THE GREAT TRANSFORMATION PART 2: MORE ON MARKETS

The first two posts in this series are:

The Great Transformation: Mainstream Economics and an Introduction to a New Series

The Great Transformation Part 1: The Market

In Part 1 I discussed the definition of markets in *The Great Transformation*, and noted that Karl Polanyi gives a definition, while mainstream neoliberal economic theory doesn't. The absence of a definition in neoliberal theory is crucial to its success. Neoliberal economists do not have to account for the vast differences among markets: they can treat all markets as identical for purposes of their mathematical edifices.

Polanyi's simple definition enables him to discuss the differences among markets and the different purposes they serve in different societies. In the Mercantilist era, say up to about the early 1800s, Polanyi identifies three different kinds of markets: external, internal and local. Local markets serve the local community as in the case of householding societies. Polanyi says they are not intrinsically competitive, nor are they focused on gain. P. 61

External markets are for long-distance trade, what Polanyi identifies as the carrying trade. They form at natural stops along the trails of transport, at river crossings and ports. They do involve gain, and the propensity of some people for truck and barter, but they are limited to specific sites and specific goods. They are not essentially competitive, Polanyi says. Over time, long-distant market sites turn into towns, and their principle purpose is to manage external trade. They are not a function of the nation state, but of those towns, which work to keep their long-distance markets apart from the lives of those in the countryside.

> The [Hanseatic League] were not German merchants; they were a corporation of trading oligarchs, hailing from a number of North Sea and Baltic towns. Far from “nationalizing” German economic life, the [Hanseatic League] deliberately cut off the hinterland from trade. The trade of Antwerp or Hamburg, Venice or Lyons, was in no way Dutch or German, Italian or French. London was no exception: it was as little “English” as Luebeck was “German.” The trade map of Europe in this period should rightly show only towns, and leave blank the countryside—it might as well have not existed as far as organized trade was concerned. P. 66.

The third kind of market, the internal market, is a deliberate creation of the nation-state. As Polanyi explains it, the towns worked to maintain the separation between long distance and local markets, as a matter of self-protection of the town and of the town officials and elites. They feared the destructive impact of mobile capital on their existing institutions, and on their prerogatives and status.

> Deliberate action of the state in the fifteenth and sixteenth centuries foisted the mercantile system on the fiercely protectionist towns and principalities. Mercantilism destroyed the outworn particularism of local and intermunicipal trading by breaking down the barriers separating these two types of noncompetitive commerce and thus clearing the way for a national market which increasingly ignored the distinction between town and countryside as well as that between the various towns and provinces. P. 68-9.

This classification of markets by their reach is convenient for the story Polanyi is telling, but there are modern counterparts. In many cities around the country, but especially in Europe, say Paris, there are local market streets, where you can find your daily food and your minor needs, like a plate to replace the one that mysteriously broke. There are weekly or bi-weekly markets where you can find all sorts of things, from a sweater to a giant vat of choucroute garnie, with nearly black juniper berries punctuating the Toulouse sausages and the hunks of pork. These are just like the local markets Polany describes, and just as important to daily life in these otherwise impersonal cities.

Scattered throughout the city, there are stores focused on specific area of France, Auvergne butchers, stores selling Charolais beef, Perigord stores, with their jars and cans of confit du canard, and many others, wine shops specializing in Champagnes or wines from Burgundy. These stores connect people to their roots in the country, and might be regarded as internal markets.

In the wealthier parts of the city there are other kinds of markets. You can find African, Indian and Near Eastern textiles and jewelry, and lots of similar things. There are shops selling Italian shoes and clothes, branded and unbranded. There is fantastic jewelry and jeweled pieces from world makers, and at prices that bug out the eyes. Each of these kinds of stores are grouped together, so that a person searching for antique French furniture only has to visit a few streets to get a good sense of what is available. This view of consumer culture reinforces Polanyi’s view that a market is a place.

Of course, standard economics rejects this simple definition. Here’s a typical reaction, from Santhi Hejeebu & Deirdre McCloskey (H/T commenter Alan)

> …Polanyi never got over the

> noneconomist’s inclination to think of markets as literal marketplaces, rather than relationships among people in many different places…

The authors are both economists, so this is not a mistake. Their definition of a market is “relationships among people in many different places. Let’s try an example. In *BKB Properties, LLC v. SunTrust Bank*, (MD Tenn. 2011) the owners of the plaintiff wanted a fixed rate loan from SunTrust Bank to build a new building for their car dealership. SunTrust would only agree to a floating rate loan, and offered to sell plaintiff an interest rate swap to create a synthetic fixed rate. Plaintiff agreed. Several years later, when interest rates fell in the wake of the Great Crash, BKB’s owners wanted to refinance the note, and when SunTrust refused, plaintiff exercised its right of prepayment. SunTrust refused to accept the prepayment and release the mortgage on the land unless the plaintiff paid a stiff penalty to cancel the interest rate swap, which had a 10 year term, while the note was prepayable. The Court ruled for SunTrust, saying that this is just a routine contract case, and that the parties are assumed to understand the terms of the documents they signed.

Note that SunTrust could have purchased a swap to protect its interests more intelligently than BKB Properties, Ltd., a shell corporation set up by a car dealer. SunTrust could have canvassed offers from several banks and hedge funds, which at least sounds like a market.

But on the given facts, was this a market transaction? In the world of Hejeebu and McCloskey it certainly is. After all, these are two parties with some kind of relationship who are in different places. Swap creators don’t post prices, don’t disclose transactions in any usable way, and according to the Court don’t have any duties to their customers. The relationships that Hejeebu and McCloskey talk about are limited to Buyer Beware, and that’s good enough for them.

In Polanyi's world, maybe not. At that time, there was no physical place one could go to buy and sell swaps, at least if you were a car dealer in a suburb of Nashville, TN. Specifically, there was no analogue to the stock market, or an electronic exchange. There was no place to find data, no place to find alternative bids, no quote sheets, and there was often negotiation over the terms of a swap which affected its value to both parties, again with no transparency to outsiders who might have learned of its existence. In sum, there was no place for any activity that sounds market-like.

Definitions matter. Polanyi's definition gives us a good idea of what he is talking about, and his three kinds of markets are useful and convenient in his analysis. How do we talk sensibly about the "swaps market"? In what way is it like the market for choucroute garnie?

THE GREAT TRANSFORMATION PART 1: THE MARKET

The Great Transformation by Karl Polanyi opens with a discussion of the changes in industrial societies in the 1920-30, which he says wiped out the social structures of the 19th Century. His explanation of that change begins with a history of markets, and their role in creating what he calls the market society. In mainstream economic theory, there is no definition of the term market, as I discuss here. I found a definition of market economy in Economics by Samuelson and Nordhaus, 2005 ed. p. 26.

> A market economy is an elaborate mechanism for coordinating people, activities, and businesses through a

> system of prices and markets. It is a communication device for pooling the knowledge and actions of billions of diverse individuals. P. 26.

This is obviously not an analytical definition. I argue here that it means that a market economy is any economy except a command and control economy.

