The Dialectic of Economy and Politics

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THE CONTENT

1. INTRODUCTION

I was interested in relations between politics and economics since my student days. My intention to explore these relations had grown at the Faculty of Economics, where I mainly studied the socialist economy. However, I was not quite happy with it, realizing that in the socialist countries politics totally dominated over economy. While researching, surrounded by walls of politics and economics, I began to explore the capitalist economy. Despite numerous difficulties to find professional books, studies and works of economists from the West, I learned about the theories of great economists:

- Smith 1776,
- Ricardo 1807,
- Jevons, Menger, Warlas 1871,
- Marshall 1895,
- Fisher 1907,
- Samuelson, Hick 1938-1948,
- Arrow 1954. etc.

First of all, I needed a basic "ground" for thinking about the economy, an actual and specific foundation to build my own understanding of economics and life. I tried to connect the ideas of famous economists with reality, in order to figure out the emergence of those ideas, on the one hand, and to understand their impact on reality, on the other hand. Undoubtebly, these ideas were significant if you place them in the context of reality and time when they were born. However, these ideas are totally different if you place them in today's context. I tried to isolate and determine the essence of economics, which is dominant regardless of the epoch observed. I came to the realization that economy always depends on politics (i.e. the power and wealth on which every society rests), because the relationship between politics and economics has always been strong. It is especially noticeable nowadays, therefore, to understand the current economic picture of the world it is necessary to go outside the framework of the economy.

Instead of holism and holistic observation of reality, I have noticed a boundary in the economy, accompanied by exclusivity of economists: either market or regulation. Although some economists talk about the connection between markets and regulation, basically they were divided into those for the market (liberals) and those supporting the control (dirigists). I was surprised by that dividedness and the reduction of economic science to the conflict between the two main ideas, although life and economic theory and practice, reflected in it, have been impressively complex, especially today in this interdependent and globally connected world. In addition, the simple fact - that the free market does not exist without a state – is being neglected. A lot of energy and effort has been spent in the battle of liberals and dirigists til this day. I wondered if it had its positive side? Perhaps the conflict of economic ideas is neccessary, perhaps it generates new knowledge and insights, perhaps it reflects the progress of economic science and its impact on material reality. I say perhaps, because I am not sure about all this despite the opinion of some economists, such as Madzar (Madzar, 2013), claiming that it may be good for economic science.

However, concern remains with me. How much are those polarizations the result of poor understanding of economic processes, and how much they are ideological speculations? I especially wondered: What if they are utopian? Which part of it belongs to a fiction?

With significant efforts to understand economic phenomena and processes, and to summarize the findings regarding the relationship between politics and economics, I tend to find the way that will hopefully shed some light into the haze of economic science, which has collapsed in the 21st century and often insists as a part of abstract models that do not exist in practice. In today's complex world, it is necessary to understand the economics and the politics, in order to comprehend the enormously complicated relations in the society. I therefore emphasize this as a mission of this book, in order to navigate readers through the maze of modern economic and political events.

I was not impressed by the market-oriented fundamentalism of the West, as it has often been painted utopian colors. This extreme means the assumption of a fully competitive market, free of all failures (mistakes), powers, and political interventions! This is an idea of the market as a perfect mechanism. This is an ideal, but not the reality. For example, how to

succeed at the labor market? Stiglitz and Krugman, great economists and Nobel Prize laureates in economics, believe that the labor market has never existed according to the theory. Today, in transitional countries, people are increasingly wondering where is this market which will valorize their value in the correct manner?

Unfortunately, the market mechanism failed to comply with the schedule of knowledge, the most important resource nowadays. When will market successfully allocate the atomized knowledge – we still don't know. According to some leading economists (Madzar, Draskovic et al.), institutions are the most important. I know, the institutions need to be developed, they are the link between the state and the market. But when will institutions enable that process, and is it even possible? It seems to me that in answering to this question, whether in terms of institutional development or in terms of proposing another model, there is a significant presence of utopia. This is particularly important in regards to the transition duration of existing institutions. Perhaps the market is expected to be a superior mechanism, a top regulator, while the man and the society are imperfect, primarily because the man is not only economic entity, but - more importantly for understanding the economic activity - man is a political entity. This means that the political power of the individual or the group is an essential factor in economic activities and decision making. What is a solution? We know that all of the attempts made so far did not yield results. Democracy, as a significant achievement and value, has not had a mechanism to regulate the system, not through the history, nor it has it today. Who are the guarantees of democracy? Unfortunately, those who have political power! Those who create monopolies and distort the market! Those who work for themselves, but not for all members of the community. Consequently, Pareto equilibrium, or any other, seems unrealistic.

Today's reality is a redistribution of wealth and exploitation, which has begun long time ago. So far, all societies have worked on redistribution. The majority, which does not affect their work, must waive a large part of their work in favor of minority. Sometimes it is less noticeable, sometimes more, but it is a permanent process. This was the main division in any society, different was only the form of redistribution and the manner of its justification. In the past it was justified by religion, which was dictated by political power, ironically defending the wealth of a small number of people, while preaching about the salvation of every human soul, of every human being.

Wealth in the function of the church! Cynicism, almost inexplicable! It lasted for centuries. Political power is sometimes supported by the military. The positive processes and human aspirations for progress must not be ignored. That is the positive side of history! Thus the democracy was born, because it was necessary for the market. Do not forget that the state created the market, and then the market produced the democracy. Market and democracy are inseparable, because the market needs democracy, and vice versa. Individual freedom, as a core value, was finally implemented. But democracy and individual freedom simultaniously carry uncertainty and irreversibility. Due to irreversible processes, 80% of the income goes to 1% of the richest people in the world and continues the spillover of wealth towards that minority. It is not immanent only to capitalist society but to all other societies, and it will be as long as the world is ruled by political power.

People have strived to make a better political system since the 11th century. Great examples are: Thomas Aquinas, Thomas Hobbes, John Locke, and others. But, as I mentioned, all these efforts have not changed the mechanism. Income is still overflowing into the hands of a small number of individuals. Perhaps it is not noticeable nowadays, because the technologies have changed our standard; people live in the illusion of democracy, believing that they make decisions about the most vital things in their lives (i.e. about the results of their work). Unfortunatelly not! The most important thing is to accept the truth, and then to seek the mechanisms for advancing the position of individuals and achieving the stability in the society.

Bended under the winds of power, and squashed between the cognitive limitations, economic science has often fabricated virtual economic models, which means that they were not found in reality. Modern economists have been conceited. There are many macroeconomic papers claiming that the crisis can not happen. There are many books that glorify capitalism, particularly in the period after the Second World War. However, many ordinary people have not experienced these benefits and advantages praised in hymns. President Kennedy wrote that "a rising tide lifts all boats," but this was probably related to a small number of people in America, becoming a great inequality, unemployment, workers' discontent, an industrial machine that "swallowed" the personality and worker’s time. Stiglitz wrote an article "The Myth of America’s Golden Age," explaining that although the statement of President Kennedy was true, it was just a little grain of truth. Ame-

rica was marked by the ascending overflow, especially during the last few decades.

American institutions enabled almost unlimited influence of corporate donations on political campaigns, and distortion of the political system.

While living in a communist country, I was faced with a distorted image of reality. Political marketing was creating a picture of milk-and-honey life, but in reality most people was living in poverty, unemployment, political discrimination... In addition to the dominant Marxist school of thought, I discovered the world of Western economic thought, worshipping Adam Smith (who was misinterpreted), and the amazing efficiency of the market economy. On one hand - the best world was communist world, on other hand - the glorification of the best world of all worlds - the world of market.

Today, one of those worlds has disappeared from the face of the earth, and the other has introduced us to unbearable economic situation.

The hypothesis of this book is that we may have doubts about the market because it has its flaws. However, the market can be a powerful force for raising the standard of life through balancing the market relations and politics. The key is to integrate the political and economic system, and to find the boundary line, which is an indicator of the optimal relationship between politics and economics.

This book has no ideological aspiration, especially not in the form of Marxist ideology, which has been continued in the former socialist countries. The aim of this book is to gain knowledge that will enable the creation of less divided society, which is the dominant interest of all. The economic model that works in the interest of all citizens is sustainable. Such economic model could not be separated from the political model. Also, the subject of inequality is related to the relationship between politics and economics. Therefore, one of the goals of this book is to provide insight into the importance of differences in income and wealth, which has been kept under the rug due to many reasons (imposed by the politics and interests of the rich).

Economic science studies are in regards to how people behave and how they interact in order to improve their well-being in an environment characterized by scarcity. During the long development of society, humanity has made great progress, people have learned how to make better choices,

how to cooperate, and how to use their talents and intuition, to subsequently produce as many goods and services. This resulted to achieve great success in bringing down restrictions and improving the life expectancy and well-being.

However, this process was not easy. Many mistakes have been done, and many obstacles have been crossed, reducing people's expectations. Such situations have created enormous concern to many, because they suffered setbacks and lost opportunities. In addition to rarities[1], we must also fight stagnation, adversity and crises of all kinds. Also, we have learned that the real world is more complicated, and economic interactions are more complex than ever before. Economic science has explained the main economic activities in their complexity: saving, consumption, production, competition, money, speculation, currency exchange, and cycles. Economic science has explained those activities in many ways, developing fundamental concepts, creating economic body of knowledge. In reality, however, it goes much "deeper". Understanding the complex situation of the real world demands expertise of other sciences - history, psychology, political science, and others.

This book has the ambition to provide a broader basis for finding opportunities and threats for individuals, companies and, ultimately, the nation. Yes, in addition to funds from the economy, it expands horizons towards politics, in order to smoothly sail between the traps, and succesfully find its port of salvation – for a better world and for the progress of an individual.

Let me repeat: apart from outstanding events, all segments of modern life include good and bad things – but money has prevailed, tyranny of profits and short-term success dominates the world, without any other control except egoism; all this has led to disloyalty and destruction; unfortunately, there is no room for ethics or any other relation in the world, which would provide some noble meaning.

First chapters of this book will analyze some bad tendencies in the world, using certain statistics to demonstrate the level of threat to humanity

[1] The economy starts from the idea that all goods are rare. There is no way a country can produce infinite amount of goods. This means that no matter how the economy of a country is developed, it does not produce enough to be able to satisfy even a small number of all its inhabitants.

from the occurrence and duration of these tendencies. The following chapters will explain the emergence of the current bad situation in the world economy, with large divisions and inequalities, which are a great temptation for economics and politics. It will identify positive trends and progressive role of technology, which are the engine of development and the main instrument of spreading limited resources. It will discuss the adversarial nature of technologies that carries progress, along with its negative consequences. In the greater part of this book we will try to find out what is the role of politics in the development of negative trends and the worrying state of the world today. We will try to give a better understanding of opportunities and threats, and to provide more resources to navigate towards the survival of man and mankind. Message to the reader is to read this book till the end, not allowing the "boring" chapters to stop him/her. Benefits of this book can be gained only by reading and thinking about the issues raised and analyzed in it. They are useful for individuals, businesses and nations in order to make the best decisions in today's extremely complex and imperfect society. It is not going to be easy, because it takes time and dedication, but I hope that the reader will be pleased after traveling through the chapters, appreciating the value of knowledge and experience that will be acquired.

Appendix 1. Marshal about the difficulties in economic research

The element of time is a chief cause of those difficulties in economic investigations which make it necessary for man – with his limited powers – to go step by step; breaking up a complex question, studying one bit at time, and at last combining his partial solutions into a more or less complete solution of the whole riddle. In breaking it up, he segregates those disturbing causes, whose wanderings happen to be inconvenient, for the time in a pound called Ceteris Paribus. The study of some group of tendencies is isolated by the assumption other things being equal: the existence of other tendencies is not denied, but their disturbing effect is neglected for a time. The more the issue is thus narrowed, the more exactly can it be handled: but also the closely does it correspond to real life. Each exact and firm handling of a narrow issue, however, helps towards treating broader issue, in which that narrow issue is contained, more exactly than would otherwise have been possible. With each step more trhings can be let out of the pound; exact discussions can be made less abstract, realistic discussions can be made less inexact than was possible at an earlier stage. (Marshall, Principles of Economics, p 232).

2. SEARCHING IS A TASK, THE RESULT MAY BE AN AWARD

The average families today are concerned about how to educate their children, how to obtain health care, how to deal with retirement age. Young people are concerned about how to buy their own place to live, when and how to start a family? Unfortunately, most people have these concerns. I-nequality of income and wealth has been present in many areas of everyday life, in articles we read or in daily discussions at home, at school, at work. We keep hearing stories about economic growth on the global level. However, this growth has stopped long time ago. Even if economic growth is realistic, it does not change the living standard of most people. Moreover, middle class' quality of life is worse and worse.

In industrial countries, the majority of employees are not happy with their wages. They seek the increase, often very diligently. However, an inadequate income is not the major concern of industrial life. The biggest concern is the loss of all or almost all of livelihood. This fear affects men and women at almost all levels - in factories, in administration, in education. These anxieties and worries leave aside the question of inequality, and that is one of the most complex issues of modern society, as well as the great temptation of politics and economics, which should be primarily addressed.

Inequality among individuals and nations raises the question: "What is the cause of this inequality?"

It began with an excess in the agricultural society, and continued with a development of the market society. Triumph of exchange value, brought by the commercialization of labor and land, has paved the way for the mechanization of production. Manufacture was increasingly based on the machines, among which the most important was the steam engine. The machines based on scientific and research work increased the production per employee, and reduced the prices of products, allowing the survival of entrepreneurs. Society dreamed of a better world where shortages will redu-

ce, and the capital will grow. Unfortunatelly, the dreams did not come true. The creation of human knowledge and the research efforts (machines in every factory, in every field, in every office, in every store) were supposed to abolish every kind of poverty, hunger, inequality, uncertainty… But they seem to contribute the opposite. They manufacture incredible quantities of products, but instead of making our lives easier, the level of stress we experience is higher than ever, the feeling of insecurity is intense, and the unemployment is ever-present.

The knowledge and skills are being promoted, but they are not a guarantee of standard improvement nor finding the place under the sun. Income inequality is increasing and the world is polarizing. Consideration of these processes is enormously relevant and becomes the object of attention among famous names in the economic science, earlier Pareto and Kuznets, today Stiglitz, Piketty, Milanovic and others.

Recent studies of the income distribution and the state of the economy have stimulated my ambition and efforts to analyze the central problem of our reality: who gets what in the distribution and based on what? This question preoccupied me long time ago, since my childhood and elementary education. Namely, the meager life of my villagers urged me to ponder: what can be changed in the way of life in the countryside? My youthful eyes watched the hard work of peasants in the fields, breeding cattle and maintening the household, with so much care, so much hardship, but all in order to survive. Those who worked in companies or public administration were more relaxed, but they could not rely on their wages only. They also worked on their farms to cover the costs for the family existence. They also financed their children, sending them to high school, then to college to gain the light of knowledge. Although the education was free, due to the accommodation costs it was a big expense, so that a small number of children continued their education after finishing primary school in my native village. I was interested in economics, a science that would help me make a contribution to the development of companies and communities in rural parts of my country; a doctrine that provides important knowledge to the success of individuals, businesses and nations.

Our family enjoyed a basic standard of living in a line with revenues. My father, Michael, had a job and was very capable man. In my point of view, he was not paid enough for the contribution he made to the company

where he was working. It seemed absurd and I could not understand why the wages were so small, because the workers were pretty engaged. Since my childhood, not much has changed in this regard. I wondered - I sought answers, I studied economics - I read literature - looking for answers ... I often asked myself: what truly sets the value of our work? Intuitively, I realized that this was essentially a question of understanding economics or household, which has been my preoccupation at the time. That question is a key for understanding who gets what. Later it turned out that this was a major issue of economic science. After all, Ricardo has impressively stated: "To determine the laws which regulate this distribution (wages, rent and profits) is the principal problem in Political Economy." (Ricardo, 1817, p . 23).

My parents wanted to educate their children, although I did not understand why. Vidosava, my mother, used to say that a man should be lit by "light of knowledge." Even today I am not sure if my parents perceived the true importance of education. I am more convinced that they saw it as a way to escape from the hard life in the countryside. I am infinitely grateful to them, because I think that uneducated man has no future. Also, I definitely realized that poverty means spiritual and material poverty. Goethe has wisely set this concept in a broader sense: "He who cannot draw on three thousand years is living from hand to mouth." I am not saying that the knowledge has been valued in the right way, but in most societies it was prefered in relation to the physical work. We must not forget the most important role of knowledge: it blooms one's personality, through creativity and achievements of the human spirit through philosophy, art, literature, technology, physics, and so on.

My role model was not Marx nor Lenin, nor Adam Smith, nor David Ricardo; it was our godfather, a famous economist Obren Blagojevic. First stories about him I heard from his aunt, living next to our house, and whom he much loved and visited. As a boy, I met him several times. His aunt Jovana was talking nicely about him, but his uncle Milan especially praised him. Stories about him were like fairy tales. Among other things, I learned that Obren Blagojevic received his doctorate in France, and it was written on his diploma: "Happy is the country where you will live and work." He was one of the best students of the Belgrade Faculty of Law. I asked my father about him and he also talked good about him, as they were hunging out in their youth and knew each other well.

My curiosity of the earliest childhood grew stronger, so I sought to find out more about Blagojevic, to "implement" the concept I developed during village parties and "workshops" in cold winter days. After all, those "workshops" were pretty educational for me. I realized that people in the countryside were wise, eloquent and curious. My mother read a lot, my father too. In a way, my parents were to "blame" for my love for the book, which has kept up to date. Peasants of my native village were good examples of how to clearly and beautifully express their thoughts. Even today I admire the eloquence of my mother. She knew how to behave in every situation, always miraculously finding the right words. She was tutoring me without pressure or tension; she taught me about the importance of knowledge resources, and encouraged me to read about different topics.

My tendency to absorb the smell of knowledge (especially economic), led me to Obrena Blagojevic's dissertation titled "Charles Fourier". He wrote it in Paris, where he spent one year on the research study, which he defended in Belgrade, at the Faculty of Law. Reading his book led me to think more about history and man, on the relationship between the individual and the society. My quest and my knowledge broadened; my synthetic reflections on politics, economy and inequality are presented in this book. I realized that science (also) has its limitations, its insufficient achievements, weaknesses, and even deformation. It does not mean that science is worthless or harmful. On the contrary! I strongly believed that science is the most sophisticated human activity, which represents the pinnacle of human spirituality. A science has enabled the progress of mankind. I explained that role in my book "The Ray of Creation." Naturaly, the progress was contributed by other forms of spirituality, but it seems that creation is the main engine of progress; without its leadership, spirituality would hardly be affirmed in such extent. Many other sciences are linked to economics through strong ties. I dare to say that science is the major factor (resource) of economic development and progress.

My thinking about the economy has begun at the time of the last informative revolution, which lasted from my childhood to the present day. In those several decades the profound informational and technological revolution has occurred. It was the second segment of my work and interests, which began reading the articles in "Children's newspaper" about the first steps in the development of computers and programming (the late 60-ties of the 20th century). Articles about new technological developments were truly

extraordinary reading. I was reading with great enthusiasm about the new ways of entering and processing data, about punch cards, and the first computer programs... It was the most beautiful revelation for me. I had a great desire to learn more, seeing it as a huge step in the progress of mankind. I could not have even guessed that I would, in addition to economics and finance, deal with this field extensively for many years, studying the greatest achievements of this science at the IBM, the world famous company for information systems and information technology, writing papers and books, participating in international meetings and conferences about e-economy.

Thus, right at the picturesque Bajovo polje grew my obsession with new technologies, new things, and innovative ideas. In the peacefulness of my hometown, where I breathed the smells of flower meadows and imbibed the light of life under the blue Piva sky, in numerous, for me angelic, beautiful moments of blending spirit and matter, I imagined the progress of my village, its people and community...

My basic thinking on the development of the society begun at that time. I was thinking about the resources that we used in the household, the lack of human capital (i.e. knowledge and skills) in the family and society, the scarcity of natural resources, poor yields of potatoes and other vegetable crops that we cultivated. In the summer season I was often looking at the sky, praying for rain. Drought was threatening to destroy our fields and livestock. My village did not have a source of water, so the problem of irrigation in agriculture depended on the weather, or the "grace of God". These were important lessons from the science which I would study later in life. Simply put, it was about the fact that the economy is the science of the rare resources distribution. Very early I began to contemplate and wonder why some households were richer, having greater assets and income, and living more comfortable in beautiful houses? Why were some families, such as dynasty Petrovic in Montenegro, so influential? Was there an economic factor supporting their political power? I participated in heavy farm works, such as mowing and collecting hay, building facilities for households, often remembering how hard life was, as "too short of hands, too short of power" (the thought of economies of scale). All the physical work was done by my father and me. Due to injured spine my father often could not work, so the most of it fell on me. I tried to find the way how to improve the methods of work, how to achieve greater effects with less work, how to organize the work

activities (efficiency). It was a hard work. I did not have ahy books about economics, nor about managing the household, but my consultants and the first teachers were wise and hardworking farmers.

The same need for innovation I have today. A few years ago, Professor Veselin Vukotic in one of his speeches, said: "Jovovic will never give up his innovations."

Inquisitiveness lived in me, so strong that I could not explain it. There were several entrepreneurial-minded people in my village but the most intelligent among them was Novak Jovovic. He is a remarkable man. He constantly introduced innovations in their household, applying new technologies, simplifying certain tasks. I gladly spent time with him. He knew how to communicate with us youngsters, and how to convey his wisdom to us, how to imperceptibly arouse our interest in learning. He taught us lessons that could not be taught at universities, nor by the leading American professors, such as was the one he's lecturing to me. Novak spoke clearly, transferring ideas and knowledge with ease and understanding, connecting things in the best pedagogical manner and with incredible humanity and respect towards children, treating us as equal. That was my great school of theory and practice, or their integrity, proving that the theory is the best practice and vice versa.

Also, many other farmers have been endowed with extraordinary eloquence. I listened to them talking about various topics, but their views on politics remained in my memory. These people had a fantastic sense for understanding of politics. They have unobtrusively sown the grain of contemplation in my brain about the relationship between politics and life. Those were the foundations of my "knowledge structure": the first concept of economy and the first concept of politics. Naturally, I later upgraded this basic knowledge, but I must admit that this book would not be in front of you without these roots.

It was a golden age of my youth, for my youthful eyes have not seen much of a life. Growing up in the area of Piva in Montenegro, I saw poverty, unemployment, disharmony between reality and its embellished image, coloured by a great master of management: Josip Broz Tito. However, I did not wonder why was this so?

Supporting Tito's politics was a common thing, praising his regime was a default behavior. Without prejudice. Many people expressed positive

opinion about Tito's system, although very small number of them thought quite the opposite. But, the truth is hidden in the deepest sanctum of the soul. One man, probably one of the million, publicly expressed his opinion: "It is a path to slavery", he said. It was Milovan Djilas, an author of the book "The New Class" (1957), where he analyzed and criticized the communist system. Although, if he had not published that book, he would had probably become a leader of Yugoslavia.

Yugoslavian economy was led by a powerful man and his powerful executives. One can not say that there was no economic growth at the time, but the question is: What was the base for that growth? Yet, the economy was not in the first place, but politics was. Prosperity of the community members, based on sustainable economic growth, was not the goal of this policy. Their only goal was the redistribution of the cake under the influence of politics. The great division on economic grounds was an expansion process. Workers did not have the instruments nor the strength to fight for equitable share in the distribution.

Inequality has also appeared in the communist system, although it was young, promising that the it was an antipode to capitalism; Nevertheless, inequalities have marked the era. Again, in capitalist countries, the story of inequality is shown as a long-hidden problem of these societies.

I realized that how important is the knowledge of economic and political ideas through a history, in order to understand the world and life.

Economic ideas emerged from the economic life. They were a typical product of particular time and place, a reflection of the world they interpreted. This world is not static, it is constantly transforming. Thus, the economic ideas must change in order to maintain relevant. Economy changed with change of the object of economic study. In my studying of the economic ideas I was not swayed by some individual participants, because I made them alive (in my mind) and therefore interesting. I saw them as a reflection of the world in which they developed. To be fair, the focus of my attention were the ideas of Adam Smith in the context of the initial trauma of the industrial revolution; the ideas of David Ricardo in the later, mature stages of the revolution; the ideas of Karl Marx in the era of unbridled capitalist power; the ideas of Johan Maynard Keynes, as a reaction to the impending disaster of great crisis. The creativity of ideas helps their understanding. I realized it through my lectures and discussions with non-economists about

the current economic issues. This has initiated discussions about banking and banking policy on money and monetary policy, international trade, budget deficit, public debt, and inequality. By participating in such discussions in different situations, many non-economists had solid opinions and views "better" than I did[2]. Economists explain the present situation and try to understand it. However, that understanding does not depend only on the present situation, because the present is undoubtedly the product of the past. What we believe is that today's economy has deep roots in the past. In the context of studying this book, the topic of politics and economics can be understood only if the roots are analyzed and understood - if we look at the past with regards to prices and production, employment and unemployment, distribution of income and wealth, savings, investments, the nature and promise of capitalism and socialism - only then we will be able to understand the present in a relevant way. And not only the present but also the future, because the future will inevitably retain some aspects of what exists today. This is one of the starting points of the book. This will motivate readers to learn more about themselves and about the world, with the benefit of interesting economic ideas.

Another starting point is that the economics can not be explained only by the economy - its relationship with politics is a special bond with life. "Political economy or Economics," said Alfred Marshall, the great professor at the University of Cambridge, "is the study of mankind in the ordinary business of life." (Marshall, p 1). In this wide area, there is no human behavior and existence that could be ruled out as irrelevant. Within the theme of this book, the central question is: What determines the prices of goods and services? And how to distribute proceeds from economic activity; what determines the proportion that goes to wages, interest, profits and, though less obvious, land value, and other fixed and priceless objects that are used in the production? It's about the value theory and the distribution theory. Economics deals with the issues since Adam Smith; in fact, before that the price theory was not necessary, and there was no need for the wage theory. These issues are becoming more prominent in modern economics, alongside with other vital questions. Firstly, how to distribute income in the form of wages, interest, profits and rents, and how much is that distribution fair or unfair? For many centuries, the analysis of the resulting inequality has occu-

[2] This behavior has been explained to me by my dear professor Bosko Gluscevic who claimed that "ignorant are brave"

pied the most prominent talents of the economics profession. In almost all of economic history most people are poor, relatively few are rich. Hence, there is an urgent need to explain why is it so - and, unfortunately, very often, a need to say why it should be so? Income distribution remains the most delicate job for economists.

Appendix 2: Economics as a function of growth and happiness

The complicated analysis which economists endeavour to carry through are not mere gymnastic. They are instruments for the bettering of human life. The misery and squalor that surround us, the injurious luxury of some wealthy families, the terrible uncertainty overshadowing many families of the poor – these are evils too plain to be ignored. By the knowledge that our science seeks it is possible that they may be restrained. Out of the darkness light! To search for it is the task, to find it perhaps the prize, which the "dismal science of Political Economy" offers to those who face its discipline (Pigou, 1952, p. vii).

3. TREND OF AN INCREASING INEQUALITY

3.1 Introduction

In a modern world everything seems promising because we see a great revolution towards democracy, at the global level. Very often it has been discussed about the end of history, not because of the historical stability but the predictability of the overall evolution: country by country, they all become democratic. Simply, it is a process of a generalization of democracy. In a sense, that is not far from the truth. After Europe, the democracy comes to Latin America, Africa, Eastern Europe, and now we see some similar events in Libya, Tunisia and Egypt. People say that democracy will be everywhere. And the only reason for this is the relationship between democracy and the market economy. In fact, today we have a high trend of generalization of the global market economy. Thus, the market economy is almost everywhere in the world, apart from the few exceptions (e.g. North Korea and several other countries). Therefore, the market economy is a strict element that moves the world towards the creation of democracy. However, the market economy could not be implemented in a dictatorial regime. It requires transparency, innovation, freedom of movement for the people, and capital. The market works in favor of democracy, while reciprocally, the democracy encourages the economy towards the market. In recent decades, the market economy has eliminated the dictators (in Spain 30 years ago); and the democracy has eliminated centrally planned economy (in the Soviet Union). So people could say, "No more questions about democracy and the market, there is no more reason for discussion. The market and democracy have spread worldwide to help the economy grow." We can also say that we had history lessons even before the 18th and 19th century, at the time when democracy was born. Many authors claimed that there was some sort of flow: strong government needs to create economic growth, and therefore it needs to introduce a market economy; with the creation of the market economy comes the middle class, and the middle class wants proprietary rights; property rights, in return, can not be sustained without government

arbitrate, which dictates the rules of the game; the middle class needs the rules of the game, and these rules are in favor of democracy. It happened in the United Kingdom in the 17th century, earlier in the Netherlands, and later in other countries. Strong government → middle-class → democracy.

It could be said that the dialogue on democracy and the market is completed! Things are going very well. Unfortunately, it is far from a truth. Firstly, what is democracy? Is democracy only a matter of free choice? Of course, not. Democracy are not just the elections from time to time. It is much more than that; it is transparency, free press, an independent legal system, trade unions, the rules of association, the rights of non-governmental organizations, civil rights and freedom of expression. And all that is very difficult to implement. Through the history we have had democracy in some specific moments, but democracy is not irreversible. Democracy can appear, and then disappear. That was the case of the United Kingdom: a flexible regime, and then Cromwell. Something similar happened in France - the Enlightenment, and then the Revolution a few years later. A lot of time passed between the Revolution and the democracy - one and a half century. Generally, the implementation of democracy is a long process!

If we look at what is happening in the world today, we will see several different situations: Eastern Europe is moving amazingly fast towards democracy; just recently, only twenty years ago, some countries were under dictatorships (Hungary, Poland, Czech Republic), and now they have parliaments, political parties, trade unions, free press, and so on. This is an interesting story. There are serious attempts to build democracy in Latin America: Brazil, Argentina, Peru, Bolivia, etc, where full democracy has been established with a few exeptions. Africa has also introduced the process of democratization in many countries. Some real democracies have already emerged in Ghana and Senegal. China is also moving towards democracy.

What are the main recipes and conditions for democracy, not only to commence but to live and survive? I think the first condition is that people stand against their leader (dictator). A real "trigger" for democratization in most countries was when people stopped fearing for their lives. Or the dictators decided to stop killing their own people. It happened in Eastern

Europe; for example, Gorbachev decided not to kill and punish the people who were against the communist system.

Another dimension of sustainable democracy is the introduction of stable rules of the game: determining the constitution, organizing the legal system, property rights and so on. The main mechanism of democracy is that people realize that it is better to live in a democratic system. Because, even in non-democratic systems, people may have more reason to feel that life is not so bad. There is security, stability, but only for those who do not criticize the regime. Democracy is much more risky, it is full of problems. People can accept a long-term democracy, if they are not disappointed in democracy itself.

The risk of disappointment in democracy today is very high, not only in the countries where democracy is at the beginning, as in the Middle East, but also in the countries with a strong democracy. If people do not understand that democracy does not bring jobs, then why choose democracy? Today, the case of Tunisia and Egypt shows that people do not see any sign of a better life in a democracy, because they do not live better. There is a risk that society would downgrade, which had happened in Europe at the beginning of 20th century – people of Germany turned against democracy because of high unemployment, eventually they slipped into Nazism. This can happen in many African countries, for example in Egypt. The risk exists in all countries!

Democracy will not last if we do not fight for it. Why? Because there are deficiencies in the democratic principle. There are two problems. The first problem is the globalization of the market – namely, the business is global, but democracy is local. Many decisions at the global level should be made by market, not by politicians, which means that the leaders are not needed because they do not make decisions. People may say, "Forget the politics, it does not matter, it is not necessary." However, globalization of the market without the globalization and democracy, or the rules of the game, is a threat to democracy. It is also a threat to the market, because the market without rules is exposed the criminal activities or illegal activities. If there is no global policy and rules, it also entails an open space for drugs, mafia and crime.

Another weakness of democracy is a profound nature of democracy, based on individual freedom. I am free to make decisions. I am free to do

whatever I want, and I do whatever I want. What does it mean? I am free to decide: where to live, where to work, how to make an agreement with my family, my children, my nation, and the future generations. So, to me as a free individual, it is allowed to be disloyal. The essence of freedom is to be free and to be disloyal. Thus, we all can be disloyal to the others, except to ourselves. This means that we think only about our own interests. I am an entrepreneur of my own life, and I care only about myself – I am not interested in partners, I just want to achieve the best for my own good.

What happens in a society with such attitudes of individuals and companies? The idea of a common vision, a common goal, a common work, is lost. Such society is not a sustainable one. Therefore, the solution is the long-term stability of society or the local (national) freedom.

A commitment to local has two threats to democracy: the question of environment and religious fundamentalism. There are two long-term trends in today's development: one that says you should not worry about democracy, the environment is more important than freedom, man can survive without freedom; the other says that religion is more important than democracy.

The main challenge is to present a long-term strategy, and to consider democracy the long term. How to achieve this?

The key question of democracy is the fight against poverty. If we are not able to solve the problem of poverty in the context of democracy, and more and more people in the world are poor, the democracy will disappear. Unfortunately, poverty is not on decline. It is growing. More than one billion people are starving, over 2.5 billion people are poor and the trend is increasing!

There is a clear connection between job creation and poverty reduction, as well as the connection between them and democracy. We must focus on this topic.

3.2 The extent of inequality

The extent of inequality is so large that draws attention and interest of economists. Although this issue has been put under the rug and kept out of scientific interest, for centuries, it exploded, especially since the last global financial crisis (2007). For a long time, economists have not been interested in this topic. Within the economic profession there was no unique attitude about inequality, mostly conflicting opinions. The issues of distribution were left aside. For one reason or another, economists did not pay attention to the fact that wages stagnated, even though GDP was growing. This had a significant impact on the perception of the economy, providing the incomplete explanations of economic events, where the dominant part of the economy - distribution - created incredible inequality. There was no input for behavioral change, no fundamental understanding of what was happening in the economy, and, therefore the economic policy for focusing on a different course could not be set.

Where was the focus of economic science? On the national economic pie. Its increase was supposed to change the position of the poor. Economists selected one economic dimension – the maximization of the production - and payed the most attention to it. They mused how to increase the pie and find the ways to make it bigger. Here is a fundamental question of efficiency. In fact, the economic doctrine has a long tradition, which lasts until today. A question of distributing the pie the economists left to politicians.

Oxfam[3] has clearly presented the scale of the growing global inequality at the annual gathering of the world's economic and political elite in Davos 2014, as follows: 85 of the world's billionaires, who can fit in a bus, have as much wealth as the poorer half of the world's population, which makes up about three billion people! Two years later, this bus could have been replaced by the van with 40 seats. The drama increases. Oxfam has claimed that members of the richest population would own as much as the other 99 percent of the world peoples together by the end of 2016. This prediction proved to be solid! Milanovic in his book "Global Inequality"

[3] Oxfam is an international confederation of 18 non-governmental organizations working with partners in more than 90 countries to eradicate the causes of poverty.

provides data that in 2013 there were 735 of two-billionaires (equivalent to $2.25 trillion against $0.45 trillion), and their total net worth was $4,5 trillion. Compared to 1987, their real wealth increased five times. The obvious implication of this calculation is that the real value of wealth of billionaires per capita has not increased. The average value of their wealth amounted to $3 billion (according to the prices in the United States in 1987 and 2013, but the number of super-rich has increased (Milanovic, 2016, p. 35).

Forbes list of billionaires for 2013 showed 1,426 people whose net worth amounted to one billion dollars or more. This small and selected group together with their family members make one hundredth of a hundredth of the global one percent at the top, and their total assets amount to $5.4 trillion. According to the Credit Susis report for 2013, a total world wealth was estimated at $241 trillion. This means that a tiny group of individuals and their family controls about 2 percent of the world's wealth. These billionaires have two times greater riches than the whole of Africa.

Recently, the topic of inequality has become more common, and particularly concerned have been Stiglitz, Piketty and Milanovic.

The central message of Stiglitz's book "The Great Divide" is that high level of inequality in America is not inevitable: "Deepening inequality is not driven by immutable economic laws, but the laws we have written ourselves." (Stiglitz, 2015, p. 10). This attitude can be analyzed, although the book itself is considered a major contribution to understanding the roots of inequality. However, I will agree with Stiglitz that inequality is largely driven by the laws we have written ourselves, which means that different measures could lead to different outcomes: to better economic results (however it is measured) and less inequality.

The basic starting point of his book regarding inequality is that economics and politics can not be separated. Economic inequality and political inequality are intertwined such as the politics and economics are intertwined. It is a vicious circle, because economic inequality grows into political inequality, especially in the political systems where the capital has an unbridled power. Political inequality, on the other hand, worsens the economic inequality. And here we must return to the political system and the trust in the political system.

The question of the relationship between politics and economics is a challenge for me. My dilemma is whether to spend a lot of time in order to contribute to the science, and the practice of politics and economics. This is a particularly complex problem, because it includes several issues, such as: globalization, poor economic management, and the role of state and market. Stiglitz points out: "It is almost certain that globalization, despite its merits in encouraging growth, has increased inequality - especially if we bear in mind that it has been poorly managed" (Stiglitz, 2015, p. 17). The policy has contributed to the mismanagement of the economy and globalization, because it had favored the interest groups. Therefore, it is logical that we must search for solutions in politics; the market can not solve these problems. If the policy has left some space for monopolies and monopoly power, for incentives of even greater abuse of the financial sector, for unequal trade, etc., the market will only increase the monopoly power. Stiglitz emphasizes (2015) that political system should be reformed, introducing democracy which will make governments responsible for the entire population, and sensitive to the interests of all people.

I am also grateful to Thomas Piketty and Emmanuel Alliance for my successful analysis of this topic. Their persistent and systematic work provides databases of inequality in numerous countries. Evidently, this book was influenced by many other scientists: Francois Bourguignon, Branko Milanovic, Paul Krugman, James Galbraith, and Ljubomir Madzar.

Montenegro is my intellectual home. If I have written here the ideas and principles that I hope will fix the world, then it is a merit of all those that have allowed me to explore; clever students were my constant encouragement, and I learned a lot from my exceptional colleagues. Brilliant economists of the world are an inexhaustible source of my knowledge and encouragement, as well as some top politicians (local and foreign), who fight for ideas that I believe in, develop and find them useful for mankind. Particularly inspiring for me was an example of a great politician – Francois Mitterrand.

Great motivation in my efforts was the notion that "inequality has a harmful effect on the overall demand in the economy." Actually, inequality ultimately harms everyone. The analysis of inequality in the United States by Stiglitz, Krugman and others, helped a lot. "The growing inequality in U.S. has moved money from the bottom of the economic pyramid to the top, while those at the top spent less than those at the bottom, thus overall

demand weakened." (Stiglitz, 2015, p. 26). This situation has been maintained by economic bubble (technology), whose burst led the economy into recession. Recipes for overcoming the recession are various; for example, former president Bush reacted to the recession by reducing taxes for the rich.

Careless management of the economy and globalization causes an increase of inequality. Partial cause lies in politics, and therefore the solution can only be found in politics. The market can not do it alone. History has shown that the market requires the state and the control. Without that, the market will produce: monopoly power, abuse of the financial sector, unequal trade relations... How to reform democracy? How to implement transition? Careless management of transition causes slow escape from poverty.

Huge political corruption is present in many countries. Icing which covers it does not help. Enron, and many other bad examples, indicate this. What happens following the growth of inequality? A crisis!

According to Stiglitz, the most effective tool in strengthening demand and fostering equality are fiscal measures - tax measures and spending measures, implemented by the parliament and government (Stiglitz, 2015, p. 26). They stimulate the economy (occasionally) by cutting interest rates and the mitigating regulations. Such a policy has many risks and should be taken with a full understanding of the impacts and consequences. Monetary policy measures, which have been occasionaly applied even in the strongest economies, for example in the US, have caused economic bubble and enormously high growth of inequality.

America sustained its economy through the policy of low interest rates and lax regulations. This sustainability was based on the real-estate bubble, or the new construction property and indebtedness of households on the basis of property, in order to maintain excessive consumption. However, the reason was the reduction of income of the majority, and reduced revenues caused cutting profits. It was time for new solutions, the excessive borrowing was allowed in order to extract high profits. Crises are the side effect of such policies, they do not fall from the sky - as some kind of natural phenomenon – they are the consequence of a human factor. Delusion that the market is always efficient and stable was often paid dearly. There are three types of inequality:

- Inequality within nations. For example within Montenegro;
- Inequality between countries. Income in Morocco is lower than income in Spain, and
- Global inequality.

Literature and modern life are a good example of these inequalities. Small reminder: Ricardo said that the issue of distribution is "a key issue in the political economy." The analysis of distribution nowadays is not very popular. But it is necessary, because it raises a lot of questions. Are the uninhibited markets effective and stable? Can bankers give too much loans? Can property owners borrow too much? Can ideology influence the decision-making in the economy? Can interest groups influence the economy and to what extent? What causes the big economic fluctuations that characterize capitalism from the beginning? What causes a lack of efficiency in the economy? What are the mechanisms of redistribution of income? Are the macro-crisis just the tip of an iceberg? Are the crisis comprehensive because of the errors of million people in the entire financial sector and other economic sectors? Does everyone make mistakes: banks, especially investment banks, rating agencies, government? Why are state aid and rescue programs well accepted in the crisis situations?

Why is the wrong economic policy implemented? For example, former american president Bush was giving tax breaks to the wealthy, showing generosity to pharmaceutical companies, expanding other fields of state aid to corporations, enabling the growing "social benefits" to rich companies in various sectors; he was doing it covertly or openly...

This way, money is pouring into treasuries and wallets of a small percentage of people, instead of investing in the economy boost.

Solutions are often wrong. It is especially wrong to search the fiscal moderation, imposing austerity in a situation when the economy requires a completely different cure.

Any economic instability leads to increasing inequality. Inequality deforms society in many ways. Particularly sensitive issue are the hurt feelings of the fair competition, equal opportunities and a sense of community. A "just society" is the vision, where everyone has the opportunity to advance, where everyone has equal opportunities. Many social unrests were caused due to the feeling that the system is unfair. We recently watched millions of people protesting against the robbery, against

economic and social unfairness in the oppressed communities. Demonstrations erupted in Libya, Yemen, and Bahrein. Governments were demolished in Egypt and Tunisia. These are serious warnings to a small percentage of the rich - the great polarisation in the society is not sustainable.

3.3. Pareto and Kuznets

Classical economics dealt with the distribution of income between the three classes: workers (wages), capitalists (profit) and landowners (rent). It was kept later with the new economic paradigm: "marginalist revolution" and synthesis of the two paradigms (classical and marginal) named Marshall's neoclassical economics.

In the early 20th century, Vilferdo Pareto, the French-Italian Professor of Political Economy at Lausanne, Switzerland, became interested in the income distribution among individuals (not classes). At that time, the data on personal income were available for the first time, due to the economic development (countries became richer), and greater fiscal role of the state. The first statistical data on the income distribution became the basis for obtaining information about state taxes, which were introduced in order to ensure financing of education, health and, above all, war. Due to ideological shift, all individuals become equal before the law. This means that the rich must contribute more in line with higher wealth and income. Taxes were more tied to income, which increased the need for records of income and its distribution among households. so, Pareto began the first studies of individual inequalities in the tax data at the end of the 19th century.

Pareto has explored how the inequality has changed with the income levels. He believed in the "iron law of inequality between individuals", where differences in social arrangements (whether feudal, capitalist or socialist) remained more or less unchanged. Elite can vary; one can control differently the society, but the income distribution - the level of inequality – remains unchanged. Today it is known as the rule of "80-20", showing that most things have an unequal distribution. In a regular relationship, 80 percent of people produces only 20 percent of production and income (the remaining 20 percent of people produces 80 percent of the results). This rule was discovered in the quality control, marketing and business

administration. According to Milanovic something similar happens in the global distribution of income. Explaining the income distribution under this rule, Pareto indicated that inequality did not change, because the income practically does not change along with the development (shown by the analysis of empirical data that he used).

This hypothesis lasted until 1955, when Simon Kuznetz, Russian-American economist and statistician, has proposed the first real theory about what makes changes in the income distribution. He proved that the inequality between people was not the same, regardless of the type of society, but predictably varies, depending on the level of development of society. Inequality of the poor societies must be at a low level because the income of the most was at the subsistence level, and economic differences between people were small. After that, as the economy developed and humanity shifted from agriculture to industry, appeared a gap appeared between the average earnings of industrial workers (richer) and farmers (poorer). The labor division in the industry caused the differences in income. According to Kuznetz, the source of the difference is actually the gap in income between the agricultural and industrial workers, as well as different wage levels within the industry. In addition, in the most developed societies, the state begins to play the role of redistributor (education becomes more widespread), thus decreasing the difference. His research was crowned with the famous "Kuznetz hypothesis" of inverse U curve, showing income inequality during the economic development. Inequality must first grow before it starts to decline.

This idea, however, is not entirely new. Some 120 years ago, a French scientist in the field of social sciences and politician Alexis Tocqueville, spoke of the inequalities in his book "Memoir on pauperism" (1835). According to him, inequality is historically characterized by this inverse U curve, because in primitive societies the inequality did not exist, as it does not exist in civilized societies. Although, between these two extremes there is inequality of conditions, income, and knowledge. Alexis Tocqueville did not study the causes of these inequalities.

Kuznetz theorem also did not sufficiently explain the causes of inequality, however, some new elements have appeared in explaining the behavior of income inequality. Factors, such as the financial depth, the extent of state spending or public expenditure, economic openness, etc., have been considered in determining the movement of inequality. Many

economists have argued that the analysis should be extended, because it gives a better understanding of trends. They provided explanations, such as: efficient and large financial sector would enable the poor to finance education through loans, in order to reduce inequality, since the doors of educational opportunities are opened to everyone, and no longer reserved for the rich only. The state expenditure (as a part of the gross domestic product, GDP) or state administration (as a part of the total labor force) are the factors of reducing inequalities; firstly, because it helps the poor, and on the other hand, it limits the inequality of wages. Greater openness to trade in poorer countries reduce inequality, because it increases the demand for intensive consumer goods (such as textiles) that specialize in this country; this leads to a tendency of increased wages for non-specialized workers, compared with the wages of specialized workers or profit capitalists. In rich countries, openness to trade should produce adverse effect, since rich countries tend to export high-tech products. Manufacturing requires highly specialized workers (for example, computer specialists, or engineers), so that the earnings of those with a university degree relatively grow compared to those with high school degree. Hence, the inequality grows.

Modern economists would test the Kuznetz hypothesis by involving all these factors and possibly a couple of new, except income, often in an ad hoc manner (for example, adding the age structure of the population or the distribution of land ownership). The results are better than when we take only income into account, but not spectacular.

A French economist Thomas Piketty has recently produced a series of empirical studies along with other economists (Emmanuel Saez, Anthony Atkinson, Abhijit Banerjee), including several countries, which have undermined Kuznetz hypothesis and his extended hypothesis. Researches were synthesized in his book "Capital in the 21st century".

3.4. Piketty

Piketty's book "Capital in the 21st Century" was enormous success. But not unexpectedly. The inequality issue has gained a lot of attention in a recent years. Instead of globalization and technology euphoria, the annual gatherings of the world's elite show a growing concern and pessimism in terms of the latest financial crisis and economic recession that came later. At the 2013 world conference, the inequality has reached the very top of the priority list among the participants.

Piketty has collected plenty of data confirming a growing inequality, especially in the last three or four decades. Piketty has placed this phenomenon in the historical context. According to him, capitalism is characterized by a high degree of inequality. The wealth is rapidly growing, faster then economic growth, which means that the percentage of capital in relation to the national income will infinitely magnify. We need to acknowledge this ever increasing inequality.

Stiglitz believed that inequality was not inevitable. In response to Piketty's book, he has written two articles explaining this phenomena.

Economists do not have a full explanation for the growing inequality in the developed countries. Economic powers have certainly influenced the disappearance of some businesses, performed by the middle class; globalization caused a decrease in wages; due to the competition of cheap unskilled workers, social changes have played a role. But all this does not explain the large inequality in many countries. Stiglitz argues that one of the main reasons for inequality is the mindset of the rich. The best tool of achieving this is their tax policy. First of all, reducing the capital gains tax, so most of the income remains in their hands. It has always been the practice. Monopoly or near-monopoly position, and influence on the tax policy have contributed to the economic power of the 19th century, since the time of John D. Rockefeller till Bill Gates[4] at the end of the 20th century.

According to Stiglitz, a large part of today's inequality is the result of manipulation of the financial system, for example in the United States.

[4] The wealth of Bill Gates is estimated at $80 billion in 2016. To illustrate, suppose that he spends $1,000 a day it would take him 216 thousand years to spend his wealth.

Changing the rules "purchased" by lobbying, funding of election campaigns, etc., the financial industry in the United States has created chaos in global finances, but the creators remained intact because of the rules that allowed a generous bank rescue. Stiglitz argues that in the United States the largest number of creators of the trade and economic policy come from 1% of the richest (Stiglitz, 2015, p. 96).

Piketty argues that inequality is a natural consequence of capitalism. According to him, market capitalism naturally creates immoderate inequality.

This issue should be viewed more as a political problem, because the competitiveness of the market depends on politics. At the initial courses on economics we learned that competitive markets, which promote efficiency and innovation, actually reduce profits. However, we do not have a truly competitive economy, although, there is no such thing as a "pure" capitalist system. Capitalism relied on the state from the beginning when it comes to investments in education, technology and infrastructure. It might be the combination of the market and the state, or the mixed economy. Politics has always played an important role in the economy. Historically speaking, the success of economies depended on the balance level between politics and economics. The balance is in relation where the state deals with what it does the best, and other activities in the economy are left to the market. The role of the state was irreplaceable in researching the new technologies, especially in the high-tech sector. Success depends on the balance between politics and economics, public and private sectors, with the necessary public investments and establishing adequate social protection. State relies on taxes. Taxes should fund those economic needs that the market can not solve. In such use it can contribute to improving economic efficiency and reducing inequalities. Tax laws are the basis for this. It is not enough just to collect money, you need to know where to invest it. And there are priorities: social problems, inequality, unemployment, and environmental problems.

Making tax policy should acknowledge the impact on the income distribution. As Stiglitz (2015) has stated, three basic principles must be taken into account. Firstly, it is better to tax bad things than good things - for example, pollution and speculation, instead of labour and saving. Secondly, it is better to tax land, oil, and other natural resources, which will not

disappear when taxed. Thirdly, more general principle is based on the first two, and that is that taxes should encourage activities of general benefit.

Corporate taxes should reduce taxes for those who create new jobs. Same applies to closing "loopholes" that allow tax evasion. For the financial sector, there should be a special set of taxes. This is in favor of the developments in this sector, which are largely influenced by the emergence of the financial crisis in 2007.

Should the monopoly profits end up being taxed at an adequate rate? This is a tax on income realized by the owners of natural resources. In many cases, oil, gas, and mining companies do not own these resources, but exploit them from the land in public ownership, as long as they pay a fraction of their true value.

I agree with the opinion that the Piketty's proposal to solve inequalities through taxation - more precisely, through global taxes on wealth – is politically unfeasible, despite its benefits. However, as stated earlier, there are clear steps that should be taken in tax laws to return politics and economy in balance.

Piketty has given the "political" interpretation of inequality, explaining it by the government's decision to increase or reduce the direct taxation of current income and inherited wealth, as well as the effects of wars (i.e. the destruction of physical capital and the reduction of capitalists income). This is an explanation of the political theory of income distribution, where social attributes (what is just or unjust) and economic interests, through voting and the party views, determine the route by which inequality develops over time.

3.4.1 The basic results of research on inequality by Piketty

In a 15 years long research, Piketty and his associates have collected extensive statistical material from the developed countries (more than 20 countries), for a period of the last three centuries. The general finding is that capital generates economic inequality, and that inequality immanent to capitalism as a socio-economic system. Return on equity (ROE) has a natural tendency to be much higher than the rate of economic growth, as proved by Piketty. This leads to a strong increase in inequalities in society. Piketty offers methods to solve this problem (cooperative solutions). These are, above all, measures and instruments of a modern macroeconomic

policy, which must establish a balance of the market and the state. Disturbance of balance between these two key institutions leads to extremism in the form of market fundamentalism or state totalitarianism. Piketty "believes in the market" without corruption, without greed, without monopoly. "If we want to regulate capitalism," said Picketty, "we need to have confidence in democracy, to organize fiscal, social and financial institutions that will control the multinational companies and financial capital." This way we will build "capitalism with a human face" argues Piketty. Historical analysis method, which Piketty applies, is important in order to avoid the mistakes of the past.

In terms of inequality in the distribution of wealth we are going back to the 19th century, at the time of Balzac, when the wealth was concentrated in the hands of a small number of individuals, and when the economic elite consisted of wealthy heirs, not those who earned a place in society through accomplishments. Piketty has called it a "hereditary capitalism," indicating "Rastignac’s dilemma" (according to Balzac's character), where the question arises: what is the relative importance of inheritance in relation to accomplishments? This leads to social stratification (extreme inequality). According to Piketty, this uncontrolled and rampant stratification in the 21st century is a serious hindering factor for sustainable social development.

Therefore, Piketty proposes a shift in a current government policy, especially in the area of inequality and redistribution. In terms of inequality, the situation in the 20th century has changed drastically compared to the 19th century. This was contributed by several crises: the World War I, the World War II, local wars, hyperinflation, and a number of bankruptcies due to the Great Depression of the 1930s. All this has led to massive destruction and disappearance of capital and assets, and the further growth of inequality was stopped. In addition, social movements and revolutions have put pressure on the capitalist elite to agree on social and tax reforms (which had been rejected until 1914). This was supported by economic theory of John Maynard Keynes, the "father" of state capitalism. After the World War II this theory "created" the welfare state introducing a strong redistributive and social function of the state. The Protestant ethic is significant because it affirmed hard work as a key factor of good life. Work ethic, dedication, rationality, savings and commitment are characteristic of the value system of that time (described by Max Weber). "Thatcherism" and "Reaganism" initiated the degradation of the welfare state, and the transition to a

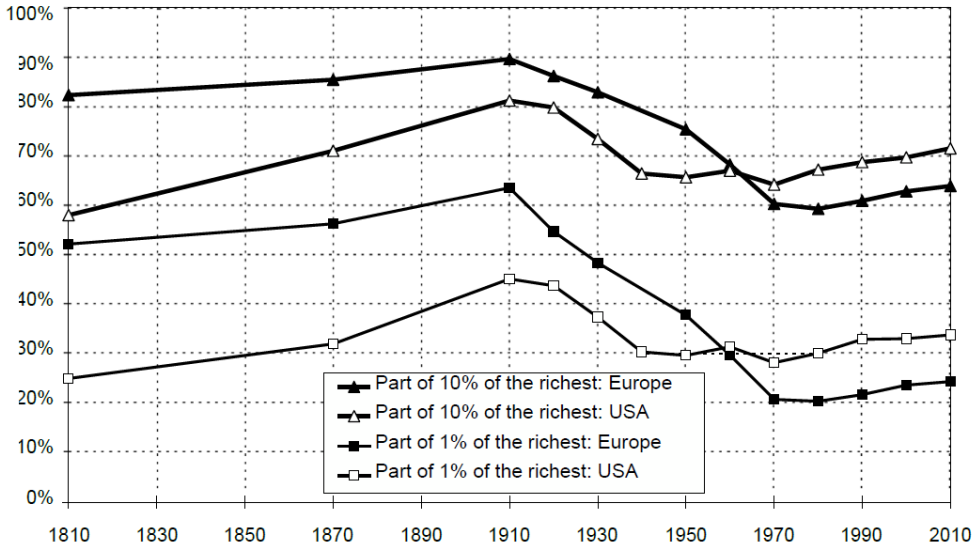
neoliberal concept of capitalism. This has particularly weakened the European social model, seriously affected by the global financial crisis, and the concept of austerity and "cost cutting", imposed by German Chancellor Angela Merkel and International Monetary Fund.

At the end of 20th and the beginning of 19th century, the level of inequality has increased dramatically. Piketty believes that we are going back to the "hereditary capitalism". The global financial and economic crisis, which has begun in 2008 and continues to have negative effects, enhances the process of deepening inequality, both globally and at the national and regional levels. Also the tax policy, which was in favor of the rich and powerful by using the "tax havens" ("offshore" companies) at the global level. The tax base between countries has been openly "stolen" (Piketty), even within the European Union (e.g. Luxembourg has become a "tax haven"). Inequality is huge not only in wealth, but also in power (10 percent of wealthy individuals share 86 percent of the total wealth). Bargaining power of trade unions and employees has weakened, and the power of multinational companies and capital markets has increased in general, which further led to the enlargement of capital income. Therefore Piketty raises the question: how to stop such tendencies in the 21st century? It is necessary, according to him, to develop the mechanisms and institutions of social, educational and fiscal policies, that will prevent such concentration of capital and deepening inequality, which is harmful in the social, political, and economic sense. Piketty, as noted above, advocates the introduction of progressive taxation of the capital at the global level. It requires consensus, coordination and greater cooperation between the countries on issues of economic policy. Piketty’s key findings are:

By the mid-twentieth century the wealth inequality was high, although, higher in Europe than in the US (Chart 1); A part of 10% of the richest in the national income is 45-50% in the years 1910-1920, dropped to 35% in the years following the World War II, and stayed below 35% till 1970; after 1970, the fraction of the 10% of the richest increased at 45-50% (1970-2010) (Chart 2);

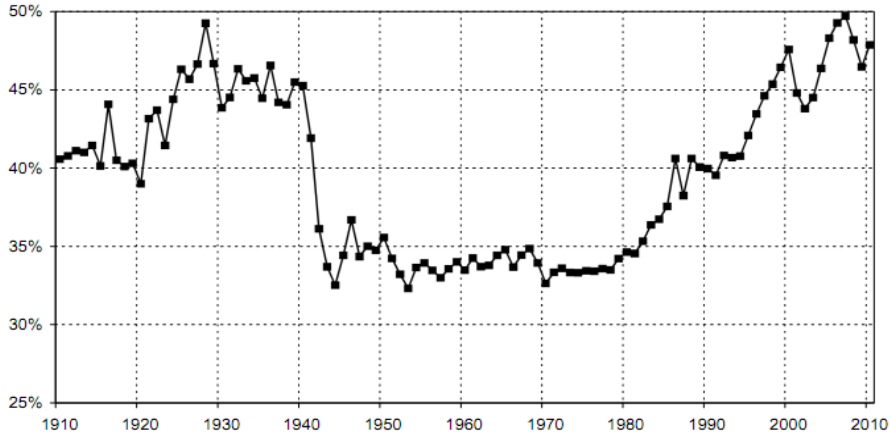
In the developed countries the private capital is growing, and the public capital is reducing (Chart 3); The increase of the portion of the ten largest countries (1970-) particularly 1% of the richest in the developed countries (Charts 4 and 5).

Graph 1. Inequality of wealth: Europe and usa 1810-2010



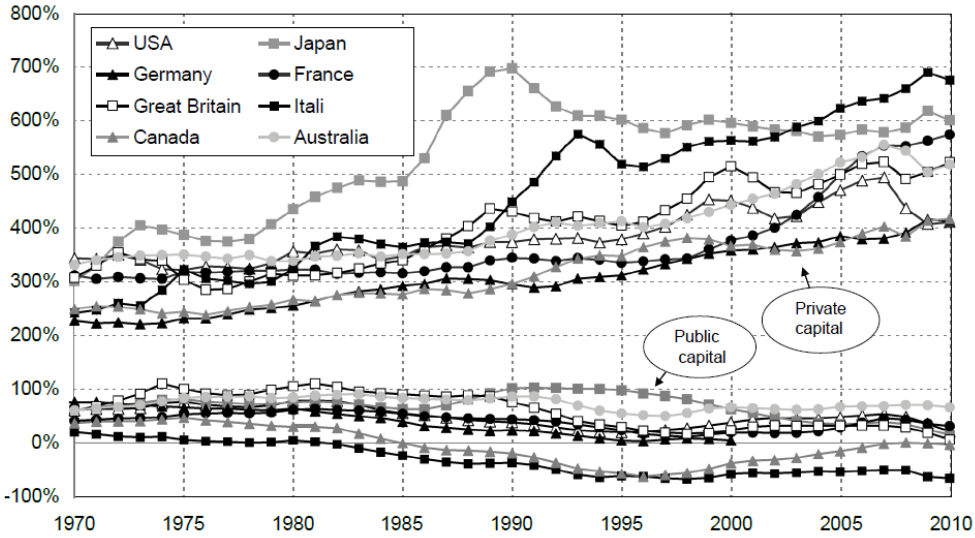
Source: Pikety 2015

Graph 2. Percentage of 10% of the richest in revenue distribution in the US 1910-2010



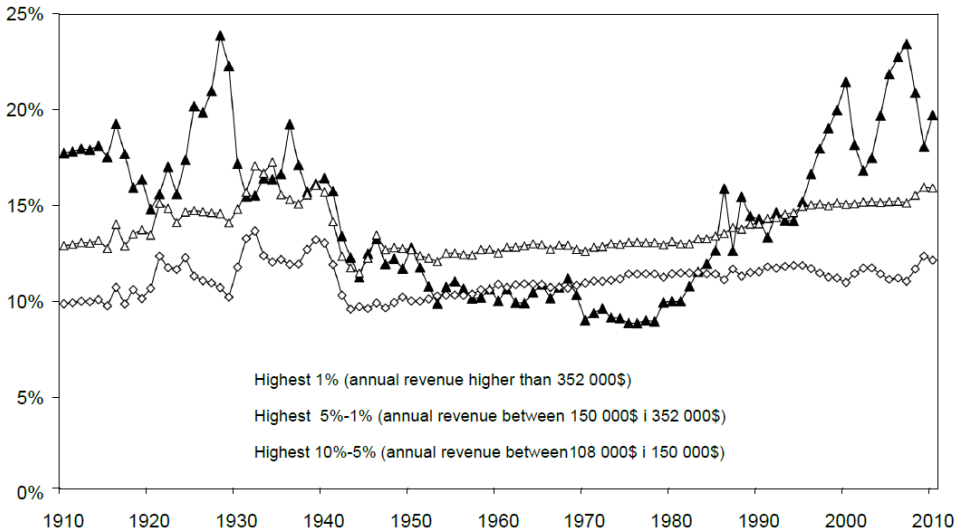
Source: Pikety 2015

Graph 3. Private and public capital 1970 - 2010



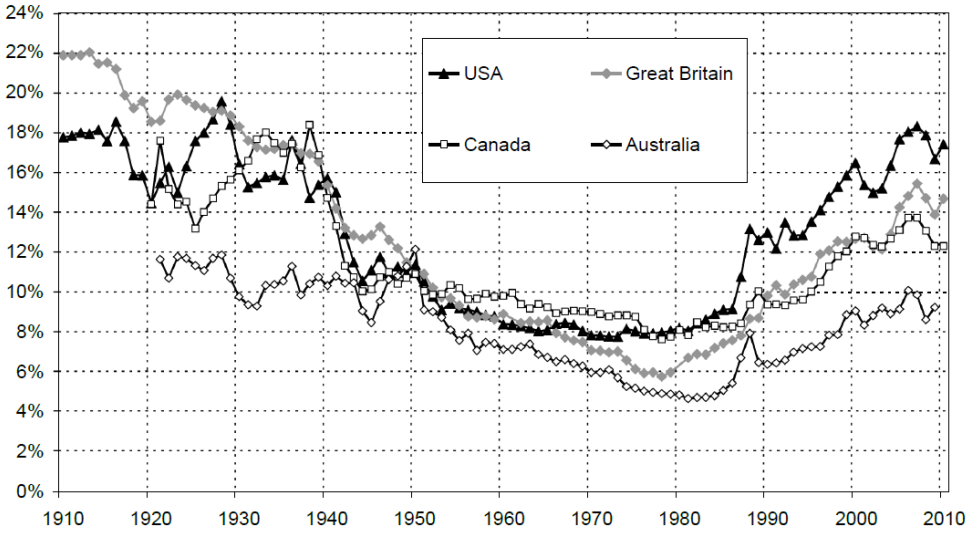
Source: Pikety 2015

Graph 4. Top 1% and 10% in USA 1910-2010.



