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Schlock Economics

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Abstract

After the collapse of USSR, Communism came to an end in 1990 and Capitalism emerged alone as the only feasible way to organize a modern economy. But the recent financial crisis which erupted in the US and spread almost in the entire globe proved Capitalism as well a failed economic system. Laissez Faire / Non intervention in the market which is the essence of capitalism was the reason for the current financial crisis. The hegemonic west propagates the rules of capitalism through the subject of economics. The professional job of economist is either to create new models or extend the existing one which always gives misleading results for understanding the ground realities of the Universe. For more than 100 years this tradition was unable to give a single solid discovery. Since there is no concept of intervention in the economic affairs of individuals as well as states therefore immoral and unfair practices are used without any hesitation for running the affairs of business. Ground reality exhibits that the science of economics can claim neither scientific laws nor universal truths. In short there is utmost need for reassessing the entire academy of mainstream Economics.

KEYWORD: Errors in capitalism, Unreal, irrelevant and shock Economics

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Schlock Economics

“The Prophet Mohammad (S.A.W) once said, "Adam and Moses argued with each other. Moses said to Adam. 'O Adam! You are our father who disappointed us by eating the wheat grain in the Paradise and turned us out of Paradise.' Then Adam said to him, 'O Moses! God favored you with His talk (talked to you directly) and He wrote (the Torah) for you with His Own Hand. Do you blame me for the action which God had written in my fate forty years before my creation?' So Adam confuted Moses, Adam confuted Moses," the Prophet added, repeating the Statement three times" (Bukhari).

1. Introduction:

If everyone remain in the Paradise, then it will be impossible to test the deeds of each person. So God expelled Adam from paradise to earth so as to test every person with his deeds by interacting with different people under different circumstances. The expulsion of Adam from paradise actually started the essence of life on earth; a part of the divine scheme to make people work and run the affairs on Earth. In the presence of everyone in the paradise what meaning would one put on patience, tolerance, and cooperation as well as earning livelihood? Who would work for whom and why? Why would people hoard wealth or need condemn the act? What shall be the need or form of societal organization? Above all, will economics exist as a social science; if yes to what end?

To earn the livelihood, throughout the history different nations devised and implemented different economic systems not only within

their own territory but also propagated and tried to implement them forcefully on other nations and locations around the globe. In the recent past that is in the 20th century there was a tussle between Communism and Capitalism in the form of cold war for bringing the maximum number of nation under the umbrella of their economic system. After the collapse of Soviet Union in the 1990, Communism came to an end; and Capitalism became the only economic system practiced in almost all parts of the World. Because the United States of America, the world's remaining hegemonic power, advocates capitalism, the adoption of the economic system becomes a priority for poor/LDC countries to get support and/or aide from the hegemonic USA.

The Western countries propagate the rules of Capitalism through the subject of economics. But the recent financial crises which erupted in USA and spread almost in the entire globe proved Capitalism as well a failed System. Non intervention in the Market by the government which was the essence of Capitalism (i.e the death of Laissez Fair) is usually considered as the reasons for the current financial crises. Many scholars termed the current Financial Crisis as the end of Capitalism. The current crisis not only left economies and lives in a mess, but it has also dealt the subject of economics and the advocates of capitalism a heavy blow.

It is believed in the opinion of mainstream economist that the purpose of an economic activity of every individual is to enhance his satisfaction by whatever means. Without intervention and hence applying the logic of market economy this implies that powerful/west should exploit the weak and poor by any means and method which is not universally accepted. For example according to economist the primary purpose of

economic activity for the US will be the enhancement and satisfaction of US citizens only but not to every other economy. For this rationalist and selfish approach many scholars like Robert Heilbroner and William Milberg termed the science of economics as nothing but a hand maiden of modern western capitalism, and its primary purpose is to make this trouble system work. Mainstream economics assumes that people are always busy and engaged in rationally calculating and maximizing his utility. Therefore the purpose of the present study will be to highlight the intellectual limitation of economic profession?

In the science of Economics, econometrics is allocated for the measurements of things in the economy, like Biometrics, Sociometrics, anthropometrics, psychometrics and similar fields in other disciplines of science. Researchers and academicians usually define econometrics, "as the application of mathematical and statistical methods to the analysis of economic data for prediction/forecasting purposes". That is, economists use the tools of econometrics to forecast future development in the economy in order to form the basis of future economic planning. In other words, prediction or forecasting is the process of making statements about events whose actual outcomes have not yet been observed. Economists since the 18th century have claimed that Economics should be treated as "predictive science", which always proved to be misleading. In fact, economists were unable to predict any crisis until today. After the 2007/08 financial crisis, Queen Elizabeth II of Britain, blushed an economist by asking at a party: "Why Economists even Nobel Prize winning ones were unable to give a glimpse of the crisis in advance?" A question arises that as usual, economists are always busy and engaged in their research, but why were economists unable to predict the crisis in advance?

The science of economics which was developed by a generation of economists possesses analytical tools and insight/models. Economists assert that like Physics and other discipline of science, this mainstream economics should be treated and modeled alike. The purpose of the present study will be not only to evaluate the usefulness of these principles and tools for understanding the hard realities of the universe but will also to asses and evaluate whether the methodology has the capability to predict future economic event?