Polanyi takes a completely different tack in defining the term market. He begins with a discussion of the way economies functioned in the earliest societies. Production and distribution of goods, he says, are based on three different schemes. In some societies, all production from hunters and gatherers is shared as needed, a principle of reciprocity. In some, all such production is given to one person, a headman or a chief, whose responsibility it is to distribute them properly, a principle that Polanyi calls redistribution. The third principle is householding. In these societies, the basic unit of production is the household which may be as small as an extended family or much bigger. Each household is responsible for providing itself with its needs. In each society, the motives of production and of exchange of products are different, and each shares some facets of each of these three principles. Here’s Polanyi:

> Broadly, the proposition holds that all economic systems known to us up to the end of feudalism in Western Europe were organized either on the principle of reciprocity or redistribution, or householding, or some combination of the three. These principles were institutionalized with the help of a social organization which, inter alia, made use of the patterns of symmetry, centricity, and autarchy. In this framework, the orderly production and distribution of goods was secured through a great variety of individual motives disciplined by general

> principles of behavior. Among thee motives gain was not prominent. Custom and law, magic and religion cooperated in inducing the individual to comply with rules of behavior which, eventually, ensured his functioning in the economic system. P. 57

Polanyi says that Aristotle drew a distinction between householding and production for gain. The household produced for its own needs. When production exceeded its needs either accidentally or purposefully, it sold the remainder for money to buy things it could not produce. Aristotle and Polanyi do not see this as a movement away from the basic system of householding, so long as the excess production could otherwise have been used by the household.

The genius of Aristotle is his recognition that the sale of the excess was motivated by a search for gain, not by the relations inherent in the society itself or in any household. Inside the groups, the basis of exchange remains what it was before, such as distribution by the head of the household. But gain was the primary motive for activity in the open markets. Here’s Polanyi on this difference:

> In denouncing the principle of production for gain as boundless and limitless, “as not natural to man,” Aristotle was, in effect, aiming at the crucial point, namely, the divorce of the economic motive from all concrete social relationships which would by their very nature set a limit to that motive. P. 57.

It’s here we find Polanyi’s definition of the term “market”:

> A market is a meeting place for the purpose of barter or buying and selling. P. 59

Polanyi explains that standard economics is based on some other understanding of the term markets, and that his research shows that the facts contradict every element of the standard definition and the role of markets in society before Mercantilism took over.

> The reasons are simple. Markets are not institutions functioning mainly within an economy, but without. They are meeting place of long-distance trade. Local markets proper are of little consequence. Moreover, neither long-distance nor local markets are essentially competitive, and consequently there is, in either case, but little pressure to create territorial trade, a so-called internal or national market. Every one of these assertions strikes at some axiomatically held assumption of the classical economists, yet they follow closely from the facts as they appear in the light of modern research. P. 61

He goes on to show that as markets began to form, society began to regulate and control them. In some societies, the tools were custom and ritual. In larger societies, governments took over control, along with other institutions.

Polanyi says that markets are not part of a society, but outside it. Societies impose controls to protect themselves from these intruders.

As a side note, this simple definition coupled with the discussion of social control fits pretty well with my definition, and with my motivation for the definition, which is set out in that post. Perhaps that explains why I like this book.

> A market is the set of social arrangements under which people buy and sell specific goods and services at a

> specific point in time.
>
> Social arrangements means all of the things that constrain and organize human action, including laws, regulations, social expectations, conventions, and standards, whether created or enforced by governments, institutions or local traditions.

This summary of the early history of markets in *The Great Transformation* gives, I hope, a good sense of the basis of Polanyi's argument. It differs from the standard economics version, where markets arose spontaneously out of people's general love of truck and barter, and the introduction of coinage to ease the problems of different levels of value. There are substantive criticisms of Polanyi's history, one of which was suggested by commenter Alan: *The Reproving of Karl Polanyi*, Santhi Hejeebu; Deirdre McCloskey Critical Review; Summer 1999, I'll discuss some of the criticisms, but for now let's take time to think about this alternative history. We know a lot of the support for neoliberalism arises from the story of the evolution of the market system in what seems to be a natural and inexorable process from the earliest times to the present. It makes it seem so natural, so obviously human and desirable. Polanyi asks us to consider this simple question: What if standard economic history is just plain wrong?

THE GREAT TRANSFORMATION: MAINSTREAM

ECONOMICS AND AN INTRODUCTION TO A NEW SERIES

I’m on the road, but fortunately finished with the If this is Tuesday it must be Brussels part, so back to my usual posting.

Joseph Stiglitz has written several books on inequality recently, T*he Great Divide: Unequal Societies and What We Can Do About Them*, *Rewriting the Rules of the American Economy: An Agenda for Growth and Shared Prosperity* (available at www.rewritetherules.org), and *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*. James Surowiecki reviews these in the New York Review of Books. He is the economics writer at the New Yorker, and as far as I can tell from reading his columns, he is fairly liberal on economic issues. Therefore, the review is a good example of the hidden assumptions of liberal economics and liberal economics reporting.

Surowiecki agrees that inequality has increased in the US, to the point that even Jeb Bush has raised it in a campaign speech. He agrees that the very top incomes are dramatically greater than 50 years ago. He says Stiglitz focuses on two issues, rent-seeking by the rich, and poor corporate governance. Rent-seeking is the practice of rigging the laws and institutions of the market to jack up the profitability of a business. One recent example is Martin Shkreli, who uses monopoly power to suck money from sick people and their insurance companies. Poor corporate governance is shorthand for sycophantic boards of directors who pay unreasonable compensation to top management.

Suroweicki focuses, as Stiglitz does, on income inequality. Stiglitz says that inequality is not only a social problem, it is bad for economic growth. Surowiecki explains his thinking: inequality

> … hurts demand, because rich people consume less of their incomes. It leads to excessive debt, because people feel the need to borrow to make up for their stagnant incomes and keep up with the Joneses. And it promotes financial instability, as central banks try to make up for stagnant incomes by inflating bubbles, which eventually burst.

Surowiecki has several objections to Stiglitz’ diagnosis of the problems of the economy. First, like Stiglitz, he isn’t going to address wealth inequality, because “…the rise of high-end incomes in the US is still largely about labor income rather than capital income.“ As to the impact of inequality on economic growth, he says the evidence is weak, though fixing it couldn’t hurt. And he disagrees that poor corporate governance is the cause of bloated C-Suite pay.

Of course, incomes at the bloated level of the top .01% aren’t about labor at all. They are either a sort of golden handshake by which the richest invite new members to the rich club, or a simple money grab. There is no evidence of a connection between the pay and the competence of the work done or its value, which Suroweicki acknowledges.

Suroweicki has a different explanation for the rise in top incomes. Asset managers and financial people generally make more because more money is under management. Other CEOs make more not because of special competence or better results, but because of “… the rise of ideological assumptions about the indispensability of CEOs, and changes in social norms that made it seem like executives should take whatever they could get.”

On the issue of the impact of growth, both Surowiecki and Stiglitz seem to accept the idea that growth will help solve the problem of inequality. This is a form of an argument liberals often make to conservatives: See, the thing we prefer is also good for you. But Surowiecki begins his review with the statement that all growth is going to the top of the income distribution, and the vast majority of workers aren't getting any of it. Stiglitz knows this also. Why bother with this argument, then, since they know that the thing rich people want, namely growth, is of no value to the vast majority? And that's besides the question of the possibility of unlimited growth, or the areas in which growth occurs. If health care sector grows because of increased pollution, why is that a good thing?

Both Suroweicki and Stiglitz recommend the usual array of solutions, but Suroweicki is less confident that they will work. They might affect some people at the margins, but that's apparently all anyone can reasonably expect, and getting those changes is unimaginable in this sour political atmosphere. I agree with both that just because the solutions seem familiar to the point of boredom, we shouldn't give up on pushing for them.

It all seems so distressing. I think in part that's because it doesn't seem to get at the reasons things are as they are. It simply accepts that the way things are is the only way things could be and we just need to try to work with that system. That won't work. The rich have too much control. And the problem seems deeper than just a few tweaks. Suroweicki hints at the real problem when he says that we are missing the changes in social norms that make it seem natural that the C-Suite Class grab all the money, without mentioning the abandonment by that class of any pretense of interest in their employees or the wider society. I spent most of the first part of this year looking at whether mainstream economics made sense. It doesn't, even if it enabled Krugman to get some things right. So now I want to look at a different way of imagining the entire subject area.