Source: Pikety 2015

Graph 5. Inequality of income: 1% of the more abysmal 1910-2010.



Source: Pikety 2015

3.5 Does inequality affect economic efficiency?

Dealing with this issue is important, among other things, because inequality affects an important economic phenomenon - economic growth. Does countries with greater inequality grow faster or slower? Some economists think that inequality is good for growth, but there are also opposing views.

The question is: why is this so? Advocates of the first view hold that inequality is essential to provide an incentive for people to progress, work hard, or enter into risky entrepreneurial ventures. None of the above could be achieved without inequality of a return on capital. On the other hand, advocates of bad inequalities (such as bad cholesterol), believe that inequality does not offer opportunities to everyone, it is a means of preserving the acquired positions. This occurs in situations where the inequality of wealth is used as a tool against political changes in society (i.e. agrarian reform or abolition of slavery), or to ensure that only the rich have access to education, or to enable that the rich hold the best jobs. All this reduces the economic efficiency. If someone's ability to get an education strongly depends on the wealth of his/her parents, it is equal to preventing the society to gain skills and knowledge for the majority of the population (poor). Discrimination re-

garding inherited income is no different from any form of discrimination, for example, gender or race. In all cases, the society decides which abilities of certain groups of people will be used. Economically speaking, such a society is unlikely to be successful. Depending on what kind of inequality is in question - "positive", required for the initiative, or "negative", securing the monopoly for the rich – or which one of the two is dominant in a certain period, inequality can be seen as good or bad.

Benevolent view of the economic inequality, providing initiative to individuals to be effective, has dominated among those who wanted to justify the wealth by saying that without inequality there would be no investment nor creation of wealth, or its enlargement. According to this, workers (or the poor) can spend all the money they earn. If every member of the society had the same (relatively) low income, there would be no savings, no investments. This is a view on wealth that a capitalist is a "machine for savings" and an entrepreneur.

The opposite view is that capitalists are renters, doing nothing, expecting that money "finishes the job" in their favor. From this viewing angle[5], the capitalists are just parasites who live by clipping coupons.

The idea of inequality harmful for the society, which dominates for the last few decades, has stemmed from the previous perspective on inequality, or wealth. Interestingly, it comes from the same starting point as the explanation of inequality as a benevolent force: there are capitalists who want to invest. But conclusions are different here. People (rich, middle class, poor) vote on how much taxes should be, taking into account the predictions of government spending, funded from tax budget and usually in favor of the poor.

Societies with the greatest inequality will choose high taxation because many people will benefit from it, and will always outvote the rich. In this case, high taxes reduce incentives for investment and labour, which slows down the growth rate. Thus, democracy does not go in favor of the rich. The richness requires high inequality, and democracy does not support it. On the other hand, what guarantees to the poor that the rich will save and invest, if they oblige to it. The problem of realization remains. Therefore, the capitalist system must generate the income distribution before taxes, which is sustainable and which will encourage people to vote for highrt tax rates. Hence, it is necessary to distribute the assets between people as evenly

[5] This has been thoroughly described by Stefan Zweig.

as possible. It's not easy thing to do, nor to change things in the short term. Education is a measure that would give the fastest results, because development of "human capital" can equalize the income distribution, and even create a different mindset regarding the level of tax rates.

Will the change in economic development also result in a different way of viewing the usefulness of inequality? It is very likely. The lower level of economic development requires more physical capital. Thus, it is necessary to invest more in machines, roads, and other fixed assets. As the economy develops, the fixed capital becomes less scarce and, in relation to it, the human capital becomes much more valuable. This means that the spread of education becomes essential for economic development. Interestingly, this is true for societies deprived of democracy and voting rights.

Regardless, inequality represents a social burden against which we must fight. Plato has written about it 2400 years ago in his famous work The Republic.

3.6 Inequality and economic justice

Income inequality is also an important issue because it relates to two areas, usually in the center of the people's interests, but often irreconcilable: economic efficiency and economic justice. Economic efficiency is related to maximizing of total production or economic progress of the society. Economic justice deals with an acceptance of the sustainability of social arrangements. Also, economic inequality plays a significant role. Inequality based on heritage, race or gender, can be viewed as unfair, even if it is detrimental to economic development. If the majority of people or influential minority find the social order unjust, the sustainability of these types of arrangements will be compromised.

When assessing the desirability of different social arrangements, economists tend to use the so-called "welfare function", which includes the well-being of all members of a social arrangement and the well-being of all members of the other, in order to find a better one. It is called "welfare society". The goal is to compare the well-being of all community members in a social welfare arrangements with other social arrangements, in order to choose the better option. How to establish a welfare state? The best way is just to add up the the individual utility. Accordingly: if the society is composed of three persons, the overall social utility is equal to the sum utility of the first, second and third person. Individual utility function of each person is such that decreases at each new unit revenue. It is reasonable and empiri-

cally confirmed hypothesis, based on the idea of reducing marginal utility of income. Now, suppose that three persons have the same utility function. Then the optimal distribution of income would be exactly the same income for everyone. If the first person gets a little more than other two, the extra income must give less satisfaction to the richer person A, than to person B and C, who are poorer (since they have the same function of declining marginal utility). Thus, the total benefit would be increased if extra revenue transfer of person A grows beyond the point where each person has the same amount of revenue.

This is a major contribution to the idea of welfare. English economist Anthony Atkinson in his famous article on measuring inequality (1970) has also dealt with the ranking of different social arrangements. Atkinson has set a measure that calculates social inequality as the relative amount of the total revenue that is "lost" from the perspective of well-being, because the same total prosperity could be achieved with lower total incomes, equally distributed between individuals. Even though the pie for the distribution is smaller, if the are pieces are the same, the overall satisfaction of reduced pie would be the same as the total satisfaction of the larger, or unequally distributed. Thus, a measure of inequality reads: how much of income is "lost".

However, this is easier to set theoretically, than to measure it practically. There is no acceptable way to meaningfully measure the social arrangements when individual utilities are combined. Simply, although everybody applies the concept of reducing marginal utility, its level varies between them. For example, if a person A lives happily, we can not say that he/she is really happier than a person B, who shows the happiness differently, not as noisily as a person A. Obviously, utility matrices are different.

Moreover, if we know everybody’s exact utility, and if the welfare could be theoretically maximized, there will only remain an ethical problem because the distribution, which guarantees the largest selection of utility, and revenue will came into the hands of those who have the highest utility function, that is, those who most successfully convert income into utility. English economist Francis Edgeworth has used this idea in the late 19th century to defend inequality. He argued that wealthy people with more "refined" taste deserve higher income because they derive more satisfaction from, say, better food and wine! According to this unusual defense, higher income should be transferred to those who can enjoy it best! The critique of this idea by Amartya Sen is known as the "capability approach".

There are three options for assessing an inequality: 1) the same utility function can be taken for everyone (this is not the case in real life), which leads to the maximization of total utility at the point when the income is equally divided. This is the idea behind Atkinson's "equally distributed equivalent income", 2) we can try to find individuals who are "efficient" utility generators, and give them higher income, and 3) we can do the reverse, and give higher income, as in Sen's Capability Approach, to those who have a greater challenge to enjoy the pleasures than the given group of goods and services. This way could easily reduce the total utility measured by simply adding up of the individual utilities.

A more sophisticated approach of the welfare supporters is designing social welfare functions, where utility of each member is included. Utilities are not added up, they only describe the state of welfare achieved for each individual. Here is used Pareto criterion: changes in income will not lead anyone into a worse situation. But the problem of this criterion is that it could not be found in the real world.

At the end, it is obviously impossible to compare individual utilities. Utility and welfare are very limited in the ranking of social arrangements. Therefore, it is difficult to base a measurement of inequality on this theory.

According to Rawls' (1997-1971, pp. 65-80) differential principle of fairness, economic inequality in a society should be increased until the gains on stimulative are greater than losses on inequality; the latter means that inequality can deepen, thanks to greater productivity, until the position of one category of the population, the least favorably located in the social structure, has improved.

3.7 The dimensions of inequality

According to the Credit Suisse Research Institute's Global Wealth Report (2015), 10% of the richest on the planet possess 87.7% of the world's wealth. This is the case in many countries: in the United States, CEO earns even 276 times more than the average employee in the company, while in 1960 it was "only" 20 times. Part of the wealth accumulated by 0.1% of the richest has increased from 7% to 22% of the total resources, while among 90% of the less rich, the wealth has reduced from 37% to 22.8% (1985-2015). Among 0.1% of the richest, 10% controls 11% of the total wealth, which is an increase of 8.8% compared to 1970 (Emmanuel Saez & Gabriel

Zucman). In developing countries, the fruits of growth have often been appropriated by a small number of people.

These inequalities can also be found in other spheres of life: education, health, culture and many others.

Generally speaking, the wealth is concentrated in the hands of those who control innovations, applicable in a wider range. Technical progress does not cease to increase the distance between worker productivity and his wage: the distance (productivity grows, wages decrease) is two times higher today than twenty years ago in the 19 largest industrial countries (Frey and Osborne).

In many countries and nations, transfers to the poorest are increasingly slowing down, being less and less effective. According to the World Bank, the fund transfers to developing countries have been slowly increasing in 2015, and are inefficiently used because of high level of corruption in these countries.

Since 2005, incomes before tax and transfers to the middle class in developed countries have stagnated or decreased[6]: 65% of households in 25 most developed economies (about 540 to 580 million people) have experienced stagnation or decrease of their income between 2005 and 2014. In the United States, the average income has strongly decreased since 2008; while the level of household debt exceeded $9,300 in 1980, or $65,200 in 2015, and their savings rate has melted from 13.3% in 1971 to 5.1% in 2016. The consequence is that the middle class today makes a little more than 50% of the active American population, while in 1971 it was 61%.

Transfers made by the governments in developed countries, and the decrease in taxes cover this income reduction, but not completely: if incomes are decreasing or stagnant in case of 65% of the population in OECD countries, only 10% of the population feels a decrease in their disposable income. In the United States, tax policy and transfers have also mitigated the income reduction for 81% of households, and increased the disposable income for almost the majority of households (98%). In Italy, incomes and disposable incomes have reduced for almost 97% of the population. In Sweden, the incomes have stagnated or decreased for only 20% of households, while the available incomes have increased for almost a majority of the population (98%). In France, the transfers have increased disposable income on average 3% for everyone above median income.

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[6] McKinsey Global Institute, 2016.

In developing countries is slowly forming the middle class. In 2015 it consisted of 1.5 billion people, or 50% of global jobs.

All this has led to the dissatisfaction of the middle class, and that is a serious threat to economic and political stability in the world.

As pointed out, the inequalities are manifested in various dimensions. There are inequities in health care, education, political representation, (in)security, gender (in)equality, and child poverty. However, the inequality of options is also evident. The most important issue is the income inequality, on which everything else rests. Thus, some countries are worse in specific aspects, and better in other. However, inequalities are related, and poverty causes unequal opportunities.

Access to higher education is difficult in many countries, especially where education is largely private, for example, in the United States or in England. Some countries provide free higher education (e.g. Scotland), and some give students loans with low interest rates (e.g. Australia). Thus, many countries offer "justice for those who can pay." However, the gap between aspirations and reality is very high. Therefore, equality in education should be based on the democratization of education. Inequality of outcome follows the unequal opportunities, which in turn contributes to economic weakness. Politicians must understand that education provides greater innovation, stronger economy, and higher incomes - and thus higher taxes. Investing in what economists call "human capital" - investing in people - is crucial for long-term growth. To be competitive in the 21th century means having an educated workforce with university degrees and postgraduate education.

Increasing polarization of society into rich and enormously high percentage of the poor has a negative impact on functioning of society. So divided societies do not have a stable economy, due to the lack of effectiveness. The history of old and modern times is full of unambiguous examples. There are several reasons why such economies are not effective, where rich and poor pay a high price.

Inequality reduces consumption by redirecting money from the bottom towards the top, from the broad base of the poor towards a small number of rich. A small percentage of people who earn more consume a smaller portion of their earnings, compared to those with lower incomes. Redistribution of money to a small percentage of rich people reduces consumption. It appears that the consumption of the rich is high because it is noticeable. Thus, if the money goes to a broader base of the middle class and

the poor, the money is consumed, and depending on the number of these layers of society, consumption increases.

Logically, when the money accumulates on top, the total consumption decreases. The demand in the economy will be less than it is able to offer, which causes unemployment, and further decrease of demand. If consumption is not provided through normal economic measures, then some other measures are being introduced, such as technological inflation at the end of the 20th century, or the property inflation at the beginning of 21st century, followed by government spending, which is the only solution when the economy sinks into recession.

Another problem is the growth of speculative markets which create space for " rent-seeking," where the leaders are being richly rewarded. In an economy of rent-seeking, many things are not natural towards the market economy. People are not earning on the basis of labor and capital, but through the domination of the means of payment - commissions, fees of usurious loans, and the like. Financial sector unduly "grabs" more than it contributes. In some countries (as seen in the United States), it can wreak havoc in the economy. Thus, economic rent in financial sector and other types of rent enables redistribution from the bottom towards those at the top.

Unfortunately, rent-seeking does not contribute to the size of the economic pie, because the attempts to grab a bigger piece of the pie do not affect the size of the pie. Yet the bigger problem is that rent-seeking hinders the optimal allocation of resources and weakens the economy. In the countries rich in natural resources, there is a very strong tendency towards activities of rent-seeking. If the access to resources is achieved under favorable conditions, the only people who get rich are those who are able to, while the economy remains weak, without the production of goods and services that are useful, and will magnify the benefit of all.

The next challenge, which causes inequality, is the lack of motivation among working class. Many economists, including Alferd Marshall, have noticed long ago that attitude towards workers affects productivity. Marshall noted that "higher wages may increase the efficiency of the workers by various channels, making it worthwhile for the employers to offer wages that exceed a market-cleaning level" (Marshall, 1987, p. 54). This has been theoretically and practically demonstrated (i.e. numerous examples confirm the theory in practice).

In many countries, in the US, Europe or China, people perceive great injustice in the way the wealth is redistributed. Regrettably, people who con-

tributed to the transformation of the economy are not on top of the economic pyramid (naturally, no one is against the wealth of the people who are the bearers of new technologies and inventions). This is not the case only in the developed capitalist countries, but also in countries in transition and the former socialist countries, where workers are faced with unfair distribution, exploited by their executives, who live to the highest standards. Therefore, workers are losing motivation. Deep cracks have divided economies of those countries, and led to their unsustainability.

There is also the problem of mistrust in the political system, which is the result of inequality. People come into a situation that "in every transaction – in every encounter with a boss or business or bureaucrat – they see the hand of someone out to take advantage of them." (Stiglitz, 2015, p. 105).

3.8 The causes of inequality

Inequality - as a major challenge of politics and economics – is growing, which means that the causes of inequality come in new varieties and are influenced by new forces. Inequality has always existed and probably will always exist. Particularly problematic is the increase of inequality in almost all forms, and in various parts of the world. Previously we talked about one source of inequality, rent-seeking, which enables the wealth of a small number of people, increasing their piece of the pie, compared to the others. In addition to increasing wealth, there is a way to get rich through the increase of the national economic pie. However, the increase of wealth at the top is usually achieved through the increase in rent and monopoly power. The main cause of the increased inequality is political choice, laws and their administration. If speculators pay less in taxes than those who make a living from their work, it means that the speculators are encouraged to do so. The tax system and its fairness are dominantly important. If those at the top do not pay their fair share of taxes, the workload for others will increase; This means that the rich can retain and reinvest their profits, thus becoming richer and richer. A billionaire Warren Buffett is fond of saying that his tax rate is lower than his secretary's. And even more terrible is that he has huge unregistered capital gains, and when the value of his assets increase, since he owns securities, it increases the value. If Buffet does not sell his shares or other claims, he does not pay any tax. Thus, if the richest keep their property, its value can grow from year to year, and they do not pay any tax. However, inequality has roots in the past.

The key for the emergence of inequality is the accumulation of agricultural surplus and the relative ease or difficulty of spreading crops. Therefore, the geographic factor has been very significant because favorable conditions for agriculture have favored the nations who have had them. There is, however, another level of inequality growth - within developed societies. The accumulation of surplus of agricultural products required the creation of a state with the power concentrated in the hands of a small number of people. This unequal political power has had a tendency to continue concentrating.

A small group of people have access to economic surplus in order to achieve economic and political (even cultural) superiority, which makes the surpluses increase possible.

The strength of power and wealth exists at the world level. It increases global inequality and divides the world into rich and poor countries. The roots are in the geographical distribution of resources, but also in the benefits of power and wealth, which is often gained by destruction of the poor countries. The second level of inequality has been emerging through accumulation of wealth in a possession of few. Moreover, there are rich people in the poorest countries whose wealth is equal to the wealth of those in the richest countries. So, if we start from the root of inequality, it is in the production of economic surplus within the first technological revolution - the development of agriculture. Inequality has increased during the next technological revolutions (e.g. the invention of the steam engine or a computer), which have particularly contributed to the world we live in today.

According to Thomas Piketty, the share of income that goes to the richest of 1% has doubled since 1979, and almost tripled till today. It is understandable if you take into account such a low effective tax rate (20% on capital gains) in many countries. The specific problem is: how to hide those assets? Usually using offshore tax havens, or "loopholes" in the law. Although there are supporters of the theory that lower tax rates have a stimulating effect, the reality shows that the tax system, set askew, encourages the flourishing of the rent-seeking activities, and this reduces the investment in the creation of real companies, real inventions, and real service to others. Thus, the tax system can play an important role in mitigating inequalities.

Establishing a market economy, which is in favor of the rich, is not just financially costly but also unfair. It is the creation of a surrogate capitalism, in which losses are socialized and profit is privatized. That has nothing to do with true market economy.

It is especially important to emphasize that society can not function without "a sense of national solidarity and cohesion, and that sense of shared purpose also rests on a fair tax system." (Stiglitz, 2015, p. 186).

How to find balance between politics and economics? In answering this question, it is necessary to gain insight from the historical ties of politics and economics. To understand intertwining of politics and economics in a historical context, we must understand why the world is so divided on the rich (1%) and the poor (99%). In the following chapters we will discuss about different perspectives of politics and economics in order to contribute to understanding of this topic.

Let's start with the economy in which the individual has a free choice and decide on the basis of his/her subjective attitude. Previously, in chapter four we will analyze some negative trends in the world, which are correlated with an increase of inequality. It is a major challenge to modern economics and politics.

4. NEGATIVE DEVELOPMENTS IN THE WORLD ECONOMY AND POLITICS

4.1 Inequality becomes global

Before 2008, globalization, technology, and financial liberalization were being praised for many years. Philosophy of unstoppable growth was spreading, promissing benefits for everyone who "behaves properly". All this has affected the world to quickly forget colonialism, slavery, slicing Africa, and a long history of exploitation.

And then, in 2008, suddenly came a rise of consciousness, and a loss of confidence in developed countries, because they did not fulfill their promises, and therefore they lost their moral authority. However, they lost it for many reasons, especially for doing nothing to reduce inequalities. On the contrary. The topic of inequality attracts more and more attention, not only among economists and scientists, but also among top leaders and global institutions. Conferences on unemployment and economic recession are often held. Unemployment is becoming a global problem, and experts are seeking the causes. Although, Western leaders still have not offered concrete measures to support economic growth and reduce unemployment.

A special emphasis is on strengthening the interdependence of the world. It means that wrong economic policy of developed countries may bring down the economies of underdeveloped countries, which have shown the considerable vigor in dealing with globalization. However, the countries that lead the wave of globalization are dealing with their own problems: America is facing political problems, Europe is facing badly designed euro, etc.

For now, it is well known that inequality of income and assets in most rich countries has been growing for decades, especially in the United States. Has the inequality intensified or reduced in the poor and developing

countries? To answer this question we do not have enough data. The research of World Bank's economist Branko Milanovic, conducted in collaboration with other researchers, provides an important basis for this topic.

The difference in inequality between countries has increased since the 18th century. Industrial Revolution enabled enormous wealth for Europe and North America. Distinctions between the rich and all the rest, as a global problem, lasted until the World War II. Even today, inequality between countries is larger than inequality within the countries. Branko Milanovic wrote about the decrease of inequalities between the countries in the period 1988 - 2008. Although the gap has decreased significantly (e.g. between developed West and Asia), huge differences still exist. The growing economies of China and India have rescued hundreds of millions of people out of poverty, which is the reason for some optimism in terms of poverty reduction. Asia, the Middle East and Latin America might be catching up with the West, but the poor still remain neglected everywhere, even in China, regardless of the slight rise of living standards. The improvement in reducing inequality is small, and from the perspective of the individual it is minimal.

According to Milanovic (2014), the income of the richest people in the world have increased by 60 percent, while the income of the poor have not changed. Eight percent of the world population earns 50% of the global profits, while the other 50% goes to the richest 1% of the world population. The imbalance is huge, and the income growth was the most pronounced among the global elite, which consist of financial and corporate leaders in developed countries, as well as the growing middle class in China, India, Indonesia and Brasil. Milanovic reveals the loss of elite's income in Africa, some Latin American countries, and the post-communist Eastern Europe, and the former Soviet Union.

The growth tendency of income and assets inequality throughout the Western world began in the 70s of the 20th century. This tendency is still present in the United States, Great Britain, and Israel. After 2000, the income inequality has grown, even in traditionally egalitarian countries, such as Germany, Sweden, and Denmark.

United States are the leaders in terms of income inequality and opportunity. American inequality began 35 years ago. According to Stiglitz, it was caused by the problems in political system and the US democratic governance. Today, it has reached amazingly serious proportions. The richest

Americans in 2014 gained 22% of total income, while the median income in America has not changed nearly a quarter century.

Unfortunately, Europe has followed the US example. European politics is to blame – decisions about savings led Europe into recession (or even depression). A disturbing number of unemployed ($27 million) after the 2008 crisis proves the severity of this situation.

Systematic manipulation around rapacious slicing of the pie has become global. All productive and innovative companies are at risk. However, the companies that are skilful in avoiding taxes have benefits. They are ready to take, but not to give back.

It is curious that companies like Apple or Google, with extraordinary human resources, are doing everything to avoid tax under the Act. These companies are good when it comes to income from selling their products, they are everywhere, but when they need to pay tax on those sales, they are nowhere. Seems like they forget or neglect the enormous benefits they gained from the state (e.g. workforce educated at universities funded by the state directly and indirectly). The research on which their products are based – Internet – is conducted by the state or taxpayers. Also, their prosperity partly depends on the judicial system, including a strong intellectual property protection. Evidently, these companies accept the national support in all spheres, especially in generating innovation.

International community is faced with unfair and distorted global tax system. Such a system has a crucial influence on the growing inequality in most developed countries.

This problem becomes complex, because globalization leads to greater interdependence. Multinational companies operate in the global arena and dictate the rules of the game. They take advantage of globalization in different ways, thanks to the impact they have and the lack of regulation at the global level.

Therefore, they avoid their global responsibilities, and there is no international agreement on the taxation of corporate profits. For them it is allowed to use transfer pricing, profit transfer, etc. Unfortunately, the average worker has no use from globalization; on the contrary, his/her income is decreasing from year to year.

The existing tax systems have not emerged by themselves. Their constellation was influenced by lobbyists of the large multinational companies.

4.2 Fragility of the world financial system

World banking sector is more sensitive and less profitable. It plays an increasingly limited role in financing the economy due to serious regulations and reduced interest rates. It is gradually being replaced by the so-called "shadow banking system," which emerged in 1980s after regrouping of all financial intermediaries outside the banking sector (commercial banks, hedge funds, monetary funds, pension funds, funds for secularization, companies for the capital investments, and other). These entities are not a subject to any state or central bank control; they represent 25% of global financial assets, which is equivalent to the annual domestic product. "Shadow banking system" represents a significant risk to the world economy due to very high-risk loans granted to risky companies.

In addition, the new techniques of financing over the net are being developed rapidly and without serious control.

Public debt continues to grow uncontrollably. Due to delays in solving the current problems, despite insufficient income, everyone is funded through loans. World debt (public and private) have increased up to $57,000 billion since 2008, making 300% of global domestic product in 2014. This is the highest level so far. The debts of the private sector have reached 130% of GDP in 1999, and 150% in 2015. The public debt in developed countries has reached 71% of GDP in 2001, and 100% in 2013.

High debts during the past year have led many countries into bankruptcy: in August 1998 the Russian government, due to the inability to deal with debts and interest on debts, decided to declare the suspension of payments. In 2013 Cyprus had to finance the survival of Cypriot banks (the most important for the state), since the government has not been able to do so, bank account holders over $100,000 in savings saw that their funds had been allocated for the repayment of the country dept, 47.5% of their deposits. Greece failed to avoid bankruptcy. Venezuela continues to pay its creditors ($10 billion was payed in 2016), while facing difficulties in providing the most needed goods.

Many countries, European and other, are close to experiencing the same situation in the years to come, in spite of efforts to avoid the crisis by reducing the interest rate. Italy, Portugal, and even France, are not far from bankruptcy.

In order to encourage banks on crediting and reducing the cost of borrowing, the central banks in developed countries have maintained a negative interest rate on loans: $19,000 billion debt is being repaid with negative interest rate, allowing banks and financial institutions to finance viable projects, encouraging businesses, refusing them interest costs ... But this has almost punished the banks and insurance companies, which lived from placements, and guaranteed income that were not able to achieve (Davies). Understandably, the client savings (in a situation of negative interest rates client must pay depositing money to the bank) have turned to alternative placements. Otherwise, according to the European regulations, the insurers must be based on the rate of return on long-term bonds (in Germany 4.2% per year) for the solvency implementation. However, it turned out that it is difficult to achieve.

4.3 Protectionism is introduced everywhere

In response to the previous impulses, the countries are trying to introduce as many barriers of various kinds. International trade is weakening, and protectionist barriers are imposed everywhere: after 2011, despite the 20% increase of domestic product, international trade has stagnated. And in 2015, the use of subsidies and protectionism has increased by 40%. In October 2015, and mid-2016, the G20 countries have implemented 145 measures of trade restrictions, in response to 100 measures which facilitate this exchange. The main protectionist measures in Europe and the US are focused on imports of chemical materials from China (mostly plastic and rubber). Every country differently makes the traffic of goods difficult for the companies from other countries. Other restrictions, which are being rapidly introduced, include restrictions on the free movement of people.

The spirit of protectionism is spreading. For example, according to the CBS New York Times[7] study, 57% of Americans believe that US fore-

[7] CBS News, News York Times, 8-12 jule 2016.

ign trade with the rest of the world has resulted in job destruction (40% in 1996).

More broadly, in developed countries, workers whose income does not grow have a very negative opinion about the arrival of foreign workers and immigration. They support the nationalist political parties: more than 50% of the US population support the idea that the entry of goods and services from abroad leads to reducing domestic employment. Protectionism is also growing in Europe and Latin America.

4.5 The weakening of international institutions

All international institutions languish under the forces of market globalization. The United Nations (UN) have a difficult task to maintain legitimacy. Maintaining security in the world – which is their main goal – has been hampered by the development of international terrorism and the multiplication of illegal traffic. Actions against international terrorism are inefficient, due to their constant change of location. Security Council is, obviously, another obsolete body. Its composition reflects the distribution of the power like it was 1945, without democratic and transparent decision-making mechanisms.

4.6 Strengthening businesses beyond national borders

Globalization has led to a situation where the state has less and less impact on the market, thus the companies are no longer loyal to the nations in which they have been established. According to the OECD, fiscal optimization, which companies undertake, is costing the countries between $180 and $240 billion annually, or 4% to 10% of the income generated through taxes (Hiault).

According to a US Congress study, 47 multinational US companies moved their headquarters out of the country in the period between 2004 - 2014, due to the tendency to pay less taxes. Thus, $2,100 billion has been "hidden" abroad by US companies (Rubun).

Also, companies are increasingly conflicted with the state in terms of security. For example, Apple has opposed to the FBI, refusing to deliver a data description of the iPhones used by the terrorists. Apple did it in the name of the client security. Companies are increasingly owned by shareholders from a single country, profiting through freeing of loyalty to the nation. In

the UK, 50% of the largest company shares hold foreign investors, more than 45% in CAC40, more than 50% in DAX, and 32% in the Nikkei (Edward 2016, Phillippe 2013; Chang 2015). Even in the United States, which hold the most developed financial market in the world, more than 16% of the shares of 500 companies that are listed as the largest on the Stock Exchange, are owned by the foreigners.

Finally, the most powerful companies have a high capacity to influence decision making in politics. In the US, 20 companies and associations spent more than $420 million in 2015 to influence Washington's decision[8]. More than 30,000 lobbyists work in Brussels, impacting 75% of the legislative projects of the European Union (Traynor).

4.7 Controversy of technological evolution

It seems that technological evolution, although spectacular, lacks the power to significantly improve the life of human population in the decades to come. The recent innovations (mobile phone and Internet), that have shaken the methods of work and consumption (removing intermediaries in trade, culture, changing the company's management and administration, stimulating exchanges...), but they did nothing to improve human life compared to the time of steam engine or an electric motor.

Moreover, technical progress has socially and politically negative effects: countless robots are replacing even more countless workers; Internet facilities and a large amount of data are empowering public and private control, and monitoring lives of each individual. In addition, the related facilities, nanotechnology, biotechnology, neuroscience, artificial heart, artificial womb, cloning and creating artificial organisms, has woken an irreversible evolution of the nature and the mankind.

Nonetheless, technical progress did not help to stop the production and prevalence of weapons, nor the increase of an average temperature on Earth (three degrees by the end of the century); the glaciers are still melting, causing the rise of the sea level for nearly 1 meter, which threatens to jeopardize the 136 coastal metropolis (e.g. New York), and other highly populated areas (e.g. the rivers Ganges and Brahmaputra River).

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[8] Opensectet.org, Top Spenders, 2015.

On the other hand, technological progress also has positive effects. It helps people to better position themselves, individually, to successfully treat illnesses, to learn faster, to eat good food, to have more comfortable accommodation, to buy more than ever, to save a huge amount of energy, to control emissions of carbon dioxide and greenhouse gases, to reduce hard and boring work, to use cheaper and more efficient range of services, to improve health education, to increase the security of justice, to extend lifespan (people will live at least 120 years in the future). Many diseases will definitely be exterminated (leprosy, filariosa, etc.). Untill 2050, tuberculosis and AIDS would probably disappear, as well as Ebola... New discoveries in the field of neuroscience may provide better medicines for neuroregenerative disease, and better application of teaching methods for each individual… Education could become broader and more democratic. The best online teachers will be available for the students worldwide. Web semantics could enable the automation and improvement of a large number of consulting services. Cloud computerization should enable numerous applications, especially the sharing of teaching contents. Virtual labs with remote control could enable students and teachers of disadvantaged geographical areas to have access to expensive experiments and experiences. The software solution with the 3D effect is already available to everyone at affordable prices and with many facilities, providing a huge explosion of creativity in designing new products, opening new ways for individuals to express and release themselves. Transport could become more intelligent, more convenient, more economical, the means of transport - cars, trains, planes - could become a self-driving devices, reducing traffic jams. New buildings could produce more energy than they consume, transferring the excess energy to decentralized and intelligent networks. These facilities could also become self-sufficient in the production of organic food…

5. AN INDIVIDUAL AND PERCEPTION OF POLITICAL-ECONOMIC REALITY

I support the view that the understanding of economics is based on the analysis of the behavior of individuals who participate in economic activities through the exchange in an effort to improve their situation. Real economy is a set of interactions and transactions between individuals, who are striving to be better today than yesterday, and also, better tomorrow than today. However, the environment where individuals perform their economic activities is changing. Also are changing the preferences of individuals, therefore, it is impossible to mathematically model the economy, or to formalize it using mathematical relations. The model of passing the time is wrong, even though at the moment of creation it may be correct, because the economy is a complex dynamic system. This does not mean that these models and modelings should not be used as a tool to understand the complex economic and political reality. These models are bounded on the explaining the economic reality. The first economic model was set by Riccardo, explaining the benefits of foreign trade. Macroeconomic models were subsequently used, mostly to explain the effective balance of the economy, through choosing endogenous and exogenous variables, primarily with aggregate values. In reality there is no aggregate supply, no aggregate demand, no aggregate labor market, and no aggregate preferences. There are only preferences of individuals, demand by individuals, labor supply by individuals...

Abstraction, as a scientific method, is the ability to process the real world in the brain! It is a possibility to circulate in time, to perceive the phenomenon of the past, and to predict the future ones. All this is followed by the production of associations! "A process is time in motion." This logic of process circulation leads us to examine the occurrence of phenomena, the processes, and the question: What will come out of something (into what will something develop)! For example, we have the current state of a process that has its origin, and its course into the future. The current state of the

process has a beginning (an idea). To understand the current state of economic and political processes we need to explore: How did we come up with them? Where is the beginning? How has the idea developed from its birth until the present day? What will happen with this process in the future? What causes the idea – the one we begin to realize today? Obviously, the circulation of thought is two-sided: towards the past and towards the future. To understand the present, we need to introduce a new dimension of the past, or the future. This is how we see the major trends in the economy and politics, those which are long-term. The history does not repeat, evidently, but many tendencies certainly persist and, as such, they make the basis for predicting the future (after we understand the present and the past).

Earlier, I have tried to develop abstraction and to understand the economic activities of individuals, while building my own economic model. I dealt with that even before I gained wider knowledge of economic theory and practice. Recently, that interest in economic issues has grown significantly in most social stratifications. Why is this happening? On the one hand, our ambitions are growing: we expect that our standard of living improves progressively, therefore we are interested in how to achieve these expectations. On the other hand, we become very concerned when we fail, when we realize that we are the victims of poor economic management, and that we do not use all opportunities in life. Generally speaking, we realize that economic knowledge is crucial in order to fight against the scarcity, using natural resources and opportunities. I think that most people feel this today more than ever in the history of mankind. We have learned from the classical economics of the 18th century that human behavior in the presence of the scarce resources follows pretty regular models, which can be explored and explained, with consequences that go far beyond the perception of an untrained observer. However, economic interactions, including most people nowadays, are more complex than those in the 18th or 19th century. Economic science has undergone certain historic path, which can be analyzed thanks to the legacy of the great economists. In addition, everyone develops his/her own economic view. Objective knowledge of savings, consumption, production, competition, money, specialization, international trade, and other, is being refracted through the prism of our subjective world while we participate in this journey through the world of economic reasoning. Therefore, our ability to understand and comprehend what economic science generally provides, is determining our economic mindset, our economic deve-

lopment, and our economic decisions. As an author of this book, I have a certain right to include some subjective insights in the development of theoretical views, as well as the development of my own economic model. It is an important combination in order to achieve one of my key goals: so this book would be legible to the reader, holding the reader's attention, as all interesting texts do; I want the reader to profit from reading this book, and to gain greater understanding of economics and politics, because they are not just theories or big sciences - they are very close to the real life, they are part of our everyday works and activities. Clearly, our economic methods may differ, because we believe in different things, but ultimatelly will support the need to exchange subjective knowledge.

Every day we experience some "economic" situation. For example, when entering the supermarket, we actualy enter the "live" flow of economic circulation: we choose what to buy, we decide on the basis of our purchasing power, we pick the goods, we go to the cashier, we pay with cash or credit card, we get the receipt... Indeed, we already perform an economic transaction, creating a basic unit of economy! How many of these transactions are performed every day in the world? Without them there would be no economy, which means that the economy started when the exchange began. Let’s take it to the next level: where does the goods we purchase come from, or the money as a special commodity used for paying those goods? How big is our purchasing power? What does it depend on? How do we earn for living? What have we payed at the cash register, for the goods or even for taxes and other bills, which means that we have paid not only to the manufacturers but also to the intermediaries, traders, and the state. Where goes the money we paid? Try to imagine how economic life unfolds: how goods and services and money circulate in the economy? Who decides: we or someone else? Is our work evaluated to the full extent of our salary? How many goods and services can we buy for our monthly income? Is there an invisible state that takes our income for the purpose of redistribution? Is politics interfering in our selection and how?

So, at the supermarket we fill the basket with items and "exchange" them for money, which is then exchanged for something that goes to the person who collects the money (the owner of the supermarket, or employees, because they get paid from the money at the cash register, etc.). If there was no money, we would have to exchange it of some other goods that he/she needs. Thus we participate in the field of exchange, in this case at the su-

permarket as a type of the market. The market is where the exchange takes place. It does not have to be physical area, such as a supermarket, with its facilities and shelves with goods; it could be virtualy organized, such as electronic market - for example, when we buy an electronic book via Amazon.

When we go back through the history, we see that the markets existed in the era of hunting and fishing. When one of our ancestors offered a banana to another our ancestor, asking for an apple in return, it was the first form of exchange, a rudimentary form of purchase, where an apple was equal to a banana, and vice versa. This, of course, was not the real economy. Modern economy began with agriculture, when manufacturing replaced direct hunting, fishing or harvesting bananas. Certainly, the first rudimentary exchange did not come easily - it has been a source of conflict and violence, but it was really primitive.

Today, 12.000 years after the "invention" that gave a man the ability to work the land and to make products, we use goods and services every day: we eat food, we wear cloths to protect us from cold and wet weather, or just use things that gives us pleasure. Although we do not think about how the products we use found their way to the store shelves – we know that they clearly had to be manufactured.

My contemplations on these issues began in my childhood, before the high school. As I mentioned, I lived in the countryside, my family was not poor, just very modest. In the early age I started working around cattle, and in the field. Probably because of that, I early began to think about purposefulness of labour, my and in general. What do we, my family, gain of it? My father had solid earnings for that period of time, but our budget was small. Every year we needed to sell a few heads of cattle to pay for expenses. Education of the children was pretty burdensome, especially when we started attending secondary school in another town.

My family had to invest in houses, outbuildings, land purchase, etc. (economically speaking: the development investments). We tried to earn from additional works, such as picking herbs, especially the gentian roots, which was well paid. It was hard work, because we had to climb the high mountains and look all day for the gentian. However, a significant revenue was worth the effort, and we were happy. Up there I learned the first lessons about the importance of distribution risk in the economy.

We lacked the capital and the workforce. Everything earned was spent, and little remained for accumulation. Regarding the workforce, I realized that quantity (family members) was not a decisive factor. Knowledge and skills are required to perform various activities. "Human capital" is an entirely appropriate term which defines precisely the overall knowledge which people have mastered, and which is contained in the concept. However, knowledge and skills are not God-given. Attributes of human capital, relevant for the production, are acquired and systematically accumulated through the process of learning within the family, taught by senior members. In the wider context of society, knowledge and skills are the result of investing into the educational system and the activities that take place within it. The country life is hard, therefore it is surprising how much knowledge and skills is helpful for the family members in performing everyday chores.

I also realized that the natural resources can not be used in a form that nature has given. Exploatation of the Earth for agricultural purposes requires a lot of work and investments in order to achieve full results, if we want to use the land in a long term, and to avoid the exhaustion of its fertility. Observing all this and thinking about the development of my family, I realized that success depends on how and what we do with the available resources; how much attention we pay to their protection and enhancement, how we combine them in order to achieve the best results, short term, and long term. The same principle goes for the company, and for the nation.

The first model of "my economy" was created in my imagination, based on my life experience. Here's one of my contemplations: I need to buy a pencil for school; by purchasing an ordinary pencil I have to exchange a little of my work for countless little services in order to produce a pencil. How to do it, I learned from the economic story "I, Pencil: My Family Tree" (according to Friedman, p. 30), as told to Leonard E. Reed. Mr. Reed, in the voice of the "Lead pencil – the ordinary wooden pencil familiar to all boys and girls and adults who can read and write," says that "not a single person on the face of this earth knows how to make me. My family tree begins with what in fact is a tree, a cedar of straight grain that grows in Northern California and Oregon. Now contemplate all the saws and trucks and rope and other gear used in harvesting and carting the cedar logs to the railroad siding. Think of all the persons and the numberless skills that went into their fabrication: the mining of ore, the making of steel and its refinement into saws, axes, motors; the growing of hemp and bringing it through all the sta-

ges to heavy and strong rope; the logging camps with their beds and mess halls, the cookery and the raising of all the foods. Why, untold thousands of persons had a hand with every cup of coffee the loggers drink!"

The story continues by describing the cedar logs cut into small pencil-lenght slats less than one-fourth of an inch thickness, and transported by ships to be filled with graphite, which is mined in Ceylon. After numerous processes the graphite becomes the "heart" in the center of the pencil.

"My bit of metal – the ferrule – is brass. Think of all the persons who mine zinc and copper and those who have the skills to make shiny brass from these product of nature."

This is not the end of the story. An eraser is actually a rubber-like product made by reacting rape-seed oil from the Dutch East Indies (present Indonesia) with sulfur chloride.

Thus manufactured pencil is a result of cooperation of several businesses and a large number of people, including numerous entrepreneurial activities. Entrepreneurs have been looking for solutions. They have played a key role in the development of the pencil! And also many other products and services we use.

From the apparent simplicity of an economic transaction – such as buying a pencil - I have discovered the complex mechanism of the economy. First of all, I asked myself: Why is a pencil created? Who is going to buy a pencil? How many pencils should be manufactured? What is the price of a pencil? How many resources is required to manufacture a pencil? How high is the manufacturer's profit? Who should solve this problem? I have discovered all that in time. However, this is just one suitable example.

Quite early I got acquainted with the work of Adam Smith[9], the father of economic science, which has shaped many important elements of my youthful contemplations: prices, taxes, the role and importance of capital, the role of labor, the role of knowledge, land rents, importance of foreign trade, inflation and unemployment, market, consumer sovereignty, the idea of economy as a self-regulative system… This great Scottish economist

[9] For all those who want to be educated in economics and politics I recommend "An Inquiry into the Nature and Causes of the Wealth of Nations" and "The Theory of Moral Sentiments," because Smith, like Marx in "Capital", reached the highest level of art in bringing economic ideas.

A. Smith (1723 - 1790), wrote: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We can not turn to their humanity but to their self-love, and never tell them about our own necessities but of their advantages. "(Smith, 2007, p. 52).

I realized that: "Every man lives by exchanging, or even becomes in some measure a merchant. The economy is a system of exchange, based on trade rather than on production. More broadly, the whole society is based on exchange, now every interaction is properly viewed as a kind of exchange. This is true of every conversation, every love (even when requited unfavorably), every game, every act of looking one… "(Simmel, p. 48).

Thus, every individual has his/her own interest, and will do whatever he/she thinks is in his/her best interest. Such an individual creates economic life where an "invisible hand" of competition in in power. Market manages the economic trends, as consumers with their "cash votes" choose what to buy and sell, at what price, and how much profit will be realized. The mechanism of an "invisible hand" operates through taking and choosing. However, where high profit is achieved, the others get in, and the profit decreases. In such an economic system everyone is looking for new opportunities, new profits, which direct the investments into labor and land, where the biggest profits are. According to Smith, there is the "natural order of liberty" in power.

The works of Adam Smith, David Ricardo and Thomas Malthus have set the grounds of economics.

Marginalism is the next significant theory in economics. It emerged in England, in the 70s of the 19th century. With marginalism, economists have finally begun to include demand in their analysis. Until then, the focus of economic analysis was on supply. Supporters of marginalism have formalized the concept of utility or satisfaction, which all participants in the economy tend to maximize. Accepted principle was that the same additional (or marginal) increase in assets that generate utility (glasses of beer, stream of dividends, new shoes), provides less satisfaction.

Great Depression (1929) revealed many economic issues that had previously been the subject of economic studies. Now they have been questioned! Those were fundamental issues on the organization of economic activity: Has the capitalism reached its limits? Are the business schools re-

ally just in function of the ruling class? Is it possible to manage the country such as the Soviet Union as if it wes a large company? During these deliberations, discussions and disagreements, emerged the book "The General Theory of Employment, Interest and Money" by John Maynard Keynes. It has raised the question of government responsibility to manage the economy as a whole. The book has provoked an intellectual revolution – dogma of free economy was refuted in a few years.

The economy was being renewed in the US and other countries, especially after the World War II. In addition to Keynes, the founder of the "new economy", his supporters and top economists in Chicago came up with a recipe to forestall depression in the post-war period. This "new economy" has triumphed with John F. Kennedy, who first actively accepted the Keynesian "demand management" in order to manage the business cycle, including well-known stimulating tax cuts, which have been introduced after his death.

In the 70s of the 20th century, there was a resolute "turn right" towards the market and democracy, and away from the hierarchy and planning. Adam Smith was somehow rediscovered in the 80s, thus the economics of the "new growth", which dealt with the determinants of technical change, began with "demand management" of a business cycle.

In order to discover the roots of economical science, we actually have to go back into the past, when there has been a milestone in the development of the human race - until the agricultural revolution, which later enabled all other social upheavals. Declaration of Independence, storming of the Bastille, battle of Wagram, man on the moon, entering the structure of atoms ... probably would have never happened if there has not been the most crucial of all revolutions, some ten thousand years ago – the so-called agricultural or neolithic revolution. What was so radical about this event? The organization of life in villages that produced food has changed the life of a man completely. People stopped being nomads, they organized villages and towns. Imagine this change: for thousands of years people lived as nomads, and then, six millennium BC, they started living in one place. There were conditions for countless occupations, of which many still exist. Also, there were many social distinctions between the families and individuals. But this phenomenon should not be seen solely in a negative sense, because the emergence of these differences allowed further strengthening of civilization,

making life enjoyable and safer. The fact that people were living in one place allowed them to possess things which nomads could not afford. With the beginnings of architecture came the desire for interior decoration and furnishing. The produced food needed to be properly stored, and excess began to exchange over time. That is how the grounds of future trade were set, as well as the grounds of economic activities.

5.1 People's needs (who gets what, who does what?)

After ending the nomadic lifestyle, human needs were rapidly growing. People had to meet their basic needs: food, housing, water, clothes and so on. They started wanting more and striving for more. However, a "garden of Eden" sort of fiasco, the ruthless nature, a bunch of people around us, and many other factors, are indication of a gap between what we want and what is available to us. Thus, what we want goes beyond what is available, which means that we strive for more goods. Among these aspirations and actions, an economic life is taking place. We are guided by self-interest, which includes a choice of two or more agents providing us the required satisfaction. Interestingly, we always choose things we expect to provide us more benefits at lower cost. Those who prefer beer do not buy Coke, those who prefer Mercedes do not buy Fiat. Also, it is not crucial whether what we want is of material nature or not. We want specific, tangible things (e.g. a computer, a car, an apartment ...), but also intangible, like friendship, a visit to a concert, an exhibition, and so on. Acceptable is whatever provides pleasure to an individual. People satisfy their needs through acquiring or consuming goods, and in order to achieve that they must produce the goods. The fact: what we want goes beyond what is available to us, has led to the creation of two most important economic concepts: "shortage of goods", and "costs", related to the potential opportunities. When buying a thing, we are give up something else, which would also provide us a satisfaction, and which could be purchased for the same amount of money (the concept of opportunity cost).

Human behavior during the past several thousand years confirms that the human desires are unlimited. Desires arise to the same extent, or even higher of those satisfying the existing desires. Thus, two fundamental questions of survival, with which all societies have been faced since the beginning of history, are: Who gets what and who does what? Historically speaking, this has been solved in different ways. The most commonly used

methods are: competitive prices, violence and bribery, time priorities (creating lines) and personal connections, physical appearance (such as female beauty) and, finally, planning at the state level. All these methods mean giving priority to some, and discriminating others. Historically, the best method to resolve these two issues are competitive prices through the free exchange or trading.

People create (manufacture) and trade goods for thousands years. Due to our desire for greater pleasure, the exchange is the most important method for improving our well-being. Willing choices that we make in our own interest has resulted in the movement of goods from holders, who appreciate it less, towards those who appreciate it more. In this selection, we subjectively perceive and evaluate opportunities.

The exchange takes place by means of money or other goods. People engage in the exchange because they expect that the benefit from the acquisition of given goods would be higher than costs. In a world full of uncertainty and insufficient information (rational limitation), individuals in different ways perceive the package of available possibilities for exchanging. Thus, each individual has his/her own attitude towards the things that he/she likes. There are not two men with similar talents, personality traits, worldviews, aspirations or tastes. Economists want to know why and how are these tendencies manifested as something possible to perceive. Basically we can talk about two kinds of perceiving. First, manifestations of our tendencies are narrowing under the influence of margines of relative usefulness. The amount of beer per unit of time which a person drinks (e.g. for an evening) depends on the relationship between satisfaction in drinking beer and other pleasures provided by the goods which are sacrificed for the sake of beer. Thus, a person who drinks a glass of wine every day during lunch will see that increase in the price of the wine means the renunciation of the pleasure, which would increase with higher amount of some other goods. In that case, this person will be encouraged to reduce the consumption of wine. Second, there are alternatives that an individual explores alone, gaining through those alternative the new insights into the pleasures arising from various goods and, at the same time, establishing new requirements.

Personal income is certainly a limiting or determining factor in defining the process of selecting alternatives. In the market economy, the amount of our income depends on the value of our services to others. Therefore

we make selection in accordance with our priorities. However, behaviors differ. Even though there are plenty of available resources (e.g.100€) for daily expenses, some may decide not to buy another beer when its price increases from 1€ to 2€. Satisfaction that this person feels from consuming other goods (e.g. ice cream), which costs 2€, makes it a major factor in his/her choice. On the other hand, one can spend only 50€ per day, and being very fond of beer, he/she may continue buying it despite a higher price.

We mentioned free choice, where an individual makes decision based on a subjective attitude. Through forced choice, or someone's effort to supposedly protect others from bad choices, individuals are deprived of natural rights. Such an approach gives poor economic results due to apparent disbalance in perceptions of decision-makers (even if they are better informed) and those affected by these decisions. As we know, this often happens, usually in the name of "equitable public good" or "public interest". Therefore, the redistribution of income is essential. Through income redistribution, the policy begins to interfere in the economy.

Hence, rudimentary policy starts in human society with the first surplus value. Economic reasoning is similar. Scientific consideration of political and economic issues began in ancient Greece, and the following chapters will discuss the evolution of these issues. This allows us to analyse the roots of today's events at the global level, as well as political and economical turmoils, mentioned in previous chapters.

6. ECONOMIC REASONING AND RELATIONSHIP WITH POLICY MAKING

6.1 Introductory remarks

Historical overview of relations between politics and economics is not simple, because economics, as a science, began to develop with ancient Greeks, and then within philosophy. From then until the 17th century, economics has historically favored the concentration of efforts, aimed at quantifying the consequences of policy action, and designing centralized agencies, able to achieve desired goals, which individuals would not be able to achieve through spontaneous cooperation. As a result, economic reasoning was constantly directed towards consequencialism and mechanical induction. This means that the desirability of political objectives has justified most measures of economic policy.

Although consequentialism and induction prevailed in the field of economic science, economics has not always been limited with these frames, particularly not economic reality based on economic activities and human activities in the production, exchange and consumption of goods. The definition of economics, which actually leave the door open to positivism, is kept up to date. The best-known definition of this nature, which is neither normative nor inductive, and dates back from the 30s of the 20th century, was created by Lionel Robbins in 1932. It reads: "Economics is the science which studies human behavior as a relationship between ends and scarce means which have alternative uses" (Robbins, p. 15). Undeniably, this is a subject of contemporary economic study, however, it is difficult to extract an universally valid definition due to a mutable nature of economics.

Economic science has changed, and therefore it is important to understand reasons which caused the changing orientation of those teachings over the centuries. Focusing on a single definition of economics is wrong, because it is clear that the economics has historically meant something diffe-

rent to what we believe today. That is why its relationship with politics had different meaning, depending on the historical period.

In these historic changes, the economics has evolved from something that was almost irrelevant, and has become a social science, characterized by persistent attempts to include it in the league of established disciplines. Goal of this chapter, through the consideration of this evolution, is to identify the development of the relations between politics and economics. This effort may be useful in discovering the reasons for the confusion in today's economics. It is possible that the problem of economic science starts from economists' ambition to secede from the analysis of human action and interaction, and to follow the examples of Auguste Comte (1798-1857), Léon Walras (1834-1910) and Gustav Schmoller (1838-1917), in order to understand the universal and exact mathematical laws that supposedly embody human behavior in conditions of deficiency. This caused that economic problems are left to other sciences, as an unexplained cession of the political impacts on economic human activity. Hence, the question of inequality's remained unsolved. This chapter, therefore, strives to find the essence of economic reasoning through the history, and the link of that reasoning with politics. Evidently, the stream of thought in economics is divided on the insisting on the concept of human action, on one hand, and the balance on the other hand.

I support the views (e.g. Colomabatto) that the economy at first was the study of human activities and interactions in the world, characterized by deficits and impersonal exchange, but which also exists in the frame of more general plan of divine harmony, the providence. The first studies started from the context of natural God-given balance, where human activity was driven by the quest for virtue. This early view began to evolve when the natural harmony was gradually replaced by the concept of the created balance, where human activity was driven by the quest for efficiency (by rational decisions).

This step made it possible to establish the nexus between politics and economics, given that the economics ceased with making moral judgments about human behavior. Now with an emergence of the collective and the collective interest, according to which the human activity is evaluated. "Social rationality" justifies economic decisions.

This view prevails nowadays; it assimilates and develops insights of Lord Robbins, who explains the idea of the common good and, de facto, transforms economics into professional effort towards optimization.

Lange (1945-1946) has not gone far in defining the economics as the social science concerned with the administration of scarce resources, also saying that it is a subject which depends on the standards and forms of life in human society (Lange, pp. 19-32). Instead of further elaboration on this issue, he has articulated a list of sub-disciplines derived from such a definition: economics stricto sensu, economic sociology, theoretical economics, applied economics, econometrics and welfare economics. Evidently, the political aspect of economic activities remains far from the economics. In this limited perception of economics as a science, there was not much space to explain the relationship between politics and economics.

We will try to explain the limited perception of economics as a social science until about three centuries ago.

6.2 The origins of economics as a science

The economic activities, as we have already mentioned, began several millennia ago, and systematic study of the economics just a millennium ago. The foundation of economics as a science was set by Xenophanes in the 4th century BC. In his works "Oeconomicus" and "Cyropaedia" he wrote about the importance of good governance motivated by profit and oriented towards the production of wealth, about "economics" as "a branch of knowledge." He viewed the economics as an activity worthy enough to be dealt by rulers (monarchs). Xenophanes set up several concepts, which are still critical in the economy, such as: the importance of rational production of techniques, effective management of human resources, accurate record-keeping and organization, and specialization of labor and productivity. He even saw a very clear distinction between price and value, which is a focal point of the modern economy (Oeconomicus: Chapter 1).

In ancient Greece, Plato[10] and Aristotle wrote about their cognition of economics[11]. The most famous is Aristotle's attempt to analyze commo-

[10] Plato lived about half a century after Xenophon; philosophy of Plato's economy was motivated by his willingness to impose the state control on most human activities, rather than a desire to understand their mechanisms. For example, in The Republic he stated that the trade is useful from the point of production, but he overlooked the benefits of spending,

dity exchange. In his Ethics, Aristotle is aware that the exchange or trade is only possible if there are potential gains for both sides. He understands the importance of money as a tool that simplifies the exchange of goods, as the prices of all goods are expressed by the same units. However, for Aristotle, as for any other Greek philosopher, there is no attempt to understand the economic system as a whole. Not only Greek, but also Roman philosophers, are interested in economic issues, but these are not systematic theories of economic life.

The relationship between economics and politics was not considered in the Greek world. The goal of the Greek community was to promote virtue, not wealth. According to Aristotle, people "are not joined together only for the sake of living, but for the sake of a good living..." nor "for the sake of a defense alliance, so that no one would have caused them injustice, nor for the trade and mutual benefits... togetherness (state) is what make the citizens to be good and righteous" (Aristotle, 1988, p. 91).

In the Middle Ages there was no significant progress in the economics, probably due to the heavy reliance on Aristotle, and thus on his misunderstanding of interest and trade[12]. During the Christian era, economic activities were not the subject of research. They were mostly sporadic. However, even then were raised economic problems, especially in the Roman Empire. For example, the functioning of capital market and credit. Trade and other economic activities were even seen as a sinful behavior. St. Augustine (396-430) has condemned the trade3.

Must keep in mind the fact that the medieval economic transactions did not take place in a well-regulated markets, where competition would

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which stem from different preferences of individuals. As expected, Plato viewed the division of labor as a field that requires the state control: it was actually predicted that individuals have to perform (or to assign) activities that best suit their talents, they were not able to switch from one occupation to another.

[11] The word ’economy’ can be traced back to a Greek word oikonoia "household management" or "household" (’oikos’ house, ’nomos’ managing from ’nemien’ manage)

[12] Claiming that money cannot bear fruit like a trree or a field, Aristotle contributed to the misunderstanding of the "interest rate". In addition, his theory that individuals trade the same values has led many economists on the wrong path, until the end of the 19th century. This has influenced the public opinion to reject the traders and trade in general. Many authors suggest that traders of all ages and nationalities have had a negative reputation (see St. Augustine, Edward Chamberlain 1669).

hold prices at the same level, allowing different customers and merchants to trade under the same conditions. Many transactions between individuals took place in a relative isolation from other economic entities. Thus, the possibility that one party could take advantage of another party was huge, due to a stronger negotiating position or better information.

Clearly, the fair price was not easy to establish, because the buyer was interested in the lowest, and the seller in the highest possible price. Therefore, the starting point of economists (mainly scholars) was that the solution should be based on the interest of society. The moral and theological principles were taken into account, but soon became clear that empirical insight into economic transactions and the markets was crucial. Studies in this field have led to the conclusion that the fair price is "natural" price – formed without the influence of monopoly, in a free and effective competition and, naturally, without fraud (Niehans 1990, Lamgholm, 1998). In addition, the fair price depends not only on production costs, but also on the consumer's perceived value of goods. This is the greatest improvement over the Aristotle's theory, because economic life begun introducing scientific methods (Niehans, 1990) and raising fundamental economic questions about value.

Thomas Aquinas (1224-1274) wrote in detail on the concept of ownership and the moral foundations of a private property, which are the key elements that characterize the economic profession to this day. However, he saw the main role of the private property in avoiding social conflicts. Generally accepted view in Christianity was that communities should be formed and held together due to a need to defend against aggression, or to protect against natural catastrophies. In other words, a stronger link between economics and politics has not been established. In the Middle Ages, despite the effects of economic activities, the political and social arrangements was usually not contemplated. However, there were some areas where the nexus between politics and economy could be perceived, mostly through the aspiration to increase tax revenues in order to strenghten the power of the army, or to build magnificent monuments. The economic activities were even considered irrelevant in terms of conceiving or explaining institutional arrangements. Some exceptions are important: the emergence of independent municipalities during the High Middle Ages, especially in Italy and later in Flanders. Perhaps for the first time there was more prominent impact of the economic aspirations on politics, through guilds and wealthy interest groups

(bankers, traders). Yet, the social agreement which replaced the polis (city-state), was to be based on defense, not on trade and industry. The politics and the economics were dominated by theology. Economic activities were monitored to ensure that such activities do not turn against spirituality (religion and, consequently, morality). For example, the Catholic Church forbade interest (as is the case in the Islamic world), considering it a "loan sharking". It was a situation where a stronger (creditor) exploits a poorer (the debtor). And this attitude was slowly changing.