The success or failure of an economic system is measured by the direct impact on the humans who live under the umbrella of that economic system. The level of security and satisfaction provided to the people further measures such impact. In a recent UN Food Agency report, one in every six person around the globe is malnourished. Today 2/3rd of the world's total resources have been transferred to the developed countries where only 1/3rd of the world population lives. Majority of the world's population is still living in the extreme poverty, deprivation and economic backwardness. This is one of the fruits of capitalism, where wealth remains concentrated with few individuals who keep on making more wealth from their existing wealth while a majority of people in the third world countries keeps on struggling for their basic needs. This attitude is a logical outcome of the basic assumption of mainstream economists that resources are scarce and limited. The purpose of the present study will be to evaluate whether humanity had ever confronted the scarcity of resources?

This study will not only explore the flaws and imperfection in the philosophy of capitalism but also shed some light on the plight and miseries brought to the globe by this economic philosophy.

In section II we discuss the foundation of economics. Section III highlights the role of econometrics. In section IV discusses empirical failure and the inability of econometrics in addressing the ground realities of universe. Section V concludes.

II: Foundation of the Capitalist Economic System

An academic discipline whether in the field of pure sciences or social sciences must contain several elements. Each discipline requires a commonly accepted definition of the subject and general agreement on the questions that members of the discipline must attempt to answer. Western scholars regard Adam Smith as the founder of contemporary mainstream, who published "The Wealth of Nations" in 1776. Over the next two centuries an extensive body of economic theory and models were developed.

Since the expulsion of Adam from Paradise humanity always desired and strived for the improvement and enhancement of their living conditions. They instinctively desire more and more of goods for use compared to what they command resources to produce. Man has needs that require satisfaction, so historically every nation and society tried to satisfy his needs with different means and methods. For the fulfillment of these needs two major systems have dominated the world arena in the last 100 years, namely capitalism and socialism. Socialism collapsed before the end of the 20th century and capitalism emerged as the only economic system practiced almost in the entire globe, with different flavors and varieties implemented in different parts of the world. The roots of capitalism can be traced back to the treaty of Westphalia in 1648

which concluded a thirty years religious war in Europe. The treaty brought a separation between religion and government affairs. After the treaty the church lost its influence on the affairs of government in European countries¹. This treaty actually paved the way for the present capitalist economic system.

Capitalism has since evolved into a culture, a civil order and an article of faith for millions. It has undergone great variations over time and space but its theoretical bases, aims and modus operandi remained unchanged. This basic principle of capitalist economic philosophy provides the basis for the definition of the economic problem under capitalism. In particular, the problem that capitalism attempts to resolve is the satisfaction of unlimited/ever growing human needs/wants using limited/insufficient resources and means of satisfaction. Scarcity of resources, pursuit of self-interest, and maximization of gains together make the foundation on which is raised the superstructure of mainstream economics (Samuelson 1947).

Capitalism was brought forth by many economic principles, but the following three principles which we will discuss in detail in the preceding section are the essence of capitalism.

- a) Scarcity of resources,
- b) Self interest and
- c) The philosophy of Laissez Faire.

¹ Available at *Globalism (Part Two): The Tents of Shem* by Charles Whitaker
<http://www.bibletools.org/index.cfm/fuseaction/Topical.show/RTD/cgg/ID/10816/Treaty-Westphalia.htm>

a): Scarcity of resources:

According to economists, society's needs/wants that are the economic wants of its citizens and institutions are virtually unlimited and insatiable. Economic resources that are the means of producing goods and services are limited and scarce. In other words main stream economists usually start their story with the concern that scarcity will limit future economic growth and human well being. In order to see whether humanity ever confronted the scarcity of resources in the universe, it would perhaps be appropriate to start with the contribution of Greek thinkers to the history of economic thought. The leading intellectuals and writers in the era of Greek thinkers were Hesiod, Democritus, Xenophon, and Aristotle. In the time of Greek intellectuals (800 BC – 322 BC) the population of the world was very small and scattered. Life was very simple and there was no such thing as scarcity but rather abundance of resources. Scarcity of resource or their allocations of resources to various uses were not important for the Greek philosophers and intellectuals but rather they focused their attention on the questions of fairness, justice and equity. Among the Greek intellectual, Hesiod was an exception and saw scarcity of resources as the fundamental economic concern for the pursuit of all human needs and desires. He noted that resources including time must be efficiently allocated in view of scarcity (Ptak, Justin 2009, pp. 2-3). The Greek writers did not care to give scarcity any precise meaning or explore its ramifications, but there were things as certain types of plants or rocks they did not come across so often: they were rare i.e. very small in quantity. It was the experience of *rarity* that eventually led to the notion of *scarcity*. Senior (1790 – 1864) was presumably the first economist who stressed on scarcity and regarded it as the basis of value. Senior was not the only one in its pessimism about the future. English economist Thomas R.

Malthus raised similar concerns too in his writing “*Essay on the Principle of Population*” in 1798. Malthus’ theory in brief was that humankind is permanently trapped by the intersection of two ‘laws’.