The main text for this series will be *The Great Transformation* by Karl Polanyi, published in

1944. As I get deeper into the book, I will be looking at other early economists, including at least Adam Smith (I trust commenter Alan will correct the errors I will doubtless make), and Marx, including this in particular. For those interested, here's a discussion of Polanyi's book that offers a starting place.

> He said that to understand pivotal historical events, including the breakup of the Gold Standard and the breakdown of international relations during the first half of the twentieth century, we have to consider the role of economic thought accumulated over centuries which influenced how those events took place and were understood.

We did not become a neoliberal society by accident. For a brief treatment, see this article, particularly Part 1.C, at p. 444. We will not emerge from neoliberalism without a massive struggle. And we will never emerge from neoliberalism until we have a more compelling world view.
(Minor edits for spelling, grammar and clarity.)

MANKIW'S TEN PRINCIPLES OF ECONOMICS PART 11: CONCLUSIONS

The introduction to this series is here.
Part 1 is here.
Part 2 is here.
Part 3 is here.
Part 4 is here.
Part 5 is here.
Part 6 is here.

Part 7 is here.
Part 8 is here.
Part 9 is here.
Part 10 is here.

This series is an outgrowth of a series of short essays [links here] on Thomas Kuhn's *The Structure of Scientific Change*. Economists desperately want people to think they are scientists, so much so that they will put on lab coats as in this delightful story.

> Donning customized white lab coats, University of Delaware officials cut the ribbon on the new Center for Experimental and Applied Economics at UD's College of Agriculture and Natural Resources last week.
> …
> "Our experiments pay people cash to analyze their decisions," said Kent Messer, a professor … .

Chapter 2 of Mankiw's introductory textbook has a section titled "The Economist as Scientist". He claims that just like physical scientists, economists "… devise theories, collect data, and then analyze these data in an attempt to verify or refute their theories." P. 22. Based on this section, I thought he was saying that the 10 principles I've discussed in this series were in the nature of scientific principles. I suggested that with the addition of methodological ideas and some basic assumptions about the goals of a society, they could be treated as a paradigm in the sense Kuhn describes.

The goals of this series were: 1. to examine that possibility; 2. to see if these principles served as a structure for neoliberal economic theory, and 3. to see if there were other ways of looking at these principles that would be enlightening.

The first goal seemed perfectly reasonable. According to Kuhn, you don't write a physical science textbook unless the community of scientists who study that area agree on a paradigm of the discipline. But my brief looks at these principles makes me think that they are either vacuously true, reductive to the point of absurdity, or hotly contested by other economists. I think I have shown that these principles do not operate as a statement of agreed-upon ideas about the way the economy works. They barely describe individual activity in any useful way.

Consider Principle 4, People Respond to Incentives. Of course they do sometimes, and sometimes not. And sometimes they respond in wildly disparate but perfectly reasonable ways. You see a car advertisement offering a price break for buying right now. Does Principle 4 help you understand how I might respond? Here’s a harder example. Interest rates go up. That creates an incentive to do what? Buy a house before rates go up further? Wait to see if higher interest rates cool off the housing market so houses are cheaper, so maybe even with higher interest rates your mortgage payment will be lower? Consume less and save more money? Wait for the stock market to go down and buy stocks? What conclusions can be drawn from this principle? How is it useful? Any time you might want to apply it, you have to look at the specifics of the situation, including the people who are supposedly going to respond to the incentives. Also, lacking data, there is a strong tendency to assume other people think like you do.

The function of the paradigm for Kuhn is to provide a platform for further research in what he calls normal science. There is an economics example in Part 10, the effort to figure out the relation between inflation and employment. People like Laurence Ball and Sandeep Mazumder of the International Fund, whose work I quote, can make a living working on ways to find an historical relationship, regardless of whether it says anything about the future. But surely if the relationship cannot actually be specified usefully after years of effort, it isn’t a real principle, and it doesn't form the basis for a sensible research program. Morgenerally, Mankiw admits that in this blog post that there is much about macroeconomics that people don't know.

Kuhn says that there is a difference between physics and chemistry textbooks and social sciences textbooks.

> In history, philosophy, and the social sciences … the elementary college course employs parallel readings in original sources, some of them the "classics" of the field, others the contemporary research reports that practitioners write for each other. As a result, the student in any one of these disciplines is constantly made aware of the immense variety of problems that the members of his future group have, in the course of time, attempted to solve. Even more important, he has constantly before him a number of competing and incommensurable solutions to these problems, solutions that he must ultimately evaluate for himself. P 164

That does not describe Mankiw's textbook which reads just like the physics and chemistry textbooks Kuhn describes. There are summary remarks about historical figures in the field, and the discipline is presented as a cumulative result of a steady progress of understanding. There is no question about the truth content of a single statement in Mankiw's text, no hint that respectable economists reject his conclusions. Any student who only takes intro to economics using Mankiw's textbook will never learn about the massive differences among schools of economics, will never learn that there are alternatives to the monetarist/neoliberal views implicit in the book, and will never have a way to examine economic policy problems from any perspective other than Mankiw's.

That is what makes this textbook approach so dangerous. Mankiw presents a finished survey of the field, with the imprimatur of authority, when there is no consensus. It’s a fair reading of this book to call Introduction to Neoliberal Economics. It’s not fair to call it a balanced presentation of a discipline shot through with contested assertions.

I think I’ve shown that the discipline of economics has not reached the stage at which it is possible to create universal principles. That is a waste of time, and I will not spend any more time thinking about it. But it isn’t just that there aren’t any universal principles. As Kuhn would point out, with so many schools of economics there is no platform from which to evaluate any principle. The various schools conflict with each other on every possible level, and there is no way to test any theory that will satisfy the proponents of the exact opposite theory.

The worst part is that the rich have a death grip on economic policy. They choose to support policies that benefit them at the expense of the rest of us, and they hide behind a veneer of economics professionals who say the things that they want to hear. Those people teach economics using textbooks like Mankiw’s and that of Samuelson and Nordhaus. They control policy, because they have taught the leaders of today.

This and the preceding series have been really depressing to me. There is a tiny ray of hope. Bernie Sanders is the ranking minority member of the Senate Budget Committee. He appointed Stephanie Kelton as Chief Economist. She is the brilliant economist who chaired the Economics Department at the University of Missouri-Kansas City, and she is a noted scholar in the field of modern money theory. That is a completely different way forward, and one that works for progressives and frightens conservatives. That’s got to be a good thing.

MANKIW’S TENTH PRINCIPLE: SOCIETY FACES A SHORT-RUN TRADE-OFF BETWEEN INFLATION AND UNEMPLOYMENT

The introduction to this series is here.
Part 1 is here.
Part 2 is here.
Part 3 is here.
Part 4 is here.
Part 5 is here.
Part 6 is here.
Part 7 is here.
Part 8 is here.
Part 9 is here.