Merchants and small craftsmen (middle class) began to emerge in some areas of Western Europe in the 11th century. Merchants of Italy and Flanders among the first refused to believe that their fate on Earth was entirely in the hands of God and the Church. They no longer wanted to accept the belief that only poverty brings Salvation. They knew that entrepreneurship can change their existence, and believed that wealth is not a hindrance to Salvation. Some scholars tend to prove that material wealth does not interfere with spirituality. Thus around 1530, John Calvin in Geneva claimed that God saves men independently of their will and the life they leads. At the time, a rebel from Rome, a theologian Martin Luther, wrote "Christian Liberty, claiming: Good work do not make a good man, but a good man does good works. In other words: good action, especially material success, which stems from it, is a sign of God's will, not the status of the act. On this new concept was based a new attitude towards work, which was no longer the mark of shame, but it was regarded as something that deserves praise (i.e. praise would justify the cash prizes). However, this change was hardly accepted. Merchants were still treated with distrust. This attitude began to change during the 15th and 16th century, when the emphasis from non-discriminatory attacks was transferred to the mercantile activities. Also, the criticism was directed against the misconduct of bad traders, either because they were prone to greed and neglect of charity or, more generally, because they were inclined to disturb the divine order. This was the position of the Catholic Church and leaders of the Reformation.

It seems that the spread of Calvinist[13] and Puritan ideas in particular, was crucial to adopt economic orientation towards life. According to Chri-

[13] From the perspective of the Catholic and Lutheran churches, the economic activity was seen as a tool: a way to survive, and not to be a burden for the rest of the community. From the Calvinistic point of view, the work was the goal: the purpose of human existence in the world, in order to celebrate God and His plan for this world.

stianity at the crossroads of Judaism and Greek thought, people are free to choose between good and evil; They choose whether to follow the path of Salvation, offered by God and those who spread His words on Earth. Also, the only thing a man should seek for itself is Salvation, in other words the Resurrection. It all began when God created the world. Poverty was considered a virtue, and the wealth was something totaly opposite. The community was focused on stability rather than on efficiency. Economic activities were necessary in order to survive, both as an individual and as a member of the community (the wealth often meant the ability of defense). However, the businesses were small-scale, using the family trade names. Economic growth was very low; in the period 1500-1820, Western Europe recorded the growth of an average annual rate of 0.14 percent (in terms of GDP per capita)[14].

However, there were exceptions, such as in Italy and Flanders (12th-14th century), and later during the rise of Netherlands and England (17th century). Thus, capitalism and economic activity were very much alive, even during the prevailing cultural orientation towards community. However, this practice could not change the generally accepted opinion on the responsibility of the individual towards the community, which is ahead of personal preferences. Economic activities (production and trade), could had been acceptable only if consistent with the objectives of the community, except those necessary for personal survival. It is no coincidence that the economic activity emerged much easier in areas of decentralized power, where the movements were hard to restrict, and fixed hierarchical structures were hard to maintain. Tolerance was the principle that summarized all these characteristics, first promoted in the Netherlands at the end of the 16th century, and followed by the example of England several decades later.

Accordingly, the state of the economy did not require a systematic and thorough examination, nor a proper understanding of the economic issues until the end of the 17th century[15]. The main question was: does the economic activity serves the purpose of moral approval or political control? There was no systematic research on the cause-effect relationships in economic phenomena, in order to find ways to increase the wealth of individu-

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[14] This means that an individual has experienced a rise in the living standards of about 4% over a period of 30 years (Maddison, 2005).

[15] Exceptions were the Spanish Scholastics on the continent, and Thomas Mann and Edward Miselden in England.

als (in modern terms: to meet their demand). Simply put, the individual activities for the improvement of material conditions were rarely analyzed, as if there was some kind of resistance to it, because the material wealth could be a source of potential upheaval and social changes[16]. Indications of a different attitude towards material wealth emerged during reigns of Louis XIV and Louis XV. Out of the need of the state or the king to raise taxes, which were paid for minting coins, with the imposition of legal means of payment in order to increase tax revenues, begun a political interference in monetary and fiscal matters. This required "more professional" economic analysis.

After signing The Peace of Westphalia (1648), it became more clear that international relations between rulers were replaced with relations between national states. National states needed to invest more in military technologies, which required the engagement of the entire kingdom because personal wealth of monarchs was scarce resource. Soon to became clear that wealth is an instrument of power and conquest, as well as the control over the domestic difficulties. This further developed the awareness that the wealth of the state does not depend solely on the amount of available land. The rulers had no longer been able to acquire a fortune through forced lending and confiscation but through economic activities. Therefore, studying the laws which determine the activities and transactions related to the production and distribution of revenues among the categories of owners of resources (land, raw materials, labor, fixed capital formation) became more interesting and, as expected, the economic researches have become to be valued.

6.3 Economics before marginalists

In the 18th century emerged a need to create more wealth, both for statesman and legislator, and for all the people. This art of wealth creation, according to Adam Smith, was expected from the "political economy". Political economy was faced with the necessity for greater production of wealth, and this also required to change the nature of paradigm on which economic thinking matured until the 17th century. A moral sense of economic activity

[16] 7According to Albi (2004, p. 258) this is not surprising. He explains, in a wider context, the treatment of economic relations as a part of natural order, which included the assumption of certain substantial correctness which provided explanations and prognosis ... all this could not offer any solid foundation to build a natural social order.

was not abandoned at once. In fact, although the religion was denied any moral influence on economic issues, most of the "economists" agreed with the fact that the art of political economy[17] was a tool to understand the ideas that providence and nature gives resources to a man. And those resources allowed the policy makers to pursue general interests understood both in the material and moral sense. Adam Smith emphasized the connection between individual instincts, human activity, national security and effective policymaking. Thus, he has taken a step further in relation to a Tucker's theory that commercial activity represent a fraction of the divine plan[18].

Here are the roots of the change of economic paradigm, for which the realization of the general desirable objectives during the 18th century became apparent. In order to help the king to increase his wealth and power, the efforts should be directed towards the discovery of eternal (objective) laws of trade, production and distribution, which are defined - or similar – by natural phenomena. At the same time, speculation about efficient instincts (the modern version of natural law), would help in establishing and, later, approximations of "fair" state of things, in order to recognize when the human irrationality disables the nature to follow its course and achieve the desired results. Religion plays an important role in achieving a "righteous" state of things: "This is the way religion enforces our sense of duty in life, but also the reason for the widespread tendency of people to believe in the integrity of those who look deeply imbued with religious sentiments. Such people act through another link which regulates the behavior of other people. Attention to the appropriateness of his actions, as well as own reputation, taking into account the approval in their own breasts, or the approval of others, are the motives which influence both the religious man and the man of the world" (Smith, 2008, p. 147).

During the 19th century the economics has maintained the concept of balance - supposedly ideal state of nature. Policy-making was gradually accepted as a necessary and legitimate way of restoring "stability", while the variations of the known, ideal state of affairs, demanded action to prevent, change, and punish these different variations.

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[17] "Economy" because it dealt with the production of goods and services, like Xenophon's lines of reasoning on asset management; "Politics" because it affected the wealth and stability of a community.

[18] This view of perfection / balance in the long term criticized by Hume in his Dialogues (1779). However, his criticism was mostly ignored.

From the late 17th century untill the so-called Marginalist revolution in the 70s of the 19th century, the nature and the content of economic science gave quite unison impression. Economists were homogeneous and consistent in understanding the object of their discipline. The ultimate purpose of economics was to understand the rules and the consequences of the interactions between individuals, and to understand how to achieve the proper functioning of society and the stability of the community, characterized by and held together through "the pleasure of mutual sympathy" on the one hand, and the interest, wealth and power of political bodies (the prince and the state), on the other hand. As might be expected, the concept of balance was thus accepted in the social sciences for centuries. In particular, the economics has shown only occasional interest in individual behavior, and much less attention was paid to individual consumption. Instead, manufacture has continued to play a major role until the mid-19th century.

Basically, the main purpose of economic research was taken for granted and evolved gradually, almost unconsciously, with some open disputes and without separation of different schools. There was relatively little interest in these issues: How the community could increase its wealth? Are there limits to the growth? Does it makes any sense to explore the meaning of shared prosperity, as opposed to the well-being of those who make up the social body? Growth, however, was not completely ignored, but it was sometimes seen as a temporary phenomenon, sometimes as an inevitable product of "industrial progress", but almost always as an element to be considered when evaluating and directing the evolution of social entities towards other desirable objectives.

6.4 Classical view: linking politics and economics

The foundation of classical economics is The Wealth of Nations. Its glory lasts almost until the end of the 19th century. This work did not entirely rejected the legacy of the past, it continued to nurture holism, interdisciplinarity, and deductive approach. The Book The Wealth of Nations, or the study An Inquiry Into the Nature and Causes of the Wealth of Nations is a large and extensive work. It is not presented in the form of a diagrams or mathematical models, but as a logically related and precise thinking in the text format. Smith argues against mercantilist concept of economic policy, and in favor of free trade and free markets. He has dealt less with politics, focusing on economics, and gave a quality analysis of the market functio-

ning. He launched a number of issues on macroeconomic theory (or theory of price) as it is called today.

The vision of classical liberalism, whose founder was Smith, focused on individual performance. On the other hand, most agreements were the result of instincts, which should be controlled and, in some cases, suppressed in the name of virtue (morality). It was thought, as opposed to thinking in the Middle Ages, that every subject should behave in accordance with a kind of pre-received role, according to the class/birth - as a worker, merchant, landowner, capitalist... Behavioral models were determined by the rules of the game, or formal and informal norms that have characterized the community and sub-communities (family, guild) where the individuals belonged. There were indications on self-improvement of an individual, but purpose of that was climbing the social ladder, gaining the public respect and approval of the community. Adam Smith wrote: It is the vanity, not the ease, or pleasure, which interests us. But vanity is always founded upon the belief of our being the object of attention and approbation. (Smith, 2007, p. 50)

Attitudes on instincts, a strict division of labor and directing the talent within particular limits had its consequences. First of all, a misconception of exchange. To say that exchange is a human instinctive tendency towards trade is a serious mistake. Exchange is a result of differences in individual preferences and, therefore, it provides the potential profit for trade participants. In this part, Adam Smith and the classical tradition have failed to come to the conclusion that the exchange is useful, not only because it allows specialization, but also because the goods and services are transferred from those who valuate them relatively little, to those who valuate them relatively more. They did not rest on one error, however, because they did not see that exchange is based on differences in subjective values. Classical economists have not noticed the weakness of labour theory of value, and eventually they replaced prices with values.

Generally speaking, the classical school opposed the arguments in favor of political opinion, insisting on holism and the natural order. Appleby (2004, p. 103) argues that Adam Smith achieved that by setting "automatic, self-sustaining economic laws on essential human qualities of love for 'trade and barter', and the constant urge for 'own progress'. On that road, he was followed by a long line of thinkers." This is why the classical economics (with the exception of 'older historical school' led by Wilhelm Roscher) had a static vision of the economic system. In this system there is no room for

innovation and entrepreneurship. Even the market system does not follow the vision of spontaneous interactions among individuals, which was popularized by Adam Smith. Economic activities took place in the economic reality, and economic growth was negligible. Ignoring subjectivism – preferences of individuals and theory of pricing (demand) - classical economists were helplessly explaining economic reality. They blindly followed the medieval theory of labor value, according to which the price is righteous when it rewards the manufacturer's efforts. In addition, they did not understand the role of politics in the economy.

6.4.2 Inductivistic aspects

Since the 17th century, classical economics have claimed to understand the main cause-effect changes in the economy. Thus, there are systematic causal alterations or systematic causality, and there is a system of economic phenomena. There is a clear cause-effect connection in the economics, that is, the law of cause and effect which governs what happens. In the view of the classical economists, it is possible to clearly demonstrate, understand, and identify the systematic changes of causal effects. The classical school of economics greatly contributed to that. Although the point of view is wrong, the concept is solid, because it seriously detects the existence of a cause-effect relations of economic phenomena, which was fruitful during the economic history. Ricardian, classical economists, started from the fact that the causality basis of economic phenomena is physical reality. The man lives in a given world, which features a powerful system of cause and effect, and that makes economic reality. Thus, starting from a simple physical law of diminishing returns, as well as a fundamental understanding that physical resources, labor and capital determine the chain of cause-effect, the classic economics has developed.

It was a very respectable and powerful set of ideas that regulated economy from Adam Smith to Ricardo and Mill (1870).

To illustrate this, let’s take a clean sheet of paper and at the top write down a word RESOURCE, and at the bottom CONSUMER SATISFACTION. In the middle write down a word MANUFACTURERS.

Manufacturers turn resources into customer satisfaction. This is the basic structure of the economy. Thus, economic activity starts with a piece of land, digging and mining, obtaining metals; it continues with the pro-

duction of cars and other goods that meet consumer needs. Economic flows go from resources toward consumers, and this circle requires many steps, many stages. Let's mark these key factors from the consumer-market towards the production with little arrows. In the view of the classical school of economics, causality is on the direction from resources towards consumption. Resources determine what will be manufactured, and market prices. This is a general perspective of the classical school, and from within it generates the labor theory of value.

In addition to detecting causality, the spectacular development of the natural sciences, particularly in the 19th century, has influenced significantly the method of economics and adding the inductive techniques into the economic analysis. According to the explanation of natural phenomena in physics through the formulation of the exact laws, the temptation to look for mechanical regularity in the social sciences has proved to be irresistible. Although it was more complex than in the natural sciences, due to the nature of economic phenomena and problems with testing, the search for a perfect model has begun. Simply put, the mathematics was added to the economy in order to create the economic and financial models, to explain the balance in the economy, and to explore the consequences of policy-making. The first model with mathematical evidence was developed by Ricardo, demonstrating the benefits of free trade, then Nicolas-Francois Canard (1750-1833) and Antoine-Augustin Cournot (1801-1877). However, the father of economics, Adam Smith, was the opponent of mathematizing in the function of constructivist ambitions. He expressed this in the following way, which is often quoted, with a good reason: "The man of system ... seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board. He does not consider that the pieces upon the chess-board have no other principle of motion besides that which the hand impresses upon them; but that, in the great chess-board of human society, every single peace has a principle of motion of its own, altogether different from that which the legislature might chuse to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successful. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder." (Smith, 2007, pp. 233-234)

The end of 19th century brings the strengthening of rationalism, which turned into scientism, affecting the economics to accept those constructivist ambitions and characteristics, that Adam Smith rejected loud and clear.

6.5 Subjectivist revolution

Carl Menger published the book Principles of Economics (1871), presenting views fundamentally different from the classical economics. His oppinion was revolutionary in comparison to classical economics! According to Menger, the causality of changes is dictated by the opposite side (the bottom), that is, from the customer satisfaction towards the resources. Look at the diagram, as if you've made it in accordance with previous instructions. Human needs are driven by economic activities. A chain of causal connections starts from the market and goes towards the physical reality (production resources). This attitude is an absolute revolution! The theory of labor value has been replaced by the theory of marginal utility. The theory of marginal value is part of a broader perspective, which Menger explained with great clarity. This is the main point of the Austrian school of economics, and its main contribution.

Even before the Menger there was criticism of Adam Smith's views, and opinions contrary to classical economics. The most characteristic was Jean-Baptiste Say (1767-1832), who criticized Adam Smith regarding the role of workforce. He reintroduced entrepreneurs in the economy (Essai sur la Nature du Commerce en General by Richard Cantallion). He believed that an entrepreneur in the manufacturing process depends on the continuous acquisition of knowledge (Say, 2006 [1852], Volume I, Chapter VI). Also, he based economics on individual activities and social interactions. However, Say’s introduction of entrepreneurship theory, and the lack of objectivity, did not manage to change the mainstream of economic reasoning. Seemingly, the most guilty for that was grandiose work of Adam Smith, on the one hand, and the dynamics of economic activities, which hindered Say's readers to understand the role of entrepreneurship and technological advances of the industrial revolution.

There have been other attempts (Claude Frederic Bastiat, 1801-850; Hermann Heinrich Gossen, 1810-1858), also without enough attention - which they deserved it for sharp denial of constructivism, and for breaking up with conventional holistic and pretty static foundations. Bastiat supported

the recognition of entrepreneurial growth, and was a prominent opponent of the state intervention in economic affairs. However, an opportunity to reject the old economic paradigm was yet to come. Therefore, the economics remained just the analysis of conditions in the long term, based on the theory of labor value.

More serious has been a occurrence of marginalists with Carl Menger at the helm. Nevertheless, Menger's concepts of dynamics, entrepreneurship, uncertainties, and a number of methodological insights, including subjectivism - went almost unnoticed. Resistance was minimal, but it was not enough to make a breakthrough, and even more weakened during the second half of the 19th century. The other most attractive elements of marginalism - Walras's insistence on the use of mathematics and, to a lesser extent, Jevons' rediscovery of Gossen - related to the potential technocratic, constructivist movement, have not encouraged the change.

However, all this has contributed the fact that society came to be seen as the product of human action, and not as a plan of the God's will. In the field of economics, the search for a natural balance has been replaced with attempts to give a scientific (or mathematical) definition of the general balance in terms of pricing and quantity, which determine the choice of factors. This was enabled by marginalists, who properly defined the deficiency and introduced the term of demand. Particularly important were the Walrasian marginalists, who created the perfect competition through defining characteristics of a hypothetical static "efficient" equilib. Actually, marginalism was the proponent of creating a balance: from natural balance to created balance, from quasi-divine order to created societies, from human activity, driven by instinct and inclination, to rational behaviour. Anyhow, there was a new vision of economics - marginalist vision, which developed the theory of demand, but also represented the view that economic research becomes similar to that in physics, and that economists would turn into social engineers. However, the subjectivist turn remained in the shadow of the illusion that economists are just about to find the key that will allow them to crown their quest for scientism and solve the problem of equilib, when demand was no longer exogenous (the final question that should be estimated by demographers).

6.6 Keynesian synthesis and Keynes's followers: from long-term to short-term

Menger's version was more revolutionary than Valras', as it represented a break up with tradition. In fact, he has denied both the existence of a equilibrium (except as a term that describes a situation in which the market offset), and long term relevance. Valras' version was clearly consistent with the conventional tradition, focusing on issues in the longer term: its analysis was focused on the (static) general equilib, achieved under apparently perfect and constant conditions with zero transaction costs.

Menger has lost the intellectual battle, because the real world would soon offer a challenge, which has found the Valras' supporters unprepared. New vision, which offered a diagnosis of unemployment and stagnation during the 20s of the 20th century (mainly in Europe), and during the 30s of the 20th century (in the world), has been articulated by Keynes.

Keynesianism generally recommended a greater role of the state in the market economy. In other words, politics enters into the economy in a big way. According to Keynes, the role of the state is primarily focused on stimulating demand, and the main driving force of the economy are customers. In times of economic crisis and turmoils, demand dries up because customers are afraid, and businesspeople loose optimism. Reduced demand and abstention from spending cause reduced investments. Consequently, the economy is discouraged, reduced consumer demand troubles the companies which suffer due to reduced sales. Thus, reduced business activities cause layoffs. As the companies and consumers spend less, the role of the state is to initiate demand. By bigger budget deficits and spending of any kind, the state can create its own demand, which will then start the economy. The initiated economy will in turn create a new investment and consumer demand. Hence, a vicious cycle of savings and recession turns into positive spiral of consumption and growth; politics and economics share strong mutual interactions.

Keynesians have explained that the growth before the First World War was no exception, while the stagnation was the rule. Crises are the result of bad government policies (especially printing the money). In a crisis, the behavior of society is based on a special psychology, thus the difficulties get complicated, which slows down the recovery and its spontaneous flow.

In other words, according to Keynes's vision, the capitalism is influenced by the inherent possibilities of disintegration as its success has contributed that the capital market becomes accessible to ignorant masses. Therefore, the economy has become vulnerable to "the instability of human nature," to the volatile and unpredictable instincts (animal instincts), to the perceptions and expectations in terms of "political and social atmosphere."

Keynes did not deny the foundations of Valras's (and, in general, neoclassical) preference for optimal regulation that improves efficiency. He emphasized the emotional behavior of the factors as the main problem. According to him, the best "correction" of behavior was a discretionary state intervention in order to compensate for "outcome of the mass psychology of a large number of ignorant individuals ... liable to change violently as the result of a sudden fluctuation of opinion due to factors which do not really make much difference in the prospective yield. "(Keynes 2004, p. 154).

In fairness, Keynes's economy was built on the foundations which could hardly be questioned. His a priori assumptions were clear, but his theory was consistent. This obviously does not apply to the most of Keyenes followers, who have changed many things compared to his theory, based on the business cycle of mass psychosis. This Keynesian legacy has resulted in normative instructions for creating policies in the presence of structural rigidities. This has led and to the fact that they basically dealt with the analysis of the characteristics and consequences of such rigidities (quasi neoclassical agenda, with the exception of the fact that limitations/rigidity produced in Keynesian framework have replaced alleged failure of the market), through applying econometry. We also know that Keynes was actually pretty careful about making models. He opposed to the quantitative analysis, and therefore, today's policy-making owes much more to different groups of his followers, than to Keynes himself.

7. EQUILIBRIUM IN ECONOMICS AND POLITICAL OPTIONS

7.1 Introduction

For a long time, economists have been supporting a perspective that individuals enjoy being balanced, they strive to achieve it, and know when they get there. All other elements are excluded from the domain of economic research, and left to other scientific disciplines. In pursuit of equilibrium are developed models of economy in and out equilibrium, relying on positivism[19], striving to make the economy a serious doctrine.

The equilibrium itself, which is understood as a situation without incentive to change its behavior and undertake a different action, did not mean much for the potential policy maker. This view of equilibrium provided much more than physical integrity, property rights, freedom of contracting and, possibly, the implementation of voluntary agreements. This means that politics should provide a search for equilibrium and, when this is achieved, to ensure that this equilibrium is not disturbed. Hence, an individual should get the most out of the resources available to him in his/her efforts.

Equilibrium can also be a predefined collective goal, hidden or not, and then the political question becomes a characteristic of the goal, or not being the subject of scientific research.

The idea of equilibrium carries more useful aspects, especially operatively, both in politics and in economics (economy), if the discussion introduces time and rationality. This broader framework enables policymaking in which qualified, interested planner actually develops strategies that allow the pursuit of desired goals (constructivism). In some cases, policymaking may aim to speed up slow evolutionary processes (spontaneous

[19] Positivism is a philosophical direction that strives to remain on "positive" (verified) facts, that is, on scientific grounds. It advocates the application of the methodology of natural sciences in sociology and economics.

order). This raises the question of the justification of external interventions, in order to correct the mistakes and/or to enhance cooperation. The consequences may be different, so we will briefly consider them.

Let's repeat: the idea of economic equilibrium was the central theme of more than two centuries in economic science. Therefore, the economic science was largely focused on studying the equilibrium configurations within the economy. It is an eminently static approach, which in reality has never been reached. It turned out that in a living economic reality, the economy never reaches a state that would, at least remotely, resemble the general equilibrium models (mathematically formulated or descriptively explained).

Simply put, economy is a complex system whose state is constantly evolving from period to period under the influence of external strikes and exogenous parameter changes. Given the frequency of changes, the rhythm of delayed economic reactions, the impossibility of such economic coordination - where subjects adjust their actions in order to achieve equilibrium, or to achieve time adjustment – it turns out that the general equilibrium analysis examines a state of economy which can be achieved only in the model. In the real economic life, the economy could never find equilibriium.

The first serious criticism of the general equilibrium theory came from the Austrian school. This theory has been primarily criticized for its virtue. According to the representatives of this school, the general equilibrium theory persistently analyzes their sizes and relationships, which empirically can not exist nor it can be recorded. Instead of dealing with the virtual world, they consider that the subject of economics should be transitional processes, which more closely reflects the dynamic economic reality. Simply, the economy is in constant process. Clearly, these are very different paradigms[20], with the opposite approaches.

According to Austrians, it is senseless to analyze variabiles and their mutual relations, which in reality can never happen. This is one of the deepest divisions in economics, which has arisen as a result of the question: what is a subject of the economy itself? The school of general equilibrium was first devoted to the study of the general equilibrium, and later it largely accepted the transition processes, which allowed that economy moves from

[20] See more about this in Arrow and Hein, 1972.

one equilibrium state to another. The exception is the school of the new classical economy[21]. Basically this is a static approach, because it focuses on the general balance. The Austrian School has set up transitory processes as the subject of economic research. Those processes take place between some conceptually determined equilibrium states, which can not be reached. Thus, there were two different approaches to the perception of reality in the economic science, creating a methodological distance. However, the school of general equilibrium is less extreme than the Austrian school and allows the existence of equilibrium and non-equilibrium states. With this broader view, this school has embedded into a large neoclassical synthesis. The Austrian school is less developed than the classical, therefore, the school of general equilibrium with its impressive upswing had more feedback on politics and the creation of economic policy compared to the Austrian school.

7.2 Time, statics, and dynamics in the economics

An important remark regarding the concept of equilibrium is that such concept does not prorate time, yet only if economic processes are observed in time, they can have a sense for the politics, and for the economics in general. Alchian (1950) perceived that the passage of time is essential in order to give some sense to the concept of equilibrium. There are two important reasons for this. The first reason is the change of preferences and opportunities as a result of acquired knowledge[22], technological progress, institutional evolution, and new psychological models. The second reason is that if we include time into analysis, the application must be at least partially unpredictable due to decreased or increased uncertainty. This raises the question: how relevant is the concept of equilibrium for normative purposes and for politics? When time is present, we do not know what will happen around us, what will be our reactions to new stimulation systems, how much we will change our behavior? We can only speculate, with or

[21] This school believes that the economics is always in balance. If it is not so, the economic entities, if they were not satisfied with the current state, cause reactions in order to find an optimal situation for themselves, would then move the economy into another constellation.

[22] Hayek emphasizes that a human activity is triggered by the acquisition of knowledge, which is necessarily occurring in time. As the conventional economy does not have any theory that explains knowledge (and barely mentions this question), according to Hayek, the neoclassical economy is essentially timeless.

without information. The past is not repetitive. However, in the model of time-free economics, the future is a repetition of the present, nothing happens, so extrapolations and predictions necessarily coincide.

The approach to timelessness is problematic when it comes to justifying the policy-making for the purpose of stabilization. Models based on this approach are limited, because they do not take into account uncertainty. How can the policy maker, who believes in these models (i.e. in positivism), correct the present time if he/she is convinced that it is undesirable? The policymaker will still use this approach, because he/she believes in it, despite its limitations, due to the validity of an intervention in the event that there is a little hope for spontaneous and sufficiently rapid improvements. The policy maker believes in some kind of enlightened dirigism. If problems arise, the "optimal" adjustment will be essential[23].

All of these problems, especially uncertainty, are less important if the intervention applys in the short term. Thus, a reasonable policy in the short term emerges from these models, while in the long run, through ignoring of uncertainty, the policy making turns into an inevitable source of uncertainty.

7.3 Towards rationality and awareness

According to the previously described opposing schools of economics, arise the principled differences between the two general views on economic reality: methodological individualism as a formalization of atomistic approach, and organicist (systemic) approach. These different views are not limited to differences in the approach to economic reality, as probably the most important area of society, but also to the widest social concept. Methodological individualism in the economy is based on the fact that all economic decisions, ultimately, are reduced to individual choices. The decisions of collective bodies are also ultimately extended to individual choi-

[23] For example, it strives for high growth and employment. A loose credit and monetary policy is chosen to achieve this. If any undesirable results occur, other measures will be encouraged at a later stage without much concern about the interaction between the two packages (e.g. in terms of expectation). If there is no high growth or employment, more money is being pumped. When the economy is too stimulated (inflation), the money supply is withdrawn from the circulation. In any case, it remains uncertain what happens in the passage of time. First, there is a significant time distance between the effects of policy and the impact on the economy. Secondly, the nature of the necessary correction may not be entirely obvious.

ces and decisions of individuals, as they reflect the individual choices of individuals. Individuals are actors of collective bodies, naturally, with different influences on the final decision. More broadly, relationships in society are also reduced to the interaction of individuals, because "individual is the unique unit of consciousness" according to Buchanan. Political and market arrangements are built on the grounds of individual actors' impulses and related knowledge and attitudes (i.e. awareness). Accordingly, the advocates of methodological individualism believe that all social events are acknowledged starting from the individual, and not from the collective.

The completely opposite view is the characteristic of organizational (systemic) approach. It starts from a diametrically opposed methodological basis, where the system has its logic of functioning and its regularity, independent of individual behavior. The system consists of elements (individuals), having its own special nature which gives the system an independence to react and function. Significant is the method of connecting elements and the basis on which connections are established. There is an incredibly large number of combinations, and each individually creates an appropriate system structure. Thus, the system functioning and reacting to exogenous influences depends on the qualitative nature of the network of direct and indirect connections between its elements. The system in which relationships are established through hierarchical relations will essentially work differently than the system in which connections are established through voluntary cooperation. In any case, the number of possible forms of influence (direct and indirect) is almost unprecedented with the participation of feedback and a variety of elements.

However, the same elements in different relationships will create different configurations with completely differentiated patterns of behavior and action, of both individual elements and the system as a whole. Simply put, the same elements configure different systems using different connecting combination. This actually shows that systems have their own nature of action and choice, different from individual elements (especially in economic systems). This is true, even though the elementary units of the system have their own autonomy and their own goals, toward which they make decisions. All of these characteristics are a good input for policymakers, because they can change the behavior of the system without disturbing the autonomous elements. This is done by changing the system structure defined by appropriate connections, through changing the topology of

connections so that other behavioral patterns and more favorable (expected) effects are obtained purely by system determinants.

The system can be changed by changing the elements (units) themselves, which would mean transforming the way they behave, and patterns through which they respond to exogenous impulses. Obviously, this change is more difficult to perform, because it is difficult to quickly transform the "nature" of elements[24].

A specific characteristic of the system is that its natural function is determined by the structure itself. There can be an incredibly large number of possible structures, which results in a large number of different systems with special characteristics. Clearly, there is also an appropriate way of the system reaction to exogenous strikes, that is, to all the impulses from the system's environment. This would mean that systems are individual: it is impossible to find two identical systems, as it is impossible to find two identical persons. Accordingly, systems have their own uniqueness, and can be a bearing unit in studying the society, as individuals or more important. Therefore, it is worthwhile, and even necessary, that they (also) are put at the heart of theoretical considerations in analyzing the social relations and their changes. The dilemma is which one to support: methodological individualism or systemic holism..

From the aspect of influences on economic policy, it is clear that these different approaches provide different recommendations. In addition to numerous doubts, the fact is that different economic policy recommendations already create major difficulties for economic policymakers, even in situations where the boundary between one and other phenomena is set, those originally systemic and others, which are the sum of the effects produced at the elementary units level. Theoretical dilemmas and analytical difficulties arise as the boundary between one and other phenomena, and when it turns out that the platforms are purposefull, the costs of functioning and implementing the economic policy are increased due to the "noises" in the information channels between the decision-makers and the policymakers.

Another problem should be highlighted in the systemic approach. It

[24] There have been such attempts to radically change the centuries-old tradition and culture. The last one occured during the Chinese Cultural Revolution.

refers to the complexity of the system, which makes the analysis difficult, so it can be studied only when digested. The system decomposition, however, is not easy to perform; hence, it represents a new source of multiplicity.

This shows a structural, objectively shaped weakness in economic science: many actional and operational recommendations are definitelly not a good input for economic policymakers and rational action. Also, it is not resistant to criticism of this policy, especially if there are alternative theoretical platforms with more consistent recommendations and justifications.

To summarize: As a partial response to the inconsistency of the classical economy, two different directions of reasoning have developed over the past decades. One was in the domain of rationality, and the other one was in the domain of cooperation. When it comes to rationality, it is related to what is usually defined as methodological individualism. Methodological individualism starts from the view that an individual is in the focus, not a society. Therefore, all creations of the social phenomena are explained as purposeful activities of individuals. Simply, it does not matter on what the individual's activity is based (selfishness, cold-blooded reasoning, passion, instincts, star constellation...), it is initiated by a human being. A human being may act as a sole actor in isolation (e.g. Robinson Crusoe), or may stick to an ascetic model (little or no production). However, a human being may choose to cooperate with other human beings through engaging in agreed procedures (coordination), producing his/her own product, and swapping it with others.

Individuals through interaction may form a social body, and act at the level of that body in a way that can be called "aggregate behavior". The action of an individual in such a collective environment should be conducted in accordance with a given set of rules. Methodological individualism acknowledges as it provides an important role to the institutions.

7.4 Rationality and political action

According to the advocates of methodological individualism, policymakers need to focus on the rules of the game, that is, to make it easier for an individual to behave in a meaningful way and to reduce an interaction cost of economic activities. If an individual behaves in such a manner that he/she persues his/her best interests, then this direction of economic

thinking gives a "clear" role to politics. Otherwise, when an individual does not do that, then the policy's task is to intervene because an individual behaves irrationally. This happens in situations where an individual's activity is deemed harmful to the community. In general, these are situations where an individual lacks rationality[25].

However, this approach is a different from systemic policy-making, which assumes that policy censorship is essential because it meets a common social goal, which is contrary to the interests of a selfish individual, and corrects the whole spectrum of alleged market failures.

When rationality is viewed as a criterion by which consistency is tested between goals and resources, between what an actor wants to achieve and apply the methods for achieving it, then "optimal" policy-making is justified as means of helping individuals to avoid mistakes. If an individual follows a broader notion of well-being, then rationality could only provide guidelines for describing and interpreting the dynamics of a social event. In the first case, the reason for imposing and eventually violating the individual's freedom is a deviation from the ideal equilibrium (Valras), when the acquisition of new knowledge is denied, as well as the uncertainty that can disrupt the individual's plans. This way, policymakers justify interventions and their involvement by contributing to making the individual better.

Some authors believe that the discussion on rationality is merely a terminological question, since an individual always tends to increase his/her satisfaction (e.g. utility, Zafirovski, 2003). However, given that human activity is rational, and often irrational, the issue of rationality is important both from the aspect of the individual's decisions, and from the aspect of policy making. But human nature is unintelligible, and therefore emotions affect decisions. In a human nature, there is a tendency to improve the situation and to ease the constraints imposed by the resources scarcity. People change their behavior and try to adapt to the new environment, but they also

[25] The so-called genetic backwardness is also being considered in the literature as an irrational situation, in addition to the behavior of an individual who is not in accordance with his/her personal interests. It is believed that individuals often function by applying old patterns of thinking acquired in a long and slow evolutionary process. However, technological changes, especially in the last two centuries, are very dynamic, so that old patterns of thinking do not allow us to exploit the benefits they provide. The purpose of policy-making is to bridge the gap between behavioral routines created through evolution, and those needed in a new institutional and technological context.

influence the change of an environment. They always make an effort to be different[26].

In order to improve his/her situation, an individual does not decide just rationally, but also emotionally. In the case of rational decision-making, costs and benefits are compared before choosing the most rational solution. Sometimes priority is given to emotions, established routines, self-interest, etc., while avoiding the cold-blooded interest calculations.

Simply put, individuals are not machines driven only by genetics and chemistry in the process of decision-making. Individuals are conscious beings, who are driven by the desire to improve their position. Their choice depends on the perception of the outside world, on the knowledge based on experience, memory, cultural patterns, etc. They also meet the limitations of internal and external moral assessment. An internal moral assessment is perceived in relation to deontological ethics followed by an individual. An external moral assessment is related to the credibility and reputation to which a person strives within a social impact on an individual[27].

Respecting awareness opens a series of new questions for policymakers regarding the concept of rationality and politics. First, in relation to classic paradigm, the introduction of awareness extends the subject of economics, and leads to interdisciplinarity, avoided by classical economists. Second, the principle of rationality offers a solid basis for developing arguments in favor of policy making, but awareness would be a rather fragile justification of forced intervention[28]. Third, respecting awareness raises a question of individual responsibility.

7.4.1 Social and group rationality

We have seen that individual rationality dominantly explained the

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[26] This is not from the perspective of Darwin's theory, because the man is unique in his consciousness and ability to change circumstances. So Buchanan writes about this in the following manner: "The central difference between my dog and any of us lies in his lack of any sense of becoming different from what he is… we, as human beings, also know that we can, within limits, shape the form of being that we shall be between now and the time of death, even when we fully reckon on the stochastic pattern of life expectancy. "(1979)

[27] Adam Smith wrote about human nature, introducing the notion of impartial observer in this context. In his work the A Treatise of Human Nature, Hume identifies the inner man and a common standard as a source of moral judgement.

[28] Unconscious behavior is much more difficult to prove.

individual action. The economic profession also used both strategic and genetic options to offer residual explanations. However, the concept of social rationality is totally different. The fact is that individuals are products of an evolutionary process that has become an integral part of our genetic heritage, and the impact of education is indisputable (as well as the influence of parents, friends, and colleagues). In this heritage, people emphasize the following elements as the most important: a) increasing the odds of individual's success if being a part of the group; b) the group provides cooperation according to formal and informal rules; c) cooperation creates satisfaction and new wealth, increasing reputation, and facilitating the submission of losses.

From tht perspective, social rationality makes sense. It could have three different meanings according to which policy making introduces one of three essential goals:

1. Achieving the desired goal of the group, so the social rationality is justified, because it represents an instrument of achieving a socially desirable goal; such a policy-making would take on a classical socialist function.

2. Survival of the group as a primary goal, and wealth as a secondary goal; in this case, the policymaker can support the entrepreneurial behavior of the group or its cohesion, which means that policy making is ambiguous; the policymaker may claim that the strength of the group depends on the entrepreneurial abilities of its members (e.g. willingness to risk, bearing responsibility, or respecting property rights); one solution is the market and a minimum state, the other one is a paternalistic state; on the other hand, the emphasis would be on cohesion, in which case the policy making should implement measures to avoid "social tension" in order for economic activities could operate smoothly and create a homogeneous front against external threats (aggression or competition).

3. Choosing a radical version, which includes the difference between social rationality and group rationality; here is an important social (economic) rationality because it refers to productive exchange among individuals who engage in voluntary interaction, while group rationality does not focus on the process of trade, but on the process through which a collective result is achieved; social rationality, as seen from this perspective, allows for the reduction of exchange costs, that is, the reduction of voluntary interaction costs; this is consistent to the free market, which also allows matching with

institutional competition, so institutions are no longer designed nor imposed in order to follow some collective goal or to abide by a closed social contract[29].

[29] According to Jouvenel, a social contract is an agreement between an individual and an organization that is similar to a group of individuals (Jouvenel, 1993). It is an "open" contract when there is freedom of exit (and possibly freedom to entry). It may also be a "closed" contract when applied by default (for example, in accordance with a place of birth or a place of residence), and when the cost of exit is significant or prohibitive.

8. DISAGREEMENTS IN ECONOMICS AND ITS IMPACT ON POLICIES

8.1 Introduction

Clearly, there are differences in economic science, but their objective examination are a great challenge. Certainly, a science that can not bring u-nambiguous, precise, and targeted judgements, nor it can decisively require an implementation of its economic policy recommendations. However, there are constructive suggestions on a number of elements in the area of improving economic policies, but one must take into account the conditionality of some knowledge from which the recommendations for economic policy stem. An additional reason for caution is the complexity of reality and the inability to understand it fully; to learn it from within, where officials and experts that make policies and institutional adjustments are better informed than an economist who makes recommendations for economic policy. We cannot ignore the fact that officials bear responsibility for implementing the policy. Therefore, they have to open the "four eyes", and to look at economists' recommendations with reserve.

From previous Chapters, it is clear that major scientific dilemmas exist in economic science from the beginning to the present day. Thus, here and now, we will approach to the theoretical and practical dilemmas from the position of the present, that is, from the actuality of these disagreements. Different analysts have subjective views on economic discussions, and that can not be avoided here either. I consider this question crucial for a fuller consideration of challanges in economics and politics. Therefore, I will try to distinguish the basic disputes in economic science, and to expose them as logically as possible, in terms of content and theoretical importance.

Madzar gave an important contribution to the analysis of economic disagreements (Madzar, 2010, p.p. 272-316). The question is: an individual or a society? (i.e. who comes first) This dilemma has directly or indirectly

influenced other disagreements in economic science, which are highlighted and elaborated here.

8.2 Systematic or individual conditionality of economic disorders

In economic science, from the very beginnings, there has been a profound division in terms of the causes of economic disorders. Many economists have not resisted the temptation to relate these economic and broader social disorders to individual factors, attributing them to specific forums, individuals and institutions, often linking them to the names and surnames of individuals in high political or administrative positions. This interpretation is opposite to the explanation of social movements, which assumes that important social movements are complex social phenomena, diluted and with broad impact, involving a large amount of social energy and mobilizing the social resources. This is interpreted by the fact that an individual cannot act independently, but only in an institutional context. It is natural that an individual behaves regardless of this context (motivational impulses, constraints)1.

However, one can not ignore the fact that all decisions are made by individuals, but with the described impact of the systemic context, so that their decisions are systemically conditioned. Logically, an individual remains the "unit of consciousness" guided by his/her own interests. Certainly, an individual does not function in a vacuum, and therefore individual decisions get, more or less, a systemic dimension. From the systemic point of view, the decisions of an individual are particularly conditioned by the level of decision hierarchy. Decisions at the highest level do not affect only decision-makers, but also the wider population, sometimes the entire community. Such decisions determine the public and the media, affecting the popularity of decision-makers. In addition to historical merits and collective memory, perhaps the most important thing, from the pragmatic point of view, is that the effects of the decisions will be an important determinant for the future political support, and the likelihood of (re)election, or further progress in the political hierarchy. Evidently, it is a mechanism that connects public and private interests, at least partially. In another words: between the public and the individual goals of motivated politicians, there is a natural link.

The relationship between individual or systemic decision-making is a broad area for expert evaluations and recommendations: some of them are focusing on individuals and their personality disadvantages, others on

systemic environment and systemic processes through which can be significantly influenced, using institutional adaptation.

There is also a particular aspect of this issue: is it possible to centralize knowledge? Centralization of knowledge is only partially possible, but centralization of all knowledge is unsustainable. Just because the knowledge is scattered, since no center can have enough capacity to keep it in one point, and since there are many languages through which this knowledge could be expressed and transfered to that center, there is no motivation that would direct such a flow of knowledge towards the control center. Hayek, in his truly cult and highly cited work The Use of Knowledge in Society (1945), has proved a decentralization theorem, formulated earlier. According to this theorem, decisions should be (dis)located in places where knowledge is based, as this is the way to optimally use scattered, but non-conveyable knowledge in a society. In his work, with enormous social potential and advantage, Hayek analyzes the possibility of achieving the highest production results in decentralized systems. Due to the inability to convey or concentrate knowledge at selected points (centralization), Hayek suggests the decentralization of decesion points to where, by nature, knowledge is located! Earlier attitudes about knowledge have influenced the view that an individual is primarily a carrier of social development. In the role of entrepreneurs an individual pulls the development through the discovery of new products, production technologies, and processes.

8.3 The resource mobilization in relation to optimal allocation (substitution ratio)

The efficient allocation of resources can be considered from the aspect of methodological individualism and systemic approach. Systemic approach has shown impressive results in situations where there are enough resources to mobilize, in the case of a surplus of unemployed workers (labor force reserves in farming, natural raw materials, etc.). Authoritarian political power, which uses broad discretion in the distribution of national income (e.g. socialist system in the first development stages) is able to impressively initiate the economy growth. However, besides the long-term tendencies of its growth and tempo, built-in the system, there is also an amazing inefficiency (Madzar 1990, pp. 320-325). According to Madzar, "the problem of the system inability is to at least approximate the form of optimal allocation and

rational use of resources, it is an endemic weakness that ultimately causes downfall." (Madzar, 2011, pp. 279).

In the standard market economy, the allocative efficiency and mobilization capability are quite different. It is the profit-driven economy. The economic theory at the usual level speaks of economic efficiency with the assumption of complete competition. Economists agree on this. At the practical level, as always, it depends on whether the realization is complete or partial.

However, in the case of resources mobilization this can not be the same. It could be reliably assumed that the market's allocative capacity is significantly higher at limited time intervals[30]. In a long term, the market's driving forces could fail (Keynes's primal urges), as it has happened in the recent global crisis. The problems were serious: high unemployment, deadlocked economy, unused capacities, strong potentials unsettled…There was enough space for politics and interventions, which we were also witnessing. State interventions increased uncertainty, which was the greatest business risk. The business system expected the state to reduce this uncertainty, which generated its own measures to a large exteng. This caused the state's action in the field of establishing the legal order and the institutional order instead of direct interventionist measures.

8.4 Efficiency in relation to (re)distribution and equality as a criterion for institutional adjustment

Public goods are an extremely important issue of politics and economics, especially in terms of its funding, both in the market economy and in the state-regulated economy. Several questions in this domain are ancient, for example: who and how much should pay for public goods, and how should they participate in their use? These issues have initiated disputes about normatively acceptable income distribution. In essence, they are linked to a group of questions that concern the very distribution, and they are reduced to the following: is the market the best allocation mechanism or is it the

[30] 2Keynes particularly points out the primal urges (animal spirits) which have a variable intensity; he distinguishes short-term and long-term effects. The variable nature of animal spirits is not a small problem in the market economy. It is often solved through the state interventions in order to wake up those animal spirits.

state? Not a small number of economists and doctrinal directions, who, despite differences in other dimensions, have made a complete consensus in the claim that the market does not produce a socially acceptable distribution of income, having numerous errors (cancellations). The solution to eliminate market failure is using extra-judicial, state-funded mechanisms. Naturally, deep divisions and differences occurre in the general plan. However, these phenomena and distribution processes are often not fully understood, usually in the way that corresponds to the conviction itself.

A typical example of opposing attitudes is in taxation. There were disputes over the question of what should be the tax progress and where should it begin? Equality, as one of the major supporting social values, is undeniably acceptable to many people at first glance. However, the major question is: how the policy of forcing equality affects the economy? Social transfers, as a part of that policy, are destimulating the work efforts and job offer in the broadest sense.

Decisions on redistribution are debatable, unlike economic decisions that are mostly made on the basis of marginal effects and their quantitative measures. For example, does the company need to increase production if the price of the product increases? It is the logic of economics, but also the logic of life - some activities are intensified, some are reduced. However, in (re)distributive logic that is not the case (e.g. tax progression). The destimulativeness of tax progression comes to light when making marginal decisions, especially with best paid factors. In natural decision-making, which is present and commonly used in economic activities, a destimulativeness is manifested and similarly applied to all other developmentally relevant activities (savings, investments, entrepreneurship, learning as a form of accumulation of precious human capital). Thus, the most important ones are destimulated. For example, there are two opposing views on taxation and development. One represents and justifies the proportional taxation, because it positively influences development. For the advancement of a company, as well as the advancement at higher hierarchical levels, the contribution of top-level staff is essential, while tax policy should stimulate those with higher incomes (proportional taxation). Quite opposite is among those who believe that the developmental effect depends largely on the massive but poorer paid labor force. Therefore, the progressive taxation is the choice of their economic policy. This, again, should not be viewed as black or white.

Attention must be paid to other values in order to make a decision on progressive or proportional taxation.

8.5 The role of the state in the context of contemporary Reasoning

The list of market failures was initially quite standard - the externalities, economies of scale with monopoly, public goods..., including other shortcomings: asymmetric information, asymmetric selection, the blind passenger problem, a prisoner's dilemma...

In solving this problem, some economists (Madzar in general) point out wrong to engage the state instead of the market. Madzar emphasizes: "The hypothesis of the supposed state superiority, its automatic and self-perceived ability to eliminate defects experienced at the market, has not been subjected to elementary political tests" (Madzar, 2011, p. 293).

There are widespread attitudes that the state should be immediately engaged eliminating the market failures. Rarely, there are voices that the state has flaws at the points on which it replaces the market, perhaps even larger than those of the market, which should be eliminated. According to them, the solution is not to choose between two mechanisms (one good and one bad), but to choose between two defective options, and to pick a less defective one.

In recent decades, the economists focused on analyzing the shortcomings of the state intervention mechanism. Perhaps the most representative is Stern (1989, pp. 615-22, especially 616), who has identified 9 market defects and 11 state intervention defects. Stern has shown that this is a choice between arrangements which are full of defects, and definitelly could not be perceived as superior. In fact, quite a lot of controversy is related to this issue, so the economics has not given a definitive answer so far.

However, in these foggy inquiries and numerous unexplained questions on the relative efficiency of the market or the state, there were several points for further reasoning and drawing out reliable conclusions, or differentiating some of the propositions around which a professional consensus could be reached. Some of these propositions are:

- The state can not undertake any intervention without affecting the market functioning

- Some absolutely necessary public goods can be provided only by the state
- The less state intervention, the better for economy and society

In the opinion of the author of this book, it is unbelievable that many economists ignore the fact that the free market does not exist without the state, that is, it can not survive without police, justice, and private property regulation.

8.6 Economics issues related to the impact of the state on the market functioning

In science, there are fierce debates related to market assessment and its allocative and distributive characteristics. This is also the subject of ongoing debates among economists. According to some, the functional efficiency of the market can not be achieved without a (very) active role of the state, which is far more comprehensive than the protection of proprietary rights. This indicates the market instability, especially the sharp fluctuations of the prices. For example, oil price fluctuations in the 70s of the 20th century or during 2008 and 2009; in an interval of several months, the price was doubled, then dropped to an unexpectedly low level. This raises the essencial question of the market's informative function: what kind of signals and reliable image with such a fluctuation in prices does such a market produce?

We can also cite situations when the state through its interventions reduces the market’s information power. The state often simply overthrows the efficiency that the market would secure without government interference. Is this the case with monopolies? There are also theoretical and empirical studies with the conclusion that the state actually creates monopolies and monopoly structures.

There are various regulatory agencies, which supposedly suppress and limit the power of monopolies, but through their actions they work for the benefit of the monopoly. They and other state authorities interfere in the price formation, most often in the form of their control. Impartial analysis show that price control is a way to simply destroy the market, or to completely neutralize its precious stimulative and allocative characteristics (see more: Madzar, 2011; Reisman, 1998).

8.7 New views on the state and its intervention

Decade behind us has been marked with economic and financial crisis, which became apparent in 2007 and 2008. Logically, this global turmoil in the world economy has actualized the issue of state intervention and its effectiveness. It has also re-actualized the insistence on its unconditional withdrawal from a large number of areas. There were some polarly different opinions. According to some, the crisis was caused by the state with its deregulation policy, according to others, the main cause was the market. The proposition of the state, as a hindering factor, has been established long time ago. However, it has been actualized in situations of economic crisis, as we have already seen at the sunset of this century.

An alternative view was based on an inherent instability of the market system, as a part of increasingly complex economic system. A sharp division in economic thought may soften. From the flexible perspective, the major events, such as the global economic and financial crisis, cannot be reduced to one cause, but to a multitude of causes that work together, whether influential or not. Naturally, some of these causes are more important, but from the perspective of action intensity they cannot all be put in the same plane, nor can they be treated equally. Among these different causes, the inherent instability of economy as a large system has its own special and dominant place. This remains a major and inconclusive (macroeconomic) fact of economic life, according to Madzar and Stiglitz (Madzar, p. 307; Stiglitz, p. 89).

Thus emerges a new watershed in economic thought: on one hand, economic policy is blamed as the cause of the last, big global crisis, and on the other hand it is seen as the main instrument of stabilization, in order to improve the strategic level for maintaining the global stability. This polarisation is deep. The state was called upon to intervene in a situation where it was difficult to remain crushed. Also emerged the well-known Obama package worth $1,000 billion. Indeed, there was a huge division in the economic science of this intervention, indicating the uncertainty of economic science and its low security for economic policy makers, and the inability to offer recommendations that could lead to some consensus. Paul Krugman and Jozef Stiglitz were fierce critics; they believed that the package was unnecessary and harmful, threatening to eliminate the responsibilities of

subjects for their decisions. Losing responsibility for own decisions is particularly negative among market actors, as it basically undermines the efficiency of the market. There was also an impressive group of economists who even sent an open letter to the US administration, condemning the package and demanding its immediate revokation. Among them was A. H. Meltzer (2010), one of the most respected in the United States, and perhaps the most influential monetary economist in that country.

Stiglitz discussed these issues with insights that are very important for the intecceptual foundations of modern economics and politics. His theory of asymmetric information is a major step forward in economic science. Below is an interview with Stiglitz that truly represents a brilliant assessment of the most dominant contemporary economic concepts.

Appendix 3: Interview with Joseph Stiglitz on dilemmas in contemporary economics

INTERVIEWER: So, free markets are bad?

STIGLITZ: No, free markets are useful, but in the United States and Europe, we have learned to combine free markets with an important role of the state. Markets are the engine of the economy, but we recognize that markets by themselves do not deliver. In the United States, even with its sufficient satisfactory financial market regulation, we had the savings-and-loan crises that cost American taxpayers several hundred billion dollars. The Enron scandal has now exposed the fact that without adequate regulation on the principles of accounting, people can have their life sevings wiped out overnight. Since the beginning of capitalism, there have been fluctuations of the market economy, recession, depressions, and we've learned that active government policy, stimulus, fiscal, monetary can reduce the magnitude of the downturns in their frequency. We know that; the data supports it. And yet, for reasons that I do not understand fully, the IMF has been pushing policies that are precisely contrary to that in country after country after country.

INTERVIEWER: What's good about trade?

STIGLITZ: Trade creates the opportunity for small countries to have access to huge markets and take advantage of their comparative advantages. That means that incomes can rise. Now, in the United States and in advanced industrial countries, we often say that trade is good, but imports are bad. We like to export, but we do not like to import. Why? Because we realize

that sometimes imports lead to job destruction. We recognize that it is the responsibility, though, of those involved in macromanagement, the Central Bank (the Fed in the United States) to ensure that the economy remains close to full employment. But even when we had unemployment of 3.9 percent, 4 percent, we worried. We worried about the unemployment that a flood of imports could create, even though these people could get jobs eventually elswhere in the economy. The current (Bush) administration, for insance, has proposed creating a global cartel in steel to protect American steel producers from the onslaught of less expensive steel. Korea has a far more efficient steel industry than the United States. We do not like that, and it's a threat to our steelworkers, as well as the profits of our steel industryt. So we recognize there's a problem.

But just think of what would be like if you're an economy, like many of the developing economies, with unemployment, not 3.9, 4, 4.5 percent, but unemployment of 10, 15 or 20 percent; not an economy in which the interest rates are 3, 4, 5, 6 percent, but an economy in which the interest rates are 15, 20, 25, 30 percent. In those situations, if you lose your job, you worry about not being able to get another one. At least in the US and Europe, when you lose your job, we have an unemployment insurance system and a welfare system. Imagine that you're in a less-developed country where there is no welfare system. A los of a job means that your children won't be able to go to school; they'll face malnutrition. These are relly life-threatening events; these are not just statistics. You know, unemployment went up from 4 percent to 8 percent. These are things that are going to destroy the lives of these people.

INTERVIEWER: The world has sort of swung on this pendulum from accepting command econonomies to going to free markets. Where is it goint to swing next?

STIGLITZ: Well, I think there is now an acceptance of trying to get that balance. We now recognize that there is an important role for government. The exact boundary of where that role is one thing that's hotly debated in all of the Western democracies... Some people think that there ought to be more privatization of, say, social security. Some think that the current arrangements are appropriate, but we debate them hotly. The problem is that the IMF has pushed a particular view of these economic policies, the view that says free markets by themselves work, or a view which puts more emphasis on the private markets than many of us, within our own de-

mocracies, where markets worked very well, would believe is appropriate. And so they have been pushing what can only be viewed as a particular institutions to pursue that particular political and ideological agenda. And there's a recognition that that's no longer going to be acceptable.

There is also a recognition that international agreements are not balanced – the trade negotiations of the past where an agenda that was set by the North for the North, and the North benefited. For instance, the great achievement, one of the great achievements lauded by the restraint of trade negotiations during the Uruguay Round (1986-1994) was that we finally got into service, but what service? Financial services, which are the export industry, the comparative advantage of the United States and Europe. Services like construction services and maritime services were not even on the agenda. These are the things that are concerned with developing countries. But the United States still remains protectorist in these areas, but will not even allow these to be brought up.

INTERVIEWER: So, who should set the new rules of the game?

STIGLITZ: I think we have to redesign the governance of the international arrangements, the international institutions. We have to recognize that we share one planet and that there are basic principles of fairness and equality that we have to adhere to; that the kind of hypocrites that has characterized the past really cannot be sustained. It's one of the great things about openness and transparency... These things have brought out in the open. One of the greatest achievements in the last five years is that people have seen, become aware of some of the feelings of the way things were done in the past, recognize that excessively strong intellectual-property protection meant that people in countries like South Africa were being condemned to death because they would not be able to get access to AIDS drugs…

INTERVIEWER: What is your verdict on Keynesianism, after all you've seen in the last 20 years?

STIGLITZ: There have been enormous changes in thinking about economics over the past 50 years. Adam Smith, 200 years ago, put forward the idea of the invisible hand, that the market automatically takes care of things, that the market is self-regulating. In the last 30 years we've recognized that the assumptions required for that conclusion to be tgrue are just not satisfied in more-developed countries let alone less-developed countries.

The work that I did, for which I got the Nobel Prize, focused on the problems associated with imperfections of information and particularly asymmetries of information. We recognize that these imperfections of information, asymmetries of information, are pervasive in every economy, but especially in developing economies, where the market for information doesn't work as well. And the essential result of this research of the last 30 years is to show that Adam Smith's invisible hand is not true, that whenever there are these imperfections of information and these other market failures, that markets very frequently fail, and fail massively.

Now, one of the most important market failures has been discussed, of course, for a long time, and those are the great depressions and recessions that have plagued in which 10, 20, 30 percent of the labor force can't get jobs, periods in which a large fraction of the capital stock remains idle, periods in which poverty increases. Those who believe in the free market believe that, while these events may occur, the economy very quickly recovers. That view is simply wrong. Keynes recognized that. Keynes created a particular model to try to explain why that was the case and, on the basis of that model, to say what policies could resolve these problems, what government could do to reduce the length of recessions, to get the economy out. Those policies have worked. The magnitude of the downturns, the length of the downturns since World War II, under the influence of Keynesian policy, are much shorter than they were before World War I. Kenynesian policies work.

Now, at an intellectual level, there were a lot of problems with Keynes. After all, he wrote 70 years ago and we didn't have the economic theories, like the theoires of asymmetry of information, on which to develop what is called the microfoundations of these theoires. Over the last 30 years, one of the main things that I've been working on, and a lot of other people were woeking on, is tocreate that intellectual foundation. We now have that.

So am I a Keynesian? Well, sometimes people say I'm a new Keynesian; that is to say, the basic lessons are the same, but the intellectual foundations are much stronger than they were 70 years ago, which is what we would hope to be the case. After all, that's the whole point of research, is to try to understand these phenomena better. So the way I would point of research, is to try to understand these phenomena better. So the way I would put it is they're building on the foundations of Keynes. In modern microeconomics, we have now created theories of macroeconomics that do far, far better in explaining the kinds of fluctuations that we see in East Asia, in La-

tin America, and even in the United States. And on the basis of that, we have better policies that can help redress these problems, maintain greater stability, help the economy get out of recessions when they do occur.

INTERVIEWER: What about Milton Friedman?

STIGLITZ: Well, Milton Friedman made very important contributions to economics. But the idea of free markets are basically more ideologically based that based on sound economic theory. You know, models in which information is assumed perfect just don't make sense in the modern world. You talk about an information economy where so many people are engaged in acquiring, processing, disseminating information, and the models that Friedman grew up in and that he's worked on for most of his life, information was effectively assumed to be perfect, and there wasn't the close study of how this information processing works, how markets hendle risk. So he was really in the tradition of Adam Smith, elaborating on those ideas in a very particular intellectual frame, a particularly narrow intellectual frame. And part of that progress is to say, „Well, that was an important contribution. But today we know our economy has changed, and we know more about how the kind of economy that we have today funcions, and the kinds of theories that he devleoped simply don't work well, either in the devloped or the less-developed countries." (Adamovic, p.p. 314-317).

9. POLICIES OF REGULATION AND DEREGULATION

9.1 Introduction

Socialism was an alternative to capitalism for the most of the 20th century. Socialism has failed, even in its most democratic forms. The biggest problem of socialism was the lack of sustainable economic growth. The fall of socialism has brought disappointment among many romantics, who believed that it could bring justice and honesty to the world. The utopian idea of equality, justice and righteousness did not cease with socialism decline. This idea is based on an income redistribution, and was more present in socialist societies than in capitalism. However, the supporters of redistribution and regulation have realized that capitalism is far ahead of socialism, as it creates growth and increases income and living standards. All this ensures more resources available for redistribution.

Demands for redistribution are intensifying. Alexis de Tocquiville (1830) spoke of such demands threatening to democratic governments; time has shown that his prediction was correct. More redistribution means lower growth and less investment. But regulations were strengthened to meet the need for redistribution (justified and unjustified).

9.2 Regulations

The first regulations were introduced in order to ensure funding of the army and the police. These were public goods that the market could not provide. Taxes for police support were introduced. Economists claimed that public goods require collective over market action. In developed countries, regulations were expanding in the fields of finance, banking, environment, farmacy, consumer products, and many other. Demand for regulation has often increased due to various controversies related to the market failures. Once introduced, regulation rarely get canceled. Regulations serve regulators, but they are often avoided in practice.