The first concern is the rate at which populations can grow. He opined that under conditions of ‘natural’ fertility (with early marriage and no contraception, abortion or infanticide), this would lead to an average of about fifteen live births per woman. Given normal mortality at the time, and taking a less than maximum fertility, this will lead to what Malthus called geometrical growth, namely 1, 2, 4, 8, 16. It only needs 32 doublings like this to lead from an original couple to the present world population of over six billion persons.

The second premise was that food and other resource production will grow much more slowly. It might double for a generation or two, but could not keep on doubling within an agrarian economy. Thus there could, in the long run, only be an arithmetic or linear growth of the order of 1,2,3,4. Incorporated in this later theory was the law of diminishing marginal returns on the further input of resources, especially labour. Underpinning the scheme was the assumption that there was a finite amount of energy available for humans through the conversion of the sun’s energy by living plants and animals. The conclusion was that humankind was trapped, a particular application in the field of demography of the more general pessimism of Adam Smith. Populations would grow rapidly for a few generations, and then be savagely cut back. A crisis would occur, manifesting itself in one (or a combination) of what he called the three ‘positive’ checks acting on the death rate, war, famine and disease. Hence, Malthus concluded that increased technology or land availability would result in more people living at

subsistence, not an improvement in living conditions. This conclusion is often referred to as the “utterly dismal theorem.”

The Malthusian theory can be rejected and criticized on many grounds. First they do not take adequate account of the role and impact of technological progress. The second basic criticism of the trap focuses on its assumption that national rates of population are directly related to the level of national per capita income. Ground reality shows that it is not the aggregate level of per capita income that matters for population growth, but rather the social and economic institution of a nation and its philosophy of development are probably greater determinants of population growth rates than aggregate economic variables and simple models of macroeconomic growth.

Today the world population is more than 7 times of what it was in 1750. The modern era has witnessed a vast expansion of resources not only in numbers but also in knowledge. These expansions have been accompanied by a rapid development in the means of transportation and communication, making the globe smaller in terms of time and space. Consequently, humanity has produced more output since 1950 than it could during its entire existence prior to that year (AI 3, 2006). The explosion has kept mankind ahead of scarcity in the race. The population of the world in 2010 was 3.0 times of its size in 1950. During the same period the real GDP of the world measured in international US dollars has increased almost 7 folds while the per capita income improved about 3 times. Within this broad spectrum, there have of course been vast differences over time within and across nations. According to religious prophecy if nothing remains on the surface of the earth, then according to an estimate there is enough resources in the sea and oceans which if

utilized efficiently is enough for six thousands years. In addition to providing infinite means of livelihood God has created man in the best form and endowed him with all those intellectual and practical faculties which are needed to exploit the treasures of the universe.

In fact scarcity of resources in terms of their availability is plausibly a part of divine scheme to incite humanity into action for searching their living in the land of God and at the same time be tested in how they do it. Life for that reason is a trial in this world. The history of human civilization is the history of the march of human conquest of nature. In essence, it is the history of pushing outward relentlessly the frontiers of scarcity through continuous research, inventions and innovations in science, technology and social management (Hasan 1996, p. 357).

Scarcity of resources is merely a man-made phenomenon resulting from their wasteful use and mal-distribution. Allah/God has stocked the earth with his inexhaustible treasures for all times to come not only for human beings but for other creatures as well which is mentioned in the Holly Quran on several occasions (**For example 2:29; 7:10; 14:34; 15:20-21**). Also, Allah/God has made resources in a mold that they would readily submit to human command and effort. The argument is irrefutable; it stands on testimony from the holy Quran (**For example 7:10; 14:32-33**). From the above discussion it is evident what India great moral leader Mohindas Ghandhi famously said that in the earth there is enough resources for everyone need but not enough resources for everyone greed. Economist's usual concern about increasing natural resource scarcity is not only misleading but based on the belief so as to give a justification for their attitude of selfishness and self interest.

B; Self Interest:

The second important characteristic of capitalism is the concept of self interest. Under this system the individual enter into economic struggle for personal profit. The individual use his abilities, capital and energy in those sectors which are likely to yield maximum profit and satisfaction. In the presence of self interest the entrepreneur are always seeking those techniques which maximize their utility and profit. This materialist motive on one hand leads to new inventions and development of new techniques of work and business management which facilitates to increase production at reduced cost. But on the other hand this materialist motive gives rise to selfishness and self love which eliminate sympathy, fraternal spirit and considerateness and kindle the fire of mutual conflict. Self interest makes individual indifferent to collective interest. They indulge in nepotism and become slaves of pleasure. Humans which are the best among all creatures lose the ability to see beyond self interest and behave like animals. A society whose members are self seeking, self-centered, despite having abundance of resources, can never be free of economic hardship and misery.

For the maximization of self interest the capitalist countries are always looking to foreign markets. Sometimes these capitalist countries enter into a conflict over capturing into foreign markets which sometimes escalate into wars. Self interests were the main cause of two world wars in the twentieth century. Colonialism which hurled the weak nations into the abyss of poverty through merciless exploitation is an offshoot of self interest. Despite the availability of abundance of resources and extreme economic prosperity which are enjoyed only by the minority of western countries, majority of the people around the globe are still living in extreme poverty deprivation and destitution.