Mankiw’s tenth principle of economics is: Society faces a short-run trade-off between inflation and unemployment. He admits that this is more controversial among economists than his other principles. He says that most believe this explanation:

> - *Increasing the amount of money in the economy stimulates the overall level of spending and thus the demand for goods and services.*
> - *Higher demand may over time cause firms to raise their prices, but in the meantime, it also encourages them to*

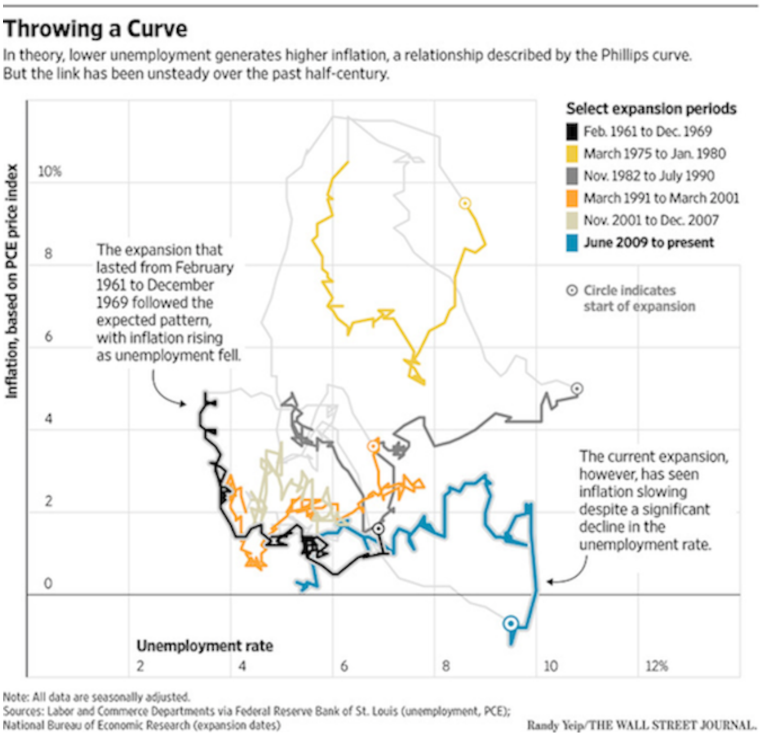
> - *hire more workers and produce a larger quantity of goods and services.*
> - *More hiring means lower unemployment.*
>
> This line of reasoning leads to one final economy-wide trade-off: a short-run trade-off between inflation and unemployment.

This gives economic policy-makers a tool for influencing economic trends. “By changing the amount of money it prints”, says Mankiw, government can put more or less money into the economy, and thus influence unemployment, at least in the short run. The Great Crash of 2008 is an example. Mankiw explains that it was caused by “bad bets on the housing market”, and led to high unemployment and lower incomes. The Obama administration responded with a stimulus package of spending and tax cuts, and the Fed increased the amount of money in the economy, in an effort to reduce unemployment. He adds: “Some feared, however, that these policies might over time lead to an excessive level of inflation.”

The frightened people were, of course, proven absolutely wrong, though they won the policy argument with the imposition of the Sequester. The stimulus package was too small, though at least it more or less happened, and of course spending on the military increased, which helped, though it would have been nice to have something for the money besides the worthless F-35. This discussion is fleshed out beginning at about page 490 (in the 6th Ed.) with a long discussion of the Phillips Curve. This Wikipedia entry is at least cheaper than buying Mankiw’s book. for those not familiar with the subject.

This isn’t so much a principle in the sense of an axiom as it is a theorem, worked up from axioms. The source of the idea is a 1958 paper by William Phillips, showing an historical correlation between inflation and unemployment in the UK, and extended to US data by Paul Samuelson and Robert Solow. The correlation and the explanation worked together to persuade people that both the grounds of explanation and the relationship were more or less permanent features of the economy. The ideas behind the explanation are neoclassical, so the correlation served to validate those neoclassical ideas.

Recently the Wall Street Journal published an essay by Ben Leubsdorf discussing the current understanding of the Phillips Curve debate: The Fed Has a Theory. Trouble Is, the Proof Is Patchy. [Paywall]. Jared Bernstein discusses it in this post and links to this New York Times post; both are worth reading to see just how unhinged we are from the simple explanation offered by Mankiw. This chart is from the WSJ article.



To read the chart, select an expansion, find the line in that color, and look for the circle, which is the beginning of the period. Then follow the line as it moves showing the changes in inflation (y-axis) and unemployment (x-axis). Here's Leubsdorf's explanation:

> But the simple link between U.S. unemployment and inflation described by the Phillips curve appeared to break down after the 1960s. High inflation coexisted with high unemployment in the 1970s. In the 1990s, the jobless rate fell as price pressures weakened. Over the past three years, inflation has declined despite a falling jobless rate.

Mankiw says there is dispute among economists about this, and Leubsdorf confirms that. He says that a recent WSJ survey found that 2/3 of economists “believed that the link exists.” Here’s a quote from a believer, Atlanta Fed President Dennis Lockhart.

> “In the absence of direct evidence that inflation is in fact converging to the target and in the absence of compelling or convincing direct evidence, I think a policy maker has to act on the view that the basic relationship in the Phillips curve between inflation and employment will assert itself in a reasonable period of time as the economy tightens up ….

Economists are fully aware of the problems with the Phillips Curve, and there are plenty of attempts to make it better. This is from the conclusion of an April 2015 Working Paper by Laurence Ball and Sandeep Mazumder of the International Fund:

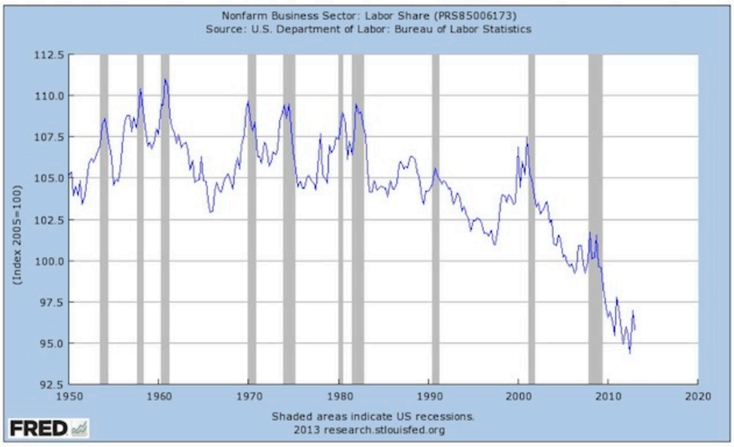
> One of Mankiw’s (2014) ten principles of economics is, “Society faces a short-run tradeoff between inflation and unemployment.” This tradeoff, the Phillips curve, is critically important for monetary policy and for forecasting inflation. It would be extraordinarily useful to discover a specification of the Phillips curve that fits the data reliably. Unfortunately, researchers have repeatedly needed to modify the

> Phillips curve to fit new data. Friedman added expected inflation to the Samuelson-Solow specification.
>
> Subsequent authors have added supply shocks (Gordon, 1982), time-variation in the Phillips-curve slope(Ball et al., 1988), and time-variation in the natural rate of unemployment (Staiger et al.,1997). Each modification helped explain past data, but, as Stock and Watson (2010) observe, the history of the Phillips curve “is one of apparently stable relationships falling apart upon publication.” Ball and Mazumder (2011) is a poignant example.

Even today people are looking for a way to find something useful in past data to predict future outcomes. As Leubsdorf noted, the Fed is using some version of this curve in deciding when to raise interest rates.

So, how does this fit with neoliberalism? One of the goals of neoliberal economics is the protection of established wealth. Inflation erodes wealth. Returns to capital may or may not keep up with inflation, depending on the strength of labor and other factors of production. Debtors are able to repay their debt in less valuable dollars, which erodes the assets of creditors. If the increased returns are less than the erosion, wealth suffers. As we have seen in the wake of the Great Crash, the governing power structure of neoliberalism demands that capital be protected whether in the form of equity or debt. This principle tells policy makers to put people out of work rather than suffer inflation.

The Fed follows this principle. This is a chart of the labor share of income.



The gray vertical bars are recessions. The chart shows that as the labor share rises, we get a recession. The following chart shows bank prime rates.