Regulations are particularly increasing in the conditions of poor economic functioning. The most recent example is 2008 financial crisis, which produced enormous pressure for several regulations - despite the regulator's failure to predict and act, or to control some of the bad events. Both banks and regulators made mistakes and bad estimates. The US federal reserve system had representatives in large banks which had been monitoring securities and loans well before the crisis. They have not prevented banks from giving risky loans or avoiding regulation. Many mistakes were made by bankers, lenders, and government officials. Simply, regulations were unsuccessful. Institutions, formal and informal, were developed to tame the negative human nature. Man is not perfect, and human nature is characterized by greed and general imperfection. The perfect human being exists only as a utopia. Seemingly, this was overlooked in the period that preceded the financial crisis. Thus, in the situation that created the last financial crisis, the government's housing policy and the policy of preventing failure by large financial institutions have encouraged a lot of risk taking by the bankers, which led to financial slump. It was the most obvious in the United States. If the market was left to function normally, there would be no spread of home loans to customers who do not have a mortgage. The weakening of mortgage standards encouraged an increase in loans. This was further encouraged by the policy of "too big to fail" (TBTF) and later the government's willingness to fund corporations to buy low-quality mortgages.

For years, the Fed was preventing the failure of large banks. Then, in October 2008, Lehman Brothers went bankrupt. This has led to panic and growing uncertainty. Nobody knew what could happen to the financial companies that risked borrowing. To repeat, there is no bigger enemy for the economy than uncertainty! The Fed responded by lending large amounts of money to financial institutions in order to maintain the credit market. It also returned the TBTF policy, and reacted by funding AIG, a major insurance company, in order to prevent its bankrupcy.

In the 20s of the last century, large banks held about 20% of security reserves. The TBTF policy and deposit insurance have contributed to lowering this ratio by large banks to 8% or lower. Increasing capital is obviously a good way to bring the issue of financial risk back to banks and investors. These capital requirements are now being introduced in many countries.

In the early economic history, all banks that had become insolvent were allowed to bankrupt. There was a kind of support in the crisis situati-

ons; banks were borrowing from the central bank with a good collateral. It was a way of avoiding and preventing the spread of problems and the manner of protecting the public. There was no bailouts as a policy that allows a bank to transfer the bank's failure to taxpayers. This policy expanded in the efforts to resolve the last global crisis, although there were better instruments to prevent the collapse of the financial system. In the period 2007-2008, the US regulators have allowed large loans to protect financial failures. Such a policy was justified by emphasizing that the payment system protection gets extreme benefits, because it allows the economy to function normally (trade and business). Suprisingly, the TBTF policy spread even to industry, encouraging extreme risks. Meltzer points out that "the protection of failing companies removes the strong discipline of the capitalist system" (Meltzer, p. 42). Thus, the logic of capital movements in capitalism has been defied: the capital moves towards growing companies and economic branches. In case of supporting large failing companies, the capital is transferred to weaker companies. This disturbs the natural logic of capitalistic system that "capitalism without failure is like religion without sin".

Regulations are not easy to apply. We know this from a series of examples: banning alcohol, banning the nuclear weapons development, banning drug trafficking, and so on. Criminals have enormous power and incentive for criminal activities, or avoiding regulation. Influential lobbyists are ever-present! However, many regulations are well designed and applied. Regulations are failing even when the are justified and inconsistent due to a poor design. Such regulations do not meet expectations and fulfill very little. First, lawyers and bureaucrats introduce regulations, but if they are costly to apply, the market usually avoids them in various ways. Second, the regulations are static, while the market is dynamic. Often, regulation can not predict all situations, and the market avoids unsuitable regulations (e.g. by influencing a regulator or by obtaining an exception for itself). Large firms also have a big influence: they contribute to campaigns of various parties, and often have too much influence on a regulator.

In many regulation initiatives, special interest groups appear and influence the allocation of funds, especially in developing countries. Regulators mostly provide for those who are best organized, and who largly contribute to political campaigns.

9.3 The power of deregulation

In the previous section we have concluded that the role of the state and the politics in economy regulation, especially after the last global economic crisis (GEC), attracts growing attention.

According to a group of economists, the major cause of GEC is the policy of deregulation. They find it difficult to have a successful economy without a successful financial sector. A strong financial sector does not function successfully by itself. It requires strict rules and their effective implementation, so that it can not cause damage to society and the economy, in order to perform its function. The liberalization of this sector, historically, has not shown success. Ideology has interfered, being more influential than the facts. The facts were contrary to the ideology of market fundamentalism. For example, in underdeveloped countries, the liberalization of their markets did not meet expectations. This policy has failed in Africa, Latin America, and many other economies. The policy of liberalizing the financial markets has often been under the pressure of the developed countries or the large world corporations, dragging those countries into crisis, one by one, although they stood well before liberalizing their market. The United States imposed this ideology on others, but also on itself. Such as the US ideology has produced the 2007 crisis.

More relaxed regulation of the financial sector resulted with negative effects: bankruptcy, their recklessness and engagement in exploitative activities, discriminatory lending, manipulation of foreign exchange and other markets, imprecision in keeping records... This was also the case during the Great Depression, and during the latest financial and economic crisis. These crises have not affected only the United States, where they first appeared, but the entire world.

The undue takeover of risks in the financial sector, combined with deregulation, has caused the most severe crisis in the last few decades. As usual, the crisis has affected mostly the poor: billions of dollars generated in manipulative practices, largely from those at the bottom of economic pyramid, have been transfered to the accounts of those at the top of economic pyramid. The poor remained unemployed and threatened by their long-term unemployment. In the deterioration of the economic situation, the financial sector sticked to the idea that the market by itself leads to an efficient and

stable outcome. According to this logic, the economy should be deregulated, monetary policy focused on inflation, fiscal policy focused to avoid progressive taxation, in order to boost economic growth. A fiscal deficit could be used to create demand!

However, the role of the market and the achievements of classical economics should not be neglected, because they have shown the market opportunities in the resources allocation. It is also known that market economies operate in a transparent environment - when all market participants have good information. Someone has to fight against the lack of transparency in the financial markets, which, unfortunately, is increasingly pronounced feature of the most world economies. How to survive in such markets, where there is no potential except for large corporations, who dictate business secrets and information closure? Countries have become hostages of financial markets and private companies. Someone should intervene in order to preserve the market mechanism. Democracy is the only remedy: how to establish it?

Many economists gave an intellectual foundation to the deregulation movement, despite the knowledge and understanding of the market functioning as a mechanism with an invisible hand, only in conditions of perfect competition. There is an understanding in economic theory of why financial markets need regulations. These findings have clearly shown the imperfection of information and competition.

A prominent example of deregulation occurred in the United States. Stiglitz explains this deregulation as a crisis of the American economic and political system. The rules of the game are set by stakeholders. Every economy needs rules and guards. The basic question is: how to establish them and by who? According to Stiglitz (2015), these rules were imposed by interest groups. Every player behaved according to the rules. Politicians responded to the political influence that corporations and banks had, as they had to satisfy rich and powerful sympathizers in order to win elections. Corporations and those with the greatest political influences used that to receive regulations and regulators that would allow them to be able to put as much money as possible into their pockets. On the stage were economists who have provided an appropriate ideology, which was supposed to bring benefits to everyone through appropriate politics and practices. Stiglitz wrote extensively about this (2015).

9.4 Practical politics

Economic philosophy and values dictate the relationship between politics and economics. However, an important issue is implementation of economic philosophy and values through practical politics. Macroeconomic practical policies are particularly significant. How does the central bank influence its areas of activity? How do banks behave? How do regulators behave? These are crucial questions for succesful practical politics. For example, if monetary policy is overwhelmed - by excessively increasing interest rates or by tightening credit limitations - unemployment will be higher than usual. Such a policy results in wage cuts due to great pressure. If the tightening is premature, as a reaction to the onset of inflation, it is more likely that the part of wages will be reduced, because during the crisis, workers are the most impacted.

Often, central banks focus on inflation only, although they'd need to take unemployment and growth into account.

The strategy for getting out of crisis affects the practical policies and political outcomes. The strategy is often to bring the economy into a capacity of full employment. This could be achieved only through monetary policy measures, despite their limited scope.

It is important to evaluate and manage monetary and other economic policies. This is usually not done. For example, since the beginning of the last financial crisis, many countries have had a shortage of loans for small and medium-sized enterprises. Good regulation would distance banks from speculation and market manipulation, which are largely a cause of that financial crisis. Thus, the banks have not yet returned to their core business: lending.

When to raise and lower interest rates - the basic leverage of monetary policy - depends on the practical politics and its government. Two elements are important here: 1) Prediction – incorrect prediction leads to wrong measures; without proper predicting of economic course, the correct measures can not be taken. 2) Taking risk – right measures are very difficult to implement: if we "brake" the economy too tight, we risk overly high unemployment rate; if we "brake" the economy too soft, we risk inflation.

9.5 Free trade ideas and practice

Free trade is the ideal of all people. Unfortunately, it's still unrealistic and uncertain when ir will be achieved. For now, free trade is only a conceptual picture, highlighted within certain advantages of capitalism. The reality, however, is controlled by trade, which gives priority to corporate interests. This issue is also related to inequality. Namely, if there is inequality in the society, as well as the allocation of a few people at the top of the wealth pyramid, there is a small chance to "pass" whatever supports the free trade regime.

Creating a free-trade area between the United States and Europe, and between the United States and a large part of the Pacific (except China), is not advancing according to the establishment of a genuine free trade system. Many authors believe that this is a controlled mode of trade, which serves the special interests of the Western developed countries. In addition to customs tarrifs, which are less and less a barrier, because they are already low, non-tariff barriers are increasingly being used, as regulatory barriers. Most of it is subordinated to corporate interests, including the intellectual property regime, subsidies, etc. "Economic power often speaks louder, though, than moral values; and in the many instances in which American corporate interests prevail in intellectual property rights, our policies help increase inequality abroad. In most countries, it’s much the same as in the United States: the lives of the poor are sacrificed at the altar of corporate profits." (Stiglitz, 2015, p. 250).

There is a paradox – although most governments claim to be free trade supporters, most of them continue to apply restrictions in international trade. Most industrialized countries restrict imports of agricultural products, textiles, footwear, steel and many other products, in order to protect domestic labour force. They also provide subsidies for some of the high-tech industries, e.g. computers and telecommunications, which are believed to be crucial for the national competitiveness and the future of economic growth. Underdeveloped countries are even more oriented towards the protection of domestic industry. Since some forms of open protection (such as customs tariffs and quotas) have been reduced or eliminated through multiannual negotiations, other, less exploited forms of protection (such as tax incentives and R & D subsidies) have been increased. There are numerous trade dissagreements.

A trend of strengthening protectionism is established, which has already been elaborated in the chapter on negative trends in the world economy and politics with current data.

10. THE ROLE OF ECONOMISTS AND THEIR INFLUENCE

10.1 Introduction

Clearly, an impact of politics on economy is strong, and vice versa. The market needs democracy, which thrive on the freedoms of individuals. Therefore, it is expected that politics is interested in economic knowledge in order to make the most favorable political decisions and economic policies. In line with the strong connection between the market and democracy, politicians need to know how the economic system works, and how people behave. They need to know organization, management, and much more. In addition to theoretical knowledge, it is necessary to know what is happening in the world. Daily observations are one way to be informed about the real world we live in. This means that one should constantly pay attention on the market and look for opportunities. Although important, such observations are marely personal, unsystematic, and unsettled. This points out to the need for a science that would reveal the essence of phenomena. If the phenomenon and essence coincided, science would be superfluous! Economic statistics largely provides the information needed for an objective view of reality. Statistical data are the codes that need to be interpreted, and understood.

When participating in economic activities, one must not make decisions blindly. In economy, one must be protected from superficiality and quick conclusions based on obvious facts. As a character in Bernard Shaw's play Saint Joan when told of the theory of Pythagoras that the Earth is round and revolves around the Sun replies: "What a fool! Couldn't he use his eyes?" This is a warning to many who similarly react to new things. Do not become a part of the mass that "uses its eyes"!

10.2 Short-term and long-term prospects

Here we will cite an example that Henry Hazlitt left as a legacy, proving that not everything is visible in the economy, nor in life. It is an example from his book "Economics in One Lesson": A young hoodlum, say, heaves a brick through the window of a baker's shop. The shopkeeper runs out furious, but the boy is gone. A crowd gathers, and begins to stare with quiet satisfaction at the gaping hole in the window and the shattered glass over the bread and pies. After a while the crowd feels the need for philosophic reflection. And several of its members are almost certain to remind each other or the baker that, after all, the misfortune has its bright side. It will make business for some glazier. As they begin to think of this they elaborate upon it. How much does a new plate glass window cost? Two hundred and fifty dollars? That will be quite a sum. After all, if windows were never broken, what would happen to the glass business? Then, of course, the thing is endless. The glazier will have $250 more to spend with other merchants, and these in turn will have $250 more to spend with some other merchants, and so ad infinitum. The smashed window will go on providing money and employment in ever-widening circles. The logical conclusion from all this would be, if the crowd drew it, that the little hoodlum who threw the brick was far from being a public menace, in fact he was a public benefactor.

Now let us take a different perspective. The crowd is right in its first conclusion. This little act of vandalism will in the first instance mean more business for some glazier. The glazier will be no more unhappy to learn of the incident than an undertaker to learn of a death. But the shopkeeper will be out $250 that he was planning to spend for a new suit. Because he has had to replace the window, he will have to go without the suit (or some equivalent need or luxury). Instead of having a window and $250 he now has merely a window. Or, as he was planning to buy the suit that very afternoon, instead of having both a window and a suit he must be content with the window and no suit. If we think of him as part of the community, the community has lost a new suit that might otherwise have been bought, and is just that much poorer.

The glazier's gain of business, in short, is merely the tailor's loss of business. No new "employment" has been added. The people in the crowd

were thinking only of two parties to the transaction, the baker and the glazier. They had forgotten the potential third party involved, the tailor. They forgot him precisely because he will not enter the scene. They will see the new window in the next day or two. They will never see the extra suit, precisely because it will never be made. They see only what is immediately visible to the eye. (Henry Hazlitt)

Obviously, we only see what is currently available to us! The mischief of the broken window has been disguised in many ways, and is the most widespread in the history of the economy. What we emphasize in this book is the holism of the world and comprehensive perception of the phenomenon. Only a complete view can perceive the essence of things, and even the essence of the relationship between economics and politics.

10.3 Growth and competition

A broader historical perspective indicates that the essence of economics is the dynamics and competition, in a smaller or larger extent. Needs are expanding, there is no status quo, just a constant change, constant motion. New needs breed new interests and motives to satisfy them through new consumer goods, new methods of production or transport, new markets, new forms of industrial organization. Accordingly, economic structure is constantly changing from the inside, always changing the old one, and creating a new one. This process of innovative change is the basis of entrepreneurship. It is a mechanism for creating and maintaining the economic systems in continuous development. How did economists view the dynamics and growth of economics?

History has shown a strong influence on the ideas of individual economists. This influence can be traced back to the great masters of Greeks thought: Aristotle, Plato and Xenophon. Xenophon’s economics has influenced the microeconomics, and with it has improved the management and organization of enterprises. There is also a tremendous influence on the ideas of Marx, Keynes, and Friedman.

Particularly significant was the influence of Aristotle's learning on the practical economy. His views on money, trade, and interest rates were treated as immoral. He has profoundly influenced the opinion and attitudes on credit, as well as practical creativity in the area. The rent of money was forbidden for a long time, practically until the 15th century. Interest earnings

were seen as a social evil that must be forbidden and avoided. Under the influence of Aristotle, merchants were regarded as evil human parasites living at the expense of others. In literature, traders were an example of a negative character. Under the influence of Aristotle's ideas, later accepted by church, poverty was favored as a virtue, and wealth as a curse.

For a long period between Aristotle and Renensans, there were no ideas of economic growth. People worked marely to survive. There was no growth, and therefore no need for the development of economic science. Exceptions were several cities-states in ancient Greece, Rome, and later, cities-centers of economic development in the Middle Ages: Bruges, Antwerp, Venice, Genoa, and Amsterdam. A certain growth appeared at the beginning of 1500. Although, during the period 1500-1820 the growth was negligible (0.01 percent!).

Supposedly, the Aristotle's ideas have influenced this dynamics and events, especially if we know that there is no growth without credit, nor there is faith in the future and new products. Limiting the credit, declaring interest as immoral activities (because the time given by God cannot be repaid) was a great constraint for the fast development of economy and its growth. However, some other factors made their impact, but they were related to previous factors, which were directly influenced by Aristotle.

It is clear that economists did not have a serious scientific power until the 18th century, when the situation changed because political strenght was increasing due to the emergence of states and state elites with imperialist orientations, especially in Europe. Since then, the significance of economic knowledge and its increased role in strengthening political power was obvious. The systems for financing wars had to be designed, banks and financial markets had to be established. With a turnaround in the economy, when economic calculations become central, somewhere between Medici and Genoa (12th and 13th centuries) as a center of financial world, it became clear that economists, and especially financiers, play an important role, forming a pillar on which the power of leading elites rests. Economists were under the influence of politics which was responsible for developing economic science. This was best demonstrated in England, where economic science flourished on the wings of the industrial revolution. The Industrial Revolution was born on the wave of a scientific revolution that began around 1500, but it was not before the 17th and 18th centuries industrial revolution exploded. The scientific revolution was also underpinned by politics and its

power. The image of the world has changed with new discoveries, conquering the ocean and conquering the sky.

Since then, a link has been created between politics and the economy! Legitimacy was given to politics, and thus to the economic decisions it brought. This legitimacy was based on political competition that has replaced God's legitimacy. With a disappearance of long-held God's legitimacy, with the overthrow of universalism and the development of individualism, a new space for economists and economics was opened. Individualism was developed in Western Europe, where, instead of the allmighty creator (God) appears man, in all his greatness of creation and decision-making. Individualism is an accomplishment that liberates man's captured forces from the dark ages of the Middle Ages and feudalism; this lighted the fire of struggle for achievements and profits. The church itself contributed to the emergence of individualism. The dominant event occurred when German rulers said that church should deal with spiritual issues and leave secular issues to the people who create material goods, and who manage economic endeavors.

Politicians are fighting for legitimacy and thus developing democracy. Legitimacy is sought through the contracts and responsibilities of the authorities and subordinates to execute them. Private property is formalized, because the economy depends on ownership. Management is possible only by ownership, as well as acquiring assets, and organizing the production venture. It was a winding road since Thomas Aquinas onwards, regarding the theory of social contracts, constitution, and democracy. Strengthening the economy requires strengthening the market, and strengthening the democracy. The market can not function without the state, whereas the state introduces democratic rules.

Politics has developed various forms of legitimacy, and has justified decision-making. The sphere of economics has always been topical and important, in spite of the fact that political activities could not be accomplished without the financial resources originally created in the economic sphere. The power of politics has been strengthened through controlling financial flows and financial markets. The greater economic development, the greater connection between the two. It happened in the 18th and 19th centuries, and even in the 20th and the 21st century. During the peacetime and developmental periods, it may not be clearly visible, as in the period of unstable economies. Evidently, the unstable conditions are not good for the

economy, especially for poorer layers of society. It seems that the link between politics and economics is often stronger than democracy and democratic regulation. Therefore, the essential relations in societies have been disturbed. Growing instability was increasing inequality.

10.4 Politics as a dominant

The relationship between politics and economics (and economists) depends on the faith in science, and society's attitude toward science. Previously, we have seen that economics experiences pretty low position in this sense. The faith in science initiates the vision and the judgement that science can do more than corresponding to its real potentials. This unlimited faith in the power of science in finding rational paths of the future successful sustainable development, Hayek has criticized in his extraordinary opus. According to Hayek, the largest part of the magnificent institutional architecture of any society, on which the allocation of resources and development greatly depend, is not the result of scientific insights nor of proper recommendations and programs. It is the result of evolutionary and spontaneous development, where tradition, freedom, and development play the key role[31].

Despite the insight into the methodological and cognitive problems of economic science, it was surprising that politics ignores economic reasoning, even when it comes to verified truths. For example, politics ignores economic calculation?! I often wondered how much is calculation important in economics. I realized that the market is based on calculation. In particular, I learned that from the great economist Ludwig von Mises, who clearly explains why is the market based on economic calculation, and that there would be no success without the respect for the logic of calculus. Knowing this, I was shocked by the behavior of managers in our companies. Basically, they did not make decisions based on the calculation. They made bad decisions. I have experienced this in the socialist economy and in the transitional economy. While working in consulting business, I advised managers to respect economic calculus; calculating indicates whether a certain economic activity is cost-effective. I explained benefits and costs to individual managers, but my efforts were in vain - their decisions were most often quite the opposite, irrational. Unfortunately, there was too much disregard and political motives, which, in my opinion, are the main cause of inefficiency in so-

[31] 1See more about this in Hayek 1998-960.

cialist economic system, and the non-competitiveness of the Montenegrin transitional economy. Over time, I realized that decision makers believed that "someone else" would solve those problems. And if they did make wrong decisions, those would become the problem of government or society. So, it was the policy issue. Everything was coloured by politics, turned upside down. The politics, unfortunately, does not create value, and in order to maintain a business system or economy as a whole, a new value must be established. I persistently tried to inculcate this through my engagement, both as a professor and as a financial director of large companies. I was amazed by the fact that even people who had important managerial positions did not understand the most basic financial lessons. Long time ago, I realized that without understanding the philosophy of the balance sheet, and the balance of success, as the best-known business control models, perfected for centuries, it is impossible to make landmark business decisions. Understanding the figures that are structured in the balance sheet, and the income statement, is fundamental to the successful running of a business, a bank, or a state. However, running a state requires the understanding of macroeconomic sizes and movements, which again stem from businesses or business entities of an economy. Through studying entrepreneurship, I came to the conclusion that, unlike ours, the best world managers were highly educated in accounting and finance.

It made me think about business through prorations of benefits and costs, perceiving broader aspects of economics. Hence, economic activity depends on the market, customers, and their needs, and on the way they perceive our products and services.

I realized that the information is not perfect, and that the overall economic knowledge greatly reduces the uncertainty. However, uncertainty is everpresent, and every activity in the economy carries possible risk.

Since the economic calculation is not enough, it also requires research. Starting with a market research, and going further, it needs reassessing the competition, the technologies, and many other elements. After understanding the importance of economic knowledge, I was able to see an important role of statistics, econometrics, and other sciences. I am deeply convinced that the economics can not be explained only using economics. Besides politics, technology has the greatest impact on economics, that is, the science-technological revolution. These days, that is the information-communication revolution, which is a forefront of changes. Changes take

place in all spheres of the economy: among customers and suppliers, in the financial sector, and among employees. The world continues to change rapidly!

The urge to manage the economy, both at the enterprise level and at the macroeconomic level, is becoming more prominent. Clearly, there can be deviations and/or manipulations of the facts. Unfortunately, as previously mentioned, these manipulations reach significant proportions. The most illustrative example of manipulation has happened in the world's strongest economy with the strongest democracy, culminating in 2007. Manipulative practices do not respect the economic calculation and regular business, but they try to make money through various speculations and combinations, making enormous figures. The dominant policy and political power influenced the change in the nature of the calculation and that allowed the distribution and distortion of relations with economic system. Privileged classes, monopolists, and manipulators use them at the expense of many others.

Great worldwide scandals, primarily those in WorldCom and Enron, as well as in many other large companies, bookkeeping companies, banks... have clearly shown serious flaws of the accounting system. The situation was terrible: distrust in the company's balance sheets, which clearly resulted in a distrust across the board. Fake data has allowed providing false incentives to managers through shares, inflating stock prices, high bonuses, etc.

I am against economists who are in favor of unrealistic models, based on the false assumption on perfect information, perfect competition, and perfect markets, where regulation is superfluous[32]. This way they give "justification" to politicians and decision-makers in regulatory bodies, investors and bankers, for their political moves and actions. These models and theories have no scientific basis, but nevertheless, have been encouraged by important factors in recent economic theory.

Lowering the bookkeeping criteria is a bad sign for an economy. For example, Wall Street has managed to deploy (before the latest financial crisis) its toxic credits all over the world. And this meant spreading the ground for crisis, and creating the conditions for crisis to expand globally.

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[32] The limitations of economic science should be pointed out. More about this see Madzar 2011.

10.5 Setting a course of economic growth

The development policy of a society and its design are a top-level policy task. The development policy is difficult to realize without relying on economic science. Madzar believes that "science can provide help and support, but in that respect its reach is limited" (Madzar, 2011). He argues that science has difficulties within itself; inherent difficulties in the knowledge of important facts, are a disincentive for practical actions in directing economic development on a scientific basis. This limited action of science in the service of some practical accomplishments will intensify if in the theoretical sphere of economic science it encounters obstacles in the examination and reliable assertion of particular truths. Therefore, problems arise at the fundamental, epistemological level.

We should point out at a great distance between economic science and practice. Economic science deals with cognitive knowledge at the theoretical, abstract level, which they support, in addition to commitments and objectives of economic policy. People of science are generally not interested in the practical realization of politics. They leave it to those who are in charge and specialized in carrying out practical measures. Without feedback from the practice, recommendation, and commitment of economic policy, the realization itself could not be successful. Scientists do not know the problems of practical politics, they do not know the obstacles that practitioners face daily. Scientists do not deal with practical events, because they simply are not aware of them, and they have no particular interest in studying them. Establishing a link between scientists and practitioners would allow scientists to obtain knowledge and expertise, which may not be characterized by some cognitive depth and analytical sophistication, but are necessary if they want to establish platforms and proposals in order to successfully direct economic development. Due to the lack of knowledge on practical problems of policy implementation, many ambitious proposals based on the theoretical achievements of economic science have proved to be virtually useless, and accordingly they were actionally unfeasible. Unfortunalelly, this is the source of many misunderstandings and the loss of faith in economic science! Therefore, the role of science in directing the economic development, and its true and genuine pursuit to set a course of institutional development and economic and political action, could be realized through engaging the

knowledge of people outside the research sphere, people who are devoted to immensely complex economic life.

An essential component, essential for achieving economic results, is the responsibility of economists who propose economic policies and measures. It is not institutionalized, so the sanction for failure can only be a certain loss of professional reputation, which is not negligible but it certainly is insufficient to correct such an approach. However, the responsibility of politicians on managerial, hierarchically sufficiently high ranking positions, is enormous. Although this responsibility is far greater than that of scientists and policy-makers, it is rarely the case that a politician or a senior state official was responsible for damages that were a result of economic policies and measures taken. Politicians, however, are at the greater risk than researchers and scientists. If some of their actions prove to be unsuccessful, they may suffer major political and other consequences. This would affect the difference in motivation for the successful implementation: economic scientists act more creativelly. Political officials and a wide circle of eco-political practitioners, who have the authority and who are expected to achieve political succeess, can not behave creatively.

This implies the creation of a gap between politics and economics. This is often the reason why many proposals from scientific circles remain unaccepted. On the other hand, fierce criticism of science at the expense of politics does not cease.

These considerations do not deny that a scientist in the field of social sciences - or any other human being - can have his own visions on economic issues. But this also means that one's opinion is not a theory, and that it has very little or no normative power at all. Opinions do not obligate. Either way, they express individual preferences or guesses regarding risky or uncertain events, based on information.

How much is the explicatory power of economics and its power of prediction suitable for a dynamic political environment? As already pointed out, I strongly agree with the opinions (Madzar, Lawson, Stiglitz...) that real determinants of economic development and social well-being must be sought outside of the strictly understood economic reality, and outside of economics as a science. In this book, I am trying to make this point clear. The political system comes first, but collective memories, institutions and patterns of behavior, created by a long evolution, are inevitable value opti-

ons. Economics, as methodologically formalized and excessively burdened by abstractions, is a dinstinct and almost incompatible science with economic policy or politics in general. Lawson argues that „Economics has increasingly become an intellectual game played for its own sake and not for its practical consequences of understanding the economic world“[33].

10.6 The role and responsibility of economists

Economists are not in a favorable position when trust in economic science is taken into account, especially as an economic policy.

Economists are too marginalized, with some exceptions. In addition to all limitations of economic science, economists must have a greater role in a link between economics and politics. The reason we might find in Paul Krugman’s words: "In my area, it is really a confusion of many scientists who never even try to compose their thoughts with ordinary language." He concluded that economists, who can not explain what they do, probably do not understand what they are doing. Krugman supports the use of mathematical models, but, in accordance with great economists of the past, such as Marshall and Edgeworth, he argues that what we have always known as "intuition", or non-mathematical explanation, is also important. He points out that he likes the Edgeworth’s analogy: Mathematic construction should be treated as a sort of scaffolding, to be removed when the edifice of science is completed (143-46).

However, the influence of economists depends on their communication with society. They have to get involved in society, presenting their researches in an understandable language. Scientists often reluctantly cooperate with the media because of: deadlines, lack of time, incapacity and unwillingness to simplify explanations and attitudes, or the lack of understanding the conventions and limitations...

Appendix 4: Politics as destiny

The degree of development of society and its democratic capacity determines a role and position of economists. Many historical periods have not been famous for giving those titles and responsibilities to economists, who

[33] More in Lawson, 2003, XV-XXIV, pp 5-27, 291-292).

by their nature belong to their profession. Logically, this has resulted in poor allocation of resources, inadequate resource evaluation, or their dissipation.

Indeed, we cannot overlook the examples when economic policy remains deaf and insensitive to numerous recommendations and tips of economic science. It often remains deaf even to concrete recommendations that explain those tips. In the previous chapters we have pointed out the insensitivity of the authorities to scientific knowledge. Many believe that the main reason for this is political arrogance and bureaucratic recklessness. There are such examples, but explaining this relationship according to individual personality abilities, who perform some important social affairs, is too logically problematic and theoretically unfounded. A typical explanation for non-observance of economic policy recommendations coincides the claim that wrong people sit on high positions. Obviously, this is a simplification of social relations and complex relationships within the social system. Madzar believes that although wrong individuals get important social functions, their selection is a systemic result. Therefore, the explanations can not be limited by their personalities but should also consider the criteria and mechanisms of this selection, which are institutionally conditioned.

The reasons for the "insensibility" of politics towards scientific knowledge should be sought in social factors, in the nature of the politics itself, but also in the "limitations within the science itself and not so negligible difficulties that it carries with itself" (Madzar, 2011, p. 182). Equally important are other limitations, such as management, which are given little attention[34].

In totalitarian political systems, the constraint related to the power of politics and the mere expression of this power must not be ignored. In such societies, the economic calculation is less important than the political one; politics determines the fate of individuals, and particularly the unlike-minded individuals are under the pressure and reprisals. Bosko Gluscevic noticed a phenomenon of functional mind in politics: "Our political system, as you know, is manifesting the emergence of functional memory. You probably noticed that as soon as someone is chosen for a public function, regardless of the fact that he did it due to some special abilities, but rather to meet the structure criteria (to be of a certain nation, gender, and age), or simply because he does not know anything to do, etc. Although before that

[34] Madzar wrote about these limitations (Madzar 2009a, pp. 145-164, Madzar 2009).

he was natural and ordinary and realistic, after the election, he suddenly changes and becomes coxcomb, he thinks that he knows something, much more than before, and in accordance to his function he demands to announce absolute judgments, to interfere with very complex problems and subtle analyzes, neglecting all those who have been highly qualified and participated in it." (Interview for magazine "Duga", 1981)

Appendix 5: The power of politics

Unfortunately, politics has determined the fate of many economists in a negative sense. The best example is the well-known Yugoslav economist Obren Blagojevic. He was the leading economist in Yugoslavia after the Second World War. His theoretical and practical work in economics must not be underestimated. He had the task to establish and organize the Ministry of Finance, which included more complex activities. It was a very tough task, but Blagojevic did it with love. In the period 1941-1948 he was an Assistant Minister of Finance of Yugoslavia, a Governor of the National Bank, a member of the Assembly of Yugoslavia, a chairman of the Economic Committee in that Assembly, and a professor of the University. Blagojevic was in charge of replacing the occupying money and releasing new currencies. He led the development of appropriate money changer regulations. He participated in planning the accounting system for the new state, and preparing decisions on taxes and other income. He also participated in creating the first budget of the new state. In addition to that, he was a representative of Yugoslavia in newly-formed global institutions: the World Bank and the International Monetary Fund.

His international engagement was impressive, especially in negotiations in the United States of America about the return of Yugoslav gold. These difficult negotiations Blagojevic successfully ended and concluded the contract completely in favor of Yugoslavia. Before the war, the pre-war government had deposited the monetary gold of Yugoslavia abroad, fearing of Hitler's invasion. Most of Yugoslav gold had been stored in the United States. After the war, Yugoslavia tried several times to return this gold, but in vain. Blagojevic was entrusted to resume negotiations. With a small delegation, he headed to the United States and after several days of tough negotiation, he managed to sign a deal on the return of monetary gold.

Shortly after returning to Yugoslavia, he was politically discredited and imprisoned for eight years.

All his successes were erased, and his contributions were no longer relevant. His fate was decided by politics! Through political decisions Blagojevic was erased from human resources, which were also very inadequate. This example shows that politics often has impact on economists, who most often become victims of their own unbridled power.

11. DEMOCRACY AND INEQUALITY

11.1 Introduction

The state organization is a powerful weapon, having enormous economic impact. During the social evolution, various social classes struggled over who would win power and govern this powerful organization. There were struggles in all social systems: patricians vs plebeians in ancient Roman society, the third estate vs nobility and clergy in feudalism, the working class vs capitalists in capitalism, etc. Using different forms, struggles were aimed at conquering a stronger political position. Through the evolution of state organization, the influence of economic factors was also present in science. Hence, the most prominent feature of capitalism is creating democracy at the market. Powerful trusts and cartels, industrial and bank unions and consortia, with their enormous financial resources, propaganda and press, they are very influential factors in public life. Since the 18th century, the big capitalists have been so powerful that they "hold the government under their feet," the stock exchanges are "the compass of public opinion", and speculators are "more powerful than ministers"... Their economic interests in the capitalist countries have become the interests of the political organization itself.

The capitalist system, as a market-based way of allocating rare resources, introduces democracy, at least on paper, and freedom as its main attribute. Democracy etymologically means the self-government, or the power of the people over themselves. Accordinglly, it is the government of all members of the society.

Democracy, market, and individual freedoms were introduced as the main values, replacing all those values that had been developed in previous epochs. What are those values, and how they historically changed the attitude towards man and his work? It is important to see and realize that econo-

mic freedom is the prerequisite for all other freedoms. First of all, it is necessary to provide economic well-being, if it the goal is to provide freedom. Economic freedom of every individual allows versatile freedom. For thousands of years, the physical freedom had been neglected. Even such spirits as Plato and Aristotle did not even think about liberating slaves, categorizing them as the creatures far below human dignity. The citizens of the Roman Republic, being proud of their democracy, had been entertained by gladiator fights, and every good republican in the arena had to applaud to these people's sufferings. Only Christianity led to the eradication of slavery. Major steps were taken towards liberalism, both in the conceptual understanding, and in the realm of reality. So, where are we today in the conception of freedom and democracy? This question will be discussed in this chapter. We start from a historical lesson on the development of society in order to make our view on reality more complete and more realistic. These are the essential issues: Are we economically free? Are we independent? What is the concept of freedom? Is freedom reversible?

11.2 Historical lesson

The most advanced nations of the world have passed through the following epochs: edenism, savagery, agricultural society, feudalism, and capitalism.

1) Edenism – the earliest epoch in the history of human society, a period of time when people lived in primitive communities. They ate only natural food, found or picked fruits, because, logically, they inhabited the most precious climate zones of Earth. A kind of remembrance of edenism remained among the people of a moderate zone being called "the golden age," "lost paradise," "eden," and so on. Some features of economic order in the period of edenism are: the absence of private property, the equality of all community members, the impossibility of any enslavement or oppression of man by man, and primitive "markets".

2) Savagery – This transition of the primitive community has taken place for several reasons. The economic factor was the main cause, as there was a shortage of natural food, and an increase in population. Many things change from the basics: instead of abundance arises scarcity; instead of collective economy everything becomes individual; instead of freedom emerges the subjection of a women to a men; instead of promiscuity (ie. free

choice of partners) begins establishment of monogamic marriage and families; instead of collecting fruits people start hunting and fishing, and making the first tools and weapons... Conflicts and wars initiated the need for improvements of weapons. The wars that emerged in this epoch had, from the outset, economic causes. For the conquest purposes were established the first political authorities, and women were excluded from decision-making. In the first, primitive political councils, when debating on war and peace, but also on other issues, all male horde members participated.

3) Agricultural society (patriarchate) – The Agricultural Revolution is a major revolution in the history of mankind, changing everything in lives and behavior of the people. Man leaves his nomadic life and retains himself on one land, turning it into private property. Additionally, he tames wild animals and starts eating regularly. Indeed, the moment when man began to cultivate the land is historical, because for the first time he managed not to depend on the generosity of nature. Man learned to produce goods for himself. Having destroyed the most of wild game through advanced methods of hunting and "smart strategy", man had to start cultivting soil in order to survive. The fruits were no longer sufficient for his survival.

Ownership over land and new production resources enabled the increase of individual wealth, and thereby the social advantage of one individual over another. Apparently, this was the basis for the formation of state in modern terms.

For the first time, agricultural production led to the creation of a basic element of real economy – a surplus value. It is the amount of agricultural products left after complying with the nutritional requirements and the cost of production. The agricultural surplus (cereals, corn, rice, barley) had a longer shelf life, unlike wild game, fish, and fruits harvested, which were unusable after a short time. The surplus of agricultural products was stored and nurtured as a fortune, or kept for hard times (in the event of harvest failure due to bad weather conditions).

This surplus has an incredibly far-reaching influence on everything that makes today’s economy and society: letter, money, state, debt, military, clergy, bureaucracy, and technology. Agricultural society was created 6 millennia before the new era.

4) Feudalism – The previous epoch increased the production of agricultural products and created surpluses that needed to be exchanged between

tribes and states. This initiates the development of trade. Demand for new products is increasing, which affects the development of new crafts. There is a growing divercity of the sociaty, impacting the social and political organization. Due to the increase in wealth, the mighty landowners become not only the owners of vast territories, but also the holders of political power. They harbore all authority over farmers, that is, the labor force. Thus, a new high social class was formed. On the other hand, the masses of farmers remained economically, socially and politically dependent on them.

In order to facilitate the exchange of goods, people who worked for their masters (landowners) received salaries or a certain kind of debt. However, their debt had to be recorded and expressed in an appropriate commodity, and that was a predecessor of money. Different things were used for this purpose with a certain value at a given time and in a given area: shells, fur, metal, and the like, depending on the specific nation, and its needs and preferences. Metal money (coins) would later become an advanced method of exchange, enabling also the creation of wealth. In order to ensure the its credibility, money needed something that resembled what we today call the state - a collective institution that would last longer than the life of the ruler, providing regulations for the participants of exchange. Money and the state go hand in hand. The value of money requires a collective institution - the state - which will guarantee its credibility. However, maintaining the state is expensive, but the surpluses made it possible to cover the costs. The state needed officials for public affairs (e.g. judiciary, police), and the rulers who certainly demanded a high standard of living. Until then, none of this could have existed, not even the organized army to defend the state from outside enemy.

It is worth pointing out that the state had an unjust surplus in favor of social, political and military powers, from its very creation. The fundamental question arises: how could authorities maintain their power, and increase their wealth, unencumbered by majority? The answer is: they asked for support, and they successfully achieved it by spreading a certain ideology. Ideology gave them legitimacy, and sent the message that authorities had the right to hold all the power in their hands. Yes, it simply must be so, because their right to hold power comes from a higher power, from God himself.

This idea was indispensable in order to maintain the legitimacy of the state hegemonic power. Someone also needed to stand next to the ruler and constantly remind others that he, the hegemon, is a representative of

force on Earth, and they should comply to everything he does. This ideological cover of the state power had to be institutionalized with the help of clergy. It had the function to preserve the state, and support its survival after the ruler's death. This also ensured the continuity of the state, it affected the prejudices of the people who feared of many occurrences in nature, and especially of death. But, the clergy did not produce anything, so its costs were covered from the surpluses made in agriculture.

The entire mechanism for the development of economy and technology was driven by this. The desire to produce more with less resources initiated the creativity of man. The agricultural economy itself drove the needs that were not present in the past (e.g. the need for watering plants prompted the discovery of new irrigation methods).

Countries with more extensive agricultural resources begun to separate and become richer. The state, army, letter, technology, barut, sea fleet, etc., could not be formed without an agricultural surplus. Agricultural states have developed all of this, creating development centers in Europe, in which wealth has accumulated. Geographical areas not having solid conditions for the development of agriculture were lagging behind, but also for other reasons. Most often because they did not have the initiative to develop agricultural technology, since food was always abundant (e.g. Australia).

5) Capitalism - This is the era of parliamentarism, market, individual freedom, and democracy.

The process of making a product requires three basic elements: human labor, tools or machines, and working space (e.g. land, factory, office, mine, etc.) where production takes place. Simply, production requires: work, produced assets (often referred to as capital) and land. In societies prior to capitalism these "production factors" were not treated as goods. However, in economic terms they were goods. For example, in the era of feudalism, farmers did not sell their work to feudalists, even though they worked hard. They were forced by the feudalists to work for them. That way, the feudal lord was taking a large percentage of their yields. The means of production (tools, above all) were made by the farmers themselves or by the craftsmen who worked at the same feudal land, to whom farmers gave their products in return. Finally, the third factor of production, the land, was not a good: ownership over land was inherited, and farmers were not allowed to acquire the land they cultivated.

Capitalism or market society was born when all of these productive factors were turned into goods, that is, when they began to be bought and sold in the free market. Workers sought jobs in the "labor market", craftsmen traded tools they produced, and the country itself acquired exchange value, which was a difference between sales transactions and land lease.

Hence, wool, spices, silk, weapons, and other products are transformed into goods with an international value, determined through the process of exchange. Trade expands beyond national borders. Spanish, Dutch, British and Portuguese merchants buy wool from England and Scotland, transporting it by ships to Shanghai where they exchange it for Chinese silk, which is then exchanged for Japanese swords in Yokohama; before returning to the West, the ships travel to Bombay to exchange swords for spices; in Europe, spices are finally exchanged for wool, much more wool than before. Merchants head for China again, as long as the business pays off, bringing profit and wealth. The world has changed, and the planet has transformed into a huge, globalized market society, which continues to be to this day.

Economic resources have been allocated differently in relation to feudalism. In England, where the market society was highly developed, the landowners reoriented themselves on international trade. It was important for them to acquire new resources in order to gain new opportunities for additional wealth provided by the international trade network. They simply replaced a bunch of farmers with sheeps, and literally threw farmers out of their habitat. Farmers were left without anything. The workforce was the only goods they had to offer. Suddenly there was an enormous supply of labor, and a small demand (the factories were not developed yet). The mass of former farmers was living in poverty, illness and misfortune. Some of them continued to cultivate feudal land, although under completely different regime; they were tenants whose lease was formed depending on the price of wool (as the main goods in international trade at the time). Now the wool had to be sold in the market and merchants had to earned enough money to pay the fees and cover the cost of living. Worries about how to survive were replaced with worries how to make enough money in the market.

The market capitalism, as a new system of allocating the rare resources, initiated the idea of factory. The creators of this idea were English and Dutch merchants who found new business opportunities. They realized that

there is a high demand for some types of goods in the international market – e.g. wool fabrics and metals. They knew they would get richer if they manufactured it quickly and cheaply. Everything coincided: on the one hand they had a mass of former farmers who begged in the streets for bread, and on the other hand, James Wat had invented rotary engines, ideal for power looms, bellows, and other mechanical devices - and that was enough! The first factories opened.

The Industrial Revolution created enormous wealth, but also a huge contradiction. Horrible poverty followed this enrichment. The inequalities brought by the Agricultural Revolution have been increased to the extreme limits, creating new, so far unforeseen inequalities caused by the industrial revolution as a triumph of the market.

A triumph of exchange value changed the world – it increased wealth on the one hand, and deepened poverty, on the other. A world was full of optimism for some, and pessimism for many others. Optimism was based on spreading the idea of freedom, the technological possibilities for manufacturing goods for all, and introduced changes in the work process. Unfortunately, all this was followed by unprecedented misery. Also emerged the new forms of exploatation. The workers remained poor, because they could not sell their workforce. Those who were employed had to work fourteen hours a day in horrible working conditions. Obviously, capitalism has been a period of great and general inequality.

11.2.1 Triumph of exchange values over life values

The history of economics generally, and the history of labor particularly, know four working systems that correspond to the respective economic and social epochs. In the oldest system (the system of primitive communist communities) there was a collective ownership over the means of production, as well as collective work, and collective consumption of labor products. This was the system of complete labor freedom. Contrary to free labor of that era, the next epoch was characterized by the labor disability. The main workforce was non-free people – slaves – owned by their masters, as well as other means of production. The masters were individuals, landowners, and craftmen. The slaves were not allowed to use their labor rights. That right fully belonged to their master. In the next social system, feudalism, the slaves were replaced by the peasants who cultivated the land,

and apprentices who worked in craft workshops. Their position was different from the slave's, because they were not directly owned by their masters. A farmer was tied to the land he cultivated, but he had no ownership over it. He was obliged to give a part of his yield to his master (according to the rules in various places); he also worked anually for several days (again according to the rules) on the property owned by his master. The apprentices were not owned by their masters, but they represented the hired labor force. Finally, the fourth known system of labor is the modern capitalist system. The essential characteristic of this labor system is the legal freedom of workers: a modern worker is neither a slave in the property of a master, nor a slave limitted by a labor contract; he is free to sell his workforce, meaning, he is free as a person. However, he does not own the means of production, and therefore he is not economically free. In rural regions, capitalism has also created free peasants.

Therefore, workers and peasants were forced to sell their workforce, and their opportunities and income depended on the labor market development. Unfortunately, today's inequalities do not make an idealistic picture of capitalism as a market-based system of allocating rare resources. However, it's not the problem of the market, but politics and rent-seeking. Although the market has built democracy, the deviations of political system have led to bad situation in capitalism. Democracy and the political system did not respond to the task of democracy - exercising power of the people over people.

The improvement of human labor has led to a mechanical society in which machines carry out many functions, and people mediate in production processes. There is a contradiction in that. On the one hand, large companies that produce a huge amount of products are trying to mechanize the production process in order to reduce costs (in Toyota, for example, only two workers can be seen on the production line, the rest of the work is performed by robots; it takes few minutes to manufacture a car). On the other hand, the more entrepreneurs manage to replace employees with robots and thus impose a mechanical way of behavior, the more of their product value tends toward zero. This means that the profit of entrepreneur decreases. Hence, the society faces the crisis, because it can not profit and return what is being taken away from the future (loans).

It all starts here. Namely, when an industrialist attempts to reduce costs and increase production, he orders a new steam engine (in the 19th

century) or a new robotic system (today), and thereby he inevitabely launches a vicious circle of chain reaction.

Manufacturers of new machines hire workers in order to manufacture enough machines. Workers receive incomes to buy houses, cars, and meet their needs. Owners of construction and automotive companies increase their profits, further investing and developing their businesses. Even when technological advances have abolished individual jobs, for example, when a steam engine replaced physical work, it created new jobs in new areas (machine management, maintenance, production of lubricating materials, production of starting fuel for machines, etc.). Entrepreneurs compete who will produce better machinery and equipment.

Logically, this cause-and-effect circle leads to the machanization of production – a situation when machines produce various products, but also other machines. The more mechanized production, the exchange value tends toward zero, as already indicated. After all, that is why iPed phone is cheaper this year than last year. All this leads to lower profits for manufacturers. At some point, the weakest in the enterprise chain will begin to show negative growth, and will no longer be able to pay off debts. The company will close and the employees will be fired. They immediately reduce their spending, which results in reduced earnings in other companies. This leads to the closure of the weakest in other company chains. More employees lose their jobs, starting a chain reaction of bankruptcy, unemployment, recession. This is how an economic crisis stops the mechanization of society.

11.2.2 Profit virus

The market society have gradually turned into our boss and, at the same time, into the largest enemy of the Earth. Since their creation, market societies have destroyed two-thirds of all forests on the planet; we created acid rains that polluted lakes, devastated water resources and land, exterminated animals and plants to the extent that the biosphere, which is our only living environment, is now disbalanced. In addition, more and more gases are generated (carbon monoxide and methane), increasing the planet's temperature causing the glacier melt on both poles, and the sea level rise. Earth's climate is irrevarsibly changing, so the entire population faces the danger of displacement.

This is a consequence of exchange values' triumph over life values. Evidently, this "triumph" have created an enormous fortune on the one side, and an inexpressible misery on the other. Now we are threatened by an ecological disaster. Many areas of everyday life (sport, culture) have been commercialized because the exchange value is in the foreground. Television also propagates exchange value, and additionally converts all civilization values into exchange value. Democracy has been constraining the market forces, sometimes achieving a balance, and often not.

11.3 Democracy and the political system

Democracy, as we know, is not only a periodical voting: in some countries such elections are used to legitimize authoritarian regimes, and to deny basic rights to the great part of the population. Perhaps the most important aspect of inequality is unequal political right. All people should be equal in political rights. The rules of the game affect the likelihood of exercising that right. The essential democratic right is the right to vote. An opportunity for everyone to participate in voting is crucial for democracy. Nevertheless, in many countries, participation in voting is difficult to optain. There are also positive examples in some countries that seek to hear the voice of all citizens, for example in Australia, where the rule of compulsory voting has been introduced, imposing the charges on everyone who did not appear at the polls.

In addition to influencing the right to vote, even more important is to influence the political process, either by favoring a particular voting model, or by impacting the behavior of participants in the political process. Thus, money can influence and control the media, or it can directly influence politicians (the so-called political bribery). Clearly, the rich can use it when valid rules of the game are not established nor respected. Therefore, it is necessary to establish laws that would regulate lobbying, candidate funding, and staffing policy. This is the premise of political equality, and the way to prevent its abuse. Some western democracies have reduced these abuses; some are striving to achieve a full equality of vote, introducing, for example, public funding of the media, and guaranteeing equal access of candidates to all media.

However, in some western democracies (e.g. the USA), corruption is not executed directly, but through pre-election donations by the so-called "purchasing of politics". It is a privilege of wealthy people, turning the

world into a vicious circle – economic inequality leads to a political inequality, which again instigates economic inequality.

This has enabled the richest (1% of the world population) to take a quarter or a fifth of the national income. The great economists have documented a drastic inequality in many countries. Stiglitz believes that inequality in the United States is "a matter of political choice," and this is not the only case. In his interview for Vanity Fair, Stiglitz has explained that American inequality exists at every stage of life. He particularly pointed to the education - where wealthy people transfer their privileged position to their children.

According to Stiglitz, when we talk about inequality as a political choice, the question is where the rich decide to spend their money: whether on tax reliefs for wealthy people or on education for ordinary people; whether on weapons for civil wars or on health care for the children; whether on subsidies for the rich cotton producers or on charity for the poor? Why not charge taxes for big companies or taxes for environmental pollution?

Although inequality grows in developed countries, it is the case in most countries (see Stiglitz, Piketty, Milanovic...). There is no way to separate politics from inequality, because inequality plays an important role in political life, as seen in Egypt, Morocco, Libya, Syria, etc. Inequality was not resolved neither by socialism under Gamal Abdel Naser, nor by the later neoliberalism in Egypt and Tunisia.

Inequality is deepening. Despite the emergence out of poverty, there has been a huge increase in inequality in China, with growing numbers of millionaires and billionaires. In India, an increase of millionaires and even billionaires is impressive. The devastating situation is in Africa, where the number of the rich people is growing, and the number of the poor is enormously high - approximately 415 million people are surviving with less than $1.25 per person a day.

How to gain citizens' trust in the political system? Why would people vote if they feel that they do not make decisions as individuals? What is a voter’s position nowadays? How much are people interested in participating the elections? These are the inevitable issues of modern democracy, in a situation where trust between the citizens and the state disappears - and pre-

vails pessimism, the lack of interest, and a loss of trust in democracy. Many people think that way.

Trust in the political system directly affects the economy. When trust in institutions is lost, trust in business arrangements is also lost. In the public sphere, trust in politics is the most important!

Democracy must ensure that every new generation become richer than the previous one. This means taking care of all social classes, especially the pillars of society. Inequality is the price paid when abandoning democracy, because democracy provides equal conditions for all. True democracy creates opportunities for all members of society.

Democracy means equality at every stage of human life. Therefore, it is crucial not to create differences between children in pre-school age, nor in education, as the main pillar of progress in every society! Poverty is a threat to democracy because it divides children, since the poor social groups can not afford higher levels of education. Thus, it prevents the poor from getting a "decent" job, which is required by employers, not just academic education, but also postgraduate studies.

Democracy implies that everyone has a health care as a basic human right. Rich or poor, everyone must have adequate health care. Human lifespan depends on the degree of health care. Some countries, such as the Skadinavia, are able to provide good health care, free high education, and good public transport for everyone. Skandinavian economic indicators do not lag behind other developed capitalist countries. On the other hand, the United States have dark statistics in health care and poor health outcomes. Free education for the Americans is just a dream.

11.4 Democracy in the 21st century

The main question today is why a distortion of democracy happened at all? The democratic market sets the rules of the game. If the rules of the game are not set up in the right way, the market does not function properly. The market is a powerful mechanism, and the economic theory has its merits. So, the problem is not how should the market function, but why the rules of the game are not set up to guarantee the market competition. What is happening in the political system and why? Why has the political system established the rules that allow a deformed market, where corporations and rich people can exploite everyone else?

The market does not exist by itself. There must be rules, determined by the economic procedure. Democracy is deformed, and that is a huge problem. However, knowing the problem makes it easy to get the economy back to normal, as it used to be in the 19th century. And that is a path of rational altruism and trust.

11.4.1 Trust

When people began to believe that the future could be better, the time of economic growth began.

Faith in the future came with a scientific revolution. For more than 500 years, the idea of progress has raised people's faith in the future. Capitalism was founded on this idea. Its theoretical basis has been set by Scottish economist Adam Smith in "The Wealth of Nations" (1776). Smith advocated reinvesting the profits, which brings more profits, which are again reinvested in the production. And so ad infinitum. Evidently, investing in production is the most important in capitalism.

Capitalism began as a theory on how the economy works - offering a demonstration of the money possibilities, and promoting the idea that reinvesting in production leads to rapid economic growth. But capitalism became a broader concept, beyond an ordinary economic doctrine, accessing all spheres of life. The basic principle of capitalism was that economic growth is supreme good; without growth there is no justice, freedom, or even happiness. Capitalism enabled the development of science by investing in scientific projects, which increased production, profit, and economic growth. The connection between capitalism and science was very important because it enabled: the discovery of America, an internal combustion engine, genetic engineering, and so on. All this was supported by the banks, and everything was based on the belief in endless economic growth.

Decade after decade, Western Europe witnessed the development of sophisticated financial systems, which could draw large amounts of loans in the short term, and make them available to private entrepreneurs and governments. Loans were financed by numerous investments. Spain was the first to dictate capital investments, followed by the Netherlands, England, etc. The Netherlands contributed to innovations in financing investment by discovering stock exchange, as well as limited liability companies. These ventures were funded by many investors, making the risk shared on all of

them. The development of legal system made it possible to trust the stock exchanges and credit institutions – particularly in the Netherlands, where the private property right was established.

The topic of trust is insufficiently understood. And in my opinion, trust in economic sense is more than money. Therefore, it is necessary to strive to building trust in every society and economy. Trust enables making plans and everyday transactions; it facilitates the democratic process; and finaly, trust is necessary for social stability, and also crucial for our lives.

Trust cannot be measured, but it is somewhere in the range of national income, because it equally depends on the level of trust and the investment in human capital and machines. Unfortunately, trust is degraded by an increase in inequality in many countries. When one lags after others for just a few percents, it is logical to lose trust in the system.

Selfishness does not go hand in hand with trust, although the economic tradition has glorified trust in personal interest. However, starting from the fact that such trust enables the optimum economic life, the economy becomes completely efficient. According to this, selfishness is an ultimate form of "generosity" (to itself), as Adam Smith has stated in "The Wealth of the Nations". But this selfishness must be controlled, because it has been shown that unbridled selfishness inevitably diminishes trust.

The best example is banking. It is based on the trust that the money you deposit in the bank will be there when you want to withdraw it. This trust was based on the banker’s responsibility, and the bank’s transparency. Banks responsibly give loans to prospective companies and businesses. However, this confidence is sporadic or fraud, mainly in pre-crisis periods. This situation is known to the general public, because they see the social implications of some bank activities - green loans, credit card fraud or market manipulation. There must be trust in personal interests, as well as the work for the benefit of society. A massive loss of trust is evident, and banks endanger real businesses, as well as the normal functioning of the economy. Trust among banks has also been lost.

Previously, there were examples of lost trust in the financial sector, such as the Stock Exchange collapse in 1929, caused by fraud and stock market manipulations. People believed that banks and regulators would enforce the law. However, after several decades of gaining trust and legitimate behavior was created a reward system, fostering short-sighted behavior

and excessive risks. Bankers used the political influence to disregard rules, and to set up regulators who did not believe in regulations. Politicians and ideologues from the academic circles supported them in the sense that banks could self-regulate. It was an approach that spured the incentives for innovation in finance, while banks, on this understanding, should not rely on trust as a motive for any kind of activity. Various options were given, for example, executives gained shares, high salaries, and so on. This policy encouraged bank managers and corporate executives to actively seek out every opportunity for creative accounting, in order to demonstrate a successful image of the business.

The loss of trust devalues all social values and destroys the economy. Restoration of trust is a necessary precondition for the recovery of economy.

Appendix 6: Faith in the future

It is not easy to comprehend the true position of an individual in a modern history. It seems that he/she has more faith in the future than ever (despite the pessimism mentioned earlier). This faith encourages the growth, as well as material and spiritual development. Let's show this on an example:

Warren Buffett, a wily financier, has founded a bank in El Dorado, California.

Bill Ravis, hastily trained contractor from El Dorado, finishes his first major work, receives his wage of €1 million in cash, and he deposits the sum in the Warren Buffett's bank. The bank now has a capital of one million dollars.

Meanwhile, Jane McDonat, experienced but poor baker from El Dorado, thinks about openning the bakery in her neighbourhood. But she does not have enough money to buy adequate business space and fill it with ovens, sinks, dishes. She goes to the bank presents her business plan to Warren Buffett, and convinces him that her investment is profitable. The banker gives her a loan of one million euros, crediting her bank account by that amount.

Jane McDonat now hires Bill Ravis, the contractor, to build and equip her bakery. His price is one million euros.

When she pays him with the signed check, which burdens her account, Bill Ravis deposits that money to his account in the Warren Buffett's bank.

So, how much money Bill Ravis has in his bank account? Exactly 2 million!

How much money is there actually in the bank? Yes, 1 million.

This is not the end. As usual, after two months of work, Bill Ravis informs Jane McDonart that, due to unforeseen problems, the costs of the construction have amounted to €2 million. Jane McDonat is not thrilled, but she can not give up in the middle of construction works. Therefore, she visits the bank again, assuring Warren Buffett to grant her an additional loan, and he deposits another million to her account. She transfers that money back to the constructor's account.

How much money Bill Ravis now has on his account? Yes, 3 million. But how much money is actually in the bank? Still only 1 million. In fact, it is the same one million, which had been in the bank all the time.

The current US banking law allows the bank to repeat this escapade up to seven times. The contractor will eventually have 10 million on his account, even if the bank has only one million. The banks are allowed to borrow $10 for every dollar that they actually possess, which means that 90% of the money on our bank accounts is not covered by the actual banknotes and securities. If all the owners of the bank accounts suddenly claimed their money, the bank would have immediately collapsed (except in case that government rescue them). The same applies to Atlas Bank, The First Bank or any other bank in the world.

Is this a scam, and thus, is the modern economy a scam? The answer is in the essence of trust – the only stock for most of the money in the world.

In the example of bakery, the discrepancy between the money invested by the contractor, and the actual amount of money is provided by the bakery, which is now built and needs to create new revenue, new money. The money in the bank is transformed into an asset on the basis of trust that will be profitable in the future. Thus, the owner of the bakery expects that in one year will be selling thousands of muffins, biscuits, loaves of bread, and pastry, with a decent daily profit. Repayment of the loan will be done with interest. Warren Buffett will be able to pay in cash. The whole endeavor is

based on faith in an imaginary future – both, the entrepreneur and the banker, have confidence in the future business, and the contractor has confidence in the future solvency of the bank.

An entrepreneur can not bake without a bakery. Without baking products she can not earn money. Without money, she can not hire a contractor. Without contractor there would be no bakery. If this chain does not exist, the economy would be frozen. It has been for thousands of years until the advent of a new system based on faith in the future. A special type of money is invented, called "loan". The loan allows us to build the present at the expense of the future. It is based on the assumption that our future resources will certainly be far more abundant than our current resources. When people began to believe that the future is better than the present, this kind of money begun to function. For a long time there has not been economic growth in the world, which means that the cake has been the same size for a long time. The loan is the difference between today's and tomorrow's cake. There were probably some brilliant business ideas, but there was no money for their realization. No new businesses - no economy growth.

A loan has contributed to real economic growth; growth has increased confidence in the future. This gave rise to the system of capitalism, whose theoretical foundations were laid by Scottish economist Adam Smith in The Wealth of Nations (1776), probably the most important economic manifesto of all time. He argued that selfish human need to increase personal gain was the basis for collective wealth. According to Smith, becoming richer will do good to everyone. Egotism is altruism! Smith’s logic was this: if I am poor, you will be poor, too, because I will not be able to buy your products and services. If I am rich, you will also be rich, because you will be able to sell me something.

