Mario Fabbri

The Imaginary Economy

la fabbrica
delle illusioni

cover
M.C. Escher's "Waterfall"

The image on the cover, like many others of M.C. Escher, is available from the site www.mcescher.com

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Argument of the book

There are plenty of economists,
it is economic science that is not there.
Sergio Ricossa[1]

The aim of this text is to present a conception of the economic system that is new and more appropriate than those current today, the weaknesses of which I examined some years ago in *La fabbrica delle illusioni*. [Factory of Delusions].

Suffice it to think of their inability to make robust predictions or of the irremediable contrasts between opposing theoretical schools. It is a kind of diatribe that would be given short shrift in any serious science.

The conclusion was that economic theories are not born out of dispassionate study of economic facts, as economists are usually mere factious propagandists of a political line: free-market or centralist.

They imitate physicists in their lavish use of mathematics, which does not, however, serve to make their predictions more precise but only to give a scientific look to fantastic constructions that are detached from reality.

It is an instrumental use that leads them to make egregious mathematical mistakes that would immediately come to light if mathematics were to be used for concrete purposes. In this regard, see *On the futile use of mathematics in economic theories,* here in the *Appendix*.

And my criticisms were certainly not isolated, as today there is almost a specific branch of essays specifically aimed at bringing economics to task. Just look at the title of the essay *Open letter to the economic gurus who take us for morons*, by the economist Bernard Maris, tragically killed in the Islamist attack of January 2015 in Paris at *Charlie Hebdo.*[a]

But a simple argument lays bare the futility of current doctrines:

> To build theories of human economic behaviour, what sense can there be to rely on highly sophisticated mathematical constructions, as economists do, while carefully avoiding any consideration, as if it were irrelevant, of what sociologists, psychologists and historians have observed on the ways men behave?

[a] The French title was *Lettre ouverte aux gourous de l'économie qui nous prennent pour des imbéciles* but the book has not been translated into English.

Here in fact, to present our new ideas we will not use mathematical formulae, but consider those socio-psychological mechanisms that are so important to human behaviour but are ignored by economists.

And we will not confine ourselves to generically recommending a new and better road for future research, but will make strides along it by developing the crucial concept of the imaginary economy in which we aim to incorporate the huge mass of activities that today are considered 'economic' but do not in fact produce goods or real services – like those in the medical field – and essentially only carry out the function of distributing income to many other members of society.

From this new perspective, it becomes surprisingly easy to understand a large number of behaviours and developments that are crucial for the economy but which are normally ignored by economists.

The logic that we will examine impacts all human societies to some extent, but here we will focus on its most spectacular outcomes that can be seen in the rich and technically advanced societies of our time.

A note to end with: some readers might be disturbed by the forthright tone of some of my remarks. My intention is to present some ideas for the reader's critical consideration that seem to me deserving of attention and reflection, while keeping them as simple and clear as possible and without watering them down with too many mitigations or precautions.

Such an attitude would only have the effect of dragging out the discussion without ever producing a perfect result immune to criticism. Not the right choice for a text it has been my intention to keep concise and readable.

The text is divided into three parts:

- a presentation of the basic factors that produce the *imaginary economy*;
- a quick review of its more relevant logics and characteristics;
- an inquiry into why its presence escapes common awareness.

► For a quick overall view of the terrain which we will cover, you can read the short *Story of the Ylati country*, here in the *Appendix*. I wrote it several years ago, to present simply and clearly for the benefit of acquaintances some of the logics that are developed here in much greater detail. Some readers have found this a clever detour.