As interest rates rise, we get recessions. With the exception of the recession that followed the Great Crash, it's fair to say that all of these recessions were engineered by the Fed because of inflation or fear of inflation.

The implications are fascinating. Before the Great Crash, almost all US money was created by bank lending and credit expansion. Mankiw's Principle No. 9 tells us that when too much money is created, we get inflation. The Phillips Curve tells the Fed it has to raise interest rates to stem inflation, and that it does so at the cost of putting people out of jobs. So, businesses lend and borrow too much, creating inflation or fear of inflation, and to solve the problem created by the failure of capitalists, the Fed makes sure only the working people pay the price, by losing their livelihoods, and lately, by watching their incomes stagnate or drop. And that is the outcome of applying Mankiw's Principles of Economics: damaging workers to protect the rich.

MANKIW'S PRINCIPLES OF ECONOMICS PART 9: PRICES RISE WHEN THE GOVERNMENT PRINTS TOO MUCH MONEY

The introduction to this series is here.
Part 1 is here.
Part 2 is here.
Part 3 is here.
Part 4 is here.
Part 5 is here.
Part 6 is here.
Part 7 is here.
Part 8 is here.

Mankiw's ninth principle of economics is: Prices Rise When the Government Prints Too Much Money. He describes hyperinflation in the Weimar Republic in Germany in the early 1920s. The US hasn't experienced hyperinflation, but it has had problems with inflation, as in the 1970s. He says that inflation imposes costs on societies, so a goal of policymakers is to keep it under control. He tells us the cause of inflation:

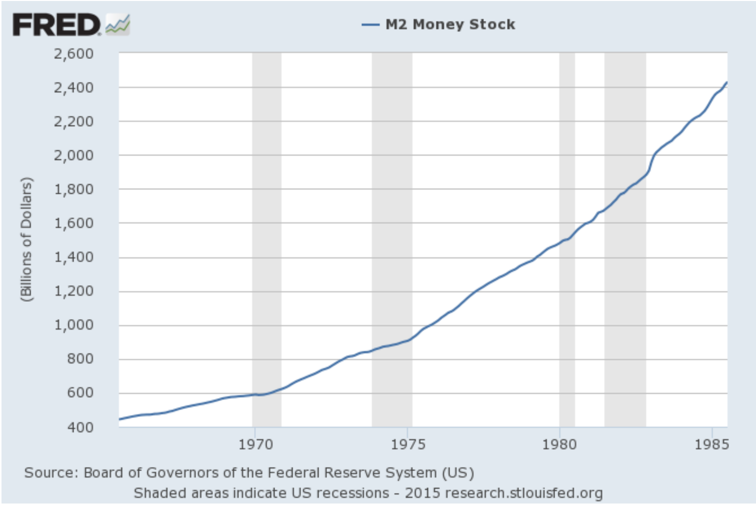
> In almost all cases of large or persistent inflation, the culprit is growth in the quantity of money. When a government creates large quantities of the nation's money, the value of the money falls. … The high inflation of the 1970s was associated with rapid growth in the quantity of money, and the low

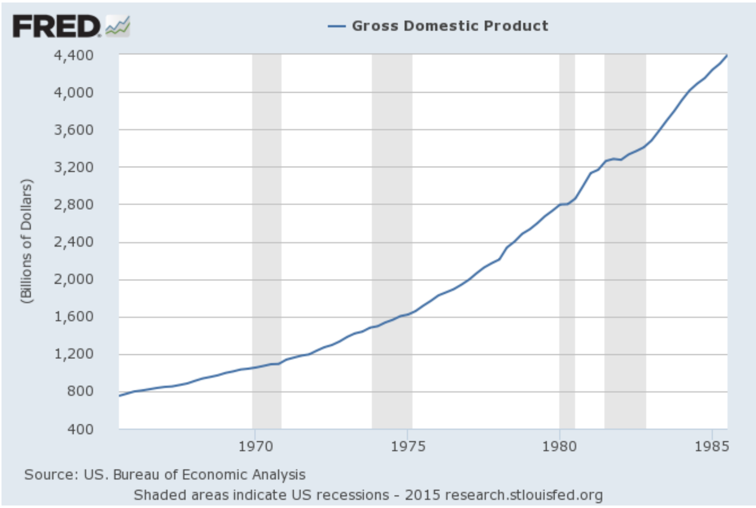
> inflation of more recent experience was associated with slow growth in the quantity of money.

As stated, this principle doesn't sound quite right. In the US, at least, the government doesn't print money, as we found out in the uproar over the Trillion Dollar Coin. That idea brought out the flying monkeys, shrieking that it would be wildly illegal for the Treasury to mint money other than small coins. According to Mankiw, in the US substantially all money is created by banks, as he explains in Chapters 16 and 17. He gives the standard description of fractional reserve banking. He explains that the Federal Reserve Board can add to bank reserves, thus creating the possibility of new loans that will create new money, or reduce reserves, reducing the ability of banks to create new money. These tools enable the Fed to control the money supply. He acknowledges that there are serious difficulties facing the Fed in exercising that control, but he claims it can be done as long as the Fed is "vigilant". Chapter 16, page 339. With this explanation, it is not clear why Mankiw claims that government is responsible for inflation by printing too much money.

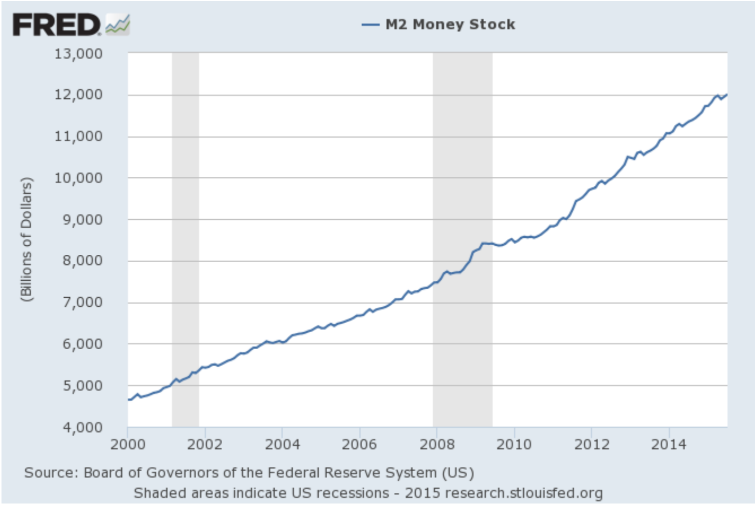
One of the difficulties Mankiw describes is the problem of measuring the money supply. In the US, there are two broad measures of the money supply, M1 and M2. The Fed quit publishing a third figure, M3, in 2006, but it is estimated by the OECD. Here's a handy chart from Wikipedia showing the various measurements of money supply. For those interested, here's an Austrian definition of money supply. And here's an argument for including repurchase agreements in the calculation of the money supply. I'm not quite sure how Mankiw would measure the money supply for his principle, especially because other economists don't agree.

I'm also not sure what to make of Mankiw's claim that the inflation of the 1970s was associated with a "rapid increase in the quantity of money.” Here’s a chart showing the growth of M2 for the period 1965 through 1985. It looks like it is rising, a bit faster after each recession (grey bars). It looks to me like the next chart, gross domestic product over the same period seasonally adjusted. Perhaps there is some other factor, or maybe I’m just reading this wrong.





Here’s a chart of M2 from 2000 to the present. There is a noticeable increase in the rate of growth of the money supply in the immediate wake of the Great Crash, leveling off in March 2009. Starting about August 2010, the increase is again greater than in the pre-Crash years. These rapid increases in the money supply match up with the Fed’s Quantitative Easing programs. It has not, as many economists (not Mankiw) predicted, led to rapid inflation.