This is why capitalism is called capitalism! Capitalism distinguishes capital from wealth. Capital consists of money, goods and resources invested in the production. Wealth, on the other hand, is hidden under the mattress or is wasted on non-productive activities. This is a narrower definition of capitalism. I support a broader view which, apart from material capital, also includes spiritual capital.

Capitalism has not only played a key role in the development of modern science, but also in the development of European imperialism. In the name of the capital, in 15th century started the colonization of Africa, A-

ustalia, USA, China, as well as numerous conflicts and wars. A complex economic system has been created, with a belief in the free market. Faith in the future is based on these values: individualism and democracy give the main tune to today's societies. (Source: Jovovic, The Ray of Creation, 2015).

12. VALUE – A CENTRAL QUESTION OF RELATIONSHIP BETWEEN POLITICS AND ECONOMICS

In the previous chapter we have seen that productive forces of capitalism grew, production expanded, institutions developed, economic system established, and all the profit was a development engine. Capitalism creates the new value, and the question of distributing this new value becomes more significant.

Adam Smith was the first economist to devote himself to researching the nature of economic system. He explained the forces that drive economic life and efforts. In the course of studying the nature of economic system, he analyzed the area which inspired him the most. That is the problem of pricing, and allocation of the resulting revenue to wages, rent and profit. He also focused on policies through which the state facilitates and promotes economic prosperity.

Smith focused a great deal on value and distribution – on pricing, and who receives income. These were current issues at the timewhen these lines were written. Smith has seen prices and distribution as central issues for economic thinking.

Economists before Smith did not have any serious theory of price and value, only confusing questions without answers.

Without wages and interests in the ancient world there could not be a price theory in the modern sense. Production costs were not a subject to attention because they were not visible, as the slaves were unpaid workforce in the household, as well as in production units. Therefore, the only thing left was to ask philosophers (Aristotle) whether the prices are fair. That will remain the central issue of economic thought up to date. For centuries, the

economic attention has been focused on convincing people that the price set by the market is justified, despite all ethical considerations.

Another puzzle remains, as a permanent subject of economists' interest, and that is: Why some of the most useful things have the lowest value in the market, while some of the least useful ones have the highest price? For example, bread and clean drinking water are both necessary and cheap, while silk and diamonds are much less useful or necessary, but more expensive. Smith's diamond/water paradox has resulted in a confusing difference in value in use and value in exchange. He has never solved this puzzle.

Smith left aside the usable value and analyzed the exchange value. He established the value-in-exchange or the labor theory of value. According to his theory, the value of each property is measured by the final amount of work for which it can be exchanged. "The value of any commodity, therefore, to the person who possesses it... is equal to the quantity of labour which it enables him to purchase the exchangeable value of all commodities." (Smith, 2008, p. 65). But there are some inconsistencies in this perspective. Namely, Smith argues that the value-in-exchange depends on all the costs of producing commodities – however, there is no convincing explanation of what determines these costs.

He was not specific in explaining what determines the shares in the sales revenue, which should be attributed to workers, landlords, and employers – the capitalists. According to him, the wages were costs required for the worker to remain in his business. That is an existential theory of wages. Smith did not clearly distinguish the income that was returned to capital and capitalists – interest and profit. He explained this income, with some difficulties, as the labour theory of value. A profit that returnes to the capitalists return is a part of the worker's labour, which, as a surplus value, is appropriated by the capitalist. This surplus value which is created beyond what is truly paid, the worker has the right to claim from the capitalist. And this is where Smith stopped, and Marks continued.

Smith also remains undecided or contradictory in explaining the rent. After declaring the price as determinant, along with wages and profit, he says that the rent is the difference of the income after paying wages and profits. "Rent enters into the composition of the price of commodities in a different way than wages and profits. High or low wages and profit are the causes of high or low cost; high or low rent is the effect of it"(Smith, 2008,

p. 172). It then connects the level of that residue to the quality of the soil: "The rent increases in proportion to the goodness of the pasture". (Smith, 2008, p. 173). There is a contradiction in Smit's understanding of prices, which should reflect the labor costs embedded in the product, and his understending of land, which "in almost every situation produces a greater quantity of food than necessary to maintain all the labour necessary for bringing it on a market" (Smith, 2008, p. 185).

David Ricardo follows Adam Smith in interpreting the basic issues of economics, but with a critical approach to his ideas. Among the factors determining the price of products, according to Ricardo's opinion, the first comes usability (utility): "If a commodity were in no way useful - in other words, if it could in no way contribute to our gratification - it would be destitute of exchangeable value" (Ricardo, p. 11). According to Ricardo, the value of "exchangeable" commodities originated from the scarcity of supply or "the amount of socially necessary labor required to produce it". In order to support his theory, Ricardo quotes Smith: "It is natural that what is usually a produce of two days or two hours labour, should be worth double of what is usually the produce of one day’s or one hour’s labour" (Ricardo, p. 13). After this quotation in his work "The Principles of Political Economy", he adds that "This is really the foundation of the exchangeable value of all things, excepting those which cannot be increased by human industry, is a doctrine of the utmost importance in political ecnomy; for from no source do so many errors and so much difference of opinion in that science proceed, as from the vague ideas, which are attached to the world value" (Ricardo, p. 67).

Ricardo has defined the rent as a payment for "the use of the original and indestructible powers of the soil" (Ricardo, p. 67). Also, the rent was not an unprofitable income, but "an increase in rent is always the effect of increasing wealth of the country, and of difficulty of providing food for its augmented population" (Ricardo, p. 77). In his analysis of economic issues, he also included wages. One of his widely cited words are "the natural price of labour is that price which is necessary to enable the labourers to subsist and to perpetuate their race; without either increase or diminution" (Ricardo p. 93). However, understood by Riccardo solely as the comodities necessary for the psychological preservation of a worker, but also as including "those comforts which custom renders absolute necessaries" (Ricardo, p. 95). Ricardo does not rule out the increase in wages under the influence of capital

infusion and technology, and the consequence is an incentive effect on the market price of labor. Nevertheless, Ricardo is famous for his Iron Law of Wages, according to which those who work should be poor, and they should not be saved from poverty either by state or employers, trade unions or by some other own action. I think, however, that Ricardo was more cautious about this issue than what was said in this law. But perhaps it is unjust towards Ricardo to claim that from that law arose his belief in the inevitable misery of those who live in capitalism, as well as the futility of every proceeding to correct it. It is the result of economic laws of capitalism.

His perception of profit is ambiguous and therefore confusing, perhaps because, in his system, it was difficult to find places for profit. If the value of a product is determined by labor costs and rent, then in that case nothing is left to earn capital. Although not overly clear, he also found a capitalist's profits in labor. People worked in the past to build a factory, machines, and plants (fixed capital investment), in order to make goods which they would invest in the production process (working capital). According to Ricardo, profit (which includes interest) is a postponed payment for invested labor. Obviously, this is a controversial explanation, because, if the profit reflects the remuneration for the labour spent in the past for the creation of capital, then every income that the capitalist receives is an undiscovered form of theft.

From Ricardo's time, there has definitely been a gap between those who glorify the capitalist system, and those who spoke against it, and who have pointed out to inequality as a huge problem and a consequence of capitalism.

The Industrial Revolution did not change the worker’s standard of living; there were visible astonishing differences between wages and welfare, on the one hand, and both employers and capitalists, on the other. At first, better life of a large number of people who left the soil cultivation to work in factories was noticeable. However, with time grew the difference between those who were working, and those who held industrial capital and labor. These differences became the focus of interest and comparison.

The worker worked literally for a meal, and an employer – capitalist had the power to insure or deny the worker's needs, and he used that power. The worker was practically the slave with a wage, and that was not a hyperbole but a true fact. That dark reality was perceived by other economists

(e.g. Adam Smith, John Stuart Mill). They strongly warned about the helplessness of workers. But the classical school generally ignored the question of power - the ability of some to profit, to gain a large share in revenues distribution. The situation is the same today. "With certain exceptions, that black hole remained in the mainstream economy" (Galbraith, 1995, p. 85).

The inequality in the distribution of income and power, and the inability of classical school to assimilate the crisis and depression, were the defects that had to be urgently solved, because they became blatant. Inequality in the revenues distribution, and inequality in the power distribution, including the power that capitalists have had, were the source and core of the Marxist revolution. But the classical tradition was burdened with critics. The first attack was on the workers. They were accused of excessive breeding, with which they (the lower class in general) reduced their lives to a naked existence. John Stuart Mill wrote about this in "The Principles of Political Economy", published for the first time in 1848.

The other defense of the classical system came from a position which slightly deviated from the middle-class economy. It was utilitarianism, which was dominantly promoted by Jeremy Benthan (1748-1852). Utilitarists emphasize that the production is a source of happiness, and all that encouraged production was useful or beneficial, whether the result of it was the suffering of a small number of people. According to utilitarians, especially Bentham, happiness is the basic motivation of each individual for the good that serves this purpose. In order to achieve this aspiration, any state interference should be excluded. Howedver, the defense of the classical system by the utilitists was not satisfactory, due to the rigidity and limitations. The dominant figure of utilitarians was John Stuart Mill, a greatly educated man, and the creator of a brilliant textbook "The Principles of Political Economy". His father, James Mill, also an economist, firmly believed that every individual was responsible for his/her own salvation. He said: "The enterprise system has its hardships, but it is the price we pay for progress and the general good." John Stuart Mill (son) continued thinking in that direction, and emphasized the unquestionable ability of the economic system to produce goods and services. He believed that there are people who suffere in that system, but that they contribute to the general good, which is positive. However, he knew that division of the human species into two hereditary classes, employers and employees, will not last forever. Here is the most frequent quote by John Stuart Mill:

"If, therefore the choice were to be made between Communism with all its chances, and the present state of society with all its sufferings and injustices; if the institution of private property necessarily carried with it as a consequence, that the produce of labour should be apportioned as we now see it, almost in an inverse ratio to the labour – the largest portions to those who have never worked at all, the next largest to those whose work is almost nominal, and so on in a descending scale, the remuneration dwindling as work grows harder and more disagreeable, until the most fatiguing and exhausting bodily labour cannot count with certainty on being able to earn even the necessaries of life; if this or Communism were the alternative, all the difficulties, great or small, of Communism would be but as dust in the balance" (Mill, p. 208). Evidetly, Mill believed that the classical system was brutally dishonest, but that it would be repaired. He embraced a closed view on wages, the so-called Wage fund theory – wage level is determined by wage fund and the number of worker's employed. To pay the laborer, a wage fund is raised. Once the wage fund is up, it is kept at the same level. Mill was later forced to abandon his Wage fund theory. He believed that communism was not the solution, but should "wait" for the situation to improve without communism?

Herbert Spenser (1820-1903) first used the phrase "Survival of the fittest" after reading Charles Darwin's On the Origin of Species, in his Principles of Biology (1864), in which he drew parallels between his own economic theories and Darvin's biological ones: "This survival of the fittest, which I have here sought to express in mechanical terms, is that which Mr. Darwin has called 'natural selection', or the preservation of favoured races in the struggle for life" (Spenser , page 418).

Although his viewpoint was negative for social progress, one can not neglect the comprehensiveness of the way Spencer and social darwinists defended the economic system of capitalism. They point out that inequality and suffering are not a problem for society, but that alleviating the suffering is socially harmful; nature has "chosen" the rich to carry progress, therefore they can not have a sense of guilt.

Spencer's followers were numerous, especially in the United States. One of the most prominent, William Graham Sumner, said: "Millionaires are a product of natural selection ... the naturally selected agents of society for certain work. They get high wages and live in luxury, but the bargain a is good one for society "(William, p. 90).

Thorstein Veblen (1857-1929) has a significant place in the history of economic thought. As a great critic of the classical system he wrote several short works at the beginning of the 20th century. According to Veblen, the basic ideas of the classical system do not reflect the quest for truth and reality; the classical system is actually based on what is convenient for an influential interest; economic life has an evolutionary character; economic institutions are changing, hence, the subject of study should also change; understanding is possible only if a person goes ahead with a change. However, in the classical system, the economic theory did not recognize it. Veblen is still up to date, thanks to the extraordinary analysis of behavior and motives of the rich. His book The Theory of Leisure Class significantly influences our views on the economic system and inequality. Veblen's legacy, with his critique of the barbaric culture (expensive entertainment, dinner parties, dances in New York and Newport palaces, etc), and conspicuous consumption, are indisputably important in perceiving the behavior of the leading class in capitalism.

12.1 The theory of subjective value

In the 70s of the 19th century there was a significant change in econonomic theory, both in style and content. It was perceived as a revolution, due to its dramatic developments. The carriers of this change were British economist Stanley Jevons, Austrian economist Carl Menger, and French economist Léon Walras. What characterizes this revolution, called the Marginal Revolution? Three unique features of this new direction in the economy can be distinguished (although attitudes vary):

- More attention is paid to economic analysis, which must be based on the theories and behavior of individual economic players;
- Greater focus on demand, which also offers a critique of the theory of labor value of classical school; marginal utility is a new and central theoretical concept;
- Mathematical formulations, primarily a differential account, are more frequent.

According to Jevons, economic science must be reformulated using mathematics, and based on natural sciences. Jevons focuses on the (marginal) utility theory and, by means of it, explains the formation of prices. His theory is a clear progress compared to classical economists. With his work, demand gained a prominent place in the price theory, while the demand

theory is based on the theory of consumer behavior. Jevons writes about the relation between the cost of production, supply, marginal utility, and prices as follows:

- The production cost is determined by the offer;
- The offer determines the marginal utility;
- The marginal utility determines the price.

Some shortcomings emrge while analyzing these attitudes. Therefore, Jevons did not completely round off his theory, although he has partly crossed the path of the Marginal Revolution. Menger and Varals complemented this path. The Austrian approach generally focuses on the subjective, atomistic nature of the economy. Stressing the determination of subjective factors, Menger defended personal interest, utility maximization, and total knowledge, as the foundation upon which the economy must be built. Aggregate, collective ideas could not have an adequate foundation, unless they rest on individual components.

Menger began researching the theory of value by evaluating goods. According to him, economic goods are those for which the needs are greater than the available quantity. For some goods is said that it has value if people in their economics perceive that the satisfaction of a need (that is, the greater or smaller completion of its satisfaction) depends on their availability of a certain good. Utility is a possibility to satisfy human needs and - provided that utility is recognized - the precondition is it has the significance of good. Explaining economic and non-economic goods, Menger reminds us of Smith's water and diamond paradox. Smith was confused by the fact that water, which has high use value, does not have an exchange value; while diamonds, which practically have no use value, are exchanged at high prices. Menger argued that water and diamonds are undeniably useful, although they differ because diamonds are scarce compared to demand for them. In addition, subjective evaluation between water and the need for water can not be linked to a certain amount. Therefore, water can not have a use value. A use value assumes scarcity, hence, only economic goods have a use value.

According to Menger, the value of a good is the least desired satisfaction that can be obtained by a given quantity of goods.

The theory of labor value has been replaced by the theory of subjective value, which is based on marginal utility and productivity. Price in

the market is created through supply and demand, determined by a marginal buyer!

The basis for the theory of utility is the assumption of a rational (economic) being that in its choice seeks for the balance between effort and consumption on one hand, and benefits and pleasure on the other hand. After finding that utility was not measurable by comparing more goods (cardinal - measurable utility), it was assumed that it was not necessary to measure it, but it was enough for consumers to rank goods according to the degree of their desires (ordinal utility). That way, through consumer preferences was created the consumer demand theory: one combination of goods has more utility than some other combination of goods, and consumer will always opt for the purchase of the combination that provides higher utility in consumption.

Menger and Bawerk argue that consumer choice depends on the degree of importance of purchased goods for a given person, the level of saturation, and quantity of that good (the possibility of its production). There is a whole hierarchy of different needs for various goods. Saturation of some good reduces its utility. Additional purchase of a good increases its overall utility, but decreases its marginal utility (marginal benefit). The importance of goods is determined by marginal utility: the consumer will make the choice of goods (change the structure of goods) until their marginal utilities are balance. In the market economy, the price must correspond to the marginal utility of goods (the degree of its importance and saturation in the market).

Marshall harmonizes Ricard's theory of value and Bower's theory of marginal utility, stressing the fact that they both focuse on different sides of the same process - the formation of value (the effect of objective factors in Ricardo’s, and subjective factors in Bawerk’s). Marshall formulated the theory of mutual relationship between supply and demand, introducing a new term - the equilibrium price: " When the demand price is equal to the supply price, the amount produced has no tendency either to be increased or to be diminished: it is in equilibrium. When demand and supply are in equilibrium, the amount of the commodity which is being produced in a unit of time may be called the equilibrium-amount, and the price at which it is being sold may be called the equilibrium-price" Marshall (1920, p.31).

In his theory of demand, Marshall introduced the proportion of inputs as fixed. He adhered to the theory of distribution, based on marginal productivity, at least in the short term. In several sections of "Principles of Economics" he indicates that all inputs should be deployed to the point where the border product is equal to the marginal cost, in order to get the most efficient allocation of resources. The productivity of each factor is subject to declining yields. Marshall sums up his famous principle of substitution as follows:

"Every agent of production, land machinery, skilled labour, unskilled labour, etc., tends to be applied in production as far as it profitably can be. If employers, and other businessmen, think that they can get a better result by using a little more of any one agent they will do so. They estimate the net product (that is the net increase of the money value of their total output after allowing for incidental expanses) that will got by a little more outlay in this direction, or a little more outlay in that; and if they can gain by shifting a little of their outlay from one direction to another, they will do so.

Thus, then the users of each agent of production are governed by the general conditions of demand in relation to supply: that is, on the one hand, by the urgency of all the users to which the agent can be put, taken together with the means at the command of those who need it; on other hand, by the available stock of it. And equality is maintained between its values for each use by the constant tendency to shif it from users in which its services are of less value to others in which they are of greater value, in accordance with the principle of substitution"(Marshall, p. 320).

Marshall's analysis of labor yields is perhaps the most interesting part of his reflections on distribution. Job demand depends on its limited productivity, as well as the demand for any factor input. However, the conditions affecting the supply of labor differ in two market periods. Regarding the short term, Marshall adopted the labor supply theory, very similar to the one developed by Jevons. Jevons focuses on a cross-section of marginal negative utility of labor and marginal utility of real income (represented by the marginal utility of a monetary wage). As in the Jevons model, workers stop working when the marginal utility of their wages is equal to the marginal negative utility of labor. Although there are exceptions, Marshal believed in the general rule where job offer is positively linked to a work prize, both in the short and long term.

According to Marshall, the long-term work offer has been primarily driven by the cost of production. If true, wages should remain at the maintenance level, as presented by several theorists. However, knowing that wages in England were not at that level at that time, Marshall found it difficult to explain why wages were higher than the costs of maintaining productive labor. Therefore, he insisted that the spiritual and physical strength of the workers must be maintained. He identified three types of employee expenditures: for essential needs, for conventional needs, and for the usual comfort. The first type is the basic physical maintenance – food, housing, and clothing. The second type includes needs which are not essential for health and strength, but are socially necessary. The third type, the expenditures for the usual comfort, reflects Marshall's belief that tastes and habits of consumers, in this case workers, change over time.

Marshall explains profit and interest, yields of entrepreneurship and return on capital. Demand for capital, which is subject to declining yields, is its productivity, and will be used up to the point where its marginal value product is equal to the interest rate, in the long run; Assuming a perfect competition system, the real return on capital is determined by its production costs.

Payment of profits is payment for business ability, which is determined by the costs of production in a long run. However, there is an important detail here. In case of any production factor, the ability of a businessman is when demand becomes effective. A businessman represents demand or distribution of marginal productivity. But, nobody hires an entrepreneur. Actually, the whole society demands goods. In other words, the company assumes that demand is effective through offering prices. Although, the entrepreneur's skills may be partly inherited, in this case a part of rent yields, the skills are acquired, representing the production costs. Therefore, Marshall concluded that production costs determine the yield of all production factors, and their supply in the long run.

Marshall's analysis of the distribution greatly relies on his Anglo-Saxon heritage in this area, and is particularly similar to Smith's and Ricardo's understanding of these issues.

12.2 Equilibrium and welfare

Already in Adam Smith's statement on an invisible hand, we have been introduced to the idea that the market is not just a resource manage-

ment system, but it also works for the benefit of all participants. This formulation is vague and imprecise for two reasons. First, there is no explanation which forms of competition give the best results. Second, Smith did not explain what was the best for society. John Stuart Mill argued that the right measure of social welfare was a sum of utility. However, it remained unclear how to measure this utility in order to practically apply the concept. Alfred Marshall argued that the market equilibrium implied "maximum satisfaction". He also believed that some of the measures implemented by the state were justified, and nevertheless led to a deviation from the market equilibrium. Many economists have dealt with the issues of equilibrium and welfare, especially Francis Ysidro Edgeworth (1845-1926). He was a utilitarian, claiming that the total welfare should be measured by the merits of individuals; and the utility of individuals implies the complete satisfaction of needs, which comes as a result of consumption and activity. According to Edgeworth, utility is a meaningful term, although it can not be measured sufficiently. He explains: "We cannot count the golden sands of life; we cannot number the innumereable smile of seas of love; but we seem to be capable of observing that there is here a greater, there is a less, multitude of pleasure-units, mass of happiness; and that is enough" (Edgeworth, 2003, pp. 8-9). According to Edgeworth, utility is an increasing income function, but marginal utility is declining. The higher the income, the lower the benefit gained from the given increase in income. If a particular income is to be split between a certain number of people, and everyone has the same function of usefulness, the best distribution of income will be that everyone gets the same part. Because, if we try to deviate from this distribution, by taking one euro (€1) from person A and giving it to person B, we will get an increase in utility for person B, which will be less than the loss of utility for person A; this comes directly from the assumption of declining marginal utility. This leads to a decrease in total utility, so we can conclude that the best equality in income distribution within a society.

This theoretical approach entails a tough question: how do we know that utility can be compared among individuals? But Edgeworth believed that this could be achieved through mathematical formulation of social well-being, as a sum of individual functions. He has definitely made progress, because his utilitarianism is exact and explained by the application of mathematics.

Continuing the tradition of utilitarians, Edgeworth analyzed equilibrium of exchange, and made a significant contribution to the theory of utility by introducing the indifference curve. The marginal utility of a commodity decreases with the increase in the consumption of another commodity. He believes that the precondition of a perfect competition in an economy with many participants can be justified. Vilferdo Pareto (1848-1923) worked on issues of utility and welfare with a different view. According to him: "The ophelimity (utility, satisfaction, pleasure) or its index, for one individual, and ophelimity, or its index, for another individual, are heterogeneous quantities. We can neither add them together nor compare them. (...) A sum of ophelimity enjoyed by different individuals does not exist, it is an expression which has no meaning" (Pareto, 2014, p. 192).

Pareto has formulated a criterion of social efficiency or welfare. It is a concept of Pareto optimality, and it reads: "We will say that members of a collectivity enjoy maximum utility in a certain position when it is impossible to find a way of moving from this position very slightly in such a manner that the utility enjoyed by each of the individuals of that collectivity increases" (Pareto, 1909; 1971, p. 261). In a modern definition, Pareto optimality is usually presented as a situation in which one person's utility can not be increased without decreasing someone else's utility.

Pareto is especially remembered by the hypothesis of income distribution, based more on the empire than on theory. Pareto's research focuses on the personal distribution of income. Hence, on the income distribution between individuals in the society, regardless of the market factors from which the income was received. His work in this field has resulted in theory that the distribution of income between the rich and the poor is strictly defined as a kind of natural law.

12.3 New ideas and new answers on value

Two influential upgrades of the classical system (Marshall's) also appeared in the early 20th century; the first was just before the First World War, and the second was 20 years later. The first was by Joseph A. Schumpeter (1885 - 1950), an Austrian finance minister in disgruntled post-war years, an economics professor and, in many cases, the most romantic and most dramatic figure in the economy. In his "Theory of Economic Development" (1911) Schumpeter gave an important dimension to Marshall's equilibrium. It originated from the central figure of Schumpeterian system,

an entrepreneur who, with the help of bank loans, disturbed the equilibrium through new products, new processes or a new type of productive organization. There was a tendency to establish a new equilibrium – a new stability and, according to Schumpeter, in the circular course of economy, where production moves in one direction, and money in the other. This equilibrium will not survive, being disturbed by new innovators. Thereby, the economic life takes place, continues and develops, and that is the nature of economic life.

The emergence of an entrepreneur in the economy means a new participant in the distribution of income. He carries a specialty, has no resemblance with gloomy workers, parasite officials, nor with various bureaucrats; he is crowned with the halo of success and positivity in the economic system. Unlike capitalists, an entrepreneur does not bear the burden of Marxist guilt. An entrepreneur is perhaps the biggest Schumpeter legacy.

The second upgrade to the Marshall system was accomplished in the works of two economists: Edward Chamberlin (1899-1967) from Harvard, and Joan Robinson (1903-1983) from Cambridge. They criticized the classical system, especially Robinson, who was a fierce critic in general. Chamberlain and Robinson discovered a number of transient options between the general justification of competition in the classical system - where the producer neighter impacts nor controls the prices - and the justification of the monopoly in exceptional situations - where only one producer can determine the prices in order to achieve monopoly profit. Accordingly, a number of other situations create monopolistic competition. And somewhere between the competition and the monopoly there was a case of a small number of participants in the same group (oligopoly).

After their work, instead of assuming competition in a large sector of contemporary, increasingly concentrated economy, emerged the assumption of a monopoly or something similar to monopoly. Thus, it was no longer possible to count on the socially optimal price and the production of a competitive market. The entry of oligopoly and monopolistic competition into a classical economic school (also called neoclassical school), took place at a great, almost staggering speed. They have been studied to this day, with the rare exception of economists associated with the so-called Chicago School, who remained the loyal supporters of classical orthodoxy.

The Russian Revolution brings socialism. More economists, not only in Europe, but also in the United States, with dialectic precision turned to the revolutionary or reformist Left. At the same time, the most prominent representatives of classical orthodoxy in its purest form came from post-war Austria into the ranks of economic profession. Those were: Ludwig von Mises (1880-1973), Friderich A. von Hayek (1899-1994), Fritz Machlup (1902 - 1989), and others. All of them, especially Mises and Hayek, believed that any deviation from classical orthodoxy means an irreparable step towards socialism. A road to socialism is "a road to slavery," which would destroy the capitalist system. Compensation for unemployment, old-age pensions, and help to the poor, lead to socialist repression and, as a consequence, causes degradation of the human spirit. According to them classical poverty has no alternative. The monopoly, which was widely discussed, did not justify greater evil - government interventions. Nothing could hinder the market force and individual freedom[35].

The economic policy of Austria can be mentioned as a paradox. Namely, in decades after the World War II it had successful economic effects, but not in the economic policies advocated by representatives of the Austrian Economic School. Much has been attributed to a good social protection system, the balance between private and public ownership in banks and other companies, and the Austrian social market policy, which, as a form of fighting inflation, did not use harsh monetary and fiscal policies, but limits on wages and prices through negotiation.

In 1929, a severe failure of the capitalist system occurred, especially in the United States, where the discrepancy between the reality and the economic ideas that were accepted and followed by economic policy was clearly reflected. US and European economies have entered into severe depression, there has been a decline in industrial and agricultural production, falling consumption, massive unemployment, and misery.

The state intervened with direct measures, providing social assistance and employment through public works. However, the recovery of economic system went slowly, and after six years of crisis, 17% of the American labor force was still unemployed.

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[35] Mises even condemned the state's interference with drug trafficking.

Classical economics had no explaination for what was happening in the economy. It was simply considered that there could not be a lack of demand, and accordingly, there was obviously no reason for public intervention in order to increase demand[36]. Public funding starts from the fact that production creates demand; the inflow that comes from production suffices the demand in the economy. The government, like a household, lived within the assets it had - or should have. This also implied financial discipline, only central banks could lower interest rates, which they did in the mid-30s to encourage borrowing and investment.

From these circumstances came the work of John Maynard Keynes (1883-1946). The modern economy, he claimed, does not find the necessary balance in full employment, it can find it in unemployment, which is completely new to economic thinking. Keynes talks about the balance of unemployment. Say's law is no longer inviolable, simply because there is a lack of demand, which for decades has been a law that everyone believed in. Keynes opens up new perspectives, claiming that the government can and must take measures to overcome the shortage of demand.

The Keynesian Revolution is based on the demand for the state spending, which is not covered by incomes, in order to stimulate demand, while the balance of insufficient employment is possible[37]. The United States started with public works and other forms of employment in the public sector since 1933 with the famous New Deal. All this was more of a necessity than the acceptance of Keynes' economic policy. It was a political necessity, which was understood by then-US President, Franklin D. Roosevelt.

It was only later, thanks to Keynes's book "The General Theory of Employment, Interest and Money" (which could be compared to the publication of "The Wealth of Nations" in 1776, and the first edition of the "Capitol" in 1867), begun the rise of Keynesianism as a new economic system,

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[36] Soy’s law: supply creates its own demand. Therefore, demand is not an issue.

[37] It is interesting to point out that there were "Keynesians" before Keynes himself. One of them was Adolf Hitler! He launched a large-scale public works program in Germany after coming to power in 1933; he did not take into account the balance of government revenues, he borrowed and created a deficit in order to develop the German army. There were also the Skadin countries, which consistently practiced "Keynesianism" in their political actions.

which overcomes the inability of the classical economy to cope with the unpleasant occurrence of deep crisis.

The key issue of Keynes' economics is not the method of pricing, nor the method of revenue distribution. The key issue is how to determine the levels of prices and employment (i.e., the rate of economic growth). As production, employment and income increase, demand based on additional revenue increases is decreasing - according to Keynes' historical formulation, the marginal propensity for consumption is decreasing.

As in the classical system, savings and investments must be equal. Investments must neutralize savings. The difference is that these two categories are no longer necessarily equal in the conditions of full employment. In order to equate savings with investments and thus ensure spending, one must reduce revenue, and hence the scarcity. Thus, equilibrium in the economy is not necessarily achieved in full employment, it can be achieved at different levels of unemployment, and even at a very high level.

In the conditions of unemployment, with the previously described tendencies of savings and insufficient investments, the unemployed capacities had only one solution. It was an intervention by the state to increase the level of consumer spending - government borrowing and spending for the public purposes. Intentional deficit. Only this could disrupt the balance of insufficient employment through spending - voluntary spending – of unspent private sector savings. Here is a general fact: after the Keynesian revolution, the state will be responsible for the overall performance of the economy!

12.4 The idea of value exploitation

I am not a Marxist, but Marx can not be avoided when studying the creation of a value. Marx's works are the best literature in analyzing the link between politics and economics.

Marx’s political ideas made him a man with a greatest influence in the 20th century. Today, at the beginning of the new century, his theories and the conception of the world have been universally rejected: the political practice that has been constructed around his name is put in the ash heap of history. No one studies Marxism anymore; no one thinks that capitalism is a morbid system, and that socialism is here. In the eyes of a mass, Marx has been responsible for many bad events, especially for the crimes that marked

the end of the previous millennium, Nazism and Stalinism. However, I do not think that Marx's analysis of capitalism should be dismissed, because it represents his best contribution to economic and political science.

Exploring Marx's work for the sake of this book, I was amazed by the similarity between his and our era. The inequality between the rich and enormous number of the poor is at a similar level. Today, almost one third of the world population is living in poverty. Demographically, Asia is dominant, while the West is a bearer of scientific developments and discoveries. Technological progress is extremely rapid. Uncertainty grows. With the process of globalization, the market is expanding strongly, unstoppably, creating global production, and global trade. Human limits are constantly expanding, information technologies connect the whole world, and new technological wave carries nanotechnologies.

Capitalism brought remarkable progress, and Marx was aware of that. He wrote the most beautiful sentences about capitalism. Also, his projection of socialism, as a society into which capitalism would be turned into, was blatantly or incorrectly understood. His hypothesis was completely misinterpreted. Marx claimed that socialism would be established when capitalism develops globally, when it reaches the level of production and economy, in which the abundance of goods and services is created. Such productive economic possibilities open up the space for whatever they need, at least at the level of basic standard. Obviously, the project of socialism was long-term, requering probably more centuries to achieve it. Or a shorter time, given the rapid development of science. This production potential, created by the science, will enable the use of resources from the outer space. That is, definitely, a road to socialism.Then, it will be possible to talk about the abundance of products, which will enable resources that are not only from our planet. The "spirit of the world" could function at that level.

So, when Marx's work is freed from political shells and caricatures for political purposes, it reveals a great scientific structure. Marx gave priority to democracy, or evolutionary changes, and this is an aspect that also opens the totally opposite essence of political views on the transformation of capitalism in relation to the present explanations and misconceptions.

Marx's major discovery is the cause of surplus value, or the exploitation of workforce. Today, this cause is less taken into account. However, the surplus values, as the creator of inequality, is explained in a wider context,

(not only the surplus value as a product of labor, but also the surplus value which depends on different rents).

Economists distinguish multiple types of income. Generally, income can depend on work, or not. Rent is not based on income but simply on ownership over non-movable property. Economists now generally use the term "rent", not only as land annuities, but also for yields (e.g. "monopoly rent" in case of monopoly). Rent is basically a source of market exploitation, because, if it grows, the capital gains grow, too. Stiglitz believes that "a large part of the increase in inequality of income and wealth is associated with an increase in rent and capital gains, which is reflected in the rise in the value of real estate and the increase in market power (exploitation) in many sectors of the market economy" (Stiglitz, 2015, p.88).

Hence, land rent are not the only source of "rent" in most economies. A large part comes from the appropriation of wealth and other types of rent.

Increasing wealth by rents does not mean that the economy is richer - just the opposite. The rents are "capitalized", they appear through the value growth at the stock market. There is a redistribution from consumers to those who have market power. The paradox is that economic productivity is smaller, although the measured wealth has been increased.

Opportunities for exercising monopoly power have appeared in many economies through the history. For example, the economies of scale have caused the domination of a small number of enterprises in key industrial branches, such as steel production. However, economies of scale have not been affected in many industries (e.g. high rents in the oil industry). Simply put, it is a rough economic power. There is a concentration not only of economic power, but also of political power. This is an importan issue, especially nowadays. These types of monopolies have occured in the 19th century.

In the 20th century emerged some new sources of market power, linked to networking externals. Microsoft Windows fasilicated the work and collaboration by using a computer, with a dominant platform for personal computers. It was mainly used in software business (text editing and table spreading). Other areas were monopolized by certain companies, such as telephony and communications.

Acquiring market power is understandable behavior, and can be explained by standard theory: profits get lower in the competitive market

(i.e. they fall to zero, and that is not good for business). If there are no regulations, it is easier to survive on monopolies and the creation of market power. Unfortunately, this can be good for a small number of participants, but not for the economy as a whole. Monopoly profits increase monopoly earnings; the value of their property value will grow, but the losses will affect other parties. A typical example are the American banks during the recent financial crisis. Apparently, their wealth has increased, but the US economy today is in a worse shape than before, and losses have been shifted to taxpayers.

Thinking about the time when my system of economic knowledge developed, I notice the extreme actuality of certain issues with the time in which Marks wrote his famous Capital. Asia dominates in demographics, while Anglo-Saxon dominate in the economy; democracy and the market conquer the planet. Technology revolutionizes the production of energy and objects, communication, art, ideologies... changing their operational methods, reducing physical work, and improving the working conditions. Nobody knows whether the market is the cause to unprecedented growth, or is it the escalation of its contradictions. The inequality of the rich and the poor increases. Groups and movements, sometimes violent, are opposed to the globalization of the market, democratization and secularization. People rely on another kind of lifestyle, which liberates from poverty, alienation, and suffering. Brave men and women fight for freedom of speech. Capitalism is being restored, especially by reducing labor costs.

This is basically our reality. Reality and legacy of ideas are constituents of the modern man: the idea that poverty is unbearable, and life is worth only if it allows for the improvement of humanity (Judaism), the idea that a dream about liberating future of full love among people must come true (Christianity); the idea of rational thinking of the world (Renaissance); the idea that philosophy is at the forefront of all sciences, and that the state is the heart of every power (Germany); the idea that the revolution is a state of emancipation (France), while democracy, empiricism, and economic politics are pillars of society (England); the idea of universality of freedom (Europe)...

Many of these ideas have paved the path that mankind passes, dreams of, and strives for. I (as many others, and perhaps you) have dreamed of a better world. All these great ideas will not guarantee fulfilling our dreams and our aspirations. Unfortunately, the barbarians knew how to destroy great

ideas, and sometimes the ideas themselves could have slipped into barbarism.

Socialism is an idea that has experienced slipping, and falling out of a dream. It was based on Marxism. I do not feel any empathy, nor a nostalgia toward this unsuspectively finished Marxist idea. My first serious contact with Marxism did not happen in my youth, even though Marxism has marked my childhood. Perhaps it's really weird, or at least unexpected, that I did not marvel at Marxism, not even during the study of economics. Somehow, I was rejected by Marxist utopianism, not having the will to analyze it more deeply. The first serious effort to study Marx's work happened much later when I set my goal to study the most important economic vision, and to connect with real life and concrete events in history. Reading Marx in my native language, but also in English and French, I was getting more and more into his theory and views on the market, state, society, history, and philosophy. I was fascinated by precision of his thought, the power of dialectics, reasoning, analyticity, the power of criticism, the clarity of the concept. It was very important for me to find out Marx's views on: the market, pricing, production, exchange, power, injustice, alienation, trade, anthropology, weather, medicine, physics, property, and history.

Today, although aware of his ambiguity, I do not accept the conclusions of his epigons. I am interested in Marx’s works, Marx's spirit, Marx's unrivaled intellectuality, as appealing as the strongest magnet. In his youth he wrote the most popular text in the entire history of mankind, expressing his attitude towards money, work, women... He presented the dialectic of history, which we inherited directly from his lifetime, and in which he created his work. I was amazed by his artistic dimension. From early age I have been fascinated by beauty. I spent a lot of time drawing, painting, and creating my ideal of beauty. I was equally fascinated by science, democracy, progress and freedom. That's why I tried to understand Marx's contribution to these topics.

His intellectualism initiates multidisciplinarity in social sciences, and many economists understood it as a necessity. For example, this is what Pigu said about Marx’s approach to studying economic reality:

Appendix 7: Beyond economics

I moved from the Economy to Ethics and concluded that the justification of current state of society is not easy. A friend who read and studied

much of what is now called moral doctrines, said to me: "But I would not say when I switched to the political economy." So I read Milton's "Political Economy" and I was quite excited. There was a vague rightness of unequal opportunities, a little less inequality of material comfort. Then, during my holidays, I visited the poorest quarters of some cities, walking down the streets, watching the faces of the poorest people. After that, I decided to study the foundation of the political economy, as much as possible (Pigu, 1928, p. 10).

13. THE IDEA OF COLLECTIVISM

13.1 The concept of exploitation

Adam Smith, as well as David Ricardo, laid the foundation for economic science. Then came Karl Marx, a philosopher and economist, who gave a radically new description of economy. Marx started from the philosophical concept of exploitation. He thought that *The Disposition Theory* showed the superiority of philosophy over the theory of economics. He put philosophy "down to earth," seeing it as a social discipline, influenced by the environment and the circumstances of life. Marx did not view the society as a collectivity of individuals, who could live in a civil, peaceful community, and in given social conditions. Namely, the classics were oriented to individuals with microeconomic legitimacy of their behavior, where methodological individualism prevailed. Together with the historical school and numerous streams of different approaches in the German speaking field, Marx was an exclusive collectivist. For him, collectives were the basic units of studying the economics, also the widest possible: nation and class.

Marx's analysis of social classes and reflections on society resulted in the definition of *communism* as a social system that abolished the alienation of man, liberating the work with free associatons of manufacturers. Communism abolishes private property and liberates man in every way. This is because needs and desires are lost, that is, their egoistic nature is lost. According to Marx, communism is a genuine solution to the antagonism between man and nature.

In his youth, Marx came to the concept of surplus value. At the same time, he studied the philosophy of mankind and the state, as well as their relationship towards economics and ownership. One of the main areas of his work was politics, its history of influence on economic conditions and economic development, and vice versa. The essence of his work was the materialistic theory of history.

Value, market, and exchange were unavoidable topics in Marx' work. He began to discuss these issues in 1847, when he was 33 years old, in relation to the abolition of the British law on cereals, which protected English agriculture. He explained why free exchange and market liberalization are desirable: the acceleration of capitalism development and globalization opens the path to socialism. This situation is more favorable for workers, and therefore the capital growth should be accepted. In general, Marx claimed that the protectionist system was conservative at the time, although free trade was hazardous for English agriculture in the short term. "The spirit of the world" has perceived socialism as a universalization of the market.

In "Wage Labour and Capital" (1847), Marx for the first time set the main draw of his theory of surplus value. It is an idea that capitalists take on the value created by workers, paying them not more than they need to survive. "Wages, therefore, are not a share of the worker in the commodities produced by himself. Wages are that part of already existing commodities with which the capitalist buys a certain amount of productive labour-power. Consequently, labour-power is a commodity which its possessor, the wage-worker, sells to the capitalist. Why does he sell it? It is an order to live." (Marx, 1973, p. 35). Labor force as a commodity is sold and purchased on the market. It has, like any commodity, value and usable value. Its use value consists in the ability to perform certain functions in the production process, and its value is determined by the amount of foods needed by the worker to survive. The worker in the production regularly makes more than the rent value. The worker's day is divided into the necessary work (in which the value of the labour-force is reproduced), and surplus labor (in which the advanced capital is propelled, creating a surplus value for the capitalist). Therefore, the relationship between labor and capital, according to Marx, is exploitative. The desire of the capitalist to increase wealth leads to a sustained accumulation of one part of the surplus value and its addition to the capital, which is in function. Thus, increasing the constant capital (c) in relation to the value of variable capital (v) increases the organic composition of capital (c + v), with the aim of achieving extra surplus value.

Workers produce more value than they get. Marx distinguishes "absolute form" and "relative form" of surplus value; "fixed capital" and "variable capital". This is a concept that still forms an important basis of contemporary economic thinking.

"The Communist Manifesto" (1848) will become the text that is most pronounced, the most interpreted, and the most read, to our day. In this work, Marx has shifted his views into a more complete concept of materialism, where the class struggle is the main motor of history, and the proletariat is the creator of a new society. That is the beginning of scientific socialism, but also the political action to conquer power. Here Marx writes: "The history of all hitherto existing society is the history of class struggles". In capitalism, the society is divided into two great classes which are diametrically different: the proletariat and the bourgeoisie.

The division of labor resulted in the enrichment of mankind and the emergence of social classes. Political power, strictly speaking, is a power that allows one class to exploit the other.

According to Marx, the bourgeoisie played the revolutionary role as a driving force of the productive potential of mankind, going beyond feudal isolation and having an advanced character.

At the time of maturing the Marx's theory of historical development, Clausius published the Second Principle of Thermodynamics, according to which the entropy of an isolated system is not equilibrium, but time strives to reach the maximum. He provided a theoretical basis for an idea that the whole reality is organized in a way that is condemned to degradation. Marx paralelly worked on the theory of the inevitable entropy of capitalism. Thus, the idea of irreversible degradation of society appeared at the same time as the idea of irreversible degradation of matter.

Marx gave a scientific analysis of the capitalist production mode. He particularly pointed out that economists' papers lack the explanation for the profound nature of wealth production, as well as the connection between economics and politics. The transition of capitalism to communism depends both on economic and political circumstances. This is achievable using institutions of democracy to establish the power of the majority in the party game. According to Marx, parliamentary democracy must be protected, even if the social majority is not a political majority. However, the most sacred freedom is the freedom of thought.

To consider the main issue, the surplus value, is to consider the relationship between capital and labor, between economics and history, between politics and society. Through a philosophical interpretation of alienation, Marx came to the capitalist theory, the world capitalism, based on a detailed

analysis of the capitalist production mode in "The Capital". A part of it is the analysis of money, as a measure of value and means of exchange, which allows the emergence of world trade and the world market. In this analysis, the main economic variable is work, and not the price - as economists before Marx thought.

So he came to the concept of capital. The basis of the theory is a surplus value, which explains the crisis of the capitalist functioning: the worker does not sell his work time, but his workforce. The engine of history is the development of productive forces, that is, the science. In the capitalist production mode, antagonism is created due to the appropriation of surplus value by the capitalists and the creation of wealth.

Technology accelerates the universalization of capitalism: on the one hand, capitalist production creates a universal industry (in other words: labor surplus, work is a creator of values), and on the other hand, technology creates a system of global exploitation of natural and human resources, a system of general utility whose fundament is the science, as well as all other material and spiritual qualities.

Marx points out that the economic struggle must continue as the political struggle, but with the constitution of the proletariat as an autonomous party. Conquering political power is the first task of working class. Thus, in his opinion, it can be ensured that the economy, not politics, manages the economy.

The main driver of society is the development of production forces. Production forces are conditioned by technology and natural resources. They partially depend on the opportunities outside the economic system as such, but also under the influence of human activities, such as inventions, conquests, and colonization. Every development degree of production forces requires an appropriate production relationship, a particular organization of production, based on specific property relations, and institutions that decide on the distribution of income and the power of decision-making. The relation of production is an economic system, in modern vocabulary. The economic system is reflected through an ideological upgrade, whose purpose is to justify the given production relationship.

In his paper "Wages, Price and Profit", Marx presented a relationship between work, exploitation and capital: "The labour is by nature in a weaker

position with respect to capital. The work is by nature more perishable than other goods. It can not accumulate. "(Marx, 1973, p. 35)

Unlike capitalists who can afford to store the products of their own factories, a worker who has not sold his workforce for a certain day definitely loses that value. Political action is needed for a radical change of society in order to establish a market order.

Marx rounded off his concept of capitalism in his great work "The Capital". It contains three basic thesis:

1. Behind seemingly objective economic relations are, in fact, social relations
2. The source of capital gain is the exploitation of labor
3. The internal opposites of capitalism lead to its collapse.

In three volumes, on two and a half thousand pages, Marx developed an exstensive and detailed theory of the production process, the circulation and division of capital. It was an explicit theory of economics, which at the same time represented the theory of society and the prognosis of historical development.

About the contribution of The Capital to Economic Science, Marks writes in a letter to a friend in Hannover, right after the first volume was published: "Every child knows that a nation which ceased to work, I will not say for a year, but for a few weeks, would perish. Every child knows, too, that the masses of products corresponding to different deeds masses require different and quantitatively determined masses of the total labor of society. This is necessity of the distribution of social labor in definite proportions cannot possibly be done away with by a particular form of social production but can only change the form in which these laws operate. And the form in which this proportional division of labor operates, in a state of society where the interconnection of social labor is manifested in the private exchange of individual products of labor, is precisely the exchange value of these products. Knowledge is required to discover how the law of values is being implemented ... This was not provided either by Smith or Ricardo who, influenced by the Isaac Newton’s causality, simply thought in the context of quantitative categories and fixed essences." (Hosfeld , p. 186).

For Marx, the economy is not explained by exchange but by production; not by visible, but by invisible. The products of labor are not

commodities until they are recognized as such, through exchange. It is a law of value or a general law of equal value.

Each commodity has usable value, exchange value, and the price. The usable value of an object is its utility for its user; it does not float in the air, it depends on the properties of the object (commodity).

The exchange value is expressed primarily as a quantitative relationship, as a proportion in which the usable values of one type are exchanged for the usable value of another type. That relationship is constantly changing with time and place. It is measured by the time of production.

The reality is not explained by the price, but by the relations between the exchange values. The price is determined on the market: it varies around the exchange value and affects the companies to manufacture in dependence of demand for usable value. The exchange value is realized through money as an instrument, or through the general equivalent of value.

Karl Marx "borrowed" from Adam Smith and David Ricardo the idea that the exchange value of some commodities is measured by the time needed to manufacture that commodity (i.e. "past labor", invested in producing machinery operated by workers, and "present work", used directly for the production of objects). That's the value of labor.

Marx refers to Smith and his labor theory of value. In "The Wealth of Nations" Adam Smith says: "The annual labor of every nation is the fund, which it supplies them originally with all the substitence which they consume in the course of the year, and which always consist either of the immediate product of this labor, or in articles bought with this product from other nations " (According to Smith, 1978, p. 98). He also writes: "Labor, therefore, it appears evidently, is the only universal, as well as the only accurate measure of value, or the only standard by which we can compare the values of different commodities at all times and at all places" (According to Smith, 1978, p. 101). Adam Smith's discussion was given a large part in the Theory of Excess Value, published from the legacy of Karl Kautsky (1905 – 1910), and which sometimes refer to as the fourth volume of "The Capital". Marx criticized Smith for his theoretical illogicality and contradictions, as well as David Ricardo, who also belonged to theoreticians of the labor value. According to Marx, their contribution was incomplete, partly due to the unresolved circumstances in which they lived, partly due to the methodical

limitations of their theoretical implications, and partly due to the limitation of their civic horizon.

Such a view was also determined by his methodological approach. Here is a key quote: "The economists of the 17th century, for example, always begin with a living whole, the population, the nation, the state, more states, etc.; they always end, however, in such a way that they discover a few defining, abstract, universal relationships, like division of labor, money, value, etc. As soon as those individual (conceptual) moments were more or less fixed and abstracted, the economic systems which ascend from the simple (and) exchange-value, up to the state, exchange among nations and the world market, began (to be formulated). The latter is obviously the scientifically correct method. The concrete is concrete, because it is the sum of many definitions, (and) therefore a unity of diversity. Hence the concrete appears in thinking as a process of summarisation, as the result rather than a starting point, although the concrete is the actual starting point and ence also the starting point of perception and conceptualization." (Marx, p. 21) His presentation in the Capital did not begin with general terms such as population, division of labor or production branch, which, according to him, represent only a chaotic, unsystematic whole without meanin. Under the influence of modern biology, discovered at his time, Marx first devoted himself to what he considered to be the model of micro-anatomy, a cellular form of contemporary reality: the commodity. Namely, at one of the first abstract levels, capitalism was, above all, a perfect market economy, permeating the entire life of the society. While his predecessors saw something like some fixed content in the commodity, for Marx it represented an elementary, undeveloped form of unity of all capitalist complexities and opposites. Therefore, the overall economic system and social system, corresponding to the economic system, according to his central hypothesis, could be adequately explained only on the basis of "immanent contradiction of commodity and its development into money and capital". (Marx, 1978, p. 21).

Let's repeat: Marx's main discovery, for which he had long worked and did not publish it for a long time, was presented in the "The Capital": "The worker does not sell the product of his work (the object that he produces), but the freedom that a boss possesses his labor during a certain times. The worker is, therefore, the partner of a contract, the type of legal fiction, with the capitalist against the rent of labor" (Marx, 1978, p. 127). Marx wrote in an extremely powerful way: "Suppose that a capitalist pays for a day’s

labour-power at its value; then the right to use that power for a day belongs to him, just as much as the right to use any other commodity" (Marx, 1978, p. 129).

Marx then articulates what is the key to capitalism, the way in which wealth is created and what links economy and politics: work is commodity like every other, but it has its specialty, since its exchange value and usable value are measured by the quantity of labor. Nobody exposed this before: one worker can produce more than he costs. This usable value is greater than the exchange value. The difference - measured by the hours of work - between the cost of worker's labor and what the capitalist pays for his labor is a surplus of value that is inherent in capitalism. It is a measure of the exploitation level. Marx describes it, using a mathematical metaphor, as the "difference" of capital-money increase. The capitalist appropriates this surplus value in the form of industrial profit, trade margin, interest or financial rent.

Surplus value allows creating wealth from nothing, by the worker. Capital accumulation creates preconditions for the application of new technical and technological achievements, which leads to an increase in productivity of labor, a decrease in production costs, and an increase in surplus. Capital accumulation leads to the process of the capital concentration, in the conditions of free competition. However, the process of capital competition comes as a result of the small capital merging, that is, taking over by large capital, called centralization of capital.

Marx sums up this in a striking formula: the capitalist must buy commodity at its true value, he must sell it according to its value, and at the end of the process he must extract more value from the process of circulation (transformation) than he invested at the beginning. No one before Marx realized that "all elements of capital, without exception, appear (wrongly) as a source of surplus value."

Marx did not at all cast doubt on the productive achievements of capitalism; on the contrary, he praised them the most. The sensitive issues in the capitalist system and their interpretation were: 1) distribution of power - which classical economists ignored effectively and universally; 2) markedly unequal distribution of income, explained by the classical tradition, but for which it never found a completely convincing justification; 3) sensitivity of the economic system to crises and unemployment – in modern vocabulary:

depression - something that, if classical economists acknowledged, has never been embedded in their theory. The tendency of the economy, as noted in the classical structure and already mentioned, went towards the full employment of its productive assets; 4) monopoly, a defect recognized by the classic tradition.

For Marx, the power was an inevitable fact of economic life; it stemmed from the possession of property, and, naturally, it inherently belonged to the capitalist. "The money-owner now strides out in front as a capitalist; the possessor of labour-power follows as his worker. The one smirks self-importantly and is intent on business; the other is timid and holds back, like someone who has brought his own hide to market and now has nothing else to expect but a tanning"(Marx, 1978, p. 176). A less metaphorical, worker, including a child, as Marx often mentioned, comes to the factory without having anything to sell except his physical effort, and has no other alternative but to be there. Hence the power of the capitalists and the helplessness of the workers. However, unequal distribution of power does not belong to the original capitalism. Marx pointed out the earlier connection of power with feudal, aristocratic and land-owned classes.

According to Marx, the key fact is that the capitalist holds the power, which is the natural attribute of productive ownership that capitalist possesses. All the payments resulting therefrom require the obedience and submissiveness of people who do not have ownership and therefore have no alternative income.

In addition, the capitalist's power is not limited to the enterprise. It extends to the society and the state: "The executive power of the modern state is nothing but a commitee for managing the common affairs of the whole bourgeoise" (Marx, 1964, p. 21). This bitter thought refers even to economists and political theorists, who describe and interpret the system, and to the classical tradition in the economy itself. "The ideas of the ruling class are in every epoch the ruling ideas, i.e. the class which is the ruling material force of society" (Marx, 1964, p. 57). In Marx's time those were capitalists and people who talk about their system.

This theorizing favors the dominance of politics over economy. Politics always had the power to "bring economists under the authority of the ruling power" (Galbraith, p. 99).

13.2 Exploitation and state regulation

Marx characterized the capitalist state as a spiritualist-democratic illusion in the function of exploiting the working class. He points out: "By the mere fact that it is a class and no longer an estate, the bourgeoisie is forced to organise itself no longer locally but nationally, and to give a general form to its mean average interest." Later he wrote: "Through the emancipation of private property from the community; the State has become a separate entity, beside and outside civil society; but it is nothing more than the form of organization which the bourgeois necessarily adopt both for internal and external purposes, for the mutual guarantee of their property and interest." Then: "Since the State is the form in which the individuals of a ruling class assert their common interests, and in which the whole civil society of an epoch is epitomised, it follows that the State mediates in the formation of all common institutions and that the institutions receive a political form. Hence the illusion that law is based on the will, and indeed on the will divorced from its real basis – on free will." (Marx, 1964, pp. 66-67). This view on the state necessarily had to stem from Marx's new paradigm of upgrading basic historical materialism.

The state, even in parts, was not a neutral and positive creative legal order, according to Marx. And the teaching of the division of power remained the only ruling idea, elevated to the level of important laws, in a transitional period in which the monarchy, aristocracy, and the bourgeoisie fought for the power. In Marx’s oppinion, all political struggles were nothing but a form of social conflicts, while democratic state with its emancipatory slavery was only a spiritualist-democratic illusion. Marx did not give a consistent form to this theory. In "The Origin of the Family" (1884) Engels has written almost the same words, repeating Marx’s attitude on the state. He will repeat even the thesis of *spiritualist-democratic illusion*. In a democratic republic, he said "wealth exercizes its power indirectly, but all the more surely," especially with regard to general voting rights.

Smith's "Wealth of Nations" was published in 1776, that is, prior to the Industrial Revolution. "The Principles of Political Economy and Taxation" by David Ricard was published in 1817, when the Industrial Revolution was still in its infancy. The theoretician of this overall overthrow was, in fact, Marx. His "Capital" was a fierce discussion with these two classics of economics. To use the words of Immanuel Kant, *he found himself in the middle of the fog instead of being able to view it from the outside*. Therefore stood

this grandiose insight, sometimes almost inevitable, with the irrational expectations of salvation, especially since, from other sources, it was transposed to a powerful time machine that hit Europe and the world. The antinomy of his thinking has led him, first and foremost, to declare the unsolvable contradictions that can prove to be solvable in the public *trial and error* process. However, this does not mean that the contradictions, discovered by Marx, did not exist in the modern world.

13.3 Where is the idea of collectivism today?

In 1883, the world was full of promises: democracy spread, globalization also, technical progress simply exploded. True, that is still happening. Therefore, the foundations of Marx's theory seem to have been overcome.

It is impossible to define social classes; the bourgeoisie and the proletariat are no longer two absolutely opposite groups; workers are divided into smaller groups; some of them became shareholders; managers are running businesses, although they are not owners, but they take a part of the profit; innovators and artists are also in that story... Knowledge becomes an essential capital; those who have knowledge get a significant part of the profit, therefore it is impossible to measure the production costs of an object using working hours needed for its production. Finaly, the surplus value measurement is increasingly uncertain.

Despite this, Marx's theory of globalization has been confirmed. We are participating in the explosion of capitalism and the crushing of traditional society, the strengthening of individualism, the apparent pauperization of one third of the world ... At the same time, the concentration of capital is getting stronger; there is delocalization and strengthening of the world market, with all the uncertainty, fetishization of goods, creation of wealth, spreading of financial industry with all its threats ... Marx has foreseen all this. He has also foressen the decrease of the labor costs, the profit rate becoming the main goal, protected and increased, while wages increase slower than productivity, and the state increases its ownership share.

Today, it is obvious that globalization is unstoppable, so it is likely that all these tendencies will continue. Since the globalization process has no direction at the world level, it will aim to reduce labor costs, first of all, through delocalization, but also through automation of services. Everything be-

comes a commodity, even humans. The tyranny of *the new*, as well as the consumption fetishism, of which Marx spoke a lot, arise in new ways.

After transiting to commercialization of social relations and the use of all resources, capitalism could open the space for a global socialism, if it does not destroy humanity. In another words: the market could open a space for fraternity. This should revitalize the principles Marx dreamed of when he wrote about universal socialism: volunteerism, the art of "work," and not "production". Consolidation and voluntary goods ("essential goods") at disposal. Through responsibility and voluntarism, all people will become citizens of the world, and the world will finally be the measure of a man.

Opinions on Marx's scientific results are divided. In the eyes of Joseph Schumpeter, Marx was a top-level economist; the philosophical origins of his learning are something that could not be neglected, given his thorough research (Schumpeter, p. 78). Thomas Nipperdey said that political eschatological perceptions in terms of the economic and social phenomena of the industrial world have made Marx a visionary. He was not only a theoretician of equilibrium and the theologian of the market – for which he was highly valued by the financial magnate George Soros. According to Charles Taylor, Marx's fundamental scientific discovery was that he saw in capitalism the most innovative and the most creative, and the most devastating at the same time, economic order in the humanity industry. But Taylor maintainted, "He should have remained satisfied with this insight instead of losing himself in the hope that complex chaos could resolve itserlf into a new harmony and simplicity" (According to Hosfeld, p. 135). Richard Sennet supposed that "Marx’s vision of fleeting *modernity* also had something to do with his origins in a world of Bieder meier tranquility and the nostalgic feeling for the ancient rhytms of the countryside that still lived within him, as was especially vividly demonstrated by his familial Sunday excursions to the hills of Hampstead Heath, singing songs an reciting Shakespeare."

It seems that the world did not end up as the great economists of the classics imagined it, as presented in the several introductory chapters of this book. The discrepancy between ideas and theoretical constructions and reality may the best illustrate Marx’s work and the circumstances in which he created his great theoretical work.

Appendix 8: The idea-reality paradox

The first Marx’s texts on the topic of "reflections of a young man on the choice of a profession", give the clearest picture of the life path that he had chosen. At sixteen, Marx noticed a conflict between the definition of "ideal" and the definition of "material" in man's life. He wrote that the chief guide which must direct us in the choice of a profession is "the welfare of mankind and our perfection" (Marx, 1964, p. 35). Led by the ideal, Marx chose to study law (Bonn), respecting his father's desire to become a lawyer. At the beginning of the study, he borrowed money from people, because he was spending more than his father was sending him. Except for food, he spent on drinks, books, and balloons. That was the beginning of Marx's extremely complex relationship towards money, which he loved and hated, and which led him into illness. That is how his "forced labor" for life begun. Thus, work and exploitation were the topics in almost all of his works. Seeking for his ideal, Marx decides to abandon law and enroll the philosophy studies in Berlin. His was constantly short in money. He got his doctorate degree in philosophy. He failed to become a professor because of his political views he expressed in his articles. He had to leave Pruss and move to Paris. He had some money savings from his parents. In addition, he earned working as a journalist, writing for a magazine. So for the first time in Paris he had solid incomes. He rented a large apartment and paid a housekeeper. But good life did not last long. Marx's family soon fell into poverty. Living in London, where the family had to evade, they were on the bottom of poverty, almost till Marx's death.