Moral sense is the basic element, which distinguishes man from other living species. As regard greed, covetousness, self interest, anger and an instinct for the preservation of race, there is no difference between animal and human. However the animal species lack consciousness of good and bad, virtue or vice while man is endowed with this sense.

Allah/God says in the Holy Quran:

“----then inspired it with its wickedness and its piety” (91:8).

This implies that the Lord of the Universe has Himself created the essence of morality in human nature. One aspect of man's creation as the noblest species is that he possesses the sense of morality. Man's physical structure in its shape and capability is unique and is endowed with the power to subjugate the forces of earth and sky. Humanity can make this conquest really useful both to himself and the entire humanity is the light of morality. But the edifice of contemporary economic system/capitalism is devoid of moral values. In the philosophy of capitalism there is neither the concept of morality and intervention, nor the concept of good or bad. Human being which is the best among all creatures can behave like animals. To earn maximum profit, nobody feel hesitation in resorting to unfair and immoral practices. Goods harmful to health and detrimental to morality are sold through attractive and deceptive advertising. To create artificial shortage products are destroyed on mass scale. Competitors are driven out of business to capture foreign markets by dumping. The rich and powerful can exploit the weak and poor as long as the situation and market allows. For example according to Quantity Theory of Money an increase in printing new currency actually increases the rate of inflation in

the same proportion. The Quantity theory of money is implemented only in the developing world. After the collapse of Breton woods system in 1971 the leader of the liberal capitalist camp USA always printed currency but never brought inflation, which actually confirms that economics theories can claim neither scientific laws nor universal truths. The Rich and powerful countries always used the economic theories for the exploitation of weak and poor countries.

Private proprietorship and partnership were the major type of business practiced since the creation of human being, while Joint Stock Company came into being in the 17th century after the industrial revolution in Europe. When a single person/group of persons cannot provides funding for some business activity, then in order to benefit from the small savings of ordinary public, the concept of Joint stock Company were introduced.

In order to exploit the third world countries these contemporary financial institutions for the maximization of their self interest feel no hesitation in resorting to fair or fould means. The logic/rule of game applied in the Global Financial Institution/Joint Stock Company can clarified from the following specific example that when a man went to a village in India. This man then announced to the villagers that he intends to buy monkeys for \$10. The villagers seeing there were many monkeys around, went out to the forest and started catching them. The man bought thousands at \$10, but, as the supply started to diminish, the villagers stopped their efforts. The man further announced that he would now buy at \$20. This increase in price gives more attraction to the villagers and they started catching monkeys again. Soon the supply diminished even further and people started going back to their farms. The offer rate

increased to \$25 and the supply of monkeys became so little that it was an effort to even see a monkey, let alone catch it. The man now announced that he would buy monkeys at \$50. However, since he had to go to the city on some business, his assistant would now act as buyer, on his behalf. In the absence of the man, the assistant told the villagers: Look at all these monkeys in the big cage that the man has collected. I will sell them to you at \$35 and when he returns from the city, you can sell them back to him for \$50. The villagers squeezed together their savings and bought all the monkeys. Then they never saw the man or his assistant again, only monkeys everywhere.

In order to advance the agenda of capitalism on global scale, or globalization, multinational corporations have taken the lead, with multilateral organization like the International Monetary Fund, World Bank, World Trade Organization and even the United Nation, supporting this agenda by preparing the ground for corporations to make headway into expanding global market. The international financial institutions (IFIs) have established an institutional framework for a process of development and free international trade, so as to create an environment of mass production. The fruits of this prosperity are enjoyed only by the minority of western people while large majority of people around the globe are condemned to live under the shadow of poverty and destitution.

The third world countries are in fact trapped with a new kind of colonialism, the international financial institutions (IFIs) have established an institutional framework for a process of development and free international trade.

Structural adjustment programs which emphasis on liberalization and opening up of the economies of the third world countries to global capital were in fact the economic and political agenda of the colonial powers.

C; *Laissez-Faire* :

Like Islam the church too in the middle Ages consider every Christian as part of a community with rights and duties vis-à-vis that community. The duty of every Christian was not only to avoid exploiting others but was expected to help the poor. Like Islam the major teaching of Church on economics was the concept of just price and the prohibition of usury/interest rate (Leviticus 25 and Deuteronomy 23). Society needed money lending, while Christian doctrine forbade it. The prohibition of usury vexed the medieval thinking. It was also difficult to decide whether 10, 12.5, 15 or 20 per cent was decent, so the bankers went on lending and investing at whatever rates the situation would bear. This brought the concept of Laissez-Faire/Absence of interference and hence market economy. According to this rule, the state should not intervene in any way in the economics activity of individuals. Decision on economic matters and their implementation should be left to the market. State interference will distort the ideal state of affairs. Later on this concept of Laissez-Faire became the policy prescription for the Global Economic governance. Free trade, freedom of capital movements and unrestricted access by multinational firms to markets around the globe should be the goals for international governance.

