law, no single individual has an incentive to change his behavior, given that the others maintain their behavior. The law creates what game theorists call a Nash equilibrium, and is a focal point in the sense of Thomas Schelling. The central implications of law as focal point are twofold. The first is obvious: if a law does not create a Nash equilibrium, then it will not be followed. In other words, laws must always include the appropriate incentives for the law to be effective. This is of course well known but widely violated, especially by corrupt and oppressive governments. The second implication is that "if a law...can cripple an economy...then the same can happen even in the absence of such a law." (69) In other words, pathological social practices can just as much be responsible for dysfunctional economies as perverse laws and official bureaucracy. This is a brilliant argument, but Basu's formulation leaves out precisely the moral content of laws. Horace famously noted that laws are futile unless they conform to the moral precepts of the citizenry. We might also add that laws themselves can create a moral force where there was none, individuals conforming to the law not only because it is in their material interest to do so, but also because they consider the law as expression a moral truth that they are willing to embrace. I do not think that this emendation of Basu's principle undermines his second point, but it does undermine the first. If laws reinforce our personal morality, they need not be all Nash equilibria of the game, because we are willing to sacrifice to conform to the law. Of course, once we admit social preferences, such laws become Nash equilibria in larger games in which preferences and the rules of the game interact. Such is life. There is a second major problem with Basu's argument--one with which must surely agree. If we withdraw the law, no single agent will change if all the others maintain their previous behavior. However, expectations might very well change. If the 55 mph speed limit law were rescinded, the motorist might believe that the policeman has no longer any reason to give him a ticket, because he knows that the policeman will believe that his superior will not reprimand him for not giving speeding tickets. How does the

policeman know this? He uses the same reasoning as the motorist. In short, unless we believe all agents have strong beliefs that expectations will not change, when the law is rescinded, behavior will undergo a quick and perhaps radical transformation. Of course, the above reasoning is really a critique of the whole notion that social norms merely "pick out" Nash equilibria. This is a common notion, comforting to methodological individualists, but quite problematic, if not simply wrong. Basu's third big idea is that the Principle of Free Contract, according to which any agreement between two mature, sane, individuals that does not harm third parties should in principle be permitted. This principle knows of no exception in economic theory, although every economist knows that there are a host of voluntary transactions that are prohibited in all known modern societies. For instance, if I am rich and I like to eat human eyes with my eggs at breakfast, and if every day there is some poor soul who is willing to sell one of his eyes to feed his starving family, a voluntary exchange between the two individuals is illegal in virtually every society. In most societies, all trade for bodily organs is prohibited. The logic underlying what voluntary trades are and are not permitted is a deep and unknown issue. Basu's goal is to determine when such economic institutions as child labor and yellow-dog contracts (a worker signs an agreement not to join a union as a condition of employment) should be permitted following the Principle of Free Contract and when they should not. Basu's argument is subtle and nuanced, and does not come to any particular conclusion. He argues that even though any one instance of, say, child labor, should be allowed according to the principle, when such an institution becomes universal, it can be deeply inefficient. For instance, one more child worker will not change the adult wage, but if all children work, the adult wage will fall. There might be a second equilibrium in which no children work and the adult wage remains high enough to support the non-working children. The hucksters who are looking for quick answers to social issues will be soon bored with this deeply nuanced book (I remember once giving a talk at the New School for Social Research in New York, after which an agitated graduate student informed me that my ideas would "confuse the workers" who must make the revolution. I had no answer for him). For the thinking person, Basu's work is a great gift.