That points us to the central question raised by the principle: how much money is too much? If Principle 9 were a scientific principle, we could use it to work out an equation for the correct amount of money, either empirically or theoretically. Mankiw doesn't offer either. Instead, he has a section explaining the debate between those who think the Fed should have discretion and those who think the Fed should follow a strict rule, like increasing the money supply by 3% per annum. P. 520. It isn't much of a principle if it doesn't lead anywhere, and doesn't predict anything.

Mankiw's phrasing, blaming the government for inflation because of its intervention with the operation of markets, fits nicely with Mirowski's 10th Commandment: Thou Shalt Not Blame Corporations and Monopolies. It supports Mirowski's Third Commandment, calling for full reliance on the marvelous market and making sure governments don't interfere. We get a good look at this in a recent paper by Thomas Palley who has been writing about neoliberalism for some time, titled The US Economy: *Explaining Stagnation and Why It Will Persist*. Palley says that there are three explanations for the Great Crash.

1. The hardcore neoliberal explanation: it was all the fault of the government. Interest rates were forced too low for too long in the wake of the 2000 recession, interfering with the market for money. For purely political reasons, the government intervened in the housing market to

encourage increased homeownership, leading to misallocation of scarce financial and other resources. This is the position of Peter Wallison of the AEI, whose dissent from the Final Report of the Financial Crisis Inquiry Commission explains this view. It is not recommended reading.

2. The softcore neoliberal explanation: it was the fault of government regulators. The regulators allowed excessive risk-taking by lenders, and perverse incentive pay structures in the financial sector. They allowed deregulation to proceed too far. That enabled bad allocation of the flood of foreign savings into an overblown housing sector. When it popped, the resulting financial disorder deepened a structural business cycle recession into a near depression.

3. The Keynesian explanation: neoliberalism did us in. The explanation is that neoliberal policies destroyed the institutions and rules that kept corporate greed in check and made sure that the benefits of a growing economy were shared between capital and labor. In the end, consumer demand was crushed by inadequate wages. It slowed to the point that it could not drive economic growth as it had during the period 1950-75. As incomes dropped, debt rose, so that when the Great Recession hit, there was no demand left to drive a recovery. The cycle of jobless recoveries has come to the point that stagnation is the plausible future for the US economy.

Mankiw argues for neoliberal explanations and solutions and certainly not the Keynesian explanation or its solutions. For example, in October 2008, he wrote that the Great Depression was largely cured by monetary policy, and pointed to studies saying that New Deal legislation like the expansion of labor rights was counter-productive because it allowed labor power to interfere with market forces.

I don’t doubt that the quantity of money might have something to do with inflation in some cases. I'm not convinced that it explains either the inflation of the 1970s, the lack of inflation in recent times, or the current inflation in Russia.

MANKIW'S PRINCIPLES OF ECONOMICS PART 8: A COUNTRY'S STANDARD OF LIVING DEPENDS ON ITS ABILITY TO PRODUCE GOODS AND SERVICES

The introduction to this series is here.
Part 1 is here.
Part 2 is here.
Part 3 is here.
Part 4 is here.
Part 5 is here.
Part 6 is here.
Part 7 is here.

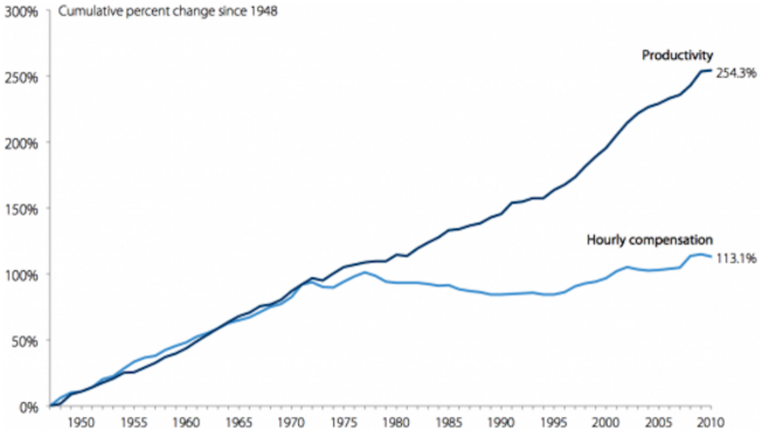
Mankiw's eighth principle of economics is: a country's standard of living depends on its ability to produce goods and services. He points out that there are vast differences between the average incomes of different countries. In the US, average income has increased about 2% per year adjusted for increases in the cost of living, he says, and doubles about every 35 years. The explanation for this change is productivity, defined as "the amount of goods and services produced from each unit of labor time." The growth rate of a nation's productivity determines the growth rate of its average income, he asserts. He dismisses other explanations, such as the prevalence of labor unions and minimum wage laws. He claims that US productivity dropped in the 1970s which accounts for the slow growth of average wages over that period. He concludes with this claim:

> To boost living standards, policymakers need to raise productivity by ensuring that workers are well-educated, have the tools needed to produce goods and services, and have access to the best available technology.

This principle supports Philip Mirowski's Sixth Commandment of Neoliberalism: Thou Shalt Become the Manager of Thyself. "Human beings [are reduced] to an arbitrary bundle of "investments," skill sets, temporary alliances (family, sex, race), and fungible body parts." The goal of the entrepreneur of you is to find some way to make yourself valuable enough to fill a slot in some corporate entity that will pay off on your investments. It also supports the Ninth Commandment, Thou Shalt Know that Inequality is Natural, because it tells the entrepreneur of you that if you fail, it's your fault for being insufficiently productive. The problem is always the workers; and never the owners of capital for they can do no wrong. That comes from the Tenth Commandment, Thou Shalt Not Blame Corporations and Monopolies, especially for investing their capital in foreign countries so jobs are created there instead of in the US. After all, the free flow of capital is critical in Capitalism, as we learn in Mirowski's discussion of Commandment 8: Thou Shalt Keep Thy Cronyism Cosmopolitan.

Mankiw's explanation is intellectually dishonest. He only talks about average incomes, not median incomes, and not the incomes of the working people of the US. That enables him to paint a false picture of the economy, and of the role of productivity in increasing standards of living. The leading work on this issue was done by Larry Mishel at the Economic Policy Institute. His April 2012 paper, The Wedges Between Productivity And Median Compensation

Growth is the seminal work on this issue. Here's an updated chart showing the disparity between wages and productivity. For a discussion of the productivity measurement, see this 2014 Bureau of Labor Statistics paper. It's important to note that Mishel is using the median wage growth for production/non-supervisory workers, not total labor compensation. With this statistic, we look at the actual experience of approximately 80% of workers.



According to Mishel, the gap in the chart from 2000 to 2011 is the result of three factors (see Table 1):

1. Income inequality increased, with the great gains going to the top few percentiles and the rest stagnant or falling, accounting for 39% of the gap.
2. Income shifted from labor to capital, accounting for 45% of the gap.
3. Output prices diverged from consumer prices, accounting for 16% of the gap.

Dave Dayen discusses Mishel's paper here, focusing on efforts of conservatives to discredit Mishel's work. The only consideration that seems even questionable is 3, and Dayen's discussion seems fair. He concludes with this:

> If you believe the Lawrence/Yglesias argument, policies that raise wages are secondary to policies that raise productivity more generally. If you believe the Mishel argument, reconnecting wages to productivity becomes central. Rather than stressing

> the need to acquire more education and skills, you would support increasing the minimum wage and allowing for more union organizing to put leverage in the hands of labor over capital. You would support proper use of overtime laws to reduce wage theft, and paid family and medical leave to keep wages strong during times of family stress.
>
> But if productivity gains just leak out to the wealthy through financial engineering, all the growth in the world won't benefit the typical worker.