In the contemporary period, debt has replaced colonial states as the mechanism by which wealth flows from the poor to the rich countries. It is now widely believed in the developing countries that the IMF and

World Bank, or the Washington Consensus have recently taken over the world and are influencing their capitalist ideologies to suit their own self interests. In the poor and developing countries, politicians, academics, journalist and numerous others concerned segments of society have come to believe that their own governments have lost all sense of autonomy and now merely follow dictation from the IMF and World Bank. For the implementation of capitalism around the globe these two agencies in Washington today exert the strongest external influence.

Professor Joseph Stiglitz has been a critic of Washington Consensus policies and the way it addressed issues across the globe. He writes:

“In its original conception, then, the IMF was based on a recognition that market did not work well-that they could result in a massive unemployment and might fail to make needed funds available to countries to help them restore their economies. The IMF was founded on the belief that there was a need for collective action at the global level for economic stability, just as the United Nations had been founded on the belief that there was a need for a collective action at the global level for political stability. The IMF is a public institution, established with money provided by tax payers around the world. This is important to remember because it does report directly to either the citizens who finance it or those whose lives it affects. Rather, it reports to the minister of finance and the central banks of the governments of the world. They assert their control through a complicated voting arrangement based largely on the economic power of the countries at the end of World War II. There have been some minor adjustment since, but the major developed countries run the show, with only one country, the United States, having effective veto. (In this sense, it is similar to UN, where a historical anachronism

determines who holds the veto-the victorious power of World War II-but at least there the veto power is shared among five countries.)

Over the years since its inception, the IMF has changed markedly. Founded on the belief that markets often worked badly, it now champions market supremacy with ideological fervor. Founded on the belief that there is a need for international pressure on countries to have more expansionary economic policies-such as increasing expenditures, reducing taxes, or lowering interest rates to stimulate the economy-today the IMF typically provides funds only if countries engage in policies like cutting deficits, raising taxes, or raising interest rates that lead to a contraction of the economy. Keynes would be rolling over in his grave were he to see what has happened to his child.

The most dramatic change in these institutions occurred in the 1980s, the era when Ronald Reagan and Margaret Thatcher preached free market ideology in the United States and United Kingdom. The IMF and the World Bank became the new missionary institutions, through which these ideas were pushed on the reluctant poor countries that often badly needed their loans and grants. The ministers of finance in poor countries were willing to become converts, if necessary, to obtain the funds, through the vast majority of government officials, and more to the point, people in these countries often remained skeptical.

...A half century after its founding, it is clear that the IMF has failed in its mission. It has not done what it was supposed to do-provide funds for countries facing economic downturn, to enable the country to restore itself to close to full employment. In spite of the fact that our understanding of economic processes has increased enormously during the last fifty years, and in spite of IMF's efforts during the past quarter century, crises around the world have been more frequent and (with the exception of great depression) deeper. By some reckonings, close to a

hundred countries have faced crises. Worse, many of the policies that the IMF pushed, in particular, *premature capital market liberalization*, have *contributed to global instability*. And once a country was in crises, IMF funds and program not only failed to stabilize the situation but in many cases actually made matters worse, especially for poor. The IMF failed in its original mission of promoting global stability; it has also been no more successful in the new missions that it has undertaken, such as guiding the transition of countries from communism to a market economy...

...The ideas that were developed to cope with problems arguably specific to Latin American countries, subsequently been deemed applicable to countries around the world. Capital market liberalization has been pushed despite the fact that there is no evidence showing it spurs economic growth. In other cases, the economic policies that evolved into the Washington Consensus and were introduced into developing countries were not appropriate for countries in the early stages of development or early stages of transition.

To take just a few examples, most of the advanced industrial countries-including the United States and Japan-has built up their economies by wisely and selectively protecting some of their industries until they were strong enough to compete with foreign companies. While blanket protectionism has often not worked for countries that have tried it, neither has rapid trade liberalization. Forcing a developing country to open itself up to imported products that would compete with those produced by certain of its industries, industries that were dangerously vulnerable to competition from much stronger counterpart industries in other countries, can have disastrous consequences-socially and economically. Jobs have systematically been destroyed-poor farmers in developing countries simply could not compete with the highly subsidized good from Europe and America-before the country's industrial and

agriculture sectors were able to grow strong and creates new jobs. Even worse, the IMF's insistence on developing countries maintaining tight monetary policies has led to interest rates that would make job creation impossible even in the best of circumstances. And because trade liberalization occurred before safety nets were put into place, those who lost their jobs were forced into poverty. Liberalization has thus, too often, not been followed by the promised growth, but by increased misery. And even those who have not lost their jobs have been hit by a heightened sense of insecurity.

Capital controls are another example: European countries banned the free flow of capital until the seventies. Some might say it's not fair to insist that developing countries with barely functioning bank system risk opening their markets. But putting aside such notions of fairness, it's bad economics; the influx of hot money into and out of the country that so frequently follows after capital market liberalization, in the manner pushed by the IMF, amounted to setting them off on a voyage on a rough sea, before the holes in their hulls have been repaired, before the captain has received training, before life vests have been put on board. Even in the best of circumstances, there was a high likelihood that they would be overturned when they were hit broadside by a big wave.