14. DEVELOPMENT OF THE STATE AND POLITICAL FORMS

14.1 Introduction

We have seen that democracies usually suffer from bad norms brought by ignorant politicians, who are often willing to make concessions to interest groups and give in to the pressure of the voting population. This is not surprising. We know that the world is imperfect and that politicians are humans like everyone else. We know that even in the procedures to which they are elected, honesty is not relevant. In fact, the behavior of politicians is aimed at ensuring the popularity and reputation needed for their selection and re-election. In many cases, loyalty to the party is essencial, resulting in a negative impact on the law quality of the law. In short, dictators are prone to behave rationally and set laws in order to improve their own well-being. However, the outcome of legislative processes is not always counterproductive or disastrous. Many standards are in line with community interests.

Honestly speaking, this is not enough, because nothing guarantees that the rules will be implemented correctly. This is impacted by circumstances. Often, corruption is involved in interfering with the implementation of a legal act, which increases the cost that a citizen must bear in order to implement a legally defined procedure. It is not only a matter of corruption. Sometimes it is a matter of avoiding responsibility; public officials often deliberately delay or multiply decision levels. In many cases the bureaucrats adjust the rules to their views and demands, encouraged by discretionary decision-making, in accordance with man's natural aspiration for prestige and authority, in order to advance in their careers.

Only the judiciary can undermine the credibility of legal rules. It is logical that credibility depends on the implementation characteristics, which include openness and transparency, but also from the interpretation of the meaning of legal rules. Based on their own judgments, the judiciary may adapt to specific circumstances. However, if cases are qualified as "specific",

the application of the same rule can generate different outcomes, which leads to the uncertainty of their change. As legislation is increasingly impacted by the political exchange of services and compromises, this issue gets more complicated. This leads to unclear texts in the law, and even possible loopholes and inconsistency. Such a practice creates a broad ground for interpretation, which complicates relations between judiciary and legislation. Judiciary and legislation evolved with state development.

The state, whether created by violence or by peaceful means, is based on social contracts. Irrespective of its origin, the starting point for the state creation is that it helps people to achieve their own good.

The majority is usually for a wider government. In a system where collective decisions are made by voting (and not by influence, inheritance, etc.), which is the case in democracy, the majority wins, so their interest is to expand the state, because it transfers wealth from the rich to the poor. The state, regarding its origin *de facto* is primarily a historical incident that the society needs to adapt.

People create the state through social contracts, giving it the authority over themselves. They expect that the state would turn the general conflict into a general harmony. It is one of the theories that explains why the state was formed. According to the second theory, the class of owners must have the state as a necessary instrument of rule. In a way, the source of the state political power is the economic power that the ownership gives to the ruling class. The state is inclined to combine two powers, economic and political, but there is also an instrument to control them, and that is democracy.

14.2 The social contracts

In the 15th century there was a proliferation of the market, and rise of the trading class. The market was required by the state, so the development aspect of that period (15th-18th century), in addition to the market development, was characterized by the state development. However, that process lasted long, until the unification of Italy (1861), and Germany in Versailles, ten years later. This was preceded by the collapse of feudal and always dueled high nobility, as well as the appearance of princely and city authorities. The nation-state marked the end of a long process. "With the rise of the nation state, there has been a close, even intimate connection of power

and trade interests" (Galbraith, p. 27). The fact is that traders "supplied the state with economic resources, which fed its internal and external power" (Galbraith, p. 27). Thus they helped to establish the state power, and then fortified it. The state, in return, implemented the policies for the well-being of traders. Even the religion was adapted to the state, that is, to the merchants.

For the first time, wealth has become a virtue, and getting rich was no longer banned. As traders were influential in the country, there was a strong confidence in state interventions in the economy. According to traders, the primary goal of personal and state policy should be the accumulation of gold and silver - material wealth, which should always be directed by every personal effort and public regulation. "It's always better to sell goods to others than to buy goods from others, for the former brings a certain advangate, and the letter inevitable damage." (Joachim Becher)[38]

14.3 The state and the market

In this chapter, we analyze the relationship between the two main pillars of economy: the state and the market. A fragmented analysis of individual periods in the economic development of the world can not give a complete answer. It can be obtained in a holistic view of history, and not in the consideration of a given moment or certain fragments of economic reality.

Innovation, entrepreneurship, and technology prepared the ground for the creation. Twenty centuries BC, on the shores of the Mediterranean Sea, between the great empire, emerged the first hints of trade and democracy. After that, a trade order would also arise with a new era. We are still living in that order and we will, undoubtedly, for a long time. This order has had, among other things, an essential characteristic that has been present through the entire history of development – the affirmation of individualism, and the human right on an absolute ideal. In the period of Greece, the trade order was only a tiny parasite within the great empires, which would share the world among themselves for the centuries to come. This order will later lead to the market and democracy (15th century), with the development of capitalism. The given process was not painless, on the contrary - there was

[38] A German supporter of mercantile thought.

often violence and injustice included, but it was improving, along with all the more advanced technologies. That order was often concealed due to the many turbulences that are still taking place today. It continues to develop persistently, triumphing with the ideal of freedom for all or, at least, for those who are determined and courageous enough to conquer it. Thus, the capitalist exchange system has been implemented, it created the market, and the market created the state; first the democracy and then the state.

The market allows the creation of profit and wealth. Profit and wealth breed crises. As long as everything is fine on the market, the bank mechanism is functioning, the present time is credited at the expense of the future. With a disturbance of the system comes crisis. What happens? Entrepreneurs are incapable to react because they are bankrupt or are on the verge of bankruptcy, banks as well. People tend to reduce spending, closing businesses, markets crush more and more, in short - the crisis is manifested in full force. Since the 19th century, when the crisis of a market society began for the first time, the state was under the pressure of dissatisfied citizens, forced to intervene. The state interferes with the economy and seeks to stop the chain reaction - lending money to the banks. To do this, the state must make its own bank, called the central bank, and through which the money is borrowed to the bankers in the crisis situations. In order to do this, the state must have monopoly on printing money. That way was created the state's privilege to have an exclusive right on printing banknotes and disposing money. In order to avoid panic situations, the state is forced to take additional measures, for example, to guarantee the savings of citizens (to a certain extent). In this case, private businesses and banks justify the state intervention, but in most other situations they feel that things would be better if the state did not interfere with their affairs. Obviously, when things go downhill, the country is required to impose banking rules, so that the evil does not recur. However, in order to avoid a collapse, the state should impose a discipline on the banking arm, so that it would not discredit a higher value from the future, than the one that can be produced in present time. This goal is contradictory to the previous one.

While the states impose rules on bankers to limit their tendency to give loans in good times, bankers find ways to redirect these rules, contrary to the general interest. And since bankers have more economic power over political factors of state institutions (which, supposedly, control the bankers)

than ordinary citizens, the attitudes of the bankers have the tendency to predominate.

This leads to collapse situations, and then politicians, instead of saving banks they save the bankers. Therefore, it is not recomended that the state takes from the poor citizens in order to help the rich. But it is reality, because politicians that way return the financial support they lended from the banks for their election campaigns. It is the so-called "hot" connection between politicians and bankers, which is somehow toxic to the rest of society.

Let's go back to this contradiction. During the economic prosperity, entrepreneurs and bankers are against the state. They are accused of being an obstacle to development, as *a parasite that is sucking the economic blood*, through taxation, more precisely. They strongly oppose every essential influence of the state on the social economy.

The first reason are the government restrictions, and the fear that the state will intensify these restrictions to the private debt that banks may create (lending from the future). This clearly means that their profit is being reduced, because without private debt there is no private profit. The second reason is the fear that the state will increase taxes, because the state has social costs (e.g., health-care, education, culture, etc.), and logically the richest are taxed more than others.

Bankruptcy and crisis completely change the attitude - in this case, they require help from the state, avoiding obligations towards society. Additionally, they *forget* that the state is an instrument in their hands to build up their surplus. Namely, powerful individuals could not be enriched without the state power. This was also the rule in the first market economy in Great Britain, and later. When capitalism came to Britain, farmers were expelled by the ambassadors, with the help of the state. Simply without the state power (police, army) it was not possible to acquire wealth on one side, while huge majority was starving in Manchester, Birmingham and London.

Support for the rich did not come only through the state power. The same country built irrigation channels, without which field and factory products would never find a way to the markets. Poor, miserable people were living in primitive buildings in order not to disturb the ambience of the "fine" world. In hospitals and schools the future workers were learning to read and write so they could provide more exchange value to their employers.

The wealth was produced with the support of the state, by workers, inventors, civil servants, and entrepreneurs. But the wealth was accumulated in the hands of the most powerful people: a) who claimed that wealth was created exclusively thanks to them; and b) who resented the uncorrect state for taking away "their" wealth through the tax system.

What happens next in the context of power? Since the rich and powerful people largely influenced the authorities (they also controlled it), it has become a steady aspiration to reduce taxes and contributions in relation to government expenditures. They demanded from the state to provide them everything that we have mentioned, but they did not intend to pay appropriate taxes for it. As far as employees were concerned, their wages were high enough to feed themselves and their children. But they were not able to pay taxes. The result was the state debt! This difference between revenues (tax collection) and costs created a public deficit. In order to cover the deficit, the state was forced to borrow from the private persons, from those worst kind – the bankers.

No matter how much they demonize the state, the private entrepreneurs cannot prosper without the state, they depend on it, but they do not want to finance it. "In fact, wealth was *always* produced collectively and privatized by those with power to do it: the propertied class." (Varoufakis, 2015a, p. 75).

The state is an instrument of the powerful people in preserving their wealth. The debt and the state monopoly over money is the source of power for the powerful people.

14.3.1 The forms of the state and the market development

Let’s go back to the historical development of state and capitalism. After the first democracies in the Mediterranean (12th and 13th centuries), the creation of a trade order continues in Italy, Holland, and France. In the new cities a free thought is born, while religious and military power gradually lose control over economy and politics. The new ruling class is made up of merchants and bankers; it deepens the Judeo-Greek ideal, creating freedom of creation, exchange of knowledge, and enrichment. The market is developing, but it requires a strong state to establish the property right. A trade order speaks only one language: the language of money. At any time is organized a unique form, around a single center, which becomes a unique

heart for all who belong to the creative classes of shipowners, industrialists, traders, technicians, bankers... The creative class is characterized by the tendency towards the new, and the passion for inventions and discoveries. Mostly due to the nature of a trade order itself, there is a replacement of one center to the other. This nature is recognizeable: competition on the market requires newspapers and elite choices. The city is the heart of capitalism due to the greater stability, which allows the accumulation of capital, and that can not be performed safely and in the long run, except within companies or families. Competition and rivalry are often accompanied by violence.

Each city, or the center, takes control of everything within its frameworks and beyond them, if possible. It takes over the most efficient energy resources and the fastest means of communication. All centers have spacious territories on which agriculture develops, as well as communication and cooperation with large ports through which they export the products. The basic power of city centers is a creative class, being the most capable to raise funds for creating new products and services and commercializing existing ones. The creative class has the capability to manage capital, determine prices, accumulate profits, finance research, underpin the army development, and promote ideology, which enables its survival.

Each center develops its own trading form, which lasts as long as the resources are available. The center attracts those who are able to work creatively: engineers, merchants, bankers, shipowners, soldiers, artists, intellectuals ... As forms change, the production of agricultural and then craft goods is being industrialized. Due to changes in form, slavery disappears and paid work arises. Also, the production of energy and information are automatized. However, with changing forms, wider fields of individual freedoms, markets and democracy are changing, too. Greater freedom is created for consumers and citizens, but the alienation of the workers is increased.

So far, a trade order has experienced nine successive forms[39]. The cities-centers are: Bruges, Venice, Antwerp, Genoa, Amsterdam, London, Boston, New York, Los Angeles ... The forms of dominant service provided are: food, clothing, books, finance, transportation, home appliances, communication, and entertainment. Technologies that extend the trade area are: rudder, caravel, printing, accounting, float, steam engine, internal combusti-

[39] 2See more Attali, 2015b.

on engine, electric motor, microprocessors... The names of the dominant currency are: groschen, ducat, gulden, denovino, florin, pound, dollar... However, a certain center could be represented by the name of a significant artist or a philosopher.

Horses enabled the predominance of Central Asia over Mesopotamia, the stern rudder returned the power to Europe, the galley allowed Venice to overcome Bruges, Antwerp triumphed thanks to the printing press, the caravel facilitated the discovery of America, the steam engine was a sign of London's triumph. New energy resources (*oil*), a new engine (with internal combustion), and a new industrial facility (automobile) transferred the power to the East coast of America, at its dominant city of Boston. Electricity gave the primacy to New York City, and the information revolution shifted the center to Los Angeles.

Bruges was the center of a new order - capitalism - between 1200-1350. It took advantage of a capital invention - stern rudder - which enabled ships to sail on wind. The ship is armed and updated, enabling control of maritime trade. Division of labor improves, agricultural productivity grows, grain prices drop, because the products is ever increasing. There is a significant innovation - the first weaving loom; finally, the development of trade promotes the formation of banks. Bruges exploits all these innovations in the best way. Trade (steel, wool, glass, jewelry...) between Europe, India and China is connected via Bruges. Wine, fabrics, glass, coins, jewelry are transported to the interior of Europe, and in return they send fur, wheat, wood to Bruges.

Venice became the next great center of capitalism in the period 1350-1500, taking control over trade between Europe and the East. And all that thanks to caravel. One jib, two square sails and one lateen sail, create a perfect mobile structure. At the end of the 11th century, Venice gets its chance in the Crusades. The Venetians encourage shipbuilding for the production of military ships. The Venetian Republic remains the only European shield from the Turkish aspirations, as well as the main spot on the trade route from the East to the cities of northern Europe. The transport of goods from the Eastern Empire to Europe is shorter now, because there is no need to use the Flemish ports, nor Atlantic ocean. Another important link is a bridge over the Bernese Alps, which was a major construction project at the time. So Venice takes control of the most important trade network, and remains a center of trade order, controlling the money flow for a long time.

Venice is not a center of technological innovation. Venice identifies and supports ideas of others, copying them and applying them. Venice successfully implements other innovations in the finances: the first gold coins was minted in Genoa (gennarino). The first check and holding were designed in Florence, however, both innovations were implemented in Venice through the system of stock exchanges, trading houses, banks and insurance companies.

Antwerp becomes the new center in the early 16th century (1500-1560), as the first industrial user of new, significant technology: moving printing plates. Chinese had the first ideas on moving the printing plates, but it was successfully implemented in Germany in 1455. Antwerp excels in printing books compared to Venice and other cities. This way, publication of the works of great philosophers, poets and scientists, reveals the rich Jewish-Greek heritage, which was until then censored by the Church. In fact, it reveals the knowledge: Jewish, Greek, Roman, Arab, Persian, which was carefully hidden by the Church. This was a great informational revolution at the time, because it enabled faster conveyance of knowledge, data and information. Today we know: technology of communication destroys the center. For example, it prevents Vatican to centralize wider area (Europe) around one pillar (church). The Protestants then rose against such centralism, and 1517 was the year of birth of the opposition to the Pope, when Martin Luther gave the Bible to the faithful people to read it, since they did not need priests any more. That was the great power of technology (printing) at the time.

Genoa (1560-1630) took over the capitalist leadership using skills based on the updated organization of account. Accounting for Genoa was as printing were for Antwerp. Huge, strategic innovation ensures dominance over another trading networks, especially after the drop of Antwerp's influence. Genoa, Patina and Mesara create their accounts of success, which later spread through the work of Luca Pacioli. Thanks to these innovations, Genoa becomes the first financial market of Europe and the heart of the capitalism. Genoese bankers dictate financial operations in Spain, France, Italy, and many other European countries.

In *Amsterdam* (1620-1788) is industrialized the production of a special ship, the "flute". It was constructed in 1570 and produced in series, and required a five crew member less. At the beginning of the 17th century, Amsterdam was transformed into a large shipyard, specializes in the sale and maintenance of ships. Its fleet becomes huge, well-armed, with a capa-

city of 2,000 tons of ships and 800 men in the crew, carrying six times more goods than all other European fleets together. The Dutch Navy takes control of the seas.

London (1788-1890) comes on the scene in the 16th century with new technologies in weaving wool, coal mining, and glass production. In 1734 was invented the marine chronometer, which improved the location of ships and allowed quicker voyage. But the dominant invention is the steam engine, constituted by a Frenchman, Denia Papen. After being patented by an Englishman James Watt, the steam engine enabled coal mining. A new weaving loom was invented in 1785 by Edmund Cartwright. Production of cotton was multiplied 10 times in ten years. It was the triumph of steam and machinery ideal.

Boston (1890-1929) becomes the new center thanks to the internal combustion engine. It is used in the United States from 1880 (21 years after it was invented in France), primarily in machine tools. In 1890 it is already implemented in the car and aircraft production. Automotive industry structures America, directly leading to the development of steel mills, mines, glassware, oil industry, and indirectly to the expansion of roads, banks and shops. With serial production of cars, US take over the dominance in the automotive industry. The leading center was Boston.

New York (1929-1980) becomes the new center, thanks to the AC motor. Electric motor through key techniques almost replaces housewives and domestic servants. So, the end of 19th century is a triumph of electricity. A small electric motor (invented by Nikola Tesla) allows the energy to improve the productivity of machines, agricultural, industrial tools and cars. Electricity is used to illuminate cities (Thomas Edison's invention). There is a whole range of new products for the use in households. Life and work change radically. New Trade Order is now concentrated around New York, and it becomes capital of the world. New jobs emerge, especially in services, increasing the number of those whose job it is to promote the consumption: banks, insurance, advertising, marketing, media...

Los Angeles was the next center since 1980, formed on the wave of the information revolution. In 1971 was designed a microprocessor, the successor to the transistor, brought out on the market by a new manufacturer Intel. It is a tiny square of silicon, which stores thousands (at first), then millions, and later billions of basic units of processed information.

Of course, in the distant past there were radical changes in a man's work. The first such radical change occurred when our ancestors learned how to systematically cultivate grains and breed the animals, rather than to wander through nature, hunt and collect food. Work has fundamentally changed again when mankind entered the industrial era. Today, it is changing for the third time in ways whose effects and proportions are equal in value and importance of the previous changes. Digital technologies, including digital networks (Internet, intranet, extranet, and VAN), computers, softwares, and other relevant information technology, are changing work and relationship between people. Digital networking and communication infrastructure provide a global platform through which people and organizations communicate, collaborate and search for information. The source and center of the information revolution is Los Angeles. Internet, as a network of all networks, has been developing since the 70s of the last century, with first software ventures: Microsoft, AOL, Oracle, Google - mostly in California.

Modern capitalism, as defined today, has only two basic assumptions about humanity: 1. that humans are primarily economic entities, as Adam Smith argued that *the propensity to truck, barter, and exchange was inherent in human nature*, and 2. that humans will always act by following their own rational interest or, at the very least, the hints of what can benefit them. At the business level, this is manifested through the principles of profit for the sake of profit, and with the assumption that every business seeks to maximize its own interest and profits to its shareholders. These essential assumptions are strengthened by intellectual trends, such as Newtonian mechanics, and its accompanying technology, as well as Darwin's struggle for survival. The original capitalist laws on competition, profit and capital accumulation have captured today's capitalism and transformed it. As Zohar Danak points out, in a ruthless search for a competitive advantage in the world, the resources are being reduced by their own actions. There is an increasingly frequent question of the sustainability of such a system. Also are raised questions about resource exhaustion, and the accompanying and threatening consequences on the environment.

14.4 The need for institutions – or the market's need for dsemocracy

Good ideas encouraged the need (demand) for free forms of institutions and their development (12th – 13th centuries). A great number of individuals begin to take things into their own hands, choosing their own way. They don't allow others to dictate their lives, and don't want to be objects or servants to politics or religion. Positive evolution takes place in the development of institutional forms that will support freedom and growth.

In Europe (15th and 16th centuries), the monarchs and clerics, emperors and popes governed the souls and bodies of the people; the population of each province suffered the terror of lords and their armies. The Pope and the Roman-German emperors competed for Caesar's inheritance. France, Castile, England, territorially closer than today, were engaged in battles without mercy. Conflicts and violence multiplied. Intolerance was the rule, and religious wars were horrible. Many writers of that time had the pessimistic vision of the future. Everyone thought the things would be get worse, like they were at the beginning of the century. But at the same time, some other authors (Petrarch, Bocca, Thomas Aquinas, Jean Bodin, etc.) identified weak signals of a positive future. In Lombardia, Venice, Flanders, there was an awakening of intellect, the desire for enrichment, ideas, body liberation, return to Greek, Jewish and Arab thought, the restoration of Gospel lessons, information technologies (publishing houses, accounting), etc. All this was accompanied by the discovery of continents, and the emergence of other social actors: entrepreneurs, traders, financiers, inventors, shipowners, cartographers, poets, musicians, painters, philosophers, scholars ... It was a movement of people and things in order to change lives. It was the Renaissance!

Much was expected from politics. Better politics can ease and improve the general situation in which, again, some people individually seek salvation, but their success depends on institutional ambience. Since then, institutions have become the key to economic progress. Institutions should provide equal opportunities for each individual, and not just for those who found better ways in turbulent times.

The space for sustaining democracy and the market should be based primarily on the development of individuals and institutions. The economic history, shown in the relevant works (e.g. "The Wealth and Poverty of Nations", David Lendes, Stubovi kulture, 2004) shows that an institutional order was crucial for the early stages of capitalism: relatively safe ownership, efficial jurisdictiary, systemically secured contractual relations, early liberation from authoritarian royal authority, etc.. Thanks to the stimulating institutions, in those early stages of development, such an ambience was of great importance for technical progress. England, as Lendes explains, created an institutional climate characterized by openness, which ensured unprecedented use of productive knowledge, and the advancement of the scientific revolution.

The level of institutional development is one of the reasons for the contrast in development between Europe and Asia, as well as North and South America. These are obvious examples showing the institutional condition of economic development. "It turned out again that development does not require resources but institutions and rules, which, by defining the information base and motivation, determine the use of those resources " (Madzar, 2011, 230).

Institutions are not easy to build. In the West, they have been built for decades, even centuries in some segments. Let's repeat: evolution has its own laws, and history has its own regularities, therefore, the great discontinuities are an exception, not a rule. Although the institution-building process is slow, it is to be expected that the legal order and fair, stimulating rules of the game will gradually improve in order to protect the property, contracts, individuals, and their freedoms and rights. Certainly, individuals are responsible for their own fate, and for the improvement of their well-being. Optimism is reality for those who learn, work, invest, save, and engage in entrepreneurial ventures. The world, however, is not regulated by formulas; some people simply have good fortune, because we live in a stochastic world where coincidence plays its part.

Politics predominantly define the rules of social interaction.

14.5 Historical periods in politics

Historical periods in politics can be distinguished according to the general perception of the rules of social interaction and institutions. We are

particularly interested in three historical periods which defined the Western civilization, and those are: Gregorian centuries, secular period, and social responsibility era. Each of them had specific rules of the game, which allows us to understand the development of economic policy making, or why this has recently developed into the main components of social interaction.

14.5.1 Gregorian centuries

Gregorian centuries were predominantly marked by the Gregorian Revolution, named after Pope Gregory VII, who extoled the primacy of the secular ruler by issuing the "Dictates of the Pope" (1075), a declaration that disproved the long tradition of emperors as supreme authorities, both in religious and secular matters. Pope Gregory VII, with the intent to pursue his goals, had to question the legitimacy of the authorities. Since the Church had an undeniable authority in the domain of secular authority, and in the domain of the goals and the nature of an individual within the society, the outcome of this debate was in favor of the Pope. The church gave legitimacy to its authority, and the emperor had to accept the rules of the game imposed by Gregory VII and his successors. Until the 11th century, secular sovereign ruled and coordinated with a large number of tribes. The only tangible sign of civil rule was a somewhat symbolic right to enforce justice (even Carlo the Great traveled through his own kingdom, confirming his reign). The cooperation between the tribes was mostly due to threats from outside attacks (by Arabs, Norman, Hungarians, etc.). There were many battles and the sovereign power was practically proven through the leadership in these battles. The influence of the Church was equally present in all tribes, because they shared the same religious belief (a very mild and compliant version of Christianity). The changes that followed, above all the significant reduction of threats from the region outside Europe, the increase in wealth, urbanization, which followed its concentration, have created a situation in which an imperator became *de facto* redundant in military terms. However, he did not have enough space to position himself as a head of religious structure. One role remained which the ruler had to emphasize in order to justify his existence, and that is the role of judicial authority. In order to have legitimacy in it, he had to rely on the Church.

According to some authors (e.g., Berman 1983), the most important result of the Gregorian Revolution was the emergence of law. This means that both the church and the state were forced to recognize *the rule of law*

and the law of rule. These rules are subordinated to secular and religious authorities. Another important result is the understanding that all people are equal before God, to whom they personally respond. It was also rooted in the theological view that an individual came to this world for the purpose determined by the divine order, or God's will, which is basically the preparation for death. Although we are all children of God, we must accept the earthly order, which is an expression of God's will. We are born to serve God and to prepare ourselves to die in a dignified manner, to receive redemption from sins, to avoid condemnation to eternal torment (in hell), and to enjoy eternal happiness.

In short, the change in structure of belief during the Gregorian epoch became the foundation of the Western early social structures, which are:

1. Equality in relation to God. The social hierarchy is determined by God's plan and must be recognized by all;
2. Existence of "righteous" rules, which are in accordance with God's plan, regardless of whether they were set by God or man. These righteous rules are above habits and traditions;
3. Secular and religious world are separated (hence, this structure is against universalism).

In this context, where religious authority was still dominant, economic activities and technological progress were modest, and growth did not reach a sustainable level. It was not a serious economic progress, although it had some changes due to certain random institutional changes. Nearly 90 percent of the European population lived in poverty. However, the limitations of economic growth were: expensive transport and communications, small and scattered populations, and consequently the absence of large markets.

Gregorian epoch illuminated the gloomy image of the Middle Ages with its institutional innovations, although they were mostly random. Some of the greatest innovations were: guilds, urban political structures (city-states), mercantile legal system, the use of large-scale money. However, certain dynamics were introduced, perhaps not only because of institutional changes, but also because of the expanded groups of opportunities. Institutional innovations were the result of an increase in wealth, which enabled the combination of a certain technological progress, a small number of wars, extensive colonization of new territories, and/or power dominance, which often enabled the creation of rents, guarded by force.

However, in the period from the 12th – 17th century, the general rules of the game were not changed, nor the nature and dynamics of the political movement. As we have said, the ruler was "appointed" by God, and the general good was limited to the religious sphere (voluntary work), without any established rules for interpersonal relations.

The basic characteristic of politics is the domination of religious structures, so the policy making was irrelevant. However, it should be noted that Gregorian revolution articulated the concept of politics as a power race. Policymaking was in the function of gaining more and more resources, and therefore, the expansion of territorial requirements. Thus, the development of compulsive, pragmatic institutions depended on the interest of the ruling rent-seekers. At the beginning of Gregorian era, seeking rent was very simple: the ruler took for himself what was available, eventually obstructed by the religious authorities. Later it was more complex, as military technology (artillery and firearms) gave competitors the power to challenge officials. So the ruler had to use more sophisticated means. Sometimes it was a bureaucratic state in order to improve control over the territory (the best example is Phillippe Auguste), sometimes those were allies with rich elites, either in situations where money was needed, either when centralized control was not effective.

Appendix 9: The Renaissance

The Renaissance led to a new relation, both towards God and towards man. Gradually, the philosophy and science separated from theology, so Renaissance brought a new, individualistic vision of man. Parallelly with Renaissance began a Reformation of the Church. A significant representative of the Reformation was Martin Luther. According to Luther, a man does not need the Church, nor forgiveness, nor priests, to deserve salvation. The Bible is available to every individual, because it is translated into the dominant European languages, Luther has translated it into German, so that every man could read it and to be the priest of his own. This way, Christianity has received a significant, major role in the development of individualism, instead of universalism. And the very act of confession is individual.

The Jesuits, led by Spaniard Luis de Molina, go further in affirming the view that good deeds provide salvation, whereby the material wealth it does not interfere. He assumes that man is free to perform an action and that God always give mercy to those who sincerely seek for it.

Thinkers inside and outside the Church gradually affirm the right to live happy on Earth and after death. (However, the right to choose a spouse, or, say, a profession, remained exclusively the right of fathers.)

Etienne de la Boetie (1530-1563) in his book The Discourse on Voluntary Servitude (Discours de la servitude volontaire, 1549), who was at the time only eighteen years old, writes that the man primarily wants to be freed, and tends to tear out of humilion. If he fails, then he more or less tacitly chooses his fate, which is, in fact, the acceptance with some measure of obedience... He asks questions: Why so many people, so many villages and towns and so many nations, tolerate one single tyrant (usually), although he has the power and authority given by them? How is it possible when a tyrant has only as much authority as they are willing to give him, or - willing to bear? How, when he can do just as much harm as they are ready to suffer, without offering resistance? Where has he acquired enough eyes to spy upon you, if you do not provide them yourselves? How can he have so many arms to beat you with, if he does not borrow them from you? The feet that trample down your cities, where does he get them if they are not your own? How would he dare assail you if he had no cooperation from you? Resolve to serve no more, and you are at once freed. The choice of obedience to him is also a form of "self-reliance" (Jovovic, p. 92).

His friend Michel de Montaigne (1533-1592) starts from Socrates' view that the unexamined life is not worth living. According to Montaigne, the essence of human nature is that it is not defined, nor still. He represented humanistic efforts of the 15th century. His greatest work, Essays, was focused on the author himself, imbued with the general principles of the philosophy and the author's own thoughts. Montaigne began writing Essays in 1571, when he was 39 years of age. According go Lanson, they differ by their elements: thoughts about the read books, reflections on observing the life of others, and regarding himself.

Although this work treats extensive material, it obeys the Montaigne’s views on the value of the ancient heritage and wisdom of various thinkers. It is summed into illustration of individual human thought, whose primacy of rule is common sense. The most important is that Montaigne, writing about himself, writes about man in general – he lends us his eyes so we could see ourselves. For him, every man carries a form of human nature. His literature is ancient heritage: Plutarch, Seneca, Ovid, Virgil, Plautus, Herodotus, Xenophon, Titus Livius, Caesar and Cicero. Quoting them, he

follows the signs of that time. However, unlike his contemporaries, Montaigne has assimilated the ancient culture. He cites the views of others for better illumination of his own thought. For Montaigne, "borrowing" other people's thoughts and sentences is not an imitation, nor theft. As the bees process honey, he "processes" the works of his role models to present his own views.

With his method and harsh criticism, Montaigne, as well as his older compatriot François Rabelais, criticizes the scholastic medieval education. Knowledge, according to him, must never become dead capital, nor to be exclusively literal knowledge. The process of thinking is what brings us to the perfection of virtue. Erudition, wisdom and knowledge have no true meaning if they do not encourage the creation in us. As Rabelais, Montaigne criticizes educational system of their time because it lacks proper development of intelligence, insisting on banal memorization of different content. (We certainly recognize this in modern education systems and processes.) Montaigne exposes his vision: education is the harmonious and parallel development of the whole personality (spiritually, physically and morally). Developing the spirit involves strengthening and developing the intelligence. Good and smart head is appreciated, and that is achieved through discussions, acquaintances and travel. Education must be non-violent, a student must be an active participant in this process, constantly applying his own knowledge. The student should not only believe in authority, he must think critically. This system resembles the Rabelais's, except that Rabelais, however, acknowledges encyclopedic knowledge (i.e. the widest possible knowledge of the students which will make the entire reservoir of knowledge), while Montaigne prefers the development of intelligence and discernment (Jovović, 2015).

An individual comes to the forefront, and the epoch of individualism begins with a secular period.

14.5.2 Secular period

Renaissance altered the human understanding, and opened up new visions of society. The most important in Gregorian epoch in terms of policy analysis and econonomy is the fact that it marked the separation of secular and religious world. This transition was not easy. As we know the Age of the Enlightenment created a solid ground for transforming from the divine

state to the state based on the treaty. The relationship between man and society, set in the form of a treaty, is not an idea that originated in the 18th century, because the Greeks had the same idea 2,000 years earlier. However, the vision of secular period differed from the Greek vision in two essential understandings. First, all men were equal (in Gregorian period, this view was already accepted), especially among Christians. People were equal by human nature, not by their roles on Earth. This was not the case in the Greek's view. Second, in a secular period, an individual is born as a human being, he/she precedes the society, and deliberately decides to form a community. In Greece, an individual acquired his human nature only when he/she became an active member of society. The relationship between man and society is relieved of religious stigma and heritage; a man becomes an individual in a social context, developing his/her ability to reason and realize. It is a great change in relation to Gregorian epoch, where each person is endowed with a multitude of natural rights, and society is only a product of interaction, or possibly a means of personal progress, but definitely not an actor by itself. The equality also exists before the law created by man, and this does not exclude the equality of the rulers before the law. This implies that the ruler passes the law.

Perhaps this is a point in historical development when the impact of the economy on politics and vice versa is recognized and inevitable. The economy is raised to the level of society, or the level of rulers, because the social contract implies improvement of the global economy, and this has become a part of the social contract. From this point, the technical and moral characteristics of economic interactions can be studied. Simply put, the economic problem has been transformed by introducing legitimacy through rational contracting from an individual issue to an issue which is relevant for the whole society. The role of economists begins to increase, and they have to explain economic phenomena by politics and its impact on the economy, as well as the economic laws. Development of economy and economic science are directed in determining the space for the state intervention and its balance with the market, i.e. finding the optimal relationship of politics and economy in order to optimally exploit the resources.

14.5.3 Social responsibility era

After secular period, politics plays an increasingly important role in the economy, and this has been already evident in social responsibility era.

Secular period created many elements which characterize social responsibility era. The most important is the separation of secular authority from the religious one. However, a lot of ambiguity remains in terms of the role of the Church. The weakness of the social contract has been shown in the American Revolution, the French Revolution and the Napoleonic period. Interestingly, the American Revolution adopted a new Gregorian system based on personal rights given by God, imposed by a local ruler who has a minimum power. In order to survive, it practically had to abandon the contractual approach. The French Revolution collapsed, although a consensus was reached on the main elements of the treaty (equality before the law and private property). Chaotic conditions after revolution have empowered the general who promised and brought peace and order (at home), who never considered that social contract was a serious foundation for his authority, but he sought divine legitimacy (crowned by the Pope).

In social responsibility era, the ruler assumes the responsibility to create a favorable environment for each individual in order to participate in the rent-seeking. This new historical environment was created at the beginning of the 20th century and mostly relied on the lessons learned from the French experience (18th and 19th century). In addition, economic growth provided opportunities for achieving social responsibility. Economic growth was based on the development of science and new technological discoveries, which enabled greater production and greater choice, so faith in the future was deeper than ever. Relying on it, the rulers promised prosperity, higher standard, and equality before the law, establishing a general agreement between the elite and the people, according to the principle from the top to the bottom. This general contract was based on the elite's motto: "We rule for the well-being of the people, and have the right to rule as long as we fulfill our obligation." This is the basis for sharing newly created wealth. However, these promises were not aimed at giving legitimacy to the governor, nor to define the essence of "good government". Three basic promises were: All members of the society are given privileges, which will introduce the system of rent-seeking in interaction; all citizens are offered the opportunity to get a share of the discretionary authority, that is, the struggle for power is opened to everyone; the concept of individual responsibility is set within a comprehensive social context guaranteed by the rulers.

The satisfactory economic growth is what provides the basis for more participants to earn an income, while slow or negative growth leads to

promises that lose credibility. However, even with satisfactory growth, there are a lot of those who come off second best, even though they participate in an illusory, mutually beneficial game, where privileges are distributed in accordance with some criterion of a social contract (consensus motivated). There should be created a climate where an individual always hopes to gain privileges in the future, in order to avoid seeking alternative political solutions. Hence, the authorities are required to stimulate the game of rent-seeking, and at the same time to generate enough wealth to meet expectations.

The division of power, as a goal of social responsibility era, represents the possibility of climbing into the scales of widely understood power, either within a political structure or within a bureaucracy, possibly jumping from one position to another, not to mention options related to the "rotary door". Evident are political structures, often creating bureaucracy in the public sector, which increase taxes, and which are enabled by the greater wealth. In bureaucracy, success sometimes depends on loyalty to the ruling elite (politicians at the top). Clearly, not everyone can get the power and rent, ending up with a racket-money in their pockets. And this role prevents them from destroying a bureaucratic machine. The game takes place, a large number of participants get passive rent, and some prefere power and privileges. A small number of participants is ready for different political solutions, because the rent system functions in sufficient degree. This forms the basis for a consensus (or lack of conflict) and defines the boundaries of discretionary policy-making by the authorities, which are required to maintain consensus and stability. It is not individual but social responsibility (large areas of economic activities). Collective responsibility is increasing in areas such as: labor market, health-care, education, savings (pensions), and even some production. As a result of political and economic development, in the continuation of social contract era, the welfare state emerges.

14.6 Welfare state

Unlimited capitalism provides the basis for the market to determine the revenue distribution. However, the main pillar of capitalism is democracy, which does not fully accept the market allocating revenues, but rather allows voters to introduce income taxes and redistribute them. This political-economic system is known as the welfare state or mixed economy.

The welfare state is involved in the production of goods and services that could be produced privately (they are often produced that way), with an exception of national defense. The state's justification for doing so is that people with low incomes can receive free or cheaper education, healthcare, and other services. The problem is that subsidies encourage inefficiency in resource spending, and often do not get delivered to the poorest.

The large welfare state changes the way resources are used. In Western Europe, the state introduced subsidies for unemployment, healthcare, education, and agriculture. After the Second World War, the subsidies in Western Europe were low, and since 1980s they have begun to grow. In the same period, the economies of Western Europe grew faster than the US economy, reducing the gap in revenue, production, and productivity that arose during the Second World War in relation to the United States. However, there was the opposite tendency, due to the growth of welfare state in Europe. Table 1 shows the average growth rate based on the Organization for European Cooperation and Development (OECD) data for 6 countries, for a period of 26 years.

Table 1. Comparative rates of economic growth

Country	1981-9	1991-2000	2000-2006
France	2,36	1,95	1,70
Germany	2,37	2,11	0,97
Italy	2,42	1,39	0,88
USA	3,25	3,30	2,42
Great Britain	2,66	2,44	2,53
Iceland	3,67	7,06	5,55

Source: Meltzer, p. 50

The political choice of the greater state spending since 1981 has allowed the growth of an average income in the United States 50% faster than in France. When the government of Margaret Thatcher reduced state subsidies and redistribution, the difference decreased in relation to the continental countries of Europe. Germany has slowed down its growth as it has allocated large funds for subsidies, and the expansion of welfare state to East Germany. The case of Iceland is remarkable, and is explained by the decline of welfare state, and the expansion of the market economy.

Although there are always pressures in favor of more redistribution and meeting "social needs", demands for lower tax rates, lower redistribution, higher growth, and higher future revenues are strong and stable. These forces maintain democratic capitalism steady. Obviously, capitalist system is adaptable to a man, which is shown by various forms of capitalism today. Capitalism in Europe is different in relation to capitalism in the US or Japan or China. Capitalism in China is the most specific. Capitalism is different in Latin America and India. It seems that a lesson learned from the development of many countries speaks in favor of the fact that competition and the open market create much more opportunities, allowing the reduction of corruption, and inefficient use of resources. The state can not be excluded from this reality.

Governments have a role to promote growth and living standard - they are responsible for the safety of investments. They exist to strengthen ownership and freedom of choice, to encourage intensive communication, where possible, and international free trade, to facilitate and stimulate growth by providing quality education, maintaining the rules of the game, and reducing uncertainty in the future. Reducing uncertainty in the future encourages investments. The government must implement revenue redistribution. Is this justified? A famous Harvard professor John Rawls supported the idea of revenue redistribution. He noticed that modern ethical theory did not provide the grounds for this. In his "Theory of Justice" (1971) the author attempts to solve the problem of distributive justice by utilising a variant of the familiar device of the social contract. The resultant theory is known as "Justice as Fairness", from which Rawls derives his two principles of justice. Everyone decides principles of justice from behind the "veil of ignorance". This "vail" essentially blinds people to all facts about themselves so they cannot tailor principles to their own advantage: "No one knows his place in society, his class position or social status, nor does anyone know his fortune in the distribution of natural assets and abilities, his inteligence, strenght and the like."

However, opposit to this argument is a democratic principle: a choice based on the voter’s political decision on their well-being, welfare of their children, and their community

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14.7 The role of the state in the socialist countries

Perhaps more than in capitalism, the state in socialism becomes an instrument in the hands of authorities. Although not necessary, the state interferes with the economy, which especially affects the redistribution. Its task is to protect democracy, and, above all, to apply regulations. And not selectively, because some rules are not applicable. An interference of the state in the economy turned out to be counterproductive for the economy.

One powerful example of state interference in the economy is a centrally planned economy. The state put the entire society under control, and those systems failed. The fact is that no market economy has experienced a failure, while all central-planning systems have experienced it.

The forms of interference are various, and often against common sense[40]. In post-socialist countries, there are numerous examples where the link between business and the state (in practice) has already been established in the socialist period. Maintaining good relations with government is one of the most important things in the business policy of a system that operates in an unregulated institutional environment. Without cooperation with the authorities one can not hope for peaceful work and proper prosperity. Apart from occasional weaknesses, there is an all-time dominance of politics over business. The government has been pushing and pressing all other potential centers of power, which had a monopoly position in socialism. This tendency continues in the capitalist system built by the former socialist countries.

In 1971, socialist Yugoslavia experienced the famous "cuts", when some of the most capable business people were removed from the social scene. Here we have the whole history of suppressing and pressing business people. As Madzar points out: "After limitating them, and making their lives miserable, it is not a suprise that we do not have entrepreneurial elite, and an initiative which could rise us economically, and put on a track of normal, propulsive, and sustainable development".

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[40] An example is 2008 when pensions and salaries in the public sector of Serbia increased 4 times - two regular adjustments and two extraordinary – which was 32% in four years. Madzar spoke and wrote about this, pointing out that no economy would endure it, not even American.

In socialism, the state hampers the countries with competition. Economy without competition can not develop normally. For, wherever there is no competition, there is no pressure to increase efficiency. Competition mobilizes the economy and makes it stronger. We are not talking about ideal situations, because the problem in some sectors (e.g. agriculture), is that many countries give subsidies, and that must be kept in mind; If the market is opened blindly, farmers are in a subordinate position. Also, competition could be disloyal. For example, agricultural subsidies in some countries go up to 50%, therefore, those who are subsidized could be price-competitive. However, the solution is not in the extremety, where the economy is at risk.

Schumpeter would have probably said that the state can not deal with market analysis and similar things, because the state is not capable for it. The state should regulate consistent laws, and ensure the rule of law, so the provisions would not be contradictory. He who works makes mistakes.

Many countries in transition deal with poorly targeted economic policy, and too much subsidies and allocations, while avoiding the important task: to regulate legal order and financial discipline, to ensure that everyone pays their bills on time. The state should enable the payment of delivered products and services. Today, insolvency pressures many economies, making it harder to get paid than to produce and deliver goods. Obviously, in modern society and modern economy, the role of the state is significant there. Monetary policy, money, loans, new projects ... are things that the state should initiate and introduce. Unfortunately, taking loans is a common practice, where the funds are not used productively and therefore penalties are inevitable.

The story about failed state is endless, but the fact is that the state must develop. Without a good government, the economic policy is bad.

Many people in the former communist countries imagined a certain market economy, where the state would provide the order, the infrastructure, and then, in these conditions, entrepreneurs would expand their business, and the economy would prosper. Unfortunately, the state does not regulate financial discipline, which jeopardizes the liquidity, creating public debt, and huge budget deficit. The principle that the state can spend as much revenue was not respected. At the end of the 19th century, states shared 10% of GDP, today it exceeds 50%.

That explains the civilizational stagnation in spite of information revolution. The growth rates are not in question. The country takes too much and gives too much. The state destimulates both the one who takes and the one to whom it gives. Indicators of a regulated state are:

- Public debt must not exceed 45%
- Deficit should not exceed 4%.

Obviously, there is no progress and improvement in a law-breaking country. "Respect the law that you made yourself," says one Latin proverb. Selective enforcement of regulations is extremely harmful to the economy. This means that a businessman can not know when that regulation will be applied. Competition forces entrepreneurs to break the rules, because if competitors break the rules, then they will, too. And not just that. Today, information systems are quite powerful. The authorities register these violations, which can be stored and then selectively used. If you are not "good" then your violation is used as a powerful means of influencing the business world. In post-communist countries, the state is powerful but the business world is impotent. As long as the power is obtained by punishing businessmen, the economy will fail. The price-control is another product of the state.

The change depends on the political will which is lacking because it deprives the state of those elements controlled by society: taking money, extracting informations, etc... It is much easier to dispose of the income made by others.

One group of economists thinks that the state should take care of a man, and that state intervention is needed in the economy, and in other areas of life. Another group of economists thinks that the state is not a good entrepreneur, nor a producer, nor an investor. Actually, the state has much more important things to do but to interfere the direct economic flows. Many economists are aware of the necessity of the state and the need for the state. Many economists will say that without the state, no metter how much of it is regulated, there would be neither markets nor market economies, and perhaps, under current conditions, there would be no civilized life in a community. Hence, the state is very important. But the state has its own jobs, and is not willing to accept them. It also has some other jobs, which do not belong to the description of its "workplace", but in which the state is happy to intertfere. What no one in today's conditions could do, except the state, is to gua-

rantee the rights and freedoms in terms of maintaining a legal order. It is the securing of property rights, first and foremost, the protection of contracts and the implementation of financial discipline, the production and maintenance and development of public goods. In economic policy there are some things that only the state can do. If you have paper money, monetary policy is imposed here, and who creates monetary policy other than the state. You have public spending which needs money, and government coercion to collect taxes. Both the state and the market! It is logical to insist on these listed functions, which are exclusively in the domain of the state. Because, in today's conditions there is noone else to do that job. A prominent US lawyer, Richard Einstein, who has been polemicizing with a politically oriented economist who advocates the state intervention, said: "He is not even aware of how much the liberals want from the state." In his view, in a liberalized society the state should do a lot. The problem is that the opportunities for corruption and abuse are much higher in those areas where the state should not interfere. However, when the state does its job: regulations, construction, legal order, application of regulations, etc., it creates conditions for the normal functioning of economy. Applying regulations is even more important than creating them and and voting for them. So, when the state does its job, there are far less possibilities for any kind of abuse. The state can also be confused with the human resources of economy and public administration. For example, public companies are filled with party personnel, and that is a type of abuse, while the state sees its political account in it. In economic policy and institution building, what is economically rational is not politically profitable, and what is politically attractive is not economically rational. Therefore, if the state does not do its job, it produces great economic and other damage.

It has been said many times that the state is a product of its government. It is difficult to imagine a situation in which the government is bad, and the state is good, because the state is an instrument in the hands of those in power. In some more civilized countries, the state and the public administration have a certain degree of autonomy and are more difficult to manipulate. However, there are always some manipulations. Politics is almighty! Even in America, there is a term *elective spoils* which means that one party gets the elections, and then it shares the "prey" in the form of various lucrative or socially reputable positions.

The most important role of the state is money management and monetary policy. This topic will be discussed in the next chapter.

15. MONEY IN ECONOMY AND CHALLENGES OF MONETARY POLICY

15.1 Introduction

"Money is to an economy what language is to communication" (Gourtani and Strup, pp. 51). Why is that so? Money reduces transaction costs, as it provides a common denominator in which all goods and services can be converted. Money allows people to engage in a series of transactions involving receiving salary or paying a purchase price over time. Money allows accumulating the purchasing power for the future. Money is also a unit of measure that helps us in keeping records of revenues and expenditures at different times. Money enables all this if it has a stable value. If not, then the exchange will create unnecessary costs, investments will become more risky, time transactions will become increasingly uncertain. When the value of money is unstable, exchange decreases, also reducing benefits from specialization, mass production, and social co-operation. What determines the stability of money? As for all other goods, the value of money is determined by supply and demand. When the money supply is constant or when it increases at a stable rate of growth, its purchasing power will be relatively stable. Conversely, when the supply of money is suddenly and unexpectedly increased in relation to the supply of goods and services, the prices will be "inflated" (inflationary) and the purchasing power of money will fall. This is another powerful tool for politics influencing the economy, because the money supply's dictated by political decisions. Poor monetary policy obviously undermines the economy, and the fact is that money was politically manipulated very early. This chapter will discuss an issue of monetary policy challenges.

15.1.1 The politization of money

The role of money and its management has become a central issue of modern economics and politics. Obviously, that is a challenge that economic and political science are facing nowadays.

Our analysis of managing money begins with understanding money using the example of a very interesting economic phenomenon - economic activities in prisoner camps (World War II), described by Richard Radford, one of the inmates. A prisoner camp in question is Oflag, which usually had from 1200 to 2500 people, living in separate barracks (200 people each).

Prisoners were engaged in an active trade of certain consumer goods and services. Most of the trade included food and cigarettes. However, cigarettes (commodity) became the currency that served for trade!

The offer consisted of food obtained mostly from Red Cross: canned milk, jam, butter, biscuits, chocolate, sugar, cigarettes, etc.. The distribution of necessities was equal and regular for each person. Private clothing packages, toilet equipment and cigarettes were equally distributed. All these goods were objects of trade and exchange.

Very soon after arriving to the camp, people realized it was not desirable, due to limited supplies, to give or receive gifts in food or cigarettes. Higher benefits were achieved through trade, as an impartial means of maximizing individual satisfaction.

Packages arrived on a weekly basis, and the trade begun with a simple exchange, for example, non-smokers exchanged cigarettes for chocolate. After a week or two, as the volume of trade grew, the exchange relations formed. Some prisoners, for example, who initially exchanged canned beef for other food, began to insist on jam and margarine.

The prisoners often did not visit other cabins, so the price of goods varied from cabin to cabin. After one month begun the trade of all goods, the relative values were known, and expressed in one commodity – cigarettes – which became standard values. Soon began frequent visits to other cabins with announcements. For example: "I sell cheese for seven (cigarettes)" and the like. The imperfection of this system influenced the placement of noticeable signs on each cabin, containing "name", "room number", "search", and "offer", with supply and demand data. The prices (in cigarettes) were publicly displayed. All this was happening in the middle of the prisoner camp in Italy!

Redford was transferred to a larger prisoner camp in Germany, together with 50,000 other prisoners. In this camp, prisoners of different nationalities were living in different cabins. Similar exchange took place as in the previous case, however, new opportunities for "earnings" emerged. Some prisoners figured out the ways how to use the preferences of various nationalities. For example, the average Frenchman drank coffee, and average English drank tea. Every time Red Cross packages arrived, skilled French "traders" approached their compatriots, and "borrowed" tea from their packages, promising them a certain amount of coffee in return. In cabins with British prisoners they exchanged tea for coffee, which they then returned to their French compatriots, as they had promised. Why did they do it? Because they took a 5% "commission" in tea and coffee for their "services". If a product was cheaper, they sold it more expensive (arbitrage), in order to get a profit (exchange value) of about 5%. Their profit also depended on the competition. Obviously, the profit droped with the increase in the number of skilled traders. Simply, everything operated like a big world stock exchange. Prices between cabins stabilized at a level equal for each cabin, regardless of nationality or the wishes of their "inhabitants". Interestingly, cigarettes were established as a measure of exchange value or valid price in the entire prisoner camp. Simply, cigarettes had a set of features:

- They had longevity (they did not get spoiled as bread or butter);
- They could be easily transferred and did not take up much space;
- They could be easily divided and had a clear value;
- They had a stable exchange value in all parts of the prisoner camp (due to their relative rarity).

By introducing money to the economy, huge opportunities and chances have been created, because it serves to keeping the values, (i.e. saving or lending and earning interests). The problem is how to keep the exchange value of money at the fixed level. In Greek language, the noun *money* has the same root as the verb *think* (since the monetary system collapses if citizens cease to think that money will keep its exchange value), and the noun *law* (since the legal intervention helps citizens to think that money will really keep its exchange value).

Redford cites that the Red Cross sometimes put more cigarettes in the packages, without increasing the amount of chocolate, coffee or tea. In that case, the exchange value of cigarettes decreased; since the number of cigarettes increased and the amount of coffee and other goods remained the same, each cigarette corresponded less to coffee and less to tea. And vice ver-

sa: when the amount of cigarettes wes decreased in comparison to other goods in the Red Cross packages, the higher was an exchange value or purchasing power of each cigarette. Redford described a similar situation: One night Aviation has mercilessly bombed the area where the camp was located. The prisoners were in panic, they did not know if they would be alive in the morning. The next day, the exchange value of the cigarette jumped to the sky. Why? Due to a heavy night, the prisoners, pressed by uncertainty, found comfort in cigarettes, smoking one after the other. The quantity of cigarettes in circulation was radically reduced, and the exchange value became higher than before. The bombing produced deflation, which is the reduction of money related to the quantity of other goods. The opposite of deflation is inflation, when the amount of money increases in relation to the quantity of all other goods. In other words, the prices of all other goods expressed in money were increasing.

Evidently, the stability of money varied depending on external events. The prisoners could not influence the stability of money. In market economies, the role of preserving the stability of money was taken over by governments, with compensation. Thus, the money was politicized and strongly tied to debt and tax, almost from its very beginning. However, that was not the case in the given camp, the money was apolitical. In a market society, with politicized money, debt accompanied the production, and debtors were less powerful or powerless, and had to borrow from the rich. Power and authority went hand in hand, provided by the surplus produced by others. The authorities that owned the money of the society, over which they ruled, managed to increase their power, and to enjoy the giant share of the collective production surplus.

15.2 A special characteristic of money

We should go back a little, and consider the sources of what some consider the main subject of modern economic debate and politics: the role and management of money and the origin of what is now known as monetarism. More than any other aspect of economic history, the most important are institutions and experience that surround the money, and not formally expressed ideas about it.

Metal money has very old origin (5,000 BC). The original metal money was used in a primitive form for a long time, usually as unequal pieces of different shape and weight. Before each payment, the coins had to be

measured. Hence the term *compensatory* payment (com+pensare – to weigh). Soon, metal money begun carving a stamp, which contained the information on weight and strength. But, that was also abused. Not until later, the stamp is taken over by the state itself, casting greater confidence due to its authority. The shape of coins was unified into metal plates as the most suitable. The term *monetary* emerges, too. Instead of compensatory there is a simple counting of coins. Significant reversals arise in further development, when the state takes over forging of money, gaining substantial, real incomes. The first coins, according to historical findings, were made in about 640 BC in Lydia, in western Anadolia. Those coins had a standardized weight of gold and silver, and a sign printed on them, determining two things: 1. how many precious metal it contained, and 2. the authority of the ruler who issued the coin, guaranteeing its value. Almost all of today's metal money come from these Lydian coins.

The Roman Empire had a coin called *denarius*, and the Roman emperor guaranteed the integrity of the coin on which his name and portrait were printed. The power of an emperor rested on denarius. Imagine just how difficult it would be to maintain that empire if an emperor had to collect taxes and pay salaries in barley or wheat? It would be impossible to collect that tax from Syria, take it into a central bank in Rome, and transport it to Britain in order to pay off the roman legions.

Due to the circulation and means of payment whose real value was not equal to the nominal one, the first banknotes were later developed, followed by an introduction of the paper money. The banknotes have almost no value, because the value of paper, paint and effort involved in making banknotes is minimal. But banknotes have the ability to replace the golden money of the corresponding value, and that is called convertibility. So, banknotes are not real money but the replacement. They are the result of the demand, or more specifically, the uncertainty of circulation. It was dangerous (and impractical) to transfer larger amounts of gold from one place to another. That is why traders entrusted this metal money to banks, and they issued certificates, which initially were in the name of the person who issued them. By their "rewriting" to the bearer, by making them in the proper form, and by guaranteeing that they could be exchanged for cash at all times, the banknotes began to fully and effectively take the role of money. In the course of development, the first banknotes that the state recognized were only those issued by a certain bank. Thus, the original voluntary consent to receive a banknote instead of coins was replaced by the so-called forced

exchange rate, i.e., according to the obligation imposed by the state that all citizens should receive them for the regulation of all monetary transactions. However, even the forced exchange rate of the banknote had completely golden cover at first, and could always be replaced by gold. Later, various limitations came to light. The coverage was no longer full or partial, it was in a certain percentage, or in many other ways. Thus, the *coverage systems* developed throughout the world.

The moment when the exchangeability of money with gold was abolished, or when their holder lost the right to receive metal money for them, the money became legal and definitive means of payment, which could be received in unlimited quantities.

Money has a universal means, which allows people to convert almost everything into everything. The body muscles and bones convert into brain when a physical worker pays a scholarship for himself from his savings. The estate converts into nobility when the baron sells it to support its servants. Health converts into education when a doctor uses his wage to pay for his daughter's education in a prestigious private college.

Ideal types of money allow people not only to convert one thing to another, but also to preserve wealth. Many valuable things can not be preserved - such as time or beauty. Some other things can be preserved for a short period, such as strawberries. Some things can last longer, but require a lot of space or expensive maintenance or attention. Cereals, for example, can be stored for years, but it is necessary to build huge silos and provide protection against moisture, fire, and the like. Money, whether it's in paper or in computer memory, can solve all the problems.

With money, everything can be easily and cheaply converted, stored, and transported. This makes money a contributory in complex commercial networks and dynamic markets. Without money, commercial network and markets would be reduced to a very limited extent, level, and dynamics. Simply, money is a life energy of creation, because it is a link between all things. Money can buy everything, and the whole world is in the continuous movement because of the money.

Another important role of money is the development of individual freedom. Money connects people and promotes creativity.

To understand the origin, role, and social power of money, is to understand the structure of modern society. However, the real character of money has been discovered with the establishment of banks; the money supply could increase or decrease through banks. The funds thus secured

could be used for investments, necessary or reckless consumerism, or for the state needs.

People came to the bank not only to save money, but also to borrow money. By borrowing and then storing the profits, people also had accounts, now based on abstract claims of metals, which allowed them to make various payments. As it was possible to spend the new deposit, the same could be achieved with existing one. That's how money was created! An additional benefit of this creativity was the bank's income in a form of interest. Making money was not an unselfish act; it was a very lucrative thing.

The borrowing, and the act of creating money as its consequence, had another very early form. Instead of the deposit being the subject of transfer by order - that is, on the basis of a written instruction or a check - the borrower could take a loan in banknotes. Banknotes confirmed that the borrower had a metal on deposit, so the receiver could go to the bank and ask for that metal. Or, more likely, he could hand over banknotes to another supplier or creditor. In the meantime, the original metal remains in bank vaults, and could also be lended. As with deposits, the same was it with banknotes: money is being created again. Altogether, deposits and banknotes exceeded the value of metal on which they were based. This, however, was completely safe and acceptable for as long as all - the original investors, borrowers, banknote holders - would not come at the same time to withdraw that metal money. Except in the case of fear, panic, or spread of rumors about the ability of the bank - which are not negligible possibilities - this would not happen.

Given the potential profits from this money-making - interest from a simple, easy-going borrowing - the temptation was obvious. This temptation created central banks, and partly the structure of modern banking regulation. Central banks were formed on the basis of various original privileges, including the exclusive right to issue banknotes (e.g. the Bank of England in 1694). They continued to regulate the lending, and the emission of money via smaller banks, not in a very disciplined way, returning their banknotes for payment in metal, and enforcing minimum levels of reserves for deposits.

The ultimate big step in attaching a distinct and specific character to the money was when kings, princes and the parliament realized that money creation can be used as a tax substitute, or as an alternative to borrowing from excessively stubborn or disinclined financiers. The elements of this discovery existed when the Roman coins were ruined in order to allow a

greater volume of payment from the given amount of metal, as an alternative to imposing taxes for the needs of the emperors and their empires. For modern purposes, this discovery came with the general use of paper money. Then, same way as the banks, the state obtained metal money, stored it in the state treasury, and issued banknotes that gave the right to claim the deposited coins. Or the government did it for the benefit of the state. Once this seemingly benign step was taken, it was almost inevitable that paper money, put into circulation, exceeded the amount of metal on which it was based. In normal times, it could be assumed that, if the issuance of a banknote was subject to an explanatory restriction, not all depositors would simultaneously claim t heir metal coins. But there was an ongoing temptation to pay for current or emergency state needs by paper money, instead of influencing an unpleasant and often impossible alternative to tax increases. The need, and not caution, would have a decisive role.

Sometimes, as mentioned, banknotes were issued by a central bank, or a bank under state patronage. And when the state could no longer have the available metal to support the amount of issued paper money, it would have stopped the conversion of banknotes into coins. A new term has been added to the economic glossary: "We are now off the gold standard."

15.3 Economists about the money

Money should produce a neutral economic effect. More specifically, its value and proportionate scarcity of quantity should be maintained in circulation, so that all who possess the money have all the reasons to want it. In the history of economy, this is a conservative standpoint that has always had universal approval.

However, by the end of the 19th century, professional economists began analyzing money and monetary policy. At the same time the future gap appeared in the classical orthodoxy - the view that money, if it's not a commodity just like every other commodity, is passive and neutral in its role of facilitating exchange. The decisive step was made by Irving Fisher (1867-1947), a professor of political economy on Yale. In the book "The Purchasing Power of Money" (1911), Fisher presented an immortal contribution to economic thought - his exchange equation. According to Fisher, prices would change with the amount of money in circulation with appropriate adjustments in terms of the circulation rate, the turnover rate, and the

number of transactions. This is an equation, which should not discourage anyone:

$$P = \frac{(MV + M'V')}{T}$$

(P is the price, M is the amount of ordinary currency in circulation, V is its velocity of circulation or circulation rate, M' are bank deposits which are subject to checks (i.e., the same use as the money in banks), V' is the turnover rate of such deposits, and T is the number of transactions or, roughly, the level of economic activity).