Mankiw doesn't acknowledge the problems with his principle, problems which have been evident for a long time as the chart shows. The source of this principle is the neoclassical argument of William Stanley Jevons and John Bates Clark which I discuss in detail here and here. Mankiw is preaching from the Natural Law Bible without mentioning it. This is a perfect example of Keynes' dismissive statement on these writers: "We have not read these authors; we should consider their arguments preposterous if they were to fall into our hands." Certainly this principle is preposterous both factually and theoretically.

MANKIW'S PRINCIPLES OF ECONOMICS PART 7: GOVERNMENTS CAN SOMETIMES IMPROVE MARKET OUTCOMES

The introduction to this series is here.
Part 1 is here.
Part 2 is here.

Part 3 is here.
Part 4 is here.
Part 5 is here.
Part 6 is here.

Mankiw's Seventh Principle of Economics is: Governments Can Sometimes Improve Market Outcomes. Mankiw says economics will refine the view of the student on the role of government. In Mankiw's book, government has several acceptable roles:

1. Enforcement of property rights. It is imperative that scarce resources are owned by individuals and firms. Government enforces the rules and protects the institutions that support these property rights. If the rights of creators of products are not protected, people won't make things. "The invisible hand counts on our ability to enforce our rights."

2. Government intervention is allowed to achieve greater efficiency or greater equality.

The first point fits squarely with Mirowski's commandments of neoliberalism. The Fourth Commandment is: Thou Shalt Retask the State to Thy Needs. The function of the strong state is to make sure that the neoliberal program can come into existence; it must, as we learn from the First Commandment, be constructed, it will not happen without force and socially acceptable forms of violence. This is accomplished by using the state to marketize everything, and by ensuring that scarce resources are put into the hands of the wealthy and secured to them. The rest of us become forced customers of private entities, health insurance companies, policing, and education. Can water be far behind? Care to buy your water from Comcast?

As an aside, privatized education really bothers me. We've learned that the Educational Testing Service has rewritten the guidelines for AP History to cut back on what wingnuts call negativity and the rest of us call reality, and to focus on US exceptionalism. The ETS is a private corporation. Its Chairman is Robert

Murley, who is also the CEO of Apollo Education Group, Inc., which operates Phoenix University. His only interest is making money. The idea that he is a scholar is preposterous. But he sets the standards for many of our smart kids, the lucky ones in schools that have AP classes.

The second allowable activity of government is to achieve greater efficiency. This entails dealing with market failures or with externalities. Neither of these is an allowable function of government in a truly neoliberal society. Markets cannot fail in neoliberalism, as Mirowski explains in Commandment 3, Thou Shalt Worship "Spontaneous Order". More important, market power is not a problem for neoliberals, as we learn in Commandment 10, Thou Shalt Not Blame Monopolies and Corporations. The idea that a government might intervene to reduce inequality is anathema to neoliberals. Mirowski explains this in his Ninth Commandment: Thou Shalt Know That Inequality is Natural.

For Mankiw, at least theoretically, government is allowed to legislate on externalities and market power. Sadly, all externalities can be litigated indefinitely. Between the courts and flaccid enforcement, antitrust law has been ignored for years. As to inequality, Mankiw tells us that markets reward those who produce things other people want to buy, which is closely related to his Principle Number 8. Markets, he admits, won't make sure everyone has food, clothing, health care, shelter, or anything else. "This inequality may, depending on one's political philosophy, call for government intervention." That might mean welfare, progressive income taxation or other programs. Then we get a full paragraph explaining the problems of using government for these purposes, including this gem: "Sometimes policies are designed simply to reward the politically powerful."

In my discussion of Principle 6 (markets are usually a good way to organize economic activity) I pointed out that Mankiw ignores the enormous amount of buying done by governments at every level, which in Mankiw’s language probably confuses the Invisible Hand. Similarly, in his discussion of Principle 7, Mankiw ignores the role of government in establishing the rules related to markets, and in enforcing a minimal level of anti-fraud rules. This role of government obviously improves market outcomes, unless the rules are “designed to reward the politically powerful.” I assume he doesn’t mention this crucial role of government in the economy because it would show that markets are a construction, not a given and that would be one too many deviations from neoliberal dogma.

That markets are constructed is most obvious in the area of “intellectual property”, a term that probably came into wide use in the late 1940s. Essentially, the people behind this term want to marketize intellectual activity, making it an article of commerce rather than a commons.

Mankiw assigns to government the obligation to “maintain the institutions that are key to a market economy.” I suspect this is more than the courts and US Marshals, but Mankiw leaves us hanging. Perhaps he means private groups like ETS, or the World Intellectual Property Organization. Or perhaps he means groups like the Uniform Law Commission. Who knows? Here’s a story about the Uniform Law Commission.

Several years ago, the group decided to rewrite the section of the Uniform Commercial Code governing security interests, which is the technical term for liens on personal property. The purported problem was that compliance with the requirements of Article 9 was so complex that bank paperwork occasionally didn’t comply. In Chapter 7 cases, the Bankruptcy Trustee is allowed to set aside a defective security interest, and sell the property for the benefit of unsecured creditors. Trustees are paid a small percentage of the funds raised, which encourages them to inspect the paperwork carefully. The idea was to amend the rules so that close enough was good enough. One of the participants in the revision process told a CLE session I attended that in drafting sessions, the members would joke that these provisions would really screw the Trustee. That was silly. Trustees have plenty of work, and only got a tiny payment for setting aside invalid security interests. The actual people getting screwed were unsecured creditors. Of course, none of the participants represented unsecured creditors, so the changes were made, and with the imprimatur of a supposedly neutral group, they were adopted in all of the states. I know for a fact that this resulted in more wins for the banks at the expense of common creditors. A decent government would have insisted on participation by all relevant groups in the drafting of these changes, which violently upset the original balance between secured and unsecured creditors that once was the hallmark of the UCC.

That's the kind of institution Mankiw wants the government to protect. Oh, and ALEC.

MANKIW'S PRINCIPLES OF ECONOMICS PART 6: MARKETS ARE USUALLY A GOOD WAY TO ORGANIZE ECONOMIC ACTIVITY

The introduction to this series is here.
Part 1 is here.
Part 2 is here.
Part 3 is here.
Part 4 is here.
Part 5 is here.

Mankiw's sixth principle of economics is: Markets are Usually a Good Way to Organize

Economic Activity. There are six paragraphs of explanation. About half say that central planning as in Communist Russia doesn't work, culminating with this:

> Central planners failed because they tried to run the economy with one hand tied behind their back — the invisible hand of the marketplace. Page 11.

Mankiw says that in a market economy, the decisions of a central planner are replaced by decisions of millions of market participants. Firms decide what and how much to make, and households decide where to work and what to buy. It is wonderful how this system is so successful at "organizing economic activity to promote overall economic well-being." The magic is prices.

> As a result of the decisions that buyers and sellers make, market prices reflect both the value of a good to society and the cost to society of making the good.

But, when government interferes with the market and prevents prices from adjusting to supply and demand, disaster awaits. Thus, taxes "adversely affect the allocation of resources, for they distort prices and thus the decisions of households and firms."

Mankiw doesn't define the terms market, or marketplace. That fits perfectly with Mirowski's Second Commandment of Neoliberalism: Thou Shalt Erase Distinctions. Here is his discussion in full:

> What sort of "market" do neoliberals want to foster and protect? It may seem incredible, but historically, both the neoclassical tradition in economics and the neoliberals have both been extremely vague when it comes to analytical specification of the exact structure and character of something they both refer to as the "market" Both seem overly

> preoccupied with what it purportedly *does*, while remaining cavalier about what it actually *is*. For the neoliberals, this allows the avoidance of a possible deep contradiction between their constructivist tendencies and their uninflected appeal to a monolithic market that has existed throughout all history and indifferently across the globe; for how can something be "made" when it is eternal and unchanging? This is solved by increasingly erasing any distinctions among the state, society, and the market, and simultaneously insisting their political project is aimed at reformation of society by subordinating it to the market. Emphasis in original.