FIRST SECTION

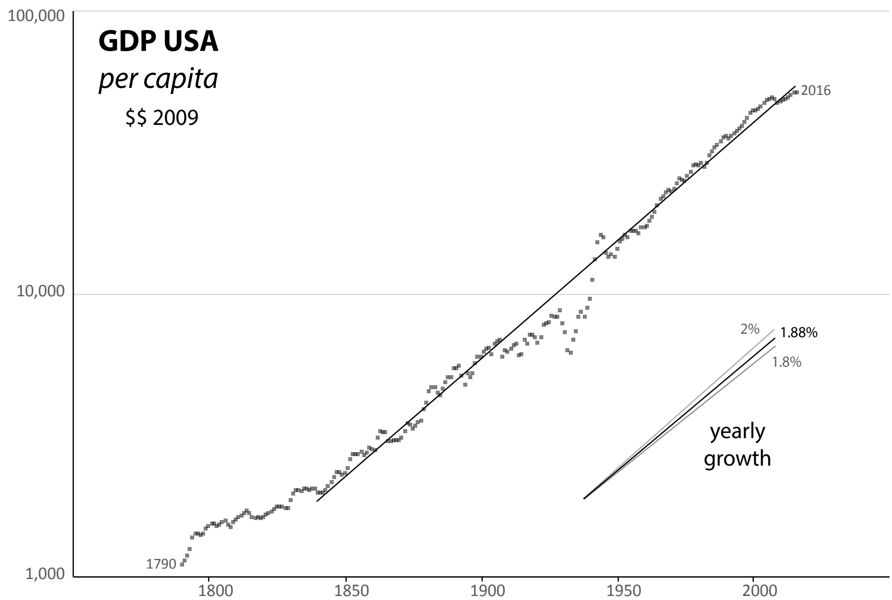
The factors in play

1. A different view of economic development

The object of our investigation is the *imaginary economy*: the growing part of the economic system that claims to be 'productive' and is not.

To assess it fittingly, we need a new repertoire of concepts that we will now present. The reader is warned that what he will find here is in irreparable contrast to the conceptions now current among experts.

The most straightforward way to present the new logic is to start with the trend in average real income in the United States from the country's birth to the present day:[a]



The vertical axis is not linear but logarithmic, so that a constant growth rate is shown as a straight line: the steeper the slope, the faster the growth.

[a] Source: Louis Johnston and Samuel H. Williamson, "*What Was the U.S. GDP Then?*" MeasuringWorth, 2017 – *www.measuringworth.org/usgdp/* Time-frame: 1841-2016; regression quality: R^2 = 0,98 and F = 9541 for 174 degrees of freedom.

Now, from the 1840s to the present day the economy, which has grown by a factor of 25, has clearly followed a straight line, albeit with small oscillations at the beginning, the famous 19th century *economic cycles*, and the dramatic zig-zag of the Great Depression of the 1930s.

But, with the exception of these temporary irregularities, average US income has grown at an incredibly stable rate of 1.9% per year for 170 years.[a]

Over this long time-span everything has fluctuated in the American economy: import-export policies – protectionism/free market – interest rates, foreign exchange rates, the political climate, the amount and destination of investments…

What are we to think then of the adamant statements of economists and politicians that the adoption of this or that policy, dear or odious to their hearts, had or would have really changed the situation of the country?

What are we to think if the American economy, apart from some limited fluctuations, from which it always recovered perfectly (!), continued to grow undeterred at the same rate for longer than a century and a half?!

I was certainly not the first to see this, but so far it has remained one of those curiosities that economists pay little attention to, in keeping with their tradition of ignoring what they are unable to explain.

And finding an explanation was impossible for them, because the trend of average US income is at irreparable variance with the ideas developed by economic theory along the road it took two and a half centuries ago.

In fact, its extraordinary linearity clashes with the idea proposed by Adam Smith in 1776 and basically upheld by most until today, that a country's economic growth is the simple outcome of the expansion of its production sector.

But – let's ask ourselves – how could the combination of the somewhat random sequence of inventions and technological innovations and the

[a] It must be stressed that this linearity depends on how correctly deflation has been calculated by the specialists, in other words, on the fact that this income in deflated dollars accurately reflects the levels and movements of *consumption* as affected by the inertia and psycho-sociological resistances that we will speak about later.

ever-changing investment decisions of industrialists produce such a steady growth rate over such a long period of time?

Such linearity, however, also suggests what a different road theory might have taken, because the remarkable stability of this 1.9% leads us to suspect that there is some ‘physiological limit’, different and more stringent than mere production capacity, that has put a cap on the growth rate of per capita income.

The most logical explanation is that the speed at which American society assimilates new forms of consumption has precise and very stable limits.

In other words, the thought crosses one’s mind that having achieved independence and following an initial period of adjustment,[a] US society set about raising its standards of living as fast as its ‘nature’ allowed, and that, this nature, has remained remarkably unchanged to the present day.

We will see how easy it is to find elements supporting the existence of *a speed cap for assimilating new forms of consumption*, and we will explore its impact on economic development.

Now we have two premises… the first is that we will use the term ‘consumption’ with a broader meaning than is common, equating it simply to the usage of income for any purchase, regardless of the purpose.[b]

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[a] A first visible sign of the sunset of the old ‘colonial climate’ is perhaps the election to the Presidency, in 1828, of Andrew Jackson, a man of the frontier, instead of the usual member of the traditional upper classes.

