The Future of Economics

In this short essay I am trying to make convincingly available to my readers an astonishing fact, or what you may regard initially as an astonishing claim. The claim is that the present economic mess has its roots in some very simple errors that were identified more that seventy years ago. The discovery of these errors was the achievement of an Irish-Canadian Jesuit, Bernard Lonergan. His writings of the last century have been made available in the past two decades, but they have so far not caught the attention of main-stream economists. What is needed is a stirring in public interest beyond the sense that something is terribly wrong, In Ireland, in Greece, In the United States, indeed globally. We need a stirring that would nudge economists and politicians to face the needed shifts of policies and practices.

How might that interest be stirred? It occurred to me that a broad compact presentation of what Lonergan has figured out just would not do. Such a presentation has been made available already and has had no impact. But what if one took one simple error, the simple error, of present economics, and aired it sufficiently to an audience that, so to speak, could pick it up and run with it?

So, I undertake to focus here on the astonishingly simple mistake that is locked into present economic teaching from school level onwards, summed up in the claim that THERE ARE TWO TYPES OF FIRM. Indeed, some of you may already be with me in that claim, and even say, "everyone knows that!" Well, amazingly, the reality of present economic teaching, research, bank and government policy, stands against that common assumption of any little business. How can this be? And how is it that such a simple oversight can give rise to the financial stupidities that have left us, well, as we find ourselves now in Ireland and in Europe? These broader questions are indeed, what interests you and I immediately. Unfortunately, the answers to these broad questions are difficult. My appeal is for your patience with my approach: let us identify the simple root, then see where it goes later, through larger puzzlings, broader readings. Let me begin then with what you will find to be shockingly simple musings that, yes, may find the echo in you expressed by the phrase, "but everyone knows that!"

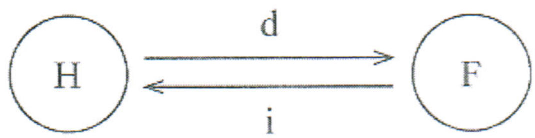
There are Two Types of Firm.

Here I wish only to talk quite simply about how the working of any particular firm, as it is presented in any elementary economic text, is so simplified as to ground a fundamental disorientation of all of economic science and practice at all levels. This is an extraordinary claim, yet I would have you grasp it as your own claim. Already I have noted my own and your bent to push further. Will the simple fundamental adjustment to the beginning of economics that comes out of this small venture really lift economics towards a new seriousness that will cut out the idiot and selfish financial goings-on of places like Wall St., the stupidities of governments in their spending and tax-policies, international economic gangsterism, etc etc? As I noted at the beginning, the answers are in fact available. My challenge here is to make the silly mistake and the necessary new beginnings popularly evident through a few homely reflections and some associated diagrams. And all this is summed up in the slogan, mentioned at the beginning and given as title of this section: **there are two types of firms**. Taking that into account - **and** into accounting - leads to a science of economics that is to clean up all the mess of finances that have destroyed businesses and nations and cultures in the past one hundred years.

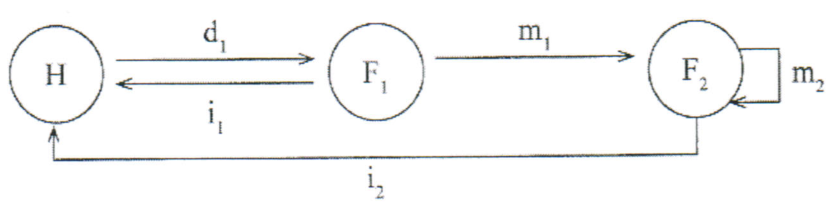
So, we start now with the standard diagram of current economic texts[1] and move fairly smoothly to a diagram that points to that new science of economics that is to save us from global disaster. I wish you to come with me slowly and quietly from the standard diagram, through two transition diagrams, to the central scientific diagram of future economics.

We start with the standard Household to Firm diagram of the first weeks of elementary economics, with the obvious meanings for the symbols of Households, Firms, income and demand:

[1] One need only check any present standard text. McShane, *Economics for Everyone*, gives a standard text simple version of economic transactions on pp. 32-33. The fuller nonsense, with government, banks, foreign trade etc, is given there on page 127.



There is an easy way to add the second type of firm, which supplies not consumer goods, but stuff for the first type of firm: maintenance and innovative stuff, which I'll symbolize as m_i. [think of **m** as pointing to maintenance and more!! I am thinking of innovation of course] Here you are:

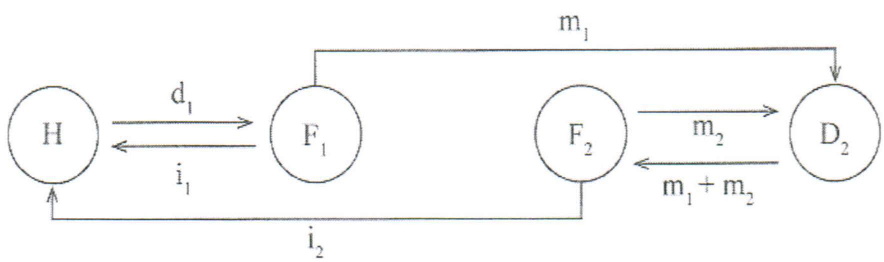


Notice now that F_2 is in the same boat as F_1 as regards maintenance and innovation. But we don't want to add F_3 , F_4 , ... I won't go into the simplification of packing in all the series of F_i

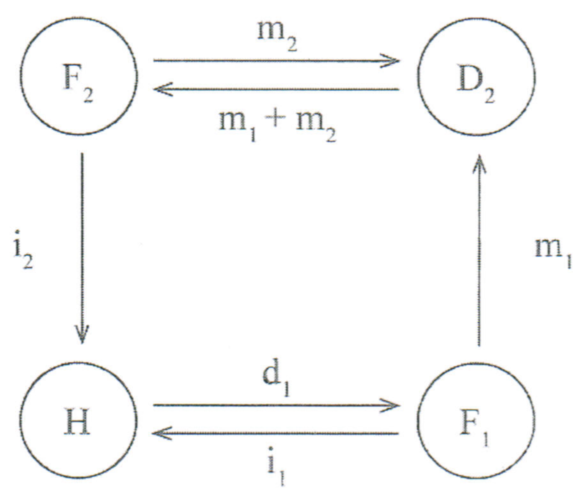
into F_2.

I just claim here that it works empirically as grounding decent measurements of business flows.

But how do we get that into the diagram?



We can make this neater by thinking of two types of demand and, if you wish, replacing Households by D_1, with flow d_1 and making e.g. d $_2$-type flowings from D_2, the demand of firms for capital stuff, marked in the diagram as m_i. Next, we find that we get a more workable diagram by laying the transactions out in a square and adding the flow lines:



This would be the beginnings of a new economics of measurable flows, one that would yield norms of financing, of profit in both normal and innovative economies, etc etc. But understanding THAT would be a slow climb through the heavy mentioned at the beginning. The fundamental need is to sort out this beginning before adding banks and taxes and international trading etc etc.