The application of mistaken economic theories would not be such a problem if the end of first colonialism and then communism had not given IMF and the World Bank the opportunity to greatly expand their respective original mandates, to vastly extend their reach. Today these institutions have become dominant players in the world economy. Not only countries seeking their help but also those seeking their "seal of approval" so that they can better access international capital markets' and must follow their economic prescriptions which reflect their free market ideologies and theories.

The result for many people has been poverty and for many countries social and political chaos. The IMF has made mistakes in all the areas it has been involved in: development, crisis management and in countries making transition from communism to capitalism. Structural adjustment programs did not bring sustained growth even to those, like Bolivia, that adhered to its strictures; in many countries, excessive austerity stifled growth; successful economic programs require extreme care in sequencing-the order in which reforms occur-and pacing. If, for instance, markets are opened for competition too rapidly, before strong financial institutions are established, then jobs will be destroyed faster than new jobs are created. In many countries, mistakes in sequencing and pacing led to rising unemployment and increased poverty.

Underlying the problems of the IMF and other economic institutions is the problem of governance: who decides what they do. These institutions are dominated not just by the wealthiest industrial countries but by the commercial and financial interest in those countries, and the policies of these institutions naturally reflect this. The choice heads from these institutions symbolizes the institution's problem, and too often has contributed to their dysfunction. While almost all of the activities of the IMF and the World Bank today are in the developing world (certainly, all of their lending), they are led by the representatives from the industrialized nations (By custom or tacit agreement the head of the IMF is always a European, that of the World Bank an American). They chosen behind closed doors, and it has never even been viewed as a prerequisite that the head should have any experience in the developing world. These institutions are not representatives of the nations they serve²".

² Source: Joseph Stiglitz, *Globalization and its Discontents*, Allen Lane, London, 2002, pp. 12-19.

III: Role of Econometrics in Economics

In other discipline of science there is biometrics, sociometrics, anthropometrics, psychometrics and similar sciences which are devoted to theory and practice of measure in a particular field of study. Similarly in the science of Economics, econometrics is allocated for the measurements of things in economics like economy. Researcher and academician usually define econometrics, "as the application of mathematical and statistical methods to the analysis of economic data for prediction/forecasting purposes". In other words the task of econometrician is the specification/statement of a theory, devising a model and then making prediction/forecasting. But the ground reality exhibits that the role of econometrics is the opposite. This trend has made the science of economics extremely doubtful because it neither explains, nor address, real world events nor facilitate policy evaluation. Many scholars think that Econometrician have been over confident in their methods; believing that if something cannot be measured, quantified, or tested by the methods of econometrics, it either does not exist or at least is irrelevant to the subject of economics.

For example in order to enhance the productivity of wheat crop a Biotechnologist applies different inputs to wheat plant in his greenhouse. He either increases or decreases the temperature or fertilizers or raining. With these changing inputs, the researcher then calculates and measures the roots and grains of the plants in order to know the change in the productivity of wheat crop due to changing inputs. The aim of the researcher in Biotechnology is to determine the unknown law of nature for the enhancement of productivity.

On the other hand in case of economics a researcher usually know everything in advance before his research. Economists devise a story and then show a statistically and economically significant relationship according to the devised story. For example if an economist designed a story that job training will enhance worker productivity and devised the following model,

Wage = $f(\text{education, relevant experience, training, innate ability})$

Wage = $\beta_0 + \beta_1 \text{ education} + \beta_2 \text{ Relevant Experience} + \beta_3 \text{ Training} + \mu$

After the collection of data if the regression results comes out that the independent variables has a negative impact on dependent variable, then the researcher would either increase the independent variables or would add log to the dependent/independent variable or will increase the number of observations/data or will do some other mathematical and statistical work so as to make the results according to the story. The researcher/econometrician is determined that he will bring and manipulates statistically and economically significant results according to the story and hypothesis in advance. In the results when t values is greater or equal to two (**$t \geq 2$**), **then it is** considered as a universal fact that the results are significant. The research is then treated that it shows an important empirical relationship in the real world which always proved to be misleading. Modern economists who are well-trained in the subject of statistics actually know that such an inference is mistaken; it is routinely undertaken and is considered as a universal truth. Usually after research the biggest compliment that one economist can give another is that his research is showing a robust relationship.

In research anything which cannot be measured, tested or quantified is usually put in the category of Ceteris Paribus / other things remains the same, which conveniently suited their hypothesis and stories. Economist always presented simple things in a complex and ambiguous languages³. Economists until today were unable to create a model for a situation in which other things do not remain the same. To investigate an issue economist strictly adheres to the principle of using econometrics techniques and often excluded other alternative approaches.

In short the science of economics, like other natural sciences, applies objective method to test hypothesis about human behavior and does not accept any metaphysical postulates due to the lack of controlled experiment. The evidence is interpreted as an element of personal judgment which leads toward different interpretations, and there is no final method to reach the truth.