This includes the idea that the rate of currency (or money) spending is more or less constant and that the short-term trading volume is relatively stable. Therefore, the increase or decrease of M or M ', the values that depend on public action or control, directly affect the price level.

No mathematical formula in the economy, perhaps none in the history other than Albert Einstein's, did not had greater popularity (even today). With it, including Fischer himself, has begun a serious rebellious concept: the change in the amount of money in the equation of exchange, while all other things, specifically the circulation rate and the extent of trading, remain the same, can increase or lower the price level. Going upward could be stopped by reducing the money supply; increasing the money supply could increase the price level - which was more the case in Fischer's period. With the equation of exchange emerged the theoretical apparatus of monetarism - a subject of the most intense economic debate in the 70s and 80s of the 20th century.

It was a great, even awe-inspiring step in the history of economy. Before that, there was an instinctive feeling that monetary experiments on banks, which were issuing banknotes, and free forging of silver money, had some impact on prices. Fischer has given credence to this instinct, although it had not yet been officially recognized, and an idea that the state or an authorized body should thoughtfully and directly take responsibility for managing money through regulating the price level. Later, in the early years of Great Depression, Fisher and his students were in the center of politics, persistently advocating and, to a certain extent, creating a plan to curb the devastating currency deflation of that time.

With Fisher, a long history of money entered in the modern era. The equation of exchange is the fundamental framework of a highly influential Professor Milton Friedman. If you control the money, allowing it to increase only as much as T (trading volume) increases, the prices will be stable - or

will become stable in several months. In the years to come, the question will be: what is actually money in the modern banking world. Standby savings deposits, purchasing power as credit card backgrounds, unused credit lines - all this will operate as money, or together with money on current accounts. Even more serious question will arise: can we control everything defined as money? Finally, there will be concerns about whether an attempt to reduce or control the money supply could have a negative effect on T, and on industrial production and employment. However, all these came with Irving Fisher and his exchange equation. A long-term preoccupation with money continues to the present day.

15.4 Monetarism

Monetarism emerged on the intellectual scene of economic thought at the end of 1940s and the mid-1950s with the significant works of its founder, Milton Friedman. In addition to Keynesianism and a new classical macroeconomics, monetarism is one of the three most influential macroeconomic schools of the 20th century. In a theoretical sense, this direction of economic thought is a modern version of neoclassical economic school, because it revives and reformes quantitative money theory and the role of monetary policy. Monetarism is partly a response to the ruling Keynesian paradigm. Therefore, the phenomenon and the strengthening of its influence in literature is often denoted as a monetarist counterrevolution. In a chronological sense, five different stages are distinguished:

- The first stage: in the 1950s, with the formulation of the theory of permanent income and the theory of stable demand for money;
- The second stage: in the 1960s, with the works on the importance and role of monetary policy in US monetary history, and the model of optimal amount of money;
- • The third stage: sinc e 1967, with the attack on Keynesian concept of the Philips curve, by introducing the natural rate of unemployment and adaptive inflationary expectations;
- The fourth stage: after 1973, when monetarism began to dominate academic institutions in the West, monetary institutions, and economic programs of controversial parties and right center parties;
- The fifth stage: in the late 1960s and the late 1970s, with the emergence of a new classical macroeconomics, often called the New Monetarism.

During the 1970s, monetarism was dominant in the economic policies of Great Britain, Germany, and the United States. In addition, monetarism also dominates in the Fed, and in international institutions such as the International Monetary Fund (IMF) and the World Bank. The strengthening of these political influences was preceded by the increase of inflation in the Western countries, the Vietnam War, the pound devaluation in 1967, the collapse of the Bretton Woods system in 1973, the first oil shock in 1974, and the failure of Keynesianism in fight against inflation, and the creation of welfare state.

The essence of monetarism was given by Milton Friedman in an interview quoted below:

Appendix 10: An Interview with Milton Friedman on Monetary Politics

INTERVIEWER: Was stagflation the end for Keynesianism?

MILTON FRIEDMAN: Stagflation was the end of naive Keynesianism. Now obviously the term "Keynesian" can mean anything you want it to mean, and so you have new Keynesianism, but this particular feature was put to an end by the stagflation episode.

INTERVIEWER: Talking about Keynesian policies, John Kenneth Galbraith, when we talked to him a few days ago, said that World War II "affirmed Keynes and his policies." Do you agree?

MILTON FRIEDMAN: No, I don't agree at all. World War II affirmed what everybody knew for a long time. If you print enough money and spend it you can create an appearance of activity and prosperity. That's what it confirmed. It did not confirm his theories about how you preserve full employment over a long time.

INTERVIEWER: You've written that what really caused the Depression was mistakes by the government. Looking back now, what in your view was the actual cause?

MILTON FRIEDMAN: Well, we have to distinguish between the recession of 1929, the early stages, and the conversion of that recession into a major catastrophe. The recession was an ordinary business cycle. We had repeated recessions over hundreds of years, but what converted [this one] into a major depression was bad monetary policy. The Federal Reserve system had been established to prevent what actually happened. It was set up to avoid a situation in which you would have to close down banks, in which you would have a banking crisis. And yet, under the Federal Reserve system,

you had the worst banking crisis in the history of the United States. There's no other example I can think of, of a government measure which produced so clearly the opposite of the results that were intended. And what happened is that [the Federal Reserve] followed policies which led to a decline in the quantity of money by a third. For every $100 in paper money, in deposits, in cash, in currency, in existence in 1929, by the time you got to 1933 there was only about $65, $66 left. And that extraordinary collapse in the banking system, with about a third of the banks failing from beginning to end, with millions of people having their savings essentially washed out, that decline was utterly unnecessary. At all times, the Federal Reserve had the power and the knowledge to have stopped that. And there were people at the time who were all the time urging them to do that. So it was, in my opinion, clearly a mistake of policy that led to the Great Depression.

INTERVIEWER: Tell us briefly how Paul Volcker set out to squeeze inflation out of the economy.

MILTON FRIEDMAN: Well, by the time Paul Volcker came along -- this was in 1968-69 [Volcker was undersecretary in the Treasury Department from 1969-74, president of the New York Federal Reseve Bank from 1975-79, and appointed chairman of the Board of Governors of the Federal Reserve Board from 1979-87] -- inflation had gotten very high and had gone up close to 20 percent. He was at a meeting of the International Monetary Fund in Yugoslavia in 1979, when the U.S. came under great criticism from the other people there for our inflationary policies. And he came back to the United States and had got the open market committee to announce that they would change their policy and shift from controlling interest rates to controlling the quantity of money. Now, this was mostly verbal rhetoric. What he really wanted to do was to have the interest rate go up very high, to reflect the amount of inflation. But he could do it better by professing that he wasn't controlling it and that he was controlling the quantity of money, and the right policy at that time was to limit what was happening to the quantity of money, and that meant the interest rate shot way up. This is a complex story. It isn't all one way, because in early 1980 President Carter introduced controls on installment spending, and that caused a very sharp collapse in the credit market and caused a very sharp downward spiral in the economy. To counter that, the Federal Reserve increased the money supply very rapidly. In the five months before the 1980 election, the money supply went up more rapidly than in any other five-month period in the postwar era.

Immediately after him, Reagan was elected, and the money supply started going down. So that was a very political reaction during that period.

INTERVIEWER: How important was President Reagan's support for Volcker's policies?

MILTON FRIEDMAN: Enormously important. There is no other president in the postwar period who would have stood by without trying to interfere, to intervene with the Federal Reserve. The situation was this: The only way you could get the inflation down was by having monetary contraction. There was no way you could do that without having a temporary recession. The great error in the earlier period had been that whenever there was a little contraction there was a tendency to expand the money supply rapidly in order to avoid unemployment. That stop-and-go policy was really what bedeviled the Fed during the '60s and '70s. That was the situation in 1980, in '81 in particular. After Reagan came into office, the Fed did step on the money supply, did hold down its growth, and that did lead to a recession. At that point every other president would have immediately come in and tried to get the Federal Reserve to expand. Reagan knew what was happening. He understood very well that the only way he could get inflation down was by accepting a temporary recession, and he supported Volcker and did not try to intervene. Now, you know, there is a myth that Reagan was somehow simpleminded and didn't understand these things. That's a bunch of nonsense. He understood this issue very well. And I know -- I can speak with, I think, authority on this -- that he realized what he was doing, and he knew very well that he was risking his political standing in order to achieve a basic economic objective. And, as you know, his poll ratings went way down in 1982, and then, when the inflation seemed to be broken enough, the Fed reversed policy, started to expand the money supply, the economy recovered... (Adamovic, "Economic Dialogues", p. 136-137).

16. ECONOMIC GROWTH AND POLITICS

16.1 Introduction

Human nature has been explored by many scientists and is the subject of most religions. The most prominent question in the interpretation of a man reads: Why is there a dissatisfaction in human nature and where does it come from? Namely, people strive for health and strength, they seek knowledge and property, they build houses and palaces. However, no matter what they accomplish, they are never completely satisfied. Those who live in poverty dream of wealth. Those who have 1 million want 2 million. Those who have 2 million want 4 million. Even the rich and famous are rarely content. Above all, they are burdened with constant worries and suspicions. Life is a race; but, is it a meaningless race? In Buddhism, this question is explained by the very nature of a man, which is based on cravings.

Let’s repeat: in human nature is to progress, to improve his/her mechanisms and patterns - which he/she uses at a given time - or to completely replace them with qualitatively new ones. His dissatisfaction with the existing, and his/her constant aspiration, perhaps craving for something significantly different - at least in the domain of hope and hypothetically viewed - but far better, is a permanent characteristic of behavior in all areas of social activity. This is related to a man's duality - the ability to create ideas and to realize those ideas. Dissatisfaction with the existing situation, and craving for something new and better, created in the ideological telescope of the future, causes tension that often leads to changes. Our recent past has shown the continuity of dissatisfaction followed by changes, which are not always positive. Our further past (the time before the Second World War) was marked by market dissatisfaction and the system based on private property. Some of the most gifted students and proven intellectuals supported the Communist Party, which propagated revolution and abolition of private property. In socialism, we became dissatisfied with socialist system, especi-

ally in the advanced stage (both in the centralist and decentralized countries), and then we became dissatisfied with the first steps of transition...

Changes are evolutionary or revolutionary. Evolutionary means changes without developmental jumps. Revolutionary jumps into development of an individual and a society bear a huge risk and do not allow for continuity to development, but often leads to proportionate retrogression. However, tendency for change is the generator of change, but the risks of revolutionary change are huge, and the result of their consequences is often negative. The initial conceptual scheme is often wrong, therefore an inadequate calculations rarely give rational outcomes. Even if they could, there is no time, because revolutions, as well as social movements, usually take the form of social breaks and deceit. Evolutionary changes allow for a different correction in accordance with a *planned model of the future*, and the ability to correct the wrong concepts.

Either way, human beings expect growth and development, both personal and social. And economic and political aspects are intertwined with the issues of growth and development.

16.2 Growth, economic visions, and the smell of power

Adam Smith did not even consider the theory of growth. Ricardo's and Marx's vision of growth was related to the capital accumulation, where return on capital was reduced, slowing the growth. Long entrepreneurship, as the carrier of growth, did not even exist as a topic. The entrepreneurship was sporadically considered at the University of Spain (15th century), in France by Jean Baptiste Say (17th century), and by Karl Menger (18th century). The entrepreneurship came to life in the works of Mises and Hayek (20th century).

A static economic vision dominated for a long time. The most representative author of this vision was Lord Robbins, who defined the purpose of economics (1933). His definition prevails even today, although it is, nevertheless, wrong. According to Robbins, economy is *securing efficiency, or maximizing goal satisfaction*. A goal can be to maximize production or to maximize the welfare of society, etc.. Maximization is limited by the available resources that we need to obtain.

Why is this important? Because such an understanding of the economy, in fact, is just the pursuit of a completely static economy, or econo-

mic thought. What kind of vision is if it *a priori* implies more constraints, and have no solution? For example, this vision represents production resources (oil, labor, and capital), and we must seek ways to make the best use of them in order to achieve our political goals. Evidently, this economist is a technocrat! He simply has to find a combination system of production factors in order to maximize the goals and minimize the costs, using the most efficient way, and according to the needs and ideas of politicians. The resources are given, and the technology is given. Essentially, there is no technological progress, and the production factors are immutable. This is a totally static vision of economy and life.

Nevertheless, the static vision evolved into a neoclassical one, because the actual economic life did take place with a certain dynamism, so the neoclassical approach had to present the dynamics in a classic vision. In another words, it had to prove that the technology was not static and that technological progress existed. However, even neoclassics did not have a consistent vision of technological progress, which became very apparent. According to one interpretation, the technological progress is given, it is an external factor. On the other hand, technological progress is a production factor like any other, and investment in technology produces technological progress (not immediately, but in a year or more). Hence, the productive factors are: land, capital, labor, and technological progress, which is achieved by investing in development and research, or investing in machines. Neoclassics simply ignored the fact that combinations of these factors change, as well as the availability of these factors. For example, the production factors could not exist or could be rare and insufficient, and then suddenly, there was enough of them, even abundantly. For example, in the 18the century coal was the primary source of energy and the world was affraid that the coal resources would be exhausted. However, after discovering new sources of energy: oil, solar energy, nuclear energy, etc., the view on this resource has changed.

Unlike this approach, the Austrian Economic School developed the theory of technological progress, based on an entrepreneurial figure. In classical and neoclassical interpretation of economic growth, there are no new discoveries, because space is limited: there is nothing new to be discovered (a lack of dynamic vision). In this limiting vision, there is no uncertainty. Everything is known. Everything can be learned. It's just a matter of information cost. If something is ignored, it is a concious decision, because there

is no will to pay the price of information. Although all information can be obtained and used in the analysis of costs and benefits.

The Austrian Economic School appeared at the end of the 20th century. Its vision was different from the classical, because it starts from the fact that information is imperfect and that everything can not be learned.

According to this vision, the entrepreneur is one who has imagination, who sees more, who discoveres new things, who tries to find possibilities of making money or reducing losses; he risks and he has a goal to create new ways of producing the existing goods, or new ways of meeting the needs of new products.

According to this school, ideas drive the economy, or technological progress and development, as a vision of economy that puts entrepreneurship at the forefront. Regarding this, Keynes wrote that we are not exempted from intellectual influence, but rather the slaves of a long-deceased economist. In his opinion, too much attention is paid to the interests of politics and economics. "Soon or late, it is ideas, and not vasted interests, which are dangerous, for good or evil" (Keynes, 1936: 383-4). That Keynes was right proved his work, so the idea of Keynesianism still lives, even today. The state has a greater role in the economy with a special emphasis on fiscal policy. It was considered that the state could stimulate economic growth through budget deficit policy, and to cool down the possible overheated economy through austerity. It lasted ten more years after Keynes death, and in the 70s of the 20th century Keynes's idea began to fade. It was overthrown by the market economy, a rival idea developed by Hayek. His contribution to the idea of the market is fundamental, but more focused on the political economy and the macroeconomic understanding of the free market benefit. Still, Keynes's idea was the most undermined by Milton Friedman, an economist from Chicago. In a field of macroeconomics, Keynes and Friedman are the most influential thinkers of the 20th century. The contradiction of their economic vision has been differentiated by various interpretations of Great Depression in the US (the 30s of the 20th century). Questions about the causes and solutions turned into more general, theoretical questions about the effects of fiscal and monetary policy. In 2008, when the world was hit by the greatest economic crisis after the Great Depression, the diagnosis of this crisis and the recipes for recovery were based on these two ideas.

16.3 About the economics of growth and the economics of happiness

The economics as a science, through the economic analysis, was devoted to the understanding and evaluating of economic activities (and its outcomes) which interact in order to improve the well-being in a world characterized by scarcity. In other words, "the pursuit of happiness" is achieved through economic activities, while the perception of happiness is necessarily individual, because only an individual is in a position to know or judge what makes him/her happy, and eventualy how to make adjustments. Therefore, it could be discussed about the pursuit of personal happiness. However, when the ruler assumed the responsibility to satisfy the general interest, the search for "social happiness" came into focus. This opens the way for normative solutions in order to satisfy the general interest.

Analysis can be focused on personal happiness. However, such a focus was natural when there was little concern for a comprehensive increase in living standards, and the main concern was to fill the royal treasures or to destroy the enemy. That was a time of small growth, while the economic goal (individual pursuit of happiness) did not encourage policy making. The happiness was a game in which someone must lose to make others win. If there is no growth, material progress can only be achieved through redistribution (violence, robbery). Three centuries ago, economic analysis draws attention to the growth and the pursuit of social happiness. Happiness is measured by a comprehensive increase in living standards. This orientation contributes to the emergence of politics in order to:

- Conceive and implement the most suitable institutional framework that will enable the growth;
- Eliminate barriers to growth, such as: lack of coordination or lack of rationality, whereby the general well-being comes first. For example, as long as people enjoy more security than income, privileges, regulation and redistribution are good for social happiness.

Adam Smith analyzed these issues, while his successors emphasized two aspects - desirable rules of the game, and optimal decision-making. Politics evolves in the context of specialization, free trade, and rooted ownership rights. Politics supports such an orientation, and develops an environment that recognizes that wealth is a value, (i.e. a virtue), not poverty, as the

Church preached. These perceptions of happiness have developed the policies that supported dynamic balance and entrepreneurship[41].

Regarding politics and economics in this context, it is important to understand two things: 1) why has the pursuit of personal happiness turned into the pursuit of collective happiness (aggregate growth economy)?; 2) the question of growth itself and the choices that policy-makers should opt when creating their own goals.

Until the secular period, the concept of happiness was not linked to efficiency (income), but was mainly related to the absence of political turmoil, and to the position in society, more widely understood as a "social virtue". Since the individuality was the priority in relation to the state (society), it was logical that "happy society" consisted of happy individuals or families, and the family was regarded as the smallest community. Policy-making was in the function of an individual, creating rules within which an individual would act in his pursuit of happiness. These rules should respect strict subjectivity, and "... dictation of rules, however, should be limited to the formalization and implementation of moral boundaries within which people can act: for example, the Locke's mini-state" (Colombatto, p. 201).

When a society has come to the fore in relation to an individual, a new conception of happiness (growth), or efficiency, has emerged. It starts from the fact that the improvement of personal well-being is a social issue and a social problem. In line with such an understanding of happiness, active policy-making is in function of social well-being. This shift occurs in the era of social responsibility, when the growth of living standard has become an element of social agreement. Economic science begins to intensively focus on growth (and development), and the question of personal happiness turns into a question of collective growth and social happiness.

[41] Apart from the Ricardian tradition, the dynamic balance represents the basis of a modern neoclassical standpoint, while the entrepreneurship is the essence of Austrian tradition.

16.4 The need to measure growth

In the era of social responsibility, when the above-mentioned shift in policy-making occurred, expecting that the government should guarantee a minimal increase in collective material wealth, the measurement of happiness becomes almost an obsession. This minimum increase in collective material wealth should be sufficient for a significant part of the population to enjoy a higher standard of living over time. This implies to a constant increase in aggregate demand, so measurement is needed to quantify happiness, or growth. When an individual addresses or mitigates the limitations imposed by deficit, the need to quantify happiness or to measure changes in happiness (growth) does not exist. Now, when the authorities have the responsibility to take care of "social happiness", it is necessary to use the scale to measure achievement.

Therefore, the authorities must provide income for the electrorate. This income should not decrease but grow and generate wealth, which should be presented by measurable indicators. How to provide this in conditions of scarcity, while preserving equity and guaranteeing happiness to all members of society? This garancy means saving or generating rents, bias in risk assessment, and misallocation of resources (bad investments). In order to maintain equality, the standard of living should weaken, as the total growth rate of material consumption is undeniably slowed down. This weakens the confidence in politics. The contrast makes the economy vulnerable to cycles, which often triggers unforeseen events, and often can slip out of control. In welfare states (European states), low rent demand leads to higher growth, higher mobility of productive factors, reduced pressure on the state, and social protection measures. It's a cycle of economic momentum. However, some kind of shock, political or economic (elections, financial crisis), put pressure on rent, and satisfaction of increased demand for rent slows down the growth, which, in turn, weakens political consensus, increases demand for social guarantees, and continues to put pressure on growth.

Given the greater role of politics, politicians increasingly interact with public opinion. They usually use figures, because growth planning requires measurement. In communicating with the public, government officials use information to their extent and conscience. Certain information, although lacking the complete picture, are becoming popular and being used and communicated on a daily basis. Politicians announce positive growth

indicators, as these figures indicate that a new wealth has been created, with more income reallocations. Thus, all individuals have a chance to improve their well-being in the future. Such figures bring optimism even to those who have achieved lower incomes and reduced living standard. A message sent to them is: your position is just a bad luck, and happiness is just around the corner. By publishing these figures, policy-makers do not claim that e-veryone lives better, because it would be an obvious lie. They dose and use information in situations of positive growth. Even when growth is slower, it is used to justify populist redistribution.

However, citizens create demand for researchers (data, media), and interest groups. For them, the need for information differs from the need of policy-makers. Namely, they are seeking tangible data in order to assess whether their expectations and complaints are justified. Politicians need data to justify their actions, in order to gain consensus and reject their opponents. They understand that controlling figures and manipulating them is more productive than hiding or ignoring them[42].

16.5 The theories of growth

The growth is often exploited by politicians and economists. In today's European political scene (2017), there is no public appearance without mentioning growth as a priority, a necessity. The economic profession has been growing for the last three centuries. In the meantime, the main challenge has been to discover:

- Why individuals do not use their opportunities;
- Why is growth different from country to country?
- Why is growth different depending on time and country.

In response to these challenges, three main approaches can be identified: 1) classical liberalism, developed by Mandeville and Hume, and later expanded by Adam Smith; 2) extensive approach; and 3) entrepreneurial approach developed by the Austrian School of Economic Thinking.

Classical liberalism identified the exchange as the main driver of growth. Increasing the size of the market extends the possibilities of trade,

[42] Here should be mentioned the question of establishing a monopoly on the creation of statistical data, to which many dictatorship rules are prone to. It could be accomplished in different ways, however, a particularly sensible choice is methodology for the preparation of statistical information.

and enables the strengthening of specialization, which promotes the development of skills and talent and more productive manufacture. Specialization also enables the development of science and a greater range of scientists. Today we could say that the exchange triggers the process of endogenous growth.

Extensive approach to growth distinguishes the first version - which is outdated today - the classical approach to growth, which predominantly relys on planning in various variants: inductive planning in the West, central planning in the Soviet Union and Mao's China, central planning in Eastern Europe, etc.. This approach promotes the use of increasing inputs (resources). According to the second version of extensive approach, growth planning implies optimal quantity of resources, which should be devoted to the "appropriate" production of new technology[43].

Entrepreneurial approach to growth is focused on an individual - entrepreneur. Individuals are motivated, above all, by profit in the pursuit of: new opportunities for making profit, new products, new production processes, new organizational and legal structures, to meet the needs of the market and create some new ones. That way are achieved smaller or larger movements, or advances that can be summarized by the term "growth". This approach considers that the basis for progress is an appropriate institutional framework, which should protect economic freedom (private property rights, contracting freedom, implementation of contracts). According to much of this literature, the state intervention should be significantly limited.

Theoretical insights of this approach have strong empirical confirmations. The data indicate that the richest countries are those with developed trade which has been improved, both within the country and in the rest of the world. On the other hand, the indisputable fact is that the introduction or strengthening of trade barriers hampers growth, regardless of the economic situation in the country. This was theoretically proved by Ricardo; voluntary exchange is always useful for the parties involved, because the differences in respect of opportunistic costs are used.

[43] Despite the critical weakness in assessing optimal investment in technological inputs, this theoretical standpoint has been abandoned. However, it emerged again in the literature on endogenous growth, and is being largely referred to in economics textbooks.

However, empirical literature leaves no doubt that fixed capital encourages the labor productivity, and that machines are the main instrument of technology, entering the real economic life, where innovators are entrepreneurs.

Apparently, this opinion also has experimental, convincing support: comparing the effects of centrally planned economies of the Eastern block with Western economies in the 20th century; East Germany and West Germany, the partially liberalized Chinese economy that led to a Chinese wonder, and the previously bad economy of China[44]. Collombato states: "More detailed and more systematic research on the links between the *respective institutions* and economic performance also shows the same results: a firm institutional framework - economic freedom – encourages a productive and entrepreneurial energy, which in turn generates economic progress and growth." (Colombatto, p. 206)

What connects the previous visions of growth, and makes the differences between them look smaller than at first glance? All previous theories view technological advancement as an important growth factor, either from the aspect of acquiring knowledge through a market process (18th century) or in establishing an extensive growth in technology investments (technological productivity) or in entrepreneurial growth theories, where technologies are bearers of change. Technological changes turn progress into growth. Although generalizations need to be performed cautiously, the main lessons of the past 500 years show that scientific and technological progress predominantly provide continuous economic growth. Throughout the history of mankind, energy and information were the pillars of the unprecedented economic growth, beginning with an industrial revolution.

16.6 Science, technology and growth

Historically, the continuous growth began in the 19th century, which was a characteristic of the West. Without questioning the importance of sharing and the common benefits of it[45], the secret of growth is much more than that. According to Lipsi et al. (2005) the secret of Western success lies in the

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[44] There is also criticism of this literature, both methodological and substantive. For example, D. Han et al (2006), Heidi (2008).

[45] Ridley points out that this is not a modern invention, and exchange is a part of human life for as long as homo sapiens existed (Ridley, 1996, p. 200).

increasing scientific approach to economic bottleneck: a rational, scientific mind can help to understand natural phenomena, and this knowledge can be applied to alleviate the constraints imposed by deficits, and to provide better life for the people.

Throughout the history, technological improvements (innovations) led to numerous events that determined the course of human progress. These were not usual, day-to-day advancements, but key events, thanks to which the human race moved forward. Simply, there were sudden "explosions" of energy, liberated from the great and miraculous technological achievements. Regarding such achievements, no matter how revolutionary in the given time, they later sink into cumulative everyday life of human progress. For example, the discovery of wheel was a revolutionary progress. Today we do not even think about it. Such inventions have profoundly changed the industry and all other spheres of life (steam engine, AC motor, etc...). A wide range of new and old products, which have been enhanced, has become available to more people. In particular, the third dimension of economy – exchange – has been specially improved by increasing the speed of transactions and reducing the price of products. Since the beginning of spear manufacture, the contribution of capital to the human well-being has been obvious. However, it took at least a million years to establish continuity of growth.

The latest (so far) revolutionary technological advancement has been achieved in the transmission of data, materials for data flow, and formats for data storrage. Today, far more information can be downloaded, stored, processed, and made available to everyone. Also, data can be transmitted quickly and effectively. The most significant feature of this revolution is its global reach and the reduction of the gap between technological innovations and users. Explosive growth of information and telecommunication technologies has laid the foundations for the global economy in two ways: 1) an impact on the money market, and 2) the changes of the very concept of the market and types of relations between business entities. The market is expanding to endless virtual space. In order to understand what has happened and how technological progress is the main historical growth factor, we will explain the historical perspective of creative power growth.

16.6.1 The creative power growth

It is indisputable that economy growth and political power are caused by the creative power growth. This significantly deviates from the simplified analyzes of economic growth, both in classical economic thought, and entrepreneurial approach to the growth. The next section will show the essential aspects of the creative power growth, supported by more fundamental scientific discoveries, both in natural and social sciences. Namely, the basic motive of this thinking is that the economy can not be explained only by the economy, and that the production factor is the deep entrepreneurship (based on the results of many scientific disciplines).

The last 500 years is the period of unprecedented and incomparable growth of human power. In 1500 AD, around 500 million people lived on Earth, today there are 7 billion of us! The total value of goods and services produced in 1500 AD is estimated at $250 billion, while the annual value in the modern age is close to $60 billion. The human population increased 14 times, and production increased 240 times. In 1500 AD, only a few cities had more than 100,000 inhabitants.

By the first decade of the 16th century, no man had yet sailed the world. Only when the Magellan's ships returned to Spain in 1522, people learned about their journey – 72,000 kilometers long, lasted three years, costing many lives, even Magellan’s. In 1873, Jules Verne wrote about Phileas Fogg, a clever British adventurer who traveled around the world in 80 days! What science fiction it was at the time! Today, everyone with decent income can safely and easily travel around the world in 48 hours! Imagine that we could transfer a modern battleship to Columbus time: it would have undoubtedly won the entire world fleet of that time without a scratch! Only five modern freighters could have taken over the cargo of all merchant fleets at that time. A modern computer could have easily stored all books and documents from each medieval library. A modern bank holds more money than all the pre-modern kingdoms had together...

In 1500 AD, people lived exclusively on Earth, and 469 years later (July 20, 1969), the man was walking on Moon! In 1674, people learned about microorganisms – Antonie van Leeuwenhoek used his hand-made microscope to discover the whole world of tiny creatures in a drop of water! Thanks to getting acquainted with microorganisms, we managed to o-

vercome most of deadliest infectious diseases, and put microorganisms into the medical and industrial service. Today we use bacteria in pharmacology, agriculture, microbiology, etc...

US scientists detonated the first atomic bomb on July 16, 1945 at 05:29:45, in Alamogordo, New Mexico. That experiment was the most significant and the most reluctant moment in this 500 year period, because the human race gained the ability not only to change the course of history, but also to end it.

This historical process is known as the Scientific Revolution. The essence of Scientific Revolution is to invest in scientific research, believing that the medical, military and economic power could be increased. With scientific results grew investments, too. Without such investments, we would have never walked on Moon, flown the planes or split atoms. For example, the US government has recently approved billions of dollars investment in studying the nuclear physics.

It was a time of great changes in the tradition of knowledge. Premodern traditions of knowledge, such as Islam, Christianity, Buddhism and Confucianism, claimed that everything important had already been known. In the past, the great deities, the God almighty, or the sages "possessed" the universal wisdom, which served as a basis for acquiring knowledge. It was impossible that the *Bible*, the *Qur'an*, or the *Vedas* lacked any important secret of the universe - a secret that could be revealed by a creature of flesh and blood. Therefore, the knowledge about everything already existed, and everyone should only ask the authority for an answer!

Despite this understanding of knowledge, even in the most conservative era, there were people who claimed that important things had not yet been discovered. Such "blasphemers" were usually silenced, expelled or persecuted. In rare cases, they established new traditions, claiming that they knew everything they needed to know. For example, Prophet Muhammad established a new religion by claiming that he knew the divine truths and that there was no other truth except the one he knew.

Modern science differs from all previous traditions of knowledge in three key reasons:

- *Readiness to accept ignorance*. Modern science is based on the Latin word - ignoramus (we do not know). It is a claim that we

are not familiar with everything yet. It is even more critical to accept that what we think we know can prove to be wrong when we acquire more knowledge. No idea or theory are sacred and are not a subject to change.

- *The central roles of observation and mathematics*. Accepting ignorance, modern science seeks to gain new insights by collecting the observation results and using the mathematical apparatus to connect these observations into profound theories.
- *Acquiring new powers.* Modern science is not satisfied with the creation of theories, using them to gain new power, especially in the development of new technologies.

An example of a new scientific method is the presentation of the General Theory of Movements and Changes. Isaac Newton published it in the "Mathematical Principles of Natural Philosophy", probably the most important book of modern times. The greatness of Newtonian theory was in its ability to explain and predict the movement of all bodies in the universe, from a falling apple to a shooting star, using three simple mathematical laws[46]. These three laws enabled gigantic steps in natural science, and contributed to the advancement of social sciences. Let's just mention the tendency of economy being modeled according to the principles of Newtonian physics!

Today, with so much enthusiasm we observe the gigantic steps in the scientific advancement! For example, the electricity in the last two centuries: Bell and his invention of long-distances voice transmission; Edison and the development of the electric light bulb; Brush, a pioneer of arc light; Thompson who gave us the first practical welding machine, and which greatly contributed to the development of several branches of science and eco-

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1. $\sum \ddot{\vec{F}} = 0$

2. $\sum \ddot{\vec{F}} = m\ddot{\vec{a}}$

3. $\ddot{\vec{F}}_{1,2} = -\vec{F}_{2,1}$

nomics; Westin, the first designer of dynamo machine; Spraque, who marked the success of practical electric rail; Acheson, Hall, Wilson, and all others who brought the revolution into economy... The work of these talented people is not finished. Now, many others explore new areas, and discover powerful and promising fields.

The idea of creation, inflamed in ancient times by noble reformers and philosophers, awakened the philanthropic spirit. The spirit that directs people from all spheres and from all positions, not to work only for material benefit or compensation - although their intellect may demand it - but to work for the sake of success and satisfaction that will bring benefits to all other people. Collecting and disseminating knowledge is their supreme motivation, because the authentic creator is only one who inspires other higher and noble feelings, and who sees far beyond the earthly things.

The connection between scientific revolution and economy, between all branches of research, many branches of economics, both old and new, can be clearly seen in the field of energy. If we want to free ourselves from poverty and misery, if we want every individual to get what he/she deserves, to live safely and comfortably, we must have more machines, more energy. However, we do not have infinite sources of coal and oil. Resources are increasingly exhausted, and demand for energy is rising. Scientists are looking for new energy sources and discovering ways to use water and solar energy, nuclear energy, and they will not stop in their quest.

One of the greatest inventions is the creation of energy. It took a long time to realize the real potential of heat for creating energy, although the conversion of heat into energy was used for millennia (e.g. hearth in the kitchen). A partial breakthrough in the conversion of heat energy into motion brought the invention of gunpowder in the 9th century in China. Six hundred years passed since the gunpowder began to be used in artillery (launching missiles). Even then, the idea of turning thermal energy into motion remained far from human imagination. Three more centuries passed before people invented a new machine driven by thermal energy.

What could be called the first known steam engine was made by Heron of Alexandria in 120 BC. It was a small balloon tank with two ejected nozzles that turned the device around the shaft when heated. The other, which had practical application, was made by the pharmacist Giovanni de Branca in 1629, and it was implemented in a pharmacy mill. The deve-

lopment of thermodynamics enabled the scientific growth of modern thermal machines. The emergence of a modern steam engine took place at the end of the 19th century, when more inventors and experts left their mark. English engineer Sir Charles Parsons patents his reaction turbine in 1884, in which the steam is processed in several steps. During the 1880s, Swedish engineer Gustaf de Laval developed a number of reaction turbines that worked at 40,000 rpm. Later, he turned to single-action turbines, where the steam accelerated to high speeds in convergent-divergent nozzles. In 1900, the largest installed steam turbine power was 1200 kW, while ten years later it was 30,000 kW! Today's conventional high-power blocks work at 600 MW, while blocks of maximum power reach 1,500 MW.

New steam engine technology was created in the British coal mines in the 19th century. As the British population grew, the forests were more cut, because the wood was a raw material for a growing economy. Also, the demand for agricultural land was often the cause for the destruction of forests. In Britain, there was a lack of firewood, so British people began to use coal as a substitute. Large deposits of coal were found in areas soaked with water, but the floods prevented the access to the lower layers of mines. In addition, coal demand was high, and the replacement of miners was inevitable in order to increase production. It was a practical problem that required an urgent solution. In 1700, the steam engine entered the scene. However, it was insufficiently functional, but it turned the heat energy into motion, increasing the production of coal.

The steam engine was improved. It was taken out of mining shafts and attached to the looms and coils. This has revolutionized textile production, making it capable of producing an ever-increasing amount of cheaper textiles. Then, a very fast steam engine was attached to the mining wagons and the train started rolling.

Since then, people have become obsessed with the idea of using machines to convert one type of energy into another. Any kind of energy, anywhere in the world, today could be used for any need, only if we could invent an adequate machine. For example, when physicists discovered that a huge amount of energy was stored in the atoms, they immediately began to think how this energy could be released and used to generate electricity, to drive powerful submarines, or even to destroy cities. Six hundred years have passed since Chinese alchemists discovered gunpowder, until the time when Turkish cannons crushed the walls of Constantinople. Only 40 years have

passed since Einstein found that each mass can be converted into energy (E=mc2), until the moment when atomic bombs destroyed Hiroshima and Nagasaki, and nuclear power plants grew throughout the world like mushrooms after the rain.

16.6.2 Great influence of scientific revolution

It takes a long way from scientific discoveries to technological and technical inventions, their application, understanding, and acceptance. The discovery of quantum physics laws (free fall, solar system, sound velocity, and quantum theory) was a major step in science, but their understanding and acceptance went very slowly, and produced various breaks in society and culture. When these discoveries occupied an important place in human civilization, new discoveries emerged, undermining the previous ones, drawing new attention and creating new changes in the human consciousness, culture and life. For example, the theory of relativity, especially the fission (splitting atoms) still causes fears and problems in a modern society. The application of fission, as mentioned above, in addition to the production of electricity or rocket propulsion, also has an inhuman dimension - the application of this discovery for the production of destructive nuclear weapon, and the creation of problematic nuclear waste, hazardous to the environment. The development of nanotechnology (nanometer - a billionth part of a meter) provides an enormous field in the detection of fine particles and their structure, which will be widely used in the development of modern techniques, particularly in the computer science and digital equipment, as well as in the development of fusion (atoms coming close, opposite to fission) that would release great energy without devastating consequences. Changes in biology, medicine, agriculture, and so on, induced the discovery of the genome structure (DNA). The application of this discovery arouses excitement and fear at the same time.

For us, an important question is how such scientific discoveries and their application, in the form of technological processes and technical achievements, influence the change in economic and political mindset. How was the space for a scientific revolution opened?

We said that steam engine, and then electricity, induced the development of industry and transport. It also changed the way of living, and people's awareness. But how has this influenced the emergence of entirely new

society - an industrial society? The application of scientific achievements led to the creation of large industrial plants, able to produce a large number of products. There was a factory line with a large number of workers (many hands), performing only certain operations, while the final product was coming out at the end of the line. Industrial production suppressed old craft production, in which one craftsman or several of them produced goods for a long period of time. The time was reduced to hours and minutes. Industrial production employed a large number of workers and the mass industrial production has begun, followed by trade, transport, consumption.

The development of industrial production leads to a complete change in the character and structure of society. The feudal and the capitalist structure of society breaks down. The owners of factories, industrial plants, banks, retail chains and other new ownership forms appear, which allows the mass industrial structure. This is followed by a rapid urbanization and development of cities, as well as eviction from villages and rural areas. Feudal possessions become less powerful and less significant. The focus of power is on industrial production and financial capital. In a social sense, there is a new class - the working class - made up of former peasants and servants on feudal lands. The working class becomes the most numerous social category in exploited and degraded position. This process takes place during the 18th and 19th centuries in Western Europe and America. In the 20th century it expands to most of world population.

Scientific development and progress of technology and technical achievements constantly grows in the contemporary society. There is a major shift from classical industrial production towards informative, digital and robotized modes of operation and production. Industrial plants introduce robots and other programmed, digital and digitally organized production methods, leading to more mass production, but also to the reduction of workers in industrial plants; the new technology moves the man from the factory line to a command position in robotics, and workers lose their jobs. Industrial production is narrowing, and the service sector is expanding (trade, transport, insurance, banks). They talk about economy tertiary sector, the new economy where financial and banking capital comes to the fore, and where IT advances. All these jobs, including the Internet, bring enormous profits. Therefore, this type of society is a post-industrial society, since it represents a shift in the dominance of industrial production and industrial capital.

Science also affects education, providing new incentives and tasks, with the aim of reforming, modernizing, developing, adapting, technicalizing and becoming more practical and applicable. Schools, universities and institutes are constantly technically enhanced and monitored by scientific and technological discoveries and improvements. In a modern society, the dominance of knowledge, information, and skills are evident. Capital grows with them. That is why they talk about the transition of a post-industrial society into a knowledge society.

16.7 Research culture

Finding solutions to a problem creates inventions and theories, not only in the economics. This means that only an intense life can find solutions! Curiosity is an essential ingredient of culture, without it there is no discovery, there are no new products and no services. Why the Americans did not discover the Old World (Europe) but the other way around? Evidently, it was not naturally predicted by some higher power. Due to a law of causation, the explaination must be sought in actual historical reality and events. Obviously, the Old World had a greater inclination to research, or greater curiosity. We know that the Greeks and other peoples around the Mediterranean have had a strong culture of curiosity. Combined with systematicity, they associated the empire (on daily basis) with reason (thinking). That curiosity spirit creates change, and the change creates the need, which led to discoveries much faster in the Old than in the New World. From the need (curiosity) of the European people to spread geographical aspects, astrology has developed. Due to the spread of communication and openness, the astrology and the economic strength of the Old World enabled the discovery of America. Inventions, particularly technical, were the driving force of economic development. Inventions were common among the nations that progressed in rational knowledge – in understanding that the phenomena around them. However, there were no inventions among the nations with a passive attitude towards the world. Thus, the Old World acted proactively, and the New World was pretty passive. In the New World, the thought was dogmatic, there was no culture of curiosity and research, only control from the top. Many nations with such a culture have disappeared (Maya, Aztecs, Indians).

Between 1500 and 1950, the Far East and the Islamic world did not come even close to Newton's physics or Darwinian biology. Does this mean that Europeans had a unique gene for science? Clearly, this is not true, the key reason is the difference in thinking. Europeans strived to link science and economy more firmly. A botanist searched for plant species, while a naval officer searched for colonies, because they both shared a similar way of thinking. Both the scientist and the sea conqueror began to recognize ignorance - they both started from this standpoint: *I do not know what is there*. They both wanted to go on that journey, and to make the discovery. Both of them hoped that these new, acquired knowledge would make them the masters of the world. The conquest of knowledge was intertwined with the conquest of territory. In the 18th and 19th centuries, almost all major military expeditions from Europe towards the far East contained scientists. They were sent not to fight, but to come to scientific discoveries. When Napoleon invaded Egypt in 1798, he brought 165 scholars with him! Among other things, they classified a new scientific discipline – egiptology – and made an important contribution to the study of religion, linguistics, and botany. In 1831, the Royal Navy sent a HMS Beagle ship to draw a map of South America coast, Falkland Islands, and Galapagos Islands. The Navy needed that kind of knowledge to prepare themselves better in the event of war. Captain of the ship, an amateur scientist, decided to include a geologist who would study geological formations. After several professional geologists rejected his call, Captain offered the job to the 22-year-old Cambridge graduate, Charles Darwin. Darwin took advantage of this opportunity, and everything else was history. On this journey, Darwin collected empirical facts and formulated insights that would ultimately become the Theory of Evolution.

The discovery of America was a crucial event that prompted the Europeans to seek for new knowledge at a rapid pace. These European *explore and conquer* expeditions are so familiar to us, but we fail to understand them and critically examine. This was the foundation for creating a new economics, new trade routes, new wealth and resources.

I emphasize: things, events, and processes should not be taken for granted! How many things, events, and actions seem completely natural - and we do not ask ourselves why. Such an attitude does not lead to the growth and development. This stands for every individual. We must not believe in the appearance and the first image of people, things, and events. The

question – Why is this so? – drives our spirit, idea, and action (dynamics, changes, movement). Such ability has raised many civilizations. On the other hand, civilizations that prevented the dynamics of human thought, control and regulation, also faced problems and slow development. They simply lost the leverage of economic and overall development. This impacted the control of opinion and research. Imagine losing the primacy in the Mediterranean, then the crash of Roman Empire: could that be understood as a natural event or it has its real causes?

The question *Why?* is the key to understanding social development. Great theories and discoveries were based on even simpler questions. At the age of 16, Einstein undertook an experiment known as the "Albert Einstein's mirror". Staring into the mirror, he was trying to figure out what would happen to his mirror image if he began to move at the speed of light. His conclusion that the speed of light is independent of the observer's speed (the speed of its source), which, among other things, was stimulated by this reflection, will later become one of two postulates of special relativity. He was constantly thinking in these simple pictures. Returning to the mirror image, at one point he imagined running alongside the ray of light and raised a key question: how would a ray of light look like? Just as Newton imagined to throw a stone until it starts orbiting around the Earth like the Moon, and he set the theory of gravity. Einstein's attempt to imagine such a ray of light will lead to far-reaching and surprising discoveries. The microcosm of an individual arises on the creation of concepts, images, and visions that reside in his/her soul - that is the philosophy of every individual. This philosophy is the origin of real world. It is a key or a fate of individuals and civilizations. It enables understanding and discovering reality, both of society and of nature. People act according to their philosophy, which is the basis of their thinking, in accordance with images they have in their heads. These images form a paradigm of thought and an individual idea of the world and the spiritual world. Paradigm of thinking determines our mindset, behavior, and action. The discovery of a new theory in relation to the old logically alters our images of reality, or our ideological world. This change of images and performances in our heads, under the influence of scientific discoveries, is called the Scientific Revolution. However, an individual changes his/her conceptual world through new knowledge - it is a personal revolution or evolution depending on the size of idea and change. The most complex change is transition - a change in theory and practice. This change of the pa-

radigm is gradual, and it is transmitted from one generation to another within the world of microcosm.

There are two thinking paradigms in the game: the orderly world as a set of events in the absolute temporal and spatial framework, and the world of relativity, which depends on the relationship between events and phenomena. We know that Einstein is the creator of the second view. He puts the man at the forefront, while understanding of the world depends on the relationship with him. Great discoveries happened in Europe, on the shoulders of giants. They are the bearers of human thought breakthrough in time. As individuals, they made history. What drives the society forward is precisely this sacred spirit of creativity, which has been conveyed through the history from one genius to another.

Appendix 11: Human monuments of beauty, greatness and awe

We are all endowed with the ability to explore, discover and invent, to inspire, design and build. Thanks to this ability our ancestors have enriched the star on which we were born with monuments of beauty, greatness and awe.

"He descends into the bowels of the globe to bring forth its hidden treasures and to unlock its immense imprisoned energies for its use.

He invades the dark depths of the ocean and the azure regions of the sky.

He peers into the innermost nooks and recesses of molecular structure and lays bare to his gaze worlds infinitely remote. He subdues and puts to his service the fierce, devastating spark of Prometheus, the titanic forces of the waterfall, the wind and the tide.

He tames the thundering bolt of Jove and annihilates time and space. He makes the great Sun itself his obedient toiling slave... " ("Man’s Gretest Achievement" by Nikola Tesla)

Appendix 12: Entrepreneurial culture

In different countries and cultures, the entrepreneurs did not have understanding and respect for good business, on the contrary. In our tradition, business was, at least seemingly, considered as a lower order, so that was dishonorable to deal with it. In addition, business was, according to this

understanding, considered as selfishness, gullibility, plunder, fraud. This emerging curtain of our strange tradition hides the aspects of our business subjects, it hampers and limits them. I would say to our people not to believe in the appearance. Our history is not only the survival of heroism and courage. Someone had to supply those heroes, give them logistics. I would say: someone had to deal with the economy in one way or another. Thus, there was the entrepreneurship and business! I like to point out to an example of Lazar Socica. First I heard of him as a hero. Afterwards I learned more, in conversations with people of Piva, in the famous "Piva" company, from even more famous Dr Obren Blagojevic. In a way, his sensibility was close to mine. Interestingly, behind the actual appearance of Lazarus hero I discovered completely new and essential characteristics of that man. He was an entrepreneur, and he was outstanding.

I must mention my frequent enthusiasm and curiosity, since the time I was a boy, or a young man, while I was interested in Njegos and Tolstoy, at the time when I still had strong emotions. They kept the memories on my hometown ambience, the picturesque fields and valleys I enjoyed during my childhood and youth, especially in springtime when they provide plenty of reasons for admiration and leasuretime. It is an outstanding natural beauty! One simply does not know what to admire more: the exquisite colours of flowers, or the fascinating smell of nature, or the diverse song of birds in the surrounding trees, or cicadas in the meadows...

"Like a fairy spread a carpet of green grass,
Inlaid with exuisite patterns of wild flowers..."

Imagination, thoughts and questions in my head were like bees in a honey flower, in a tingling atmosphere. I was looking for words to express that beauty. I admired Anna Karenina, and learned the verses by heart: "It was as if a surplus of a smothing so overflowed her being that is expressed itself beyond her will, now in the brightness of her glance, now in her smile..." But I also searched for answers. For example: Why do people behave badly, selfishly, incorrectly? Why is there no harmony among people as in the nature? Why is so much heroism in the talks among my villagers? Why is Lazar known as a hero of all heroes, and why they mostly talk about him and not about my grandfather, who was also a great hero? Looking for answers, I came to the realization that Lazar Socica had some more values, not just "heroism". Those were entrepreneurial abilities... (Jovović, 2005, p. 45)

17. THE CHALLENGES OF POLICY-MAKING

17.1 General considerations

The world has become extremely complex. Economic disturbances around the world cause a domino effect, followed by enormous damage and losses. A good example is the latest global economic crisis (GEC). It manifests in the misfortunes of those who can not be employed, and in the existential fears of those who are left without income or their income are below the most modest minimum of survival. Not to mention health risks and illnesses that are undoubtedly accompanied by a drastic deterioration of material conditions of life, all of which are inevitably accompanied by demographic rupture, and the destruction of moral standards and civilizationally adequate behaviors, forms and patterns of communication among people.

Such situations pose challenges for economics and politics. However, the environment created by crisis economic situations does not support economic science. I can not agree with Madzar that economic science is less appreciated after GEC. Further more, they blame economists for the crisis. Thus, many individuals and groups are criticized for their incompetence, which has led to the misery of entire societies and the world community, creating huge damage. When it comes to competence, it is hard to oppose and reject that criticism.

Evidently, behind these difficulties there is a huge and lasting deficit of knowledge: lack of information and lack of positive knowledge. The knowledge deficit inevitably worsens the situation (i.e. other deficits are even more pronounced). If knowledge deficit was not so deep, durable and inhibitory, the other deficits would have had significantly less power of influence and action. Problem is not only a lack of economic knowledge, but also many other deficits.

There are at least two levels of economic knowledge deficit. The first level are the authorities empowered to design and undertake economic policy measures, then to find appropriate measures and actions which should be effectively suppressed by crisis disorders. The second level are the participants in the economy: enterprises, households, and other units, influenced by economic measures; the implementation of measures and policies depends on their ability to recognize the intentions of policy-makers, and to persevere in their application. It is often interwened by difficulties, both in identifying measures and in a consistent implementation over a longer period. This problem was actual in the US economy caused by GEC. In a attempt to suppress the crisis, the US intervened with some $1,000 billion, and according to the estimates of the relevant analysts, the results were not good. This move created a lot of uncertainties, the business subjects were paralyzed, so the economy was blocked from getting out of recession. Obviously, the knowledge and information were lacking, especially at lower levels, which prevented the US economy to successfully and quickly overcome a critical situation.

However, when a culprit is recognized among economists, honestly speaking, this accusation can be overruled; according to Madzar, that is not easy to refuse. Logically, the guilt must be addressed to decision-makers on relevant issues related to the crisis. And economists are definitely far from the positions where decisions are made, almost, as much as ordinary citizens. Even if economists find themselves at important positions in the political decision-making system, their influence is negligible, because making political decisions has its own immanent legitimacy, and an individual here has far less influence. It is a policy-making machinery, so the question arises: is it possible to identify the culprits for taking the society into the crisis? This is also about the game of political interests, which in many situations disrupt the relationship of economics and politics, to the detriment of the economy and the society as a whole.

Irrespective of economic influence in the general public, econonomics has its own methodological problems. "The multi-dimensionality of problematic entities that are the subject of economic science is the cause and the generator of far-reaching disagreements in its findings and recommendations" (Madzar, pp. 319-320). The objects of economics studies are unusually complex, broad, and multidimensional. We have already made observations about this in previous chapters. Hence, different theoretical approaches

give widely differentiated results, and the key findings are in such a characteristic way shown as mutually contradictory.

17.2 Two directions of policy-making

Many liberal economists of the 19th century quoted Smith in order to support their views on the complete freedom of economic life and the minimal interference of the state. Thus, they created an appropriate but, yet, a *refined* understanding, later accepted by other authors, who were less familiar with Smith. It is noticeable that this *refined* understanding differs from the original Smith's ideas. Adam Smith says: "There are three legitimate functions of the state: 1. protecting the society from violence and invasion of other independent societies; 2. protecting as far as possible, every member of the society from injustice and oppression by every other member of it, and 3. erecting and maintaining those public institutions and those public works, which though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expense to any individual, or small number of individuals; and which it, therefore, cannot be expected that any individual, or small nuber of individuals, should erect or maintain"(Smith, 2008, p. 232).

It is obvious that Smith sees the role of the state as positive in the economy, because it is important for common good. Therefore, supplying with goods must be responsibility of the state. Common (or public) good has the characteristic that no one can be excluded from enjoying in it, once it has been produced. It is logical that the production of such goods is not attractive to individuals, given the cost-benefit ratio, since production costs are higher than the personal benefits.

Adam Smith offers arguments why the state should refrain from regulating free competition. The invisible arm of the market mechanism leads resources which enable the highest income. The available resources determine the limits of economic development. Smith analyzes what increases the availability of resources, hence we may mention his theory of economic growth, although it was not directly given. Capital accumulation is a central source of greater welfare for the world's nations. Savings lead to an increase in capital of the company, and the increase in capital will, together with population growth, lead to higher distribution of labor, higher productivity of workers, and increasing wealth. Equally important are the reforms that enable the market mechanism to work better and to manage resources for its

productive applications. It is noticeable that Smith did not recognize the role of technology in economic development, which is understandable, since Industrial Revolutions have not yet grown up in his time. As we have seen, the classic economics, whose father is Adam Smith, has dominated several centuries, while competing set of ideas was marginalism and Keynesianism.

After the World War II, Keynesianism distinguished as a ruling idea in the economics, and as a basis for practical macroeconomic policies. It lasted for 25 years. The fact is that it was created through measures of action against Great Depression. Deflation and unemployment required higher public expenditures and lower taxes, which was then politically appropriate.

However, in the 1960s, a new phenomenon – price inflation – required reduced state expenditures and higher taxes, which are the measures far from the political appropriateness. Price inflation had a form called the cost inflation (i.e. a large increase in wages and prices). Keynesianism had no solution for this problem. Unemployment and low prices were being solved, while inflation was given little or no attention. The post-war economy was characterized by the lack of inflation - namely, the prices did not grow for 25 years in the United States nor in other strong economies, until 1966. The inflation rate, however, in the world's smallest economy, began to accelerate after 1966; it rose 6% in the period 1969-1970, almost 8% in the period 1972-1973, and almost 14% in the period 1974-1975; it became a phenomenon that could not be neglected by economists and economic politics. Keynesianism did not provide a solution, and that was the reason for its gradual retreat.

Inflation was an issue in all industrial countries. It manifested as price inflation and wage inflation, which transformed into the wage-price spiral. This is a consequence of the strengthening of corporations and their impact on prices, as well as the strengthening of trade unions and their influence. The unions entered the agreements on wages with an upward effect on prices; thus, the prices and the cost of living had an upward effect on wages.

In the Keynesian model there was no solution for the wage-price spiral. It was left to the market to solve this, not the state and macroeconomic policies. Therefore, Keynesianism did not support wage and price constraints, as this would disrupt the allocation of resources.

Unlike the United States and the United Kingdom, Keynesianism and its compromise on the separation of microeconomics (and price and wa-

ge policies), as the market environment, were less influential in Europe, Japan, and other countries. In line with inflation, especially in the 70s of the last century, these countries accepted the wage and price limitation policies.

During the Richard Nixon's administration, the United States tried to limit wages and prices. However, these attempts were not considered serious nor legal. The Keynesian system was also powerless in terms of the rise in oil prices, known as the oil shock, which began in 1975.

What was left was to seek an alternative that will support the direction of political action, while monetarism proved to be an option that was only politically possible. Monetarism, led by Milton Friedman, will fill the post-Keynesian gap, especially in the English speaking countries. Friedman was a strong opponent of the state regulation and the state action in general. He considered that maximum freedom was exercised when left to the individual to freely dispose of his/her income. Friedman’s main contribution to the economics is the regulatory impact of monetary action on the economy and, particularly, on prices. In fact, he based his hypothesis on the famous Fisher's Quantity Theory of Money.

Despite the constraints (what is the cause, what are the consequences, what is the relation of money and price, what is included in the money supply), monetarism will bypass the unfavorable political asymmetry of Keynesian politics. It also defended the classical system, that is, the microeconomics, because the state intervention is not necessary to control wages and prices when competition and the market still dominate. There will be no tax increases, no cuts in public expenditure.

The era of John Keynes was replaced by the era of Milton Friedman. The market rhetoric was particularly vivid in the United States during the Ronald Reagan’s administration, and in the Great Britain when Margaret Thatcher was the Prime Minister. It was expected because it supports the politically dominant interest of, for example, Keynesianism. Finally, the classical economics is a better solution for the power issues in the economy and politics. It allows to hide the power behind the market, so it turns out to be invisible, although it exists. However, the state is not the only bearer of power, it is also a modern business which expresses its power, greater or lesser, over workers, partners and consumers. The classic tradition was welcome with its theoretical concept of perfect market. It had the role to determine wages, interest and prices for suppliers and independent consumers,

not the company or the state power. "It is the ideal mask for all the powers and injustices owned by corporations, various businesses, and powerful people" (Galbraith, p. 213). This does not mean degradation of classical economics results, which are satisfactory from the theoretical aspect, although, they often serve as a cover. Namely, power is felt in reality, it is even broadly visible, but everything is justified by the market.

Also, it is not logical for the market to rise to the level of absolute resource allocation mechanism, when we know that it has a lot of imperfections. For example, the actions of several US big companies: General Motors, General Dynamics, Gooogle, Apple, Facebook, Amazon - can we talk about competitive market with these players who dictate the rules and influence in the market developments? The problem has been intensified with globalization, because there are no game rules in the global market, so these and other powerful players are in a dominant advantage.

Malthusian theory of population, explaining the growth of population, wages, and living standards have had a major impact on the classical school. Malthus defined the existential minimum, initially as physiological, and later he changed it and defined it as social and psychological. He spoke of poverty that was largely caused by (uncontrolled) population growth. His message is understood as pessimistic. According to his theory, mankind is trapped in an eternal tension between the number of inhabitants and the food supply, which could not be changed by economic and political reforms. But Malthus was not a pessimist, he was an ambicious man who proposed measures to regulate natural growth. The best help for the poor is the social and economic policy that would stimulate a declining birth rate.

Malthus was also known for supporting the "Corn Laws" introduced in England in order to ban imports when domestic grain prices would fall below a certain level. Although it was opposite to the principles of free trade, which were supported by Ricardo and other economists, Malthus advocated for the introduction of tariffs on grain.

Another Malthus' claim, interesting at the time, was that an insufficient demand leads to unemployment. Ricardo commented on this view as an incomprehension of basic economic principles. However, Keynes will later in his Chapter 23 refer to Malthus as the forerunner of his theory. This understanding, although illogical to Ricardo, Malthus' great friend, was grounded on his assumption of population and wages. Workers' wages will be

reduced to an existential minimum, workers will produce far more than their demand may absorb, and there will be a latent tendency towards hyper-production. Thus, the total demand in the society will be insufficient to absorb the total offer, and the natural consequence will be unemployment.

These considerations significantly influenced Minimum Wage Law. The classical school influenced the customs policy, as it supported the policies that represent the freedom of foreign trade. External trade offers the benefits of international specialization: when each country improves its production and uses one part of that production for the exports, which, on the other hand, finances the imports, all countries must use their advantages in international trade. The basis of this view is the theory of comparative advantage as the basis for the international division of labor.

17.3 Policy-making in a long run

Competition is inherent to the economy to a smaller or larger extent. The needs are expanding. There is no static, just a constant change, constant motion. New needs bring new interests and motives to be content with new consumer goods, new methods of production or transport, new markets, new forms of industrial organization. That way, the economic structure is constantly changing from the inside, always breaking the old one, again and again, and creating a new one. This process of innovative changes is the basis for entrepreneurship. Hence, entrepreneurship is a mechanism for creating and maintaining the economic system in the continuous development. It is a challenge for economists and politicians to understand the polytechnical reality, and to set up the adequate development policy.

The entrepreneurship is based on the competition of new goods, new technologies, new sources of supply, new organization types, new approaches to management, and new approaches to labour. Therefore, the role of entrepreneurship in economic development is multiple. It includes not only an increase in output and *per capita* income, but also the creation of changes in the structure of business and society. This change is accompanied by the growth and increased output, which creates more goods and services for participants in the distribution. What stimulates these changes and development?

According to one theory, innovation is the basis not only for developing new products and services in the market, but also for stimulating inte-

rest in funding and creating new businesses. New investments affect both sides of the growth equation: new capital expands the growth capacity (supply), while the corresponding new consumption, or new usable value, expands the demand.

The process of product development is a process where innovation is developed and commercialized through entrepreneurship, which affects economic growth. The process of product development starts with knowledge in basic technology and science, such as electronics, or thermodynamics, or mechanics. It ends with the product and the service available for shopping on the market. The main point in the product development process is the intersection of knowledge and the recognition of social needs, which initiate the product development phase. This point, in the literature called iterative synthesis, often fails to be crossed, that is, the product does not reach the customer. Therefore, the entrepreneurs need to concentrate their efforts.

Innovations can have different levels of uniqueness. Most innovations are new products with a little technological changes. There are fewer innovations with significant technological improvements. Regardless of the level of uniqueness or technology, innovations are evaluated and developed for commercialization through various entrepreneurial mechanisms.

As mentioned before, technological progress has not stopped since the 15th century. Politics has not obstructed the technological progress, nor is it expected to do so. It simply happens in the areas with favorable institutional environment. This means that policies do not have any specific technology challenges[47].