One of the central tenets of mainstream economics is Adam Smith's proposition that, given certain conditions, self-interested behavior by individuals leads them to the social good, almost as if orchestrated by an invisible hand. This deep insight has, over the past two centuries, been taken out of context, contorted, and used as the cornerstone of free-market orthodoxy. In *Beyond the Invisible Hand*, Kaushik Basu argues that mainstream economics and its conservative popularizers have misrepresented Smith's insight and hampered our understanding of how economies function, why some economies fail and some succeed, and what the nature and role of state intervention might be. Comparing this view of the invisible hand with the vision described by Kafka--in which individuals pursuing their atomistic interests, devoid of moral compunction, end up creating a world that is mean and miserable--Basu argues for collective action and the need to shift our focus from the efficient society to one that is also fair. Using analytic tools from mainstream economics, the book challenges some of the precepts and propositions of mainstream economics. It maintains that, by ignoring the role of culture and custom, traditional economics promotes the view that the current system is the only viable one, thereby serving the interests of those who do well by this system. *Beyond the Invisible Hand* challenges readers to fundamentally rethink the assumptions underlying modern economic thought and proves that a more equitable society is both possible and sustainable, and hence worth striving for. By scrutinizing Adam Smith's theory, this impassioned critique of contemporary mainstream economics debunks traditional beliefs regarding best economic practices, self-interest, and the social good.

"Alluring. . . [Basu's] latest book, subtitled *Groundwork for a New Economics*, aims to show that many economists have dogmatically accepted capitalist theories as fact and have failed, as a result, to scrutinize their own discipline. . . . Basu devotes the bulk of the text to deconstructing some sacrosanct tenets of capitalism that have become entrenched in government policy over the past 60 years."--Timothy R. Homan, *Bloomberg* "A most interesting and . . . a most significant book. . . . Basu's book is the first serious study of the modern myth related to the 'Invisible Hand' I have seen anywhere."--Gavin Kennedy, *Adam Smith's Lost Legacy* "Basu has rethought and modernized socialism in this book. He has done so without cluttering it up with Marxist jargon or abstract mathematics; the worst the reader will encounter in this book is game theory, which, though it is not all fun and games, is pretty easy to follow. It is a book worth reading by the socialist types who run our country, as well as those who need to understand socialism to dissent from it."--*Business World* "[A] very rewarding read. . . . This is Basu's most ambitious and rewarding book, and it works--there's no public policy debate in India it's not relevant to."--*The Economic Times* "This book should be read by anyone interested in economics for its in-depth thinking, although its targeted readership is more basically professional economists."--Wladimir Andreff, *European Legacy* "Beyond the Invisible Hand will be useful to political economists who want to see how game theory can shed light on the ways that groups and races of rational actors may assume surprising dynamics. It could also be useful to policymakers who must justify arguments about group policies in standard economic terms. [The] author's contributions to political economy deserves to be taken seriously."--Jonathan Schlefer, *Perspectives on Politics* From the Back Cover "Defly, with the carefully chosen anecdote, and the sparing but subtle thought experiment, Kaushik Basu again and again dispels the myth that the invisible hand of free

markets leads to the best of all possible worlds--indeed, often far from it. With great wisdom, *Beyond the Invisible Hand* describes the frequently shocking consequences of the free markets of modern economic theory; it also sets the agenda for where that theory needs to go next."--George A. Akerlof, Nobel Laureate in Economics and coauthor of *Animal Spirits and Identity Economics*"In this remarkable tour de force, Kaushik Basu scrutinizes the foundational assumptions of economics and asks new and important questions. In his quest for a better and more equitable society, Basu leaves no room for complacency. This thought-provoking book will generate debate in the economics profession and beyond."--Justin Yifu Lin, chief economist, World Bank"*Beyond the Invisible Hand* poses a fundamental challenge to the way that economists think about many of the most important issues of economic theory and policy. Written for both economists and educated laymen, the book lays out a new vision for economics, one that will stimulate the reader to rethink current practice and give deeper consideration to issues often slighted in contemporary economic analysis. While the reader may not always agree with Basu's prescriptions, the importance of his contribution to the debate over the future of economics cannot be ignored."--Steven G. Medema, University of Colorado, Denver"With standard economic perspectives under question, the need for alternative perspectives is great. Eminently readable and timely, this book is appropriate for general readers and professional economists."--Arjo Klamer, Erasmus University

About the Author  
Kaushik Basu is professor of economics and the C. Marks Professor of International Studies at Cornell University. He is currently chief economic advisor to the Ministry of Finance of the Government of India. His books include *Prelude to Political Economy: A Study of the Political and Social Foundations of Economics* and *Of People, of Places: Sketches from an Economist's Notebook*.