Empirical failure of regression model:

George Bernard Shaw once famously said, "If all economists were laid end to end, they would not reach a conclusion". Without unrealistic assumptions, Economic theories can claim neither scientific laws nor universal truths, which is the reason for the disagreement among economists on any issue. In fact Economists, as a group, mistook beauty, clad in impressive-looking mathematics, and designed unrealistic

³The following joke represents the profession of economist, "In Canada there is a small radical group that refuses to speak English and no one can understand them. They are called separatists. In this country (USA) we have the same kind of group. They are called economists". Nation's Business

assumptions for capturing the ground realities of the universe. In fact economists were unable to settle a single theoretical dispute.

Large forecast errors in econometric models following the oil crisis in the 70's started suspicion on the conventional methodologies of economics. Even after the oil crisis, it was impossible to construct a model so as to explain the ground realities therefore economists as usual argued that the price rise was caused solely by the market forces while ignoring the crucial role played by the war between Israel and its Arab neighboring countries.

Similarly before the 1997 financial crisis in South East Asian Countries numerous papers through Econometric techniques proved every kind of Foreign Investment as extremely beneficial for the rapid growth rate of the developing countries i.e by showing a statistically and economically significant relationship between Investment and growth. After the Financial Crisis only Foreign Direct Investment were proved to be beneficial for the rapid growth of the developing countries. In retrospect East India Company came to India in the form of FDI while later on colonize the entire India. A Statistically and Economically significant relationship between FDI and growth rate of the developing countries shows FDI as extremely beneficial for the third world countries, but the real world situation exhibits these FDI as a new form of colonization⁴.

⁴ The following joke represents the job of econometrician in the science of economics "A mathematician, an accountant and an economist apply for the same job. The interviewer calls in the mathematician and asks "What do two plus two equal?" The mathematician replies "Four." The interviewer asks "Four, exactly?" The mathematician looks at the interviewer incredulously and says "Yes, four, exactly."

In support of the above statement another concrete example may be quoted from the recent paper of Asad Zaman, who regressed Life Expectancy (LE) and Log of number of newspapers published per 1000 people (LN) by using World Bank data which provides information on both variables in 1990 for nearly all countries. The regression of LE on LN has

$R^2 = 0.81$, and S.E.R of 5.2.

$$\text{LE} = 45.0 + 5.48 \text{ LN} + \epsilon,$$

(1.2) (0.3) (5.2) (Standard Errors are given in parentheses)

This model shows a statistically and economically significant relationship between LE and LN⁵. From this relationship someone may argue that the significant t-statistic on LN proves that reading newspapers leads to longer lives, and argues that developing countries should concentrate on increasing the publication of newspapers as a means for improving life expectancies.

In above model if someone raises the issue of omitted variable bias, then he further included all health relevant variables for which data was

Then the interviewer calls in the accountant and asks the same question "What do two plus two equal?" The accountant says "On average, four – give or take ten percent, but on average, four."

Then the interviewer calls in the economist and poses the same question "What do two plus two equal?" The economist gets up, locks the door, closes the shade, sits down next to the interviewer and says "What do you want it to equal?"

⁵ After research the biggest compliments that one economist can give another is that his research is showing a robust relationship.

available in sufficient quantities in the World Bank data base. This led to the following regression, with

$R^2 = 0.74$, and S.E.R = 3.8:

$$LE = 57.2 + 6.0 LN - 0.7 LHB + 0.08 ImpSan - 0.04 ImpWat + 4.8 LPhys + \epsilon$$

(8.9) (2.7) (2.8) (0.06) (0.16) (2.6)

Here, LHB and LPhys are logs of Hospital Beds and Physicians per 1000 population respectively, while ImpSan and ImpWat measure improvements in sanitation and water supply. LN remains the only variable which is significant at 95% level. Interestingly, its coefficient also remains stable despite the addition of several variables. All variables other than LN are insignificant.

Using Econometric techniques majority of the papers like the above regression model says nothing of relevance to the real world, and the policy conclusion drawn is meaningless. Countless instances of similar strategies can be pointed out in currently published papers.

Asad Zaman argued

“from the inauspicious beginning of Yule on multiple regression since 1899, no regressions model until today yield a single demonstrable and solid successful discovery of a causal relationship. In a talk on the 100th anniversary of the first published regression of Yule, Freedman (1997, p.113) writes: “For nearly a century, investigators in the social sciences have used regression models to deduce cause-and-effect relationships from patterns of association. This enterprise has not been successful.” For nearly every posited causal mechanism in economic theory, there are econometric papers on both sides of the issue. A widely believed causal

claim is that growth of the money stock causes inflation. However, in a careful study based on the most recent methodological advances, Hendry and Ericsson (1991) dispute this claim of Friedman and argue that the causality runs in the other direction. The core of the rejoinder by Friedman is simply that complex econometric analyses often fail in the real world; in support of this he cites personal experience rather than analytical or theoretical arguments. The consumption function introduced by Keynes is at the heart of macroeconomics, and has been intensively studied. Despite its central importance and extensive research, there is a bewildering variety of variables with claims to be causes of consumption, all supported by econometric analysis. Furthermore, the best available models routinely fail; Thomas (1993, p 284) writes that "Perhaps the most worrying aspect of empirical work on aggregate consumption is the regularity with which apparently established equations break down when faced with new data".