[b] This is tantamount to saying that there is no difference if Mr. Smith spends $100 on tobacco, a hoe, a picture or twenty shares in ACME Ltd. In other words, we do not ask ourselves whether he wants a hoe because he is a farmer, that is for an economic goal, or to cultivate his garden which he loves to look after himself, as classical economists would do, because they consider it essential to ascertain whether the intention behind the purchase is ‘economic’ or not. So they distinguish between an antiques dealer who buys a picture at an auction to sell it on, making an investment, and a private individual who purchases it at the same auction to hang on a wall in his home, triggering a mere act of consumption. They say that the picture purchased by the dealer is part of his ‘capital’, and the one bought by the private individual is not, unless he at some point decides to sell it. And since selling it is a typical option in the mind of real estate owners, they say that real estate is always capital. It is a nice case of hair splitting. To lovers of the history of ideas I can say that this use of the term consumption does have a precedent in the ‘naïve’ terminology of Pierre Le Pesant de Boisguilbert (1646-1714).

In fact purchases, *whatever the reason for them*, always feed the activities of the production system to some extent. And Keynes refers to their overall amount as *aggregate demand*.

Within this he ascribes a central role to the portion, distinct from consumption, called *investment* because – in this remaining faithful to Smith – he believes the expansion of the production system to be the direct cause of general prosperity. Our ideas are different and we can simplify the terminology.

The second premise is that we will reflect more on the consumption of tangible goods than of services, because tangible goods are the ones that are truly essential. And simplifications, if they lead us to focus on their logic, may actually be beneficial.

Furthermore, a distinction has to be made between health services and services such as tax consultancy but it is difficult to make this clear, at least until we explain what should be understood by "the imaginary economy".

So let's begin by pointing out that in a society every form of consumption corresponds to a *habit*, a part of everyone's normal way of life, or to a *novelty* that is finding a place among pre-existing *habits*.

And this *finding a place* is usually the result of a typical process: from its first introduction in innovative social environments to its subsequent wider adoption that changes the habits of a large part of the population.

And here we must consider that changing one's ways of life, even for the better, always entails a certain amount of stress and therefore, even if the flow of attractive available novelties were extremely rapid, some limit in the speed of their possible adoption *must surely exist*.

Let's imagine, for example, the effects of a systematic rise in consumption of – say – 7% per year:

> there would be a doubling of living standards in ten years, a four-fold increase in twenty, an eight-fold multiplication in thirty…
>
> three quarters of a sixty year old man's consumption patterns would have come into use after his fortieth birthday, and he would have to ex-

> pect similar changes in the next twenty years, so that by the age of eighty, he would be living his last years in a world where forms of consumption had multiplied 256 times compared to those of his early childhood.

This is surely not compatible with the rate of adaptation of any possible human society.

Novelties and changes can be useful and fascinating but they also engender a psychological cost and if the cost is too high we just stick to our old habits. This *must* put a cap on the growth speed of living standards *and so of economic development.*

Could this *resistance to change* be the factor which for nearly two centuries has kept the growth in American society anchored so precisely to 1.9% whereas – we have to think – technical and productive factors might have allowed a faster growth?

Here is a first clue pointing in this direction: in early 19th century Britain, the Industrial Revolution and with it the adoption of machinery triggered *an unusually rapid* supply of goods. It was precisely at this point that a number of 'under-consumptionist' authors began to note a resistance in society to raising consumption habits at the same speed, thus pinpointing the real limit to economic growth.

Thomas Malthus in 1820:

> [The history of human society sufficiently shows] that an efficient taste for luxuries and conveniences, that is, such a taste as will properly stimulate industry, instead of being ready to appear at the moment it is required, is a plant of slow growth…[a] and that it is a most important error to take for granted, that mankind will produce and consume all that they have the power to produce and consume…[2]

But nearly all other economists were euphoric about the impressive advances of the manufacturing system and championed its unconditional expansion: it was their absolute conviction that the human desire to consume is insatiable and so any increase in production – unless 'wrongly aimed at unwanted goods' – could always be profitably sold to the public.

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[a] In this quotation, as in others, '…' indicates the omission of part of the original text. It seemed to me less heavy than '[…]'.

Ricardo against Malthus:

> We all like to buy and consume, the difficulty is in the production.[3]

Now, the idea that production is the crucial problem has been correct in many historical situations and in *La rovina delle nazioni* [The downfall of nations] I examine five such occurrences: from the fall of the Roman Empire to the economic crisis in 17th century Italy.