While neoliberals do not define market, they assert that it is perfect, as Mirowski's Third Commandment says: Thou Shalt Worship "Spontaneous Order". Neoliberals assert that markets are emergent phenomena, and are inevitable and perfect. The theory of Natural Law is thus updated for the 21st Century with a metaphor from biology.

Just as Mirowski says, it is difficult to see what Mankiw means by market. There is nothing to be learned from his statement that the market economy consists of the decisions of millions of firms and households, not least because it ignores the decisions of hundreds of thousands of governmental units, controlling the spending of about 1/3 of the GDP. And it's difficult to understand how the many thousands of rules that govern many thousands of markets can be translated into formal language, let alone into mathematical terms. Mankiw relies on a sort of collective understanding to provide sufficient clues that the average reader will know what he means, which is part of the problem. If the textbook doesn't define things so that everyone is talking about the same thing, it is dangerous because people assume others agree with them when they don't. The lack of a definition is a signal of sloppy thinking.

Mankiw gives us mushy statements like markets promote overall economic well-being. The only people who can participate in markets are those with money. The level of participation is directly related to how much money one has. The fact is that markets cater to people with lots of money, those who can buy whatever they want. When resources or goods are actually scarce, markets allocate them to those with money. When there is plenty, markets can serve those with less money. But markets will never do anything for poor people.

I'm stunned by the nonchalant statement that households decide where to work. I'm equally stunned by the idea that taxes distort markets because they affect spending decisions. It goes with his forgetting to mention government as a market participant. If we didn't have taxes, that would distort markets too, because people would have to buy protection and roads and a lot more.

If, as Manikw claims, markets measure the value of goods to society, then the values of goods to society are determined by the rich. Markets do not include all the costs of production and therefore that part of Mankiw's statement is false, assuming it meant anything measurable.

This entire statement of principle is useless as a guide to anything specific. Again, I realize this is just an introduction, but students treat it as accurate. It's easy to remember and it will stick with people long after they leave school.

I've written several posts on the nature of markets as used in introductory economics courses, including this one and the linked posts, and more at Firedoglake, including this one. If you go to this link and search for Bernard Harcourt, or for masaccio markets, you can find much more. For anyone not aware of it, FDL is no more, and all my posts can be found at

Shadowproof.com., but you have to search. Here’s my definition of market:

> A market is the set of social arrangements under which people buy and sell specific goods and services at a specific point in time.
>
> Social arrangements means all of the things that constrain and organize human action, including laws, regulations, social expectations, conventions, and standards, whether created or enforced by governments, institutions or local traditions.

With that definition, Mankiw’s Principle No. 6 becomes more or less true, though meaningless. My definition carries no pretense of fairness or social justice. It doesn’t suggest that the market is perfect at any point in time; instead it suggests that markets can and should be the subject of social action to insure social goals. Maybe that’s a good reason for neoliberals and their friend Mankiw to avoid providing their own definition. After all, as Adam Smith tells us:

> Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. The Wealth Of Nations, Book IV Chapter VIII, v. ii, p. 660, para. 49.

MANKIW’S PRINCIPLES OF ECONOMICS PART 5:

TRADE CAN MAKE EVERYONE BETTER OFF

The introduction to this series is here.
Part 1 is here.
Part 2 is here.
Part 3 is here.
Part 4 is here.

Mankiw's fifth principle is: Trade Can Make Everyone Better Off. He says that that my family competes with other families for jobs, and when we shop, we compete with others to find the best prices. But if we cut ourselves off from the market, we would have to grow our own food, make our own clothes, and build our own houses. "Trade allows each person to specialize at what he or she does best, whether it's farming, sewing, or home building." In the same way, nations can specialize in what they do best. In both cases, people get a wider range of choices at lower prices.

It's obvious that there are too many humans for us to exist on this planet without the kind of trade Mankiw is talking about. There isn't enough arable land to support the huge number of tiny farms we would need to set this up, even if we wanted to, and I don't think that's what people want. And the way Mankiw explains it, it all seems so natural, probably because we've been hearing it all our lives. Everyone knows people like to trade for things. Our most ancient ancestors traveled to trade goods, and to party and marry across groups. Codification of this idea goes back at least as far as Adam Smith.

> It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy…What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom.
> The Wealth Of Nations, Book IV Chapter

> II, pp. 456-7, paras. 11-12.

As long as you have lots of money and better things to do, that makes sense. If you have spare time and the means, why not grow your own food and make your own cloth, and save your money for things you can't make? I assume that was the case for many Britons of Smith's day. As a maxim, I assume it has much older roots. It's easy to see why people who live in Whitby, England are specialists in making jet jewelry: the jet there is perhaps the finest in the world, and people have been working it into jewelry for centuries. In the same way, it's easy to understand that a small town in 18th C. England is better off with a professional blacksmith than with a forge in every home.

People in India have been making beautiful cotton textiles for centuries, as I learned from *Empire of Cotton* by Sven Beckert. Those textiles were shipped around the world for most of recorded history, until what Beckert calls War Capitalism began to take control of it in the 17th Century. For a very brief discussion of the role of cotton in Gandhi's India, see this.

What we now know is that owners of capital decide where investments are made. With low transportation costs globally, capitalists are able to locate businesses anywhere. The point is that when specialization reaches a certain level, the role of the craftsman comes to a bitter end, replaced by selling fast food or tending children. This is precisely what happened with cotton. Rich merchants stopped importing finished goods, and stopped using independent weavers in distant parts of the world, and built plants with capital intensive machines in Northern England. The price of cotton textiles went down, but millions of India's workers lost their incomes, and millions of Africans were sold into slavery to raise cheap cotton for shipment to England. Trade didn't make them better off.

Of course, it happens all the time. One

excellent example is aircraft manufacture. Boeing’s principle resource was once its amazing workers, especially its engineers and assembly line workers in northwestern Washington. But its executives wanted the big bucks, so when it came time to build the Dreamliner, they broke that system to replace those skilled workers with cheaper unskilled labor all around the world, and increased their own salaries. Then the entire system broke down. Here’s a timeline of the known failures of the Dreamliner. Currently, Boeing estimates it is losing $23.2 million on each sold aircraft. Much of this can be blamed on stupid management decisions about production. Boeing CEO James McInerny got about $29 million in 2014 compensation, and the chief of commercial aircraft, Ray Connor, got $16 million. This is payment for abject failure. I guess they benefited from trade.

Maybe that’s why Mankiw’s fifth principle is couched in such weak language. Here’s a better statement: trade can make some people better off, especially if we ignore all the people it makes worse off.

We also see how beautifully this principle supports Mirowski’s Eighth Commandment of Neoliberalism: Thou Shalt Keep Thy Cronyism Cosmopolitan, which teaches the importance of free flows of capital. The capital needed to make aircraft and textiles can be sent wherever labor is cheapest, including South Carolina. That’s neoliberal freedom. You will recall that most of the British assault on India was led by the East India Trading Company, an early corporation. These stories tell us that Mankiw’s fifth principle works well with Mirowski’s Tenth Commandment: Thou Shalt Not Blame Monopolies and Corporations. They are simply not responsible for any of the misery their trade policies hurt. And finally, see how Smith’s maxim works with the average person’s understanding of economics, that what is good for the household is good for the nation.