Concordian economics and the economic bubble

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Reading “Dazed and Confused: Eugene Fama’s Bizarre 2010 Interview” by Philip Pilkington makes it more urgent for me to convey to the readers of *Econintersect* the meaning of a “bubble” that stems from Concordian economics. Here it is, fresh as I wrote it in 2002, when it was rejected for publication by both the *American Economic Review* and the *Wall Street Journal*.

Concordian economics

Readers of *Econintersect* are uniquely equipped to understand the function of rejections (see the delightful “Is Peer Review Forcing Academics to Become Prostitutes?” by Philip Pilkington) as well as to place the following in the context of Concordian economics.

What Is a Bubble?

December 2002

What is a bubble? This is the question asked by Robert Bartley, the editor of the *Wall Street Journal*.[1] It is an important question, given our current status in relation to the business cycle, and it deserves an answer.

In the proceeding I will attempt to clarify whence my daring to suggest that I might have an answer, while Charles P. Kindleberger, for instance, admits that there is no agreed upon definition yet in the economics literature. After all Kindleberger, in the apt words of Bartley, is "the profession's high priest of bubbles, or at least of '*Manias, Panics and Crashes*,' the title of one of his books now selling well in the boom-and-bust stock market." Kindleberger, as quoted by Bartley, has acknowledged that

> *"At the time of writing* [in '*The New Palgrave*', 1987], *the theoretical literature has yet to converge on an agreed definition of bubbles, and on whether they are possible*."

Rather than spending a thousand words trying to summarize the research that leads to it, let me offer the following figure[2] as a starting point of our discussion:

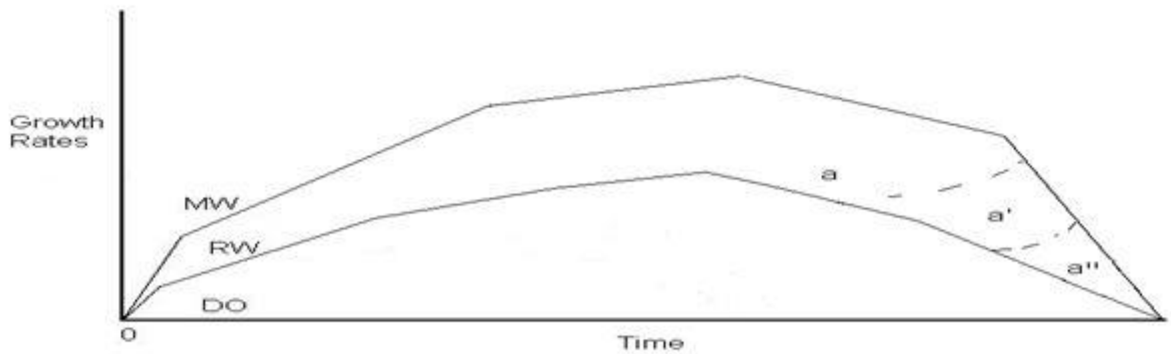

Figure 1. A Conceptual Graph of the Business Cycle

Where, DO stands for distribution of ownership rights over income and wealth. As we know, notwithstanding some significant changes this line remains rather constant over time. Hence it is here depicted as a flat line.

RW stands for real wealth. As we know, the value of real wealth tends to grow over time. But then, at times it does decrease. When its value decreases, production tends to decrease. History tells us that the decrease of real wealth can stop at any time, but there is no assurance as to when or where it will stop. With wealth gone, some civilizations have even disappeared from the face of the earth.

MW stands for monetary wealth. As we also know, the value of monetary wealth tends to grow over time as well. And it tends to grow faster than the value of real wealth. It is in this disjunction that we can find the definition of a bubble.

A bubble is a separation of monetary values from real economic values.

I am not writing this definition to suggest that the reader should accept it as the ultimate truth, but as a potential truth that results from a new economic paradigm on which I have worked ever since, in 1965, I changed the second equation in Keynes' model of the economic system and found myself in an entirely new intellectual world.[3] Contrary to the world of contemporary economics, as we can see from the given figure, the value of real wealth is systematically distinguished—and measured in any *numeraire*—from the value of monetary wealth, and the issue of ownership of wealth by individual human beings is made an indispensable and integral part of economic theory.

These and many other consequences stem from a single innovation. Rather than asking what is saving, as economists have done for more than two hundred years, I asked: What is investment? The resulting answer was:

Investment is income minus hoarding, with hoarding defined as wealth that is used neither as a consumer good nor as a capital good.

The new paradigm has many roots. While at the Bologna Center of the Johns Hopkins' SAIS, I studied economics under Professor Robert Mundell, and my work has received so much assistance over the years from Professor Franco Modigliani that it has been a beautiful duty for me to dedicate to him my first book in economic theory. Another economist who has influenced my work very deeply is the late Professor M. L. Burstein.