But not all situations are the same: for example, the great German sociologist Max Weber, in contrast with orthodox economists, writes, with some overstatement:

> Man does not 'naturally' wish to earn more and more money, but simply to live, to live as he is accustomed to live, and to earn what is necessary to that end.[4]

All things considered, the most balanced formulation, also quoted by Keynes in the *General Theory*, comes from the two under-consumptionists Mummery and Hobson:

> … in the normal state of modern industrial Communities, consumption limits production and not production consumption.[5]

2. Economic cycles and post-war periods

That orthodox economists did not clearly understand the new situation created by the *industrial revolution* is proved by their inability to find an explanation for the recurring *commercial crises* which, in their ruinous sales collapses, seemed to justify Malthus' thesis.

In the 19th century economic crises occurred with amazing regularity, one per decade. From a study of the end of the century: 1818, 1825, 1836, 1847, 1857, 1864, 1873, 1882, 1890.[6]

At a certain point it was suggested that they could be linked to the 11-year sunspot cycle, but the explanation did not hold water, like so many other theories produced in more than a century of futile brainstorming.

And yet, as early as 1837, it was observed that these crises were part of cycles which followed a precise logic:

> We find [the state of the economy] subject to various conditions which are periodically returning; it revolves apparently in an established cycle. First we find it in a state of quiescence, next improvement, growing, confidence, prosperity, excitement, overtrading, convulsion, pressure, stagnation, distress, ending again in quiescence.[7]

This print was produced in 1859,[8] after two more cycles that faithfully followed that sequence:[9]

Today there continue to be discussions about *economic crises*, but no longer about the *economic cycle*, because the neat regularity of the 19th century has disappeared, helping economists to forget about what they are unable to explain.

Until, in the second part of the 20th century, the phenomenon to some extent faded away, reflections on it were numerous but inconclusive.

For example, in 1927:

> As knowledge of business cycles grows, more effort is required to master it… Early writers upon “commercial crises” could assume that they and their readers were familiar with the phenomena to be explained… [But nowadays] elaborate preparations have become necessary, not because the direct attacks upon the problems proved futile, but because they won so many and such different results. Every investigator of the cause of commercial crises seemed to make out a case for the hypothesis he favoured.[10]

And in 1958:

> The old-fashioned pastime of making business-cycle theories is once more in style. But the theories produced in recent years differ in a fundamental way from their predecessors…[11]

These are two fine examples of the art with which ‘experts’ hide their failure to understand questions within their field of competence…

But, how can it be possible for such a widespread, repetitive phenomenon not to have a rather simple explanation?

And in fact, from the under-consumptionist perspective, it is easy to explain both the origin of the crises and – even more significantly – the reason why they occur so regularly.

As early as 1819, in the post-Napoleonic crisis that followed the sudden fall in the demand for military supplies, the Swiss historian and under-consumptionist Simonde de Sismondi, declared it was caused by a surplus of production with respect to consumption.

He was worried by the spread of machinery which increased production too much, at the same time reducing workers’ wages and consumption:

> … Entrepreneurs adjusting their production not to the needs of society, which they should be taking care of, but on the basis of their capital,

> thus making more products than can be consumed… When consumption is limited and cannot grow… the invention of a machine that replaces many men with an inanimate force is a disaster, because the inventor rather than use it to make life better for his workmen, uses it to kill the workmen of his rival.[12]

It is the same syndrome that in future will lead States to sign international agreements to prevent too many too efficient (!) steel plants being built[a] and to penalise or destroy 'excess' agricultural production.

So Sismondi, who like Keynes had centralist proclivities, 120 years earlier suggests that, in order to prevent a crisis, it is up to the State to "cool down the economy":

> There are cases where, by moderating the pace of the economic system and arresting unordered growth, [the government] would render a great service to society.[13]

But the most persuasive element in favour of under-consumptionist conceptions is that by taking into account the *speed limit on the rise in consumption* we find a simple explanation for the regularity of these cycles which remained mysterious for so long. From *La fabbrica delle illusioni*:

> [In economic cycles] only two players take the stage: consumption, limited by socio-cultural factors, which can only grow [say…] at a rate of 2% per year, and production which, limited only by technological and organisational constraints, can increase much faster… But the efforts of production cannot succeed because they come up against the insurmountable barrier of the capacity to consume: one, two, three, more times …[b]

This also suggests that the subsequent mitigation of the phenomenon is due to the transition from the vehement productive accelerations of the first industrial revolution, to the present day when the fact that the

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[a] On these topics avoided by free-marketeers see Perelman, *Railroading Economics*.
[b] From *Fabbrica delle illusioni*, p. 236, cf. p. 234 ff. for a more detailed analysis of this issue.

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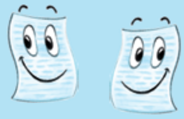

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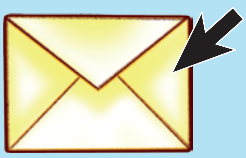

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