Social reality which are extremely complex actually contains meaning, values; ethics and so forth, cannot be measured or quantified only by the modern mainstream economics with its emphasis on mathematical modeling (as well as its employment of bizarre assumptions such as rational expectations, representative agents, two commodity worlds and all the rest that are maintained).

In analyzing social reality inappropriate techniques are utilized and forcefully implemented on others until today by the hegemonic west. Today the mainstream economic academy is dominated by the western countries which possess and utilizes a power to ensure that no approach except mathematical modeling should be used in all economic research. Today success in the field of economics depends on the number of articles published in generally recognized journals. Only refereed reviews

are acceptable while books are ignored because they are less strictly refereed. The emphasis and priority of referees are formalism and technicalities i.e. the mathematical model is correct and whether the most advanced techniques have been used for econometric estimates, while the content and insight for understanding the real world is given less importance.

It is a compulsion and obligatory on every economist to use model in their research not because of any belief in their relevance or benefit in addressing real world events. According to Paul Krugman economics is a collection of formal models⁶ applied to analysis of specific problems and to an explanation of economic phenomenon. The fundamental purpose of economic research is to create new models or to extend existing one. The professional training of economist centers on the task of learning analytic tools and knowing which model is applicable to a particular circumstance. To paraphrase the opinion of Paul Krugman, that models define the subjects of economics means that if there is no model available to explain a particular phenomena, that phenomenon is of little interest to the economic profession regardless of its importance for the real world. Krugman has suggested that this explains why little attention has been given to the determinants of economic developments, an area for which economists have not yet developed an adequate model.

⁶ The following joke represents the profession of mainstream economist.

A mathematician, a theoretical economist and an econometrician are asked to find a black cat (who doesn't really exist) in a closed room with the lights off:

- The mathematician gets crazy trying to find a black cat that doesn't exist inside the darkened room and ends up in a psychiatric hospital.
- The theoretical economist is unable to catch the black cat that doesn't exist inside the darkened room, but exits the room proudly proclaiming that he can construct a model to describe all his movements with extreme accuracy.
- The econometrician walks securely into the darkened room, spend one hour looking for the black cat that doesn't exist and shouts from inside the room that he has it caught by the neck."

The utility of a model is situation specific while the situation is always changing therefore it is very difficult to know which model is in fact applicable and whether the model can actually predict or explain the outcome of a particular situation. Despite claims of the universality of economic laws, economists have extreme difficulty identifying such laws, and agreement on the validity of any specific law may be impossible to achieve. For this reason, John Stuart Mill referred to economics as an inexact science and characterized its laws as tendency laws; that is as generalization regarding what will happen if no disturbing event should intervene.

It is a well know fact that only modelers get appointed and promoted not only in universities economic faculties but also get research grants for PhD and Post Doctorate. Researches which incorporate model are only published in core journals. This is also the reason that most economist hesitate from criticizing this tradition of constructing model in economic research.

Conclusion:

After the collapse of USSR, Capitalism stands alone as the only economic system practiced around the globe. But in the third world countries this time, has been a time of economic suffering, tumbling incomes, anxiety and resentment of starving, rioting and looting. There is a large gap between the haves and have-nots. Resources are transferred from the poor to the rich country which continues without let or hindrance at an increasing rate every year. The rules of mainstream economics

triumphed only in the west and failed almost everywhere in the globe. There is no concept of ethics and intervention in the philosophy of capitalism. Immoral, unfair and inappropriate rules are not only practiced for running the affairs of business but also thought in economics department at universities.

The foundation of mainstream economics such laissez-faire and self interest can never bring into being a peaceful and just society. Materialism give rise to self love and selfishness which eliminate sympathy, fraternal spirit and considerateness and kindle the fire of mutual conflict in the society. Licentious and immorality which are the offshoots of the policy of laissez-faire shatter the warp and woof of society. Cut throat competition become rampant and weak sections of the society are trampled down. Utilitarianism makes individuals indifferent to collective interest. A society whose members are self seeking, selfish and self-centered, despite having ample resources, can never be free of economic hardship and misery.

Unlike the Newton Gravitation Force in physics, no single law in the science of economics got the status of universal truths. In economics there can only be tendencies, and even these tendencies are subject to great variations in different countries and cultures and at different times. Many so called general economic models are in fact based on a set of implicit assumptions about human behavior and economic relationship which have no connection with the ground realities of the world. It is a compulsion on economist to use only models in research. For more than 100 years this culture of model/ assumptions in research did not yield a single solid discovery. From ordinary person to even mainstream economist, everyone is now raising the question that economist will ever reach to stage to design a model without the assumptions of other things

remain the same and then explain or even address real world issues and events. Economists were unable to settle a single theoretical dispute.

There is utmost need for reassessing the entire intellectual edifice of the contemporary mainstream economics. Contemporary economics and hence capitalism were unable to solve the basic problems faced by the humanity. In short the theory of economics does not furnish a body of settled conclusions immediately applicable to policy.

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