For a number of consilient reasons, I like to call the new paradigm Concordian economics. So far the core of Concordian economics is contained in *The Economic Process,* the first in a series of monographs that are in various stages of preparation, in "*Toward the Definition of Economic Rights*", a paper that appeared in the *Journal of Markets and Morality* in the spring of 1999, and in a few other published articles. Clearly, even though I have worked on these issues for so many years, there is still much work to be done. Above all, there is the need to organize the numbers in accordance with new categories of thought.

If we had the numbers, we would be able to analyze in detail the relationships suggested in the above figure and we might be able to make more reliable predictions about our immediate future. But we do not have the numbers and, while waiting for them, we should learn to appreciate what we have. As pointed out by Henry Poincaré, the great mathematician who so significantly advanced the discipline of nonlinear dynamics, we can learn a lot from qualitative relationships. Let us do just that. Here are a few observations.

The size of the bubble is represented by area "a" in our conceptual graph. The graph also indicates that, as suggested by area a' and area a'', the sooner we close the gap between the value of monetary wealth and the value of real wealth, the less chance we have to do damage to the value of real wealth.

In the abstract, the value of monetary wealth can even fall below the value of real wealth—all the way to the point of hindering the replacement of real wealth. We have then a serious depression.

Rather than brooding over the dangerous situation we are in at present, let us try to reach a balance between the two sets of values as soon as we can, and let us try to keep that balance in the future.

How to achieve that feat? We have to backtrack and be concerned more with the past than with the future for a moment. The question is: How do we, so often, get in such a predicament as we are at present? The question was elegantly and technically formulated by Mr. Bartley in the same article more or less in this fashion: "*Are markets irrational or are they efficient?*"

My research suggests this answer: "Yes, both." The roots of the bubble lie in a clash between individual rationality and collective irrationality.

People clearly hoard wealth to build economic security. In a climate of general insecurity, this is the only rational course of action left to individual human beings. Yet, the more we hoard, the more damage we do. This is not the first case in which we destroy what we love most.

Needless to say, even though from Jesus of the Parable of the Talents to Locke everyone knew hoarding, contemporary economic theory cannot formally recognize hoarding and the phenomenon remains outside the purview of most economists. My research, instead, has led me to place an enormous importance on the hoarding of wealth. By distinguishing—*pace* Adam Smith—hoarding from investment, and recognizing it as all wealth that is kept in a nonproductive state for any number of reasons, one can offer a tenable hypothesis that hoarding has an effect on levels of growth, inflation and deflation, and even poverty.

Clearly, the more we hoard, the less we have available for investment and economic growth.

While the impact of hoarding on growth is clear-cut, the relationships between hoarding and the value of money are irremediably complicated. We can hoard currency and keep it directly under the mattress or in a safe deposit box. This action reduces the dangers of inflation. However, people also spend money on items that they hoard. And it is here that the effect on inflation is most disturbing: This is an unpredictable demand that cannot be sustained, hence prices grow higher than they otherwise would; and while the real wealth is hidden away, the money to buy it remains in circulation and fans the flames of inflation even higher. That is the beginning of the bubble, the beginning of the separation of real economic values from inflated monetary or financial values. Then there are the effects of the—generally—abrupt attempt to unleash upon the market the wealth that has been stored away earlier. That is the beginning of deflation.

The more we hoard, the less is available to others.

Where is the solution to all this variety of different problems? The solution lies on a different level of analysis. The solution lies at the level of the analysis of national economic policies. I will limit myself to only one sentence on this broad issue.

Collective irrationality stems from the ability of current economic policies to generate economic insecurity for all.

Notes

1. Robert L. Bartley, “What's a 'Bubble' Anyway? Don't use terminology in lieu of analysis.” *Wall Street Journal*, August 5, 2002.

2. The reasoning leading to this figure is included in Carmine Gorga, “The Dynamics of the Economic Process,” unpublished manuscript.

3. For a first installment of this new paradigm, see *The Economic Process: An Instantaneous Non-Newtonian Picture* (University Press of America, 2002).

References

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_____. *The Economic Process: An Instantaneous Non-Newtonian Picture*. Lanham, Md. and Oxford: University Press of America, 2002b.

About the author

Carmine Gorga (see Wikipedia and Google Scholar) is president of The Somist Institute. The mission of the institute is to foster sensible moral leadership. He is a former Fulbright scholar and the recipient of a Council of Europe Scholarship for his dissertation on "The Political Thought of Louis D. Brandeis." By inserting Hoarding into Keynes' model of the economic system and using age-old principles of logic and epistemology, in a book and a series of papers Dr. Gorga has transformed the linear world of economic theory into a relational discipline in which everything is related to everything else—internally as well as externally. He was assisted in this endeavor by many people, notably for 27 years by Professor Franco Modigliani, a Nobel laureate in economics at MIT. The resulting work, The Economic Process: An Instantaneous Non-Newtonian Picture, was published in 2002 and has been reissued in a third edition in 2016. For reviews, click here. During the last few years, Dr. Gorga has concentrated his attention on the requirements for the unification of economic theory, policy, and practice calling this unity Concordian economics. He is also integrating this work into political science, which he calls Somism, and culture in general, which he calls Relationalism.