The challenges for policy-makers are more present among entrepreneurs. One of the challenges is to justify subsidies for the benefit of young people, new entrepreneurs, or efforts to keep unsuccessful companies in business. It is difficult to evaluate the effectiveness of such programs without statistical data and research. However, a normative response to this

[47] Regarding the challenges of policy-making in the technology, maybe we should mention the phenomenon of blind travelers, because sooner or later the entrepreneurs in one region could benefit from the research carried out in some other area, possibly through imitation. However, the significance of this concept should not be overestimated, because even if it comes to it, the policy-maker has a redistributive role, he makes decisions, but the surplus generated by innovation/imitation belongs to the protected/privileged producers or consumers.

challenge may not affect the essence of things. One of the problems is identifying the marginal projects[48].

In addition, the question remains: Are "marginal projects" solved the other way? For example, if the gap between private and social innovation causes regulation in favor of another party (consumer, worker), then the solution is the abolition of these privileges. Or, if this gap between private and social innovation comes from excessive profit taxation, the solution is to reduce tax pressure rather than subsidies.

Some policies in this area are ambiguous. For example, the encouragement to create new companies, while at the same time complicating it for ineffective companies so they go bankrupt. I do not believe that this is in the interests of consumers, because if they were sufficiently appreciated, they would not even come in the situation to need help from the state. Indeed, policy-makers see the economy (the market) as a cake to be distributed among consumers, not among producers. Instead of encouraging the risk taking, planners generate privileges or expand them. That way, they put the economy between two evils: 1) rules of the game, which prevent the growth of a cake, protecting inefficient producers, and 2) strategies, aimed at redistributing a cake among hungry guests, which are increasing in number. It is a degeneration of justice in the struggle for privileges, as Gordon Tullock pointed out more than 40 years ago.

In my opinion, the key problem of a long-term policy-making is the declining growth rate. Unfortunately, the measures of policy-makers do not take this into account, imposing a mix of measures, which ultimately come to the redistribution of a smaller or slowly growing cake. Controlling rent-seeking enables entrepreneurship, or favorable opportunities for entrepreneurs, while productive entrepreneurs still carry development and growth, through the role of innovators and the promotion of science and innovation. If the plague

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[48] The purpose of a project's subsidies is to allow marginal and extramarginal projects to see the light of the day. This means that the intervention would be justified when a project is not profitable according to the market criteria (it would be extramarginal), however, it would be beneficial according to social criteria. Instead, inframarginal projects should be out of the picture, because they would be sustainable in any case. As can be expected, a decision-maker encourages the selection, and funds inframarginal projects, or those that can prove to be successful beyond any reasonable doubt (Velstan, 2000).

of rent-seeking is not controlled, more or less crises will occur. In a such situation, the entrepreneurial culture is collapsing, especially the productive entrepreneurship. The government's long-term policy-making in order to get entrepreneurship out of the crisis can be based on a limited range of formulas. It is difficult to opt for a radical institutional change because rich and satisfied individuals do not want it. Traditional recipes, such as fiscal or monetary tricks, do not have much prospects to provide satisfactory solutions. These policies do not solve the causes of crisis, which are primarily related to unproductive rent-seeking and/or educational system, which causes the entrepreneurial paralysis. Such policies sometimes aggravate the situation. Higher taxation and interfering the interest rates do not essentially contribute to solving the problem in a long run.

Instead of policies, the hope for growth in a long run could only stem from technological advancement. Despite the politics and the constraints created for the productive entrepreneurship, technological progress actualy creates opportunities which the future entrepreneurs might want to take advantage of. However, in a more favorable political environment, the economic value of these advances will be higher. There is also a better potential of some sectors and their higher benefits. Due to the relatively loose regulation of these sectors, they could be developed faster, transferring the development more successfully to the rest of economy. This leads to the economy growth and provides favorable opportunities for the political class in trouble. Otherwise, stagnation is inevitable, accompanied by a real threat to the decline in purchasing power for huge segments of the population. Discontent with politics, seeking political change, also makes a real threat.

17.4 Policy-making in the medium run

Policy-making in the medium run has the purpose of countercyclical action, or moderating of business cycles. Choosing a business cycle justifies an intervention before the public opinion, and is attractive from that aspect. This is particularly stressed in situations where the crisis hits several countries simultaneously. In this case, policy-makers have justifiable reasons for not dealing with long-term issues, while short-term policy helps them to fill the ranks of their electrorate, but also to silence their opponents. However, this can be terrifying (counterproductive) for policy-makers; namely, if policies fail, i.e. if they achieve the opposite effect, the policy-makers weaken, becoming vulnerable to competitors. This explains their actions, which are

often late or bad, while the most important consideration is about political integrity.

Business hesitancy of politics encourages the expectation that individuals could modify their preferences, and even change their behavior from the ground. For example, it is possible to expect from individuals in a crisis to reduce their spending and switch to savings in order to face the future possible deterioration of economic situation or lasting crisis. This leads to a reduction in demand for consumer goods, but also to a reduction in investments, and part of that savings is inevitably exhausted. Part of resources will not be consumed, and will end up as a "bad investment", (i.e. fixed capital that will not be used in the production process). All this leads to deflation, as there is a surplus of production inputs (including labor), while aggregate production will drop until the demand for investment goods is adjusted with savings. This is followed by a reduction of production, depending mostly on the economy regulation, and the control of labor costs, not allowing the nominal labor cost to decrease[49].

Given the possible behavioral change, and trying to prevent the damage to the political class by these changes, policy-maker acts through expansion or contractionary policies: printing money or transforming domestic or foreign savings into domestic consumption (public debt). The goal is to link these actions with the responsibility of policy-makers (e.g., a contract that characterizes the social responsibility era). However, these actions can also be counterproductive.

17.5 Two major crises and politics

Over the past 100 years, two major crises stood out for their depth and scale: the Great Depression (1929-1933), and the Recession (2008-2009). Let's consider the policies of governments during these crises. There were three elements in the policies and strategies against the crisis: 1. universality of these crises as they hit the whole industrialized world; 2. a huge intervention, which, in the end, led to a partial nationalization and great political interference in economic activity; 3. delayed reaction by policy-makers, and new measures: corporatism or some mild form of central planning as the ultimate measure of protection against future crises.

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[49] 3Price flexibility can ensure the growth of physical production, despite the fall of factor prices, which in turn encourages investment.

During the Recession, the governments have additionally undertook enormous injections of liquid assets in order to save institutions, and even some large production companies.

According to the analysis of reactions to these and other crises, the model of social responsibility was the only model of reaction to the crisis. But, all the crises do not have the same origin. The oil crisis in 1973 was caused by unforeseen shocks in the structure of relative prices. The crisis of 1929-1933 was caused by syste

From the standpoint of politics, not much could be done to prevent the crises (e.g. the oil crisis in 1973). This is mainly about assessing whether price adjustment can transform into crisis, and whether this leads to behavior change. In the policy area, the shock could lead to behavior change, but even then the outcome does not have to be "critical".

The crises that are the result of a systemic error, either because the factors misinterpret the market signals or because the market sends distorted information, are the abovementioned major crises, where policies mostly act as previously explained.

18. THE ROLE OF DEVELOPMENT POLICIES IN EXITING POVERTY

18.1 Introduction

Over the past several decades, there has been more precise and more objective ranking of countries at the development level. Recently, the World Bank sorted economies according to their Gross National Income (GNI) per capita in four categories: countries with high-income (>$11,905), upper middle-income (>$3,855); lower middle-income(>$975), and low-income (<$975). In 2008, the average GNI per capita in these four groups of countries (adjusted in accordance with purchasing power parity in brackets) was $39,345 ($37,141), $7,878 ($12,297), $2079 ($4,592) and $524 ($1,407)[50].

In literature, developed countries must meet two criteria: 1. they operate within the limits of consumption and production possibilities, as defined by "fastest racers"; and 2. their wealth does not primarily arise from the exploitation of raw materials, but from the use of fixed and human capital[51]. Therefore, the economic development of these countries is based on a qualified (productive) labor force, quality equipment with modern machines, and maximally developed entrepreneurship. Thus, *developed countries* represent an economic elite, however, the standard concept of a developed country is necessarily arbitrary and relative. Relative - because players at the top shift, set the reference standard (e.g. GNI). Arbitrary - because GNI, as a measure based on a production quantity, does not, according to many, represent an adequate substitute for wealth and happiness. Therefore, it is not a good measure. Also, there is no defined range for standing out of the elite.

Countries which do not belong to the previously described group are underdeveloped countries. There are various reasons why these countries are underdeveloped. In many cases, the rules of the game are more or less the

[50] The World Bank Development Report, 2010.

[51] See: Peter, Development Frontier.

same, investment are slow, and the factors hardly change their behavior, skills, and entrepreneurial attitudes. However, that is not a common characteristic for the most of these countries; there are no periods of rapid growth, nor a continuing increase in welfare. There are some improvements (sometimes significant), which will probably be appropriated by a limited number of interest groups due to the intensive rent-seeking. The aid programs end up similarly, having little effect on the growth, since they end up in the hands of interest groups (Bauer, 1974, 1991). There is a considerable amount of literature about the reasons for the slow change of underdeveloped countries, and my opinion is the closest to the perspectives that focus on education and institutions (e.g. Mankiw et all, 1992; Gwartney et all, 2006).

According to their specific characteristics, "transition countries" are the economies with limited growth and low income during more or less long term periods, which opted to convert into the market economy and implement institutional changes. They show signs of mild growth with significant and long-term effects on the standard of the resident population. Certainly, the countries of the Eastern block can be classified in this group of countries, which have entered the institutional-political transition in 1989. After the first phase of institutional change, the second phase gives the opportunity of catching up with the ruling elite.

Regarding the temptations of economy and politics to which this book is dedicated, this chapter will discuss poverty in underdeveloped countries and the role of politics, both as the cause of poverty and the factor for overcoming the same. Poverty in underdeveloped countries is an important issue for politics and economics. The emphasis is on fostering developed countries and the factors that play the most important role in their economies.

18.2 What is the issue with catching up?

The differences in levels of development mean a major international inequality, that is, an increase due to the worrying growth of inequality in general. In addition to constant and serious preoccupation, in the most influential organizations dealing with planetary management, these differences are subject to analytically improved and subtle measurements of international inequalities. Recent analyzes of global inequalities give a more accurate and faithful picture, e.g. Milanovic's book "Global Inequality". All the efforts of international institutions and science have not prevented dangers

to the stability of the world, or even the planet. Although Milanovic and others have presented a completely new analytical approach to the inequality on an international scale, the most traditional observation of such disbalance remains. It is about understanding the inequality that is defined at the state level and viewed through the differences in income per capita. Measurement is done in the manner described above: GDP *per capita* differential is calculated in relation to the selected reference country. Usually, GDP *per capita* of other countries are calculated as a percentage of GDP *per capita* in the most developed countries.

According to Pavle Sicherl (2004, 2010), the analysis of time distance requires a radical change in perspective, given the time series of data. According to the conventional perspective, the comparison of discrepancies is mainly based on the absolute or relative value of certain socio-economic indicators at any given time, where the main emphasis is on the vertical differences between time series of data at any time, respectively. A new view at the time series, which for understandable reasons can be characterized as "time", has its main focus on the horizontal difference in time for each level of socio-economic indicators, for two or more compared units. According to the new focus, the time distance measures the time differences for specific indicator levels. The new statistical measure S-distance as a separate category of time differences measures the distance (proximity) in time between points, when the two groups that are being compared reach a certain level of indicator X.

In accordance with the change of perspective, Sicherl introduced the concept and the appropriate measure of S-distance. Basically, S-distance is defined as the number of years required for a country with a low GDP *per capita* to reach the reference of developed country. For example, the countries A and B have GDP *per capita* only 20% of a much developed country C's income. The conventional distance, as a static concept, would evaluate that the countries A and B lag 80% in comparison to the country C. However, this proration does not takes into account the growth rates of countries A and B, and these rates have a significant impact on the indications of lagging behind. If countries A and B have a growth rate lower than country C, the lag is hopeless, and there is no optimism. However, the growth rate of countries A and B is higher C's, because the position of lagging countries must be analyzed by taking into account the growth rate. For example: A and B have equal GDP *per capita*, which is 30% of C's; say, A develops

three times faster than C, and B has a growth rate of 90% of C's growth rate, it is clear that the developmental position of A in relation to B is incomparably better, although at the same time they have equal GDP *per capita*. Starting from this simple observation, Sicherl expanded the conventional comparison with S-distance. The simplest variant of S-distance is the one that calculates the number of years required for the country A to reach the development level of country C in the current period. This requires the prognosis of future growth rates for the particular country. Sicherl believes that even without this prognosis, by taking current growth rates, the analysis has an important task to respond to individual and social perceptions of lagging in a given period, that is, to answer the question: How is the lagging being accepted, and this is a significant input for development policies, in order to influence the possible blockade of development.

Sicherl believes that the analysis can be generalized by assumptions or estimated rates, and scenario can be made for the number of years needed for the poorer country to reach the developed countries. The important variables in the analysis are the growth rates of lagging countries, as well as the growth rates of a developed country.

How to determine the economic lagging of a small economy, such as Montenegro, in relation to the region, or to the developed countries and the European average? For the sake of simplicity, we will take only one indicator: GDP per capita (the ratio between what an economy, or the country, produces annually, divided by the population of given country). Per capita income is only an indicator of growth, it is incomplete and insufficiently analytical. But, it could be used for the purposes of this analysis, i.e., "The lighthouse on the sea is not the sun, but it gives important information to the captain of the ship or to some castaway!" (Vukotic, p.55)

Table 2 illustrates data related to the explanation of the lagging and the time dimension of that lagging[52]. Table 1 shows the GDP per capita ratio between Montenegro, the most developed country of the former SFRY (Slovenia), the least developed country of the old EU 15 (Portugal), the most developed country in the EU (Luxembourg), and the EU average in 2009.

[52] Source: Vukotic, 2008

Table 2: GDP per capita in 2009 (in €)

Country	*2009*
Montenegro	€5.215
Slovenia	€18.468
Portugal	€15.656
Luxemburg	€75.780
EU 27	€25.134

It is a question of catching up with the countries that we took for comparison, that is, how much time Montenegro needs at the given GDP growth rate to catch up with some of these countries? In order to achieve that, according to some assumptions, it is necessary that the annual growth rate of GDP in Montenegro is higher than the growth rate in those countries, assuming that the number of inhabitants remains at the same level. There are several scenarios for thinking about the future, but we will simplify the analysis by taking two scenarios.

If Montenegro wants to reach the level of these countries by 2025, at which rate should grow its GDP? How high should be the "catching up" rate if the average GDP of these countries is: a) 0%, and b) 3%? In the first case, and in order for Montenegro to have the GDP per capita in 2025 at the level of these countries in 2009, the growth rate in Montenegro should be:

Table 3: Case a – catching up

In 2025 Montenegro should have the GDP of:	*Average annual growth rate - Montenegro's "catchin up " rate 2009-2025*
Slovenia (€18.468)	7,72%
Portugal (€15.656)	6,68%
Luxemburg (€75.780)	17,05%
EU 27 (€25.134)	9,69%

Assuming that in this period all these countries of Europe will have an average growth of 3%, the "catching up" rates will rapidly increase (case b).

Table 3: Case b – catching up

In order to reach GDP per capita in 2025, countries that grow at an annual rate of 3% with an unchanged population	*The average annual rate growth of "catching up" of Montenegro 2009-2025*
Slovenia (€30.525)	11,00%
Portugal (€25.877)	9,90%
Luxemburg (€125.252 – level)	20,60%
EU 27 (€41.543)	13,00%

If Montenegro's economic policy set the goal of reaching the European average in the next 15 years, what does it mean from the aspect of the GDP growth rate, or what are the consequences on the overall policy and behavior of economic actors (enterprises, banks, households, state, consumers...)? This means that the Montenegrin economy should have annual grow rate of 13%, and since the EU average annual growth is "only" 3% (not including the population growth in both Montenegro and the EU - because it makes no big differences), so in 2025 Montenegro would have an EU average!

On a practical level, this means that Montenegro will annually produce €450 to €800 million more (13% of the current GDP of €3.5 billion is about €450 million). Clearly, this is a very high rate of growth, almost unrealistic, if the entire social organization is not changed and adjusted to it. With the constraints and problems that the transition brings, it is not feasible.

However, this "catching up" rate has a practical and psychological significance. It is important to understand that there is a need to improve every activity at all levels (company, workplace, administration, parliament). Certainly, this includes a psychological expertise of our own development.

18.3 Different views on poverty

The economics has been dealling with the correction of bad economy, through the identification of the causes of poverty, and the recipes for its reduction. In the functioning of the economic machine, economists have identified more inadequacies in the economy. Three are considered to be the main reasons for misery in large parts of the world: the lack of fixed capital, the lack of education and the lack of appropriate institutions. The economic theory offers different cures and policies for getting out of poverty.

Initially emerged the theories focused on fixed capital and advocated as a cure for the rapid growth of heavy industry, which would be fostered by central planning. If this was not feasible with domestic accumulation, which was generally low, the recommendations were to use foreign loans. These recipes did not prove to be successful, and they ended up with a lot of bad economic talks, with missing capacities and factories, which hardly produced anything, and many of them were closed due to the inability to maintain, the lack of managerial staff and the market. In addition, corruption and military regimes have flourished.

Then, the emphasis was focused on human capital and its improvement programs, with emphasis on specialist skills and training. The outcome troughout the world was disappointing. The selection of projects was usually under the control of a local elite or interest groups, who were often not interested in educational improvements, and the development of people's professional abilities. Thus, resources were wasted on these projects, and only the privilaged participants and instructors (foreign and domestic) benefited from them. Sometimes educational plans were poorly adjusted to industry needs; they were mostly aimed at creating markets on various bases, for example, markets for consultants, equipment suppliers, construction companies, etc. Regarding the programs focused on higher education, the effects were very poor in several reasons. The first is the neglectance of the fact that education is futile if there is no favorable environment for business and investment. A prominent problem is closing the door for capable and educated people, both among local producers and administrators. Therefore, many capable people, aware of the futility of their efforts, are looking for other opportunities to use their talent in a more productive way, and this is where

the rent-seeking became attractive. Also, a vast number of trained people are forced to go abroad to get the most out of their acquired skills.

When previous recipes proved to be unsuccessful or insufficiently successful, scientists turned to studying the rules of the game, as they began to notice the causes of bad economy: unreliable judiciary, state-level corruption, arbitrary decision-making of rulers, and the use of coercion. From these studies emerged the "production of experts," who recommended the transfer of Western institutions, legal systems, and business models into the poor world. There has been a broad platform of reforms and promotion of these models, which, again, have been used by politicians for political talks of change, often leading to a "smoke screen". In fact, much of that can not be underestimated, both in the positive and good intentions. Nevertheless, there are many examples of reforms that have not scratched the surface. If there were no serious changes, local governments could use it for their pockets and interests. Honestly speaking, there are some examples of success, where the rules of the game are truly changed for the better: productive entrepreneurship is driven by deregulation measures, soft budget constraints, guaranteed by the state, and more credible protection of private property.

Undoubtedly, institutional changes that eliminate privileges and waste of resources contribute to better performance. As we have seen, poor institutions allow privileges to bad politicians, and this can not eliminate poverty. On the contrary, this allows inefficient producers to waste resources and block the market powers, getting rid of competition and the free market. The economy is suffocated in internal inefficiencies, while the inefficiency of domestic firms increases in comparison with effective external competition. However, there is a very strong opinion that this model and the adoption of "good government" is only a transplant of Western practices and advices. According to this view, good government can not be achieved without political change, and these changes are not the result of expert advices and improvement of human capital. More researchers in this area (Colombatto, Berkovic, Lin) are reserved towards the success of copying the Western institutional models. Berkovic claims that the specific conditions in a country for the adoption of a particular legal code are far more important than the origin and perfection level of the law. He clearly states: "First of all, in order for the law to be effective, it must be conceived in the context in which it is applied, so that citizens have the incentive to use the law and demand institutions that work on the law enforcement and development. Secondly, jud-

ges, lawyers, and other legal intermediaries who are responsible for the development of the law must be able to increase the quality of the law in a manner that suits the demand in terms of legitimacy" (Berkovic et al., 2003, 166-167).

There seems to be an overestimation of the role of institutional context in exiting poverty, as if the appropriate institutional context is sufficient for it. We do not deny that better laws are important, but these laws need to be applied. The way they are applied is equally important. Institutional perspective has shown that the economic impact depends on the rules of the game, while the evolution (stability) of these rules depends on the relationship between policies and their improvement. The implementation of the rules, however, depends on the legitimacy of politicians. This gives us the basis for understanding why a whole set of rules and solutions are ignored by their users, even when they have proved their value in the developed world. Obviously, the institutional perspective needs to be seen in a wider interdisciplinary context, which provides more strategies for exiting poverty.

In such a context, the institutional perspective is reduced to economic freedom. Economic freedom does not exist without a legal structure that produces stable and credible private property rules. It seems that the story of economic freedoms in the poor societies is tautology, because many changes need to be made in order to achieve economic freedom. In any case, economic freedom is in a strong correlation with economic factors. These questions arises: Why is it so difficult for the poor people to use the benefits of a free market? Why are the changes in game rules slowly taking place, and without significant success? Why are these efforts turned into establishing an elite for exclusive rent-seeking? Unfortunately, they infiltrate into the field of culture, exploiting the institutional context, which also determines them in power. Seemingly, this is the strongest threat to poverty, because with such structures, poverty is increasing, and inequality in the community is rising. On one hand, the establishment of an elite for the exclusive rent-seeking is importantly determined by the institutional and cultural context, and also the preservation of power. On the other hand, these societies are not able to agree on the common basic principles of institutional changes. Therefore, it is not feasible to establish a new agreement that supports a renewed cultural structure.

18.3.1 The role of culture, behavior, and social contract

Human activity in a social context is determined by: culture, behavioral routines, and human understanding of social contracts. These elements are interacting and in combination affect the poverty, i.e., they enable a poverty analysis. Logically, there is a link between poverty, on one hand, and culture and behavior, on the other.

18.3.1.1 Culture

The value system of the poor countries is built on the ideology that poverty is a virtue. This spiritual matrix relies on the thesis: wealth can be acquired only through dishonored behavior! (?) How to abandon the value system in which poverty is virtue? What is the alternative? Is wealth dominantly focused on money when such a view of life always results in an ever-increasing and greater tendency toward material enrichment? Or material wealth as a means of achieving other components of an individual's development: spiritual and cultural development? Prosperity could be a word that explains this understanding of wealth. Prosperous societies believe that wealth is a virtue.

Value systems are shaped according to culture which includes prevailing customs and ethics. It encourages an individual to correct his/her behavior in order to deviate from the expectation of reference community. Cultural models include personal emotions, as long as their expressions are recognized (coded) by the environment. Researches provide information on the expectations and behavioral routines of an individual. Therefore, researches are often desirable, especially in situations where cooperation is needed, and in situations where contracts are incomplete, when the implementation of interaction is expensive and poor.

Exiting poverty is related to changing cultural models. In order to catch up with the developed countries, the poverty culture model must evolve. Also must be adopted the main value on which their prosperity rests, and that value is individual freedom, having two instruments: the market economy and democracy.

How to exit misery, confinement, primitivism, control, misconception, and much more that determines the culture of poor countries? Culture helps to understand how an individual thinks and observes what is happening around him/her. Based on cultural patterns, an individual can develop

his/her own moral standards. These standards are developed under the influence of outside world, possibly another culture, new ideology brought by convincing intellectual innovators, or formed within the family, among friends, teachers, colleagues... Cultural standards can be shared with the rest of the community, and in that case they define a common concept of institutional moral legitimacy (rules of the game) or social action (politics).

For a conformist, the (collective) culture and (individual) psychological models coincide. The conformist believes that public opinion and the generally accepted truth are always right and just, and that the prescribed way of action should be followed, no matter what that means. In entrepreneurial societies, conformism is an exception rather than a rule. Such societies cultivate a culture of curiosity, accepting differences, self-improving, and adapting to new environments. These are characteristics that are expected from individuals in societies where entrepreneurship drives further growth.

In societies where culture of uniformity prevails, dominate routines and more or less the same repetitive practices. Opposite to that, *open societies* accept the dynamics of willing individual action, in which the individual psychological model, in interaction with inherited cultural traits and new exogenous ideas, determines the evolutionary path of culture. In such an "open" culture, the key concepts are tolerance and deeply rooted and fairly stable moral principles. Tolerance encourages individual improvements and progress, while moral principles are the basis for achieving long-term cooperation.

When individuals are organized into groups, not held by moral standards but by groups of common desires, then it is a goal-driven culture. This conflict arises because each subgroup of a social entity has specific moral standards or lacks defined, clear and strong moral standards. In such societies, which are "goal-driven", the policy approaches are accepted as long as they seem to be useful in achieving common goals, and tolerance is most often limited by objectives. According to Colombatoo, many developed countries are also part of this "goal-driven" culture (Colombatto, p. 241).

We can identify societies where individuals are less in agreement with collective goals, defined by a majority (or a strong minority), or with means of policy-making that should be applied in order to achieve such goals. In such societies, individuals have more or less the same attitudes regarding the meaning of an acceptable or "fair". An individual has the legitimacy

to resist the state coercion, and the right to withdraw from an "implicit" social contract. According to the open market philosophy, an individual always has the right to withdraw from the group. On the contrary, the socialist attitude imposes rigid respect for cultural rules.

In the end, there is an extreme case when prevailing culture does not exist. Cultural patterns are replaced by the system of formal cooperation agreements.

18.3.1.2 Behavioral routines

Imagine an ideal world without interference in correcting behavioral routines. Behavioral routines can be driven by the spontaneous interaction between psychological models (i.e., the way we are) and culture, without any regulatory interference from the government. People would follow their own preferences, their own moral standards, their insights, choosing what is best for them in achieving their preferences. In a such (ideal) world there is no need for coercion, except for the purpose of preventing violence and enforcing previously agreed treaties. Formal rules and policies that only reproduce informal canons solve coordination problems in order to achieve common goals. Adapting to the outside world, in order to enhance cooperation, is a personal choice, and definitely not under the threat of aggression by some third parties.

In reality, however, it is difficult to achieve this ideal. Regulators and legislators are a reality, where the state is not neutral. State activity imposes behavioral rules, which can often be in line with interest groups, or are in disagreement with the psychological model of at least some groups of people, if not with the model of significant strata of society. Therefore, legislators are also important: they have their own goals, based primarily on political integrity, mixed with culture and ideology as a wider context of action. The elite that dictates the rules, usually evolves into the rent-seeking group[53]. Again, this elite usually does not try to accomplish any specific task in terms of improving well-being, except to maintain consensus and preserve power. Rent-seeking must be limited to the principles underlying an implicit social contract. In that case, the dictators of the rules have nothing to fear, and new behavioral routines will eventually be accepted. However, the situation is much more complex without these basic principles. Thus, a detrimental rent-

[53] This is especially emphasized by the public-choice school.

seeking can lead to turmoil which can be avoided under the threat of violence.

Conflicts created by various phenomena of rent-seeking, stimulated by certain groups, explain the decline of many societies (economies). Such societies can hardly be effective; it is more certain that the state action faces the resistance, and social groups break down into smaller subgroups maintained by culture and common behavioral routines.

18.3.1.3 Social contracts

Social contracts are the foundation of common policy making. The nature and content of social contracts determine the common policies and the extent to which contracting parties can deviate from it without losing power. Social contracts and their subjects contribute to understanding poverty and change. For example, the subject of contract does not have to be economic growth, but the contract can be formalized to meet other priorities. Perhaps this seems confusing if it comes to poor countries, while it is almost usual in rich environments, where there are also advocates of a zero-growth perspective, and not a few of them.

A particular problem for the poor countries is when the social contract is not formulated, and this leads to a conflict between divergent coalitions for rent-seeking. The lack of a social contract can also help us to explain the situation when individuals are deeply unhappy, or when they become victims of oppression by rent-seekers. Such dissatisfied individuals fail to initiate collective action, although they believe to possess greater potentials, and can achieve more and better, and should enjoy greater benefit.

To conclude: the presence or absence of a well-defined social contract plays an important role in the development. This is especially important when the community is divided, either due to the impact of artificial political arrangements imposed from the outside, either when some autocrat from the inside manage to replace old behavioral routines with new rents.

The main idea is this: when we (a scientist, a researcher) take into account the positioning of a community in terms of economic development, we can not exclude the characteristics of a community's co-operation, which can be assessed against its cultural basis, where reliability of partners in exchange and protection is provided by the property rules (freedom).

Culture defines acceptable and unacceptable social goals, and includes the basic principles which ultimately define the extent to which violence can be legitimately applied.

Reliability refers to behavioral routines which are credible only if in accordance with the presence of deontological principles or the use of violence. Property rights are the essence of a system based on entrepreneurial progress.

18.3.2 Rent-seeking

The "rent-seeking" game has a long history, different shapes and influences. In poor economies, we can talk about a variety of rent-seeking situations. The first is rent-seeking by a small elite which holds political power and economic power. This elite remains in power while preserving its political and economic position, preventing competitors to get any chance or opportunity to overthrow them. For this purpose, the elite is ready to use violence, threats or the adoption of rules that prevent opponents from collecting the financial resources needed to organize effective resistance through the use of justice remedies or public opinion. However, maintaining a position of power prevents positive change, because the production of wealth goes only to the hands of the elite. The moment when repression is no longer viable, institutional transition is at the beginning.

The paradox is that the ruling elite does not want to cross that critical point, because it is clear that it loses the rent and the possibility to increase (the concentration) of wealth. This explains why is poverty maintained: poverty is actually the goal of these elites, and not a problem. When a certain line is exceeded, at the medium income level, the transition certainly continues. Ruling elites can avoid it only through strong foreign support (military, financial).

The second situation related to the poor countries is the diffused rent-seeking. It can be seen in the countries with significant natural resources (Robinson et all, 2006), controlled by the ruling elite, while the rest of the population has relatively low but acceptable purchasing power, and, in addition, are not specifically related to the work efforts of individuals. This creates a huge bureaucracy, which is in the function of maintaining relative poverty through "acceptable" revenues. Thus, the bureaucracy is a beneficiary of a positive rent, while the ruling elite leads, creates and redistributes

the rent. Similar to the previous situation, this model is maintained as long as the economy has the ability to meet the demands of rent-seekers and the expectations of others in terms of revenue. When this fails, the system faces a crisis or political destabilization, turmoil, and eventual transition. Let's repeat: in poor societies, this is not an open game, but rather a discretionary one.

On the other hand, in developed societies, this is an open game or relatively open. The participants are competing coalitions, each of which tries to create privileges and benefit from them, without creating a lot of noise.

18.3.3 Exiting poverty – reaching the critical point in opened cultures and goal-driven societies

The perception of inequality and the struggle to reach critical points in exiting poverty depends on the possibility to compare living standards. Naturally, if the perception of differences and levels of living standards is sharper, then the willingness to fight is greater and the comparison of standards is easier.

Communication is precious in achieving a critical turning point. It allows broader views and comparing it with others. Opening up to other systems, and learning about living standards of others, including opportunities provided by developed societies, allows a critical point in the way of thinking, which means abandoning the policy of isolation and closure. For example, spreading the Internet and modern means of communication in the fight against poverty is fundamental. In that sense, we can metaphorically conclude that a single man (Bill Gates) has defeated a large military army of the Soviet Union. In essence, the new information technologies have opened the eyes of Eastern Europe's people, and they realized that their elites are not sincere because they used propaganda to maintain their positions. When they came in a position to compare, people from the Eastern bloc became aware that western morality was no worse than Eastern corruption and alienation. They also realized that their standard of living is far behind the Western one. However, the increased awareness lifts the fog that hides the moral base of communism, which was based on intimidation and deception. This does not apply to the idea of communism, but to politics in the former communist countries, which have used this idea to govern their peoples. New orientations appear, illuminating the path for fighting against lies and privileges.

Evidently, political positions are not easy. The ruling elite strives in various ways to neutralize the effects of comparison. They usually use anti-Western propaganda, referring to the alleged decline in Western morality, and to the incitement to aggression, exploitation and imperialism of the West. Propaganda is enriched by problematizing the placement of material progress, as a life goal, and the greed which is related to it. Instead of this "immoral" concept, there is a persuasion that spiritual wealth is the supreme lifestyle. In accordance with this come nationalism and religion. There are movements which propagate that religon is more important then democracy. We are witnessing the threat to democracy by Islamic Fundamentalism. (In the course of history, some other religions have been exploited in a similar way.) These attempts to neutralize the effects of comparison are supported by nationalism and religion, that is, by national and religious pride, in order to create an alternative culture (that suits the elites in power). They are contrary to potential substitutions that would endanger the elite because they come from democratic humanity.

Still, communication is not enough. One thing is to hear and find out, and another thing is to know and apply. That is why they should understand the conditions that need to be fulfilled, in order to take advantage of the opportunities that arise with opening and new knowledge. It is often believed that the main requirement is to make "simple" changes to the political regime, while less attention is paid to the change of behavioral routines, needed to create wealth. Instead of positive changes in goal-driven societies, behavioral routines can be slowly adapted. Such behavior will not improve the economy, while political change leads to a "negative consensus", which creates instability; At the same time, the principle of "revolving doors" becomes a political form of staff layout, and all of this is not useful for creating wealth. Riots will be widespread, quite likely. Therefore, it is not possible to create a new model of social co-operation, nor the culture is able to accomplish that. A diffused rent-seeking threatens to make the behavioral routines of rent-seeking become transformed into a cultural phenomenon.

Open cultures are also sensitive, because they do not contribute to the growth. No change gives an immediate result, and due to unrealistic expectations of open cultures, they can experience problems. Thus, due to slow changes, transition can turn into a political struggle for power and crumbs of wealth, dispite open cultures. In such a situation, certain open societies could have problems in accepting the concept of an independent but

responsible justice, implementing the property rights clearly, quickly and without obvious subjection to political pressures. Also, time and patience are relevant. New ideas are not easy to implement in bureaucratic apparatus, created in dictatorships, which is difficult to achieve in the short term. It is not easy to find and train state officials, who will change the way of work in the administration overnight; the entrepreneurs are also rare in such a society, and the lack of successful directors is evidently present. It is not easy to even train the judiciary, which is in charge of ownership, a fundamental requirement for wealth creation. Neither the judiciary can be replaced overnight, especially if it has developed a culture of servitude towards political elites, and has a habit of getting instructions and support from them. All this slows down exiting poverty and catching up with the developed ones.

In addition to the above, exiting poverty definitely depends on people's attitudes towards entrepreneurship, ownership and unhindered competition. An open culture is also necessary as a condition to take ownership from current leaders. However, this process requires cultural changes, that is: "As history shows, it takes years, perhaps even decades, perhaps even generations, to come up with some new (or renewed) culture" (Colombatto, p. 255). Since poverty is largely the result of calculated efforts to preserve a culture from exclusive rent-seeking for a small number of elites, this elite will also fight against growth, if they feel threatened by it. This is a major obstacle to changes in behavioral routine, aimed at rent-seeking. Clearly, without abandoning such culture, changes would slow down or cease.

19. TRANSITION AND POLITICS

19.1 Introduction

In the previous chapter, we discussed the role of politics in overcoming poverty, and its negative role in causing poverty. I think that politics is the main cause of poverty, not only in developing countries, but also in developed countries. Thus, in environments where rent-seeking is dominant under the auspices of politics, in addition to poverty, the society is simply "resilient" to entrepreneurship and innovation, and economic growth is not possible; human behavior is not in the function of creating wealth, it is created by the ruling elites, according to patterns that maintain the existing policy and the reallocation of economic results. This clearly indicates that cultural transition must precede institutional and economic changes. There can be no progress in the economy based on the old ways of organizing companies and society. Especially if every activity which is not in the function of the ruling politics is condemned to failure. To conclude: transition is slow and long-term process, even when there are sufficient assumptions for it. Changes are encouraged because the external environment stimulates them, sometimes unpredictably. There are fewer cases of cultural transition being fast, e.g. as a consequence of globalization or charismatic political or intellectual leadership, or a kind of dramatic crisis.

A serious study of transition began in 1989, when the Soviet bloc collapsed, and policy makers began to seek the way how to leave the central planning system as painlessly as possible. The alternative was the capitalist system, or the free market economy. Transition, as a term, is related to the transformation of hyperregulated centrally planned economy into the capitalist system. However, this is a simplification of the concept of transition. Firstly, because the process can be observed and vice versa: transition from capitalism into protectionist systems. Secondly, we are witnessing the transition of capitalist countries, primarily into post-capitalist society, where tec-

hnological progress is at the heart of this transition. Have not three Industrial Revolutions passed so far?!

The rejection of the relatively free market context occurred when a wave of protectionism struck the whole world at the beginning of the 20th century. The history of industrial organizations has excellent examples. In the 1920s of the 20th century, cartels entered the National Recovery Plan in the United States, as a need to rebuild the economy. This opened the space for the formation of cartels in order to regulate steel, chemical and other industries. Similar events happened throughout Western Europe. In some countries, cartels even became mandatory (e.g. in Italy and Germany).

In solving these issues, in the 20th century literature, the question was: What is older: institutional development or market-oriented reforms (price liberalization, solid monetary policy, balanced budget)? Some authors claimed that the rule of law can be imposed through a powerful state, which will lead to successful transition, as if transition is, in fact, the main goal of policy making. It is a top-to-bottom principle, being either radical or partial. According to Jowitt (1922, p. 223), "a successful transition in Eastern Europe will take the form of liberal authoritarianism, which existed in Western Europe in the 19th century." According to Brabant (1993, pp. 98-99) "only an authoritarian intervention in economic affairs ... can successfully carry out the process along the desired new path of development." The difference also occurred regarding the rate of change with a broad debate among economists in the 1990s. Many economists preferred a gradual transformation. They considered that a powerful and efficient state, which would be competent and capable enough, could lead to "stabilization". Changes, with the preservation of price controls and various forms of central planning during a certain transition time, would guarantee structural reforms; the old or new stakeholders would not subordinate processes only for their own function and use. A completely opposite view is a shock therapy, i.e. rapid changes, breaking the old political coalitions and structures, and creating the new coalitions, which are interested in and committed to entrepreneurship and private ownership.

Both views were aimed at responding to specific problems: to avoid the failure of transition due to uncertainty and discontent, and to ensure that the old political elite does not take control in the new circumstances. In theory, both views have been developed to enable transition success, or new constitutional arrangements. In the end, especially in some former commu-

nist countries, the solution was "both": powerful institutions are needed, before the free market forces are liberated, and the free market forces are needed to trigger institutional changes.

In practice, it is quite different. First of all, the privatization strategy depends on political leaders, not on economic theorists. Political leaders are not always new leaders, but the old ones, who change their political rhetoric and promise institutional changes in order to remain in power. However, new leaders are emerging, who are usually more innovative; they promise rapid changes and improvement of economic position for all. In transition, politics is the priority, whilst economy is completely in the background. Therefore, the solution for understanding the dynamics and potential of transition is political issue. Transition, above all, implies the change of policy, or the evolution of an existing political coalition. As there are several factors in the process (external pressures, new rules of the game, greater exposure to domestic and international public), the ruling political group may change things in some other direction. A particular problem of transition is the tendency to transpose the model of developed capitalism, which, by its very nature, does not correspond with the poor societies. Introducing the new rules in poor countries, through transposition of capitalist legal principles and institutions, is not just a technical but behavioral matter - it is a question of credibility, flexibility, recent (bad) memories...

Rent-seeking is always an issue, although more attention can be paid to avoiding the breaking of basic rules, as in democratic societies. Both in transition and in democracies, the ruling parties and the opposition follow the same goal almost in the same way: "To create and distribute rent, to preserve and exploit the government ... Success belongs to the most credible coalition led by the most powerful leaders" (Colombatto, p. 257).

This is an issue because there is no success in transition unless the game rules are not changed. However, the first goal is to preserve and distribute power - usually in an unstable and uncertain environment – thereby arises a serious question: How much does that correspond with positive changes which allow the growth of living standard? If a social contract is clearly not defined, there would be no result. It should sometimes be discovered, possibly rediscovered. In this approach we can distinguish two cases. The first is when transition is led by charismatic and effective leaders, who gained unquestionable prestige while opposing the previous regime, thus, the search for compromises and solutions could be easier. But this does not

mean that success is guaranteed in this case. Even the democratic regime faces a redistribution issue, so, if it does not, the possibility of losing power opens for the benefit of those who promise to do so effectively. The second case is when transition is led by autocrats. Institutional changes usually mean creating new rules of the game, which correspond to the new ruling elite. In this transition, the cultural change of environment can force the government to implement the promised changes, otherwise the game rules are only a formal front, so there are no positive changes which would provide benefits to the whole society.

Transition is not limited only to transition from socialist towards capitalist system. We live in the world of the fourth Industrial Revolution, which deeply transforms the way people work, and which generates changes in all domains of people's lives and work. This transition is also about the poor and middle-developed countries. There are many challenges which are complicated by economic and political changes in all countries.

19.2 Transition to post-capitalist society

As we know, America is the leader in computer and telecommunication revolution. This revolution is spreading to other countries. Today's information resources are so influential and permeated that America, Japan and other advanced nations have deeply entered the information epoch. Behind them are the other stages of development, known as the agricultural and industrial society; the third current phase indicates an increased emphasis on production, storage and distribution of information as the main activity.

The new development phase contains several different attributional cliches: as a post-industrial society or, as a post-capitalist society, an information society. A Harvard professor Daniel Bell believes that in this new epoch, knowledge becomes a pillar of innovation and policy making, and technology is the key to controlling the future. According to Bell, a new intellectual technology will be created with the help of information technology; troubleshooting devices will replace intuitive reasoning ... The pioneer of the computer, John Von Neumann, pointed out: "Modern technology increases the rate of change, not so much by reducing the time needed but as the expansion of the field - political, economic, cultural - which are under the influence" (Dizard, 1982, p. 5) Advanced information and telecommunication resources are the most common in large enterprises and companies,

with tendency to expand in small organizations and homes. They provide a wide range of information through computers. Software solutions are used in health care, education, banks, etc. Opportunities are new, unimaginable, and elusive.

The world is moving from industrial to informational epoch. J. Naisbitt (1982) pointed out to megatrends of this movement, as shown in Table 19.1. However, it is true that the transformation into a capitalist society is still underway and not completed. Nevertheless, it has already altered "the political, economic, social and moral landscape of the world" (Drucker, 1995, p. 9). Certainly, this society will be based on information and knowledge.

Table 19.1: Megatrends of development in the 80s

FROM	*TO*
Industrial society	Information society
Electromechanical industrial technologies	High technologies
National economies	Global economies
Short-term	Long-term
Centralization	Decentralization
Institutional help	Self-help
Representative democracy	Participative democracy
Hierarchy	Neworking
North	South
Possibility of choice or/or	A choice between many options

Source: Naisbitt, 1982, p. 120

According to Tofler (1990), the source of power in industrial epoch shifts from wealth to knowledge in informational epoch. Knowledge becomes the basic economic resource. Value is created by *productivity and*

innovation, which are, in fact, the application of knowledge in work. The economic challenge of a post-capitalist society becomes the productivity of knowledge and knowledge workers (Drucker, 1995). It also means that this society must become a society of organizations.

Transition from industrial to informational epoch is called the Informative Revolution. It represents the general restructuring of industrial epoch.

19.3 The lack of knowledge

In a modern information society based on knowledge (Knowledge Based Society), knowledge becomes a key factor of economic development and product competitiveness in the market. In modern economic models, knowledge and information appear in a dual role: they show how and how much of information are known by economic entities in environment in which they operate, and how much are they capable to process these information to their advantage.

Knowledge in a society appears as an asset, but in contrast to physical asset, knowledge also appears as an input (competence, skills, etc.), and as an output (innovations, patents, etc.) – (Lundvall and Johnson). Knowledge economy operates with knowledge as with the best quality goods, i.e. as with the means of production and a mode of competitive advantage on the market. In this case, knowledge can be:

- used (production process),
- purchased on the market (employment of knowledge workers, purchasing of a patent, etc.) and
- delayed or archived (libraries, databases).

The analysis of many definitions of knowledge goes beyond the needs and goals of this manuscript. It is important to emphasize that the concept of knowledge also applies to the application of knowledge. Draker stressed that knowledge represents the ability to apply information in a specific activity. Thus, knowledge includes a set of information and skills that individuals use to solve tasks and interpret information. These include: ideas, methods, values, and norms.

Knowledge and information minimize uncertainty and risk, or, according to Kenneth J. Arrow: "Information is a term that is directly opposed to the term uncertainty" (1995, p. 98). They enable more reliable

planning of the future, increasing the quality of decisions, and expanding horizons of market choices.

Empirical data clearly show that research and development (R & D), as well as other sources of knowledge, create externalities. Also, the spread of knowledge tends to be geographically bounded within the region where new economic knowledge has been created (Audretsch and Feldman, 1996; Audretsch and Stephan, 1996, Jaffe et all, 1993; Jaffe, 1989). In fact, the geographical dimensions of knowledge remain a local phenomenon, in most cases unchanged by globalization, which has enabled the free transfer of individual information along the geographic space. In the old economy, traditional production factors (land, labor and capital) are predominant as a source of comparative advantage, while in the new economy (information economy) a comparative advantage is based on innovative activity. An important source of innovative activities is the fact that knowledge spillover can not easily spread trough geographic space.

To conclude, the gap between the the rich and the poor is deep, and the events related to this resource in the modern global world threaten to deepen that gap and further aggravate exiting poverty.

19.4 Diversities in transitional planning and practice

Although transition depends on several mixed cultural and historical variables, several rather general models can be distinguished.

The first model is characterized by a situation when the transition begins from within, but it is not supported by major cultural changes. People still believe in the old system and believe that its shortcomings can be corrected, and those who are responsible for mismanagement will be replaced. Hence, there are no system changes, while cultural heritage remains more or less the same. The political forces fighting for power can have the political opponents to overthrow the political strategy, but this is not enough to get support for a deeper transition. The result is stopped transition. The politics will behave as usual, with some variations regarding the redistribution mechanism and minor reorganization of the end-user structure. This is the case of transition "from top to bottom", or from centrally planned economies to partially centralized economies. Such decentralization will diminish the central government on the periphery, so the central government will have to make some sort of an agreement. This new situation may potentially influ-

ence the creation of a new behavioral routine, "because doing business with some mafia boss is not the same as doing business with a party secretary" (Colombatto, page 259). These new routines could ultimately weaken the original cultural structures, especially when democracy, communication, and geography contribute to it. The result is individualistic society, which may be more open to alternatives, promoting individual responsibility.

As expected, the outcome depends on several variables, and particularly important is the nature of new psychological models, if they are created. Education plays a key role, and the effects depend on the educational model, or the moral standards it promotes. For example, the Western standards of morality reproduce the standard characteristics of developed West, including the Western social contract. It is a good way to make a transition from a political point of view, having an incentive for international recognition. However, this does not mean fast transition and high growth, because the Western model is not immune to rent-seeking, which definitely absorbs a large part of the productive energy.

The second model is also based on incentives from within, as a result of cultural shock or, more likely, the return to old routines, which political limitations have not managed to destroy. For example, in the Czech Republic, central planning failed to eliminate those psychological models from the period before the introduction of communism. When the pressure of the Soviet military occupation ceased, current leaders soon abolished the old regime's symbols, and returned to previous psychological models. This story is interesting and complex with regard to the outcome forecast. It seems that in the Czech Republic and some other European countries, which also had central planning and constraints, imposed by military occupation, the primary goal is not the growth that would reach the Western countries. Policies involving the return to the past are not the basis for faster growth. Also, the result of connecting reforms and evolution of old psychological models in the new technological environment should not be underestimated. The progress of transition, in this case, depends on the nature of the basic cultural system: if a given culture is focused on contributing to productive entrepreneurship, the rapid growth is possible. There are situations when the political elite wish to accomplish "the best" through a certain concept of collective cohesion (e.g. nationalism), and this choice is far less favorable for economic performance. Success also depends on the ability to attract foreign investment, which may be the only chance to create new wealth in a

short period of time. The problem is orientation towards foreign investment and the reliance of development policies on this development drive, where foreign investments depend on a whole range of factors. If one of the factors is not favorable, foreign investments will not come in sufficient quantities. Therefore, the transition process is completely uncertain. If the inflow of foreign investments is sufficient, it may overcome many problems, such as: liquidation of old companies, low standard of living, and uncertainty.

The third form of transition is when planned by dedicated governments, who understand that the current economic and political situation is not long-lasting, and that problems will increase. Hence, this model begins from the top. A good example is China. This model of transition depends on the harmony of cultural patterns, and institutional changes needed to eliminate the old rent-seeking mechanisms. Obviously, if cultural structures do not support institutional change, transition will fail. If harmony of changes and psychological models is realized, the economic success could be expected with a subtle implementation. Logically, the growth rate is important, in order to neutralize the major disruptions of old companies, which are associated with the phenomenon of high unemployment, cultural disturbances, and discontent. Only when a critical threshold is reached, the new is accepted and the old is forgotten. The choice is no longer made between the various regimes, but rather between the leaders within the current system.

Transition comes from various causes: the conflict of formal and informal rules, dissatisfaction with living standards, anticipation of future turmoils, etc. A key aspect of transition is political. However, the role of economy is significant, but the politics are dominant, and transition is a substitution of one rent-seeking system with another... The rent-seekers (new and old) realize that the course of transition and its success depend on the cultural framework and behavioral routines. This suggests that a successful transition cannot be made by achieving a kind of free market (goal). This is the case when changes are accompanied by the development of productive entrepreneurship and risk taking attitudes.

All this explains why understanding transition is not simple and why it rarely, but eventually, comes in line with what is planned. There are also many variables, which can affect the political and economic environment. Successful transition contains new psychological models, new behavioral models, new cultural structures, and new social visions. There are no relia-

ble conclusions in determining the "optimal" transition models. The complexity of transition is also influenced by the intense process of globalization, which brings new globalized cultures, shown and shared by the media. This affects the less power of nationalisms, and the concentration of ethical, historical or political identity.

19.4.1 Policy-making for transition and growth

As a cause of poverty I see the historical inhibition and delay, created by the violent environment: imposing the will and practice of rent-seeking from narrow interest groups, despite the preferences of people. Violence and pressures deprive individuals of the prospects for a peaceful, voluntary interaction. They are a defense against new ideas and the evolution of behavioral routines under the influence of these new ideas, as well as the use (in the best way) of opportunities provided by technological progress. Naturally, poverty is an undesirable situation, but the elite in power, through their exclusive rent-seeking, create cultural traps, which are in the function of rent-seeking, and that totally paralyzes entrepreneurship and development. The prospect of escaping poverty is uncertain, first and foremost due to the politics that uses the means of political oppression. In particular, the development of an open culture is prevented. Without open culture it is difficult to exit poverty, because it is not possible to obtain and conserve consensus sufficiently in the absence of a clearly identified common goal that society would strive for.

There is no escape from poverty unless violent constraints are eliminated, because they are imposed through productive economic activity. The key is a change of policy. Politics can make it meaningless: majority of assistance programs (even when they do not end up as an expanded corruption scheme), expert advice (even if it's not at a low professional level), and deceptively cheap loans (even when state lenders do not transform them into overly inflated spending programs). Violent constraints on political structures may disregard efforts to build an effective legal system. However, the legal system, and its transformation into more or less reliable and desirable rules, depends on the way people think and see their role in society, that is, it depends on cultural and political structure.

In changing the rules of economic interaction, two basic areas that should be developed are education and the judiciary.

If society seeks progress, education becomes a key issue, especially in goal-oriented societies. Education helps to create a goal-driven culture, and thus provide the basis for policy-making, while education is the leverage for the development of productive entrepreneurship and creativity. That is an instrument for the development of cultural elements necessary for building a favorable environment for entrepreneurship (cooperation, trust) and preventing the degeneration of society through the opposite cultural patterns: fractional conflicts and rent-seeking.

It should be kept in mind that education includes professors, whose mental skills and assemblages will not change overnight, depending on the generational shift. Seemingly, a good thing is that although education is usually associated with central government, the main dictators of rules do not rely on education in order to create a consensus and legitimize their power. In addition, educational structures are *de facto* autonomous and free to adapt to the new, emerging cultural models.

State education, as well as state professors, are privileged in relation to professors teaching in private schools and universities. State professors are a powerful interest group, both in terms of numbers and influence on public opinion, having daily contacts and privileged access to families of children. Again, due to a very high respect that the idea of education generally enjoys, it gives a unique place to state professors, and hence the importance of their opinion. No reformer can oppose this powerful interest group. However, pessimism should not be exaggerated in relation to dismantling of social education system. On one hand, there is a certain flexibility of professors, which arises from the very nature of education, and on other hand, private education is not independent in curricula delivery, so that changes in this area could not be carried out in the short term, due to a time limit.

There is little hope for the growth if contracts are not enforced and property rights are not respected. That is, obviously, the task of judicial system, which is perhaps the most important element that controls social interaction. According to many, the main condition for successful transition is to provide the conditions for the state to be strong enough and keep the insurers under control and enforce contracts, but not to abuse its powers. This is not a new thing, but it is extremely difficult to achieve, especially in poor countries. In order to implement it, there must be a professional judiciary and effective moral standards deeply entrenched in public opinion. Responsibility towards these professional standards, and not to any political

ruler, is the only formula for achieving independence. In poor countries, it is possible to talk about the independence of judges, because in addition to the material factor, this is also influenced by the power of governors when making laws and changing them more or less arbitrarily. This also raises the question of political integrity, or perception of the law on the basis of justice by the judiciary.

Establishing the rule of law is a discouraging task. The new (reformed) judicial system should be credible in order to overcome crime and corruption. Behavioral routines of judges should be changed. Laws should be passed according to efficiency or cultural consistency, but certainly for the sake of the rule of law.

19.5 The increase in inequality in transitional countries

According to the World Bank's research, inequality increased steadily in all transitional economies, with an exception of some countries with dramatic increase. After 10 years of transition, Armenia, Kyrgyzstan, Moldova and Russia are among the countries with the largest inequality in the world, and their Gini coefficient (the standard measure of inequality) is almost twice as high in comparison to the levels before transition (World Bank, 2002).

Many think that the inequality increase is caused by reforms and liberalization. Some seek the causes of inequality in the different conditions of these countries at the beginning of transition. The World Bank’s study (2000b) shows that positive developments largely explain the rise in inequality in Central and Southeastern Europe and the Baltics (CSB): increasing returns on education, wage decompression, and increased incomes in entrepreneurship. However, the experience of the Commonwealth of Independent States (CIS) is quite different. According to the World Bank’s study, increasing education premium and dispersion of salaries explain a very small increase in inequality. In Armenia, Georgia, Kyrgyzstan, Moldova and Russia, the differences in income associated with educational attainments indicate less than 5% of inequality, compared to 20% in Slovenia and 15% in Hungary and Poland.

According to the World Bank’s study (2002), the reasons for the large increase in inequality are:

- In overcoming the widespread corruption and seeking income. There is a strong interrelation between increased corruption and increased inequalities (and increased poverty) in the region. Corruptional impact on the poor is disproportionate (World Bank 2000c).
- In the country's tendency toward narrow shared interests, which have modified politics to their advantage, often at a high social cost. These interests were able to limit competition and concentrate their economic power through mechanisms, such as special permits and monopolies. They have diminished the meaning of state institutions and blocked reforms that would serve the public good.
- In the decrease of official wages and income opportunities. Wages on old jobs have decreased or have not been paid, while new official job opportunities are dampened by the lack of a competitive market and the preservation of corruption. People, except the privileged ones, are mostly stuck on their low-wage jobs (which are not paid at all). In order to survive, they complement their income with various forms of self-employment, mostly through self-sustaining agriculture on small plots of households. Throughout CIS, earning from such small plots covers between 40-70 percent of total household income. Access to connections and unofficial networks, and the ability to buy a work place are the key to finding a job and progressing. This led to very unequal results.

19.6 Functional gaps and financial constraints in transitional economies

Transition is based on practical endeavors, which should be designed based on economic, political and other theories and knowledge. Unfortunately, this book also shows that economic theoretical knowledge is lacking for various reasons. This is conditioned by the fact that the consequences of practical actions, initiated by these cognitive aberrations, are often undesirable. Adverse effects occur even in those system segments where they are least expected. One usually unanticipated theoretical defect occurs in the evaluation of given institutional solutions. In order to begin institutional transition it is necessary to evaluate the existing situation of these institutions in all aspects. Without a quality evaluation, it is not possible to find out which segments of the system need to be changed, by which dynamics, in which order, or should they be changed at all. In order to establish an accurate

diagnosis of economic system, it should be monitored systematically, both during its normal, regular functioning, and in the situations of weakness. This is usually not the case. However, when problems arise, there is not enought time to diagnose the cause of the problem. Quick reaction of politicians often prevents the economic profession from preparing proper recommendations. In such situations, the probability of error is high, supported by both our own and the world's experiences.

Transition, as previously discussed in this chapter, requires long past steps, including its overall location within the timeframes and implementation. As we have seen, the analysis of existing solutions is unusually demanding, since it must give a diagnosis of their functional characteristics, and, in particular, their weaknesses; in the preparation of alternatives, the choice of alternative, possibly, at least conceptual testing of new options and, finally, their democratic consideration. After that begins the implementation in the narrow sense. It includes numerous operations, new solutions, and often encounters a lack of time. Then (usually) comes to the extorted and accelerated measures, which are the best way to produce additional damages and losses[54].

There is an important factor of transition and its fate – material and financial – apart from its basic aspect of financing reforms. Undoubtedly, reforms cost a lot; they require new institutions and agencies, new information, new knowledge and routines, new equipment (communication-information) and, inevitably, new staff. All this implies significant and huge financial expenditures. Money is scarce, but transition requires even scarce and real resources.

Thus, even when the course of institutional development is set, the government, responsible for transition, faces some other limitations - financial, personnel, organizational - which are sufficient to slow the pace of reforms. If we add congenerative vacuum and lack of motivation, transition often becomes an unsolvable complex of problems. However, the most important concern is the knowledge deficit.

[54] Let’s remember Obama's $1 billion package. Numerous indisputable evidence has been collected, proving that this was a spectacular failure (Meltzer 2010a, 2010b).

20. RESTRICTIONS WITHIN ECONOMICS

We have seen that economic science is characterized by controversies. Previous chapters attempted to explain the nature of economic reasoning, and its impact on economic policy-making, and politics in general. This chapter will discuss the separation and summarizing of the main dilemmas that have a significant impact on economic policies. I particularly rely on identifying these dilemmas by Pizano (p. 160), Hayek, Mankiw (2004-2008, pp. 797-812), and Madzar (2010, pp. 314-829). First will be presented an interview with Hayek, in which he explains the problems of economic science analyzed by Pizano. Then follows the presentation of Mankiw's five major dilemmas in the economic politics of the West.

Appendix 13: Hayek on issues in economics (D. Pizano, p. 160)

Diego Pizano: Economics, to a certain extent, with the establishment of a Nobel Memorial Prize, has attained the status previously awarded only to the natural sciences. Nevertheless, many professional economists at the highest theorethical leves have shown deep dissatisfaction with the progress and the state of knowledge in economic theory. You, yourself, have stated in your Nobel Prize lecture that economists have little cause for pride and that they have made a mess of things. I would like to examine this situation; is there a deep crisis in economic theory and economic policy? Or is it just a temporary lack of confidence in the strength of discipline?

May I take the liberty of providing a preliminary answer to this very large question by pointing out some unresolved problems that the theoreticians have been unable to solve and which are at the main cause of the situation described? I shall be very brief in my presentation since most of the problems I shall mention are well known. I consider that theorists have fai-

led in explaining and understanding some of the following problems, which seem to be rather important in the real world:

• **Stagflation**: According to Professor Samuelson, there is no satisfactory theory to explain the simultaneous existence of inflation and recession; this is one of the greatest challenges theorists are now facing. Philips curves are certainly not condisered seriously in most countries.

• **Economies of scale:** According to the Organization for Economic Co-operation and Development (OECD) and other studies, decreasing costs dominate the picture in the industrial sector of the world economy (particularly in steel, petrochemicals, automobile, electricity generation, etc.) Yet no theorist has been able to incorporate them in general equilibrium systems because they have rather destructive consequences.

• **Distribution of Income**: According to Joan Robinson, there is no theory which satisfactorily explains the determinants of distribution of income („The Second Crisis of Economic Theory“, AER). As we all know, this was the goal of the economics as a discipline following Ricardo.

• **Uncertainty**: The assumption of perfect foresight made by many theorists is regarded as extremely unrealistic and yet it is difficult to let go. Some claim that that Keynes, with his liquidity preference function, managed to do so but this is still debated.

• **Determinants of economic growth:** Scholars, such as Professor Kuznetz of Harvard University have made important advances in the field of economic history. Nonetheless, explanations of the so-called residuals fall short and is still too large, up to 50 percent in some exercises!

• **Endogenization of the technical progress function**: There has been, a lot of work on this area ranging from Schumpeter’s business cycle theories to the Labini’s oligopoly models. However, there is still a great deal to be learnt about the interaction between technical progress and economic development. A particularly difficult problem is to postulate a realistic technical progress function. Perhaps this cannot be done at all, since the process of scientific discovery is not deterministic, as Popper has so clearly shown (*The Poverty of Historicism*, London, 1957).

• **Theory of decision-making and collective choice**: In this area Arrow's impossibility theorem has created rather difficult problems and no obvious solution seems to be at hand.

• **Oligopoly**: Most theorists agree that there is no single theory of oligopoly that explains formation of prices in important sectors of the world economy such as the international motorcar industry. Or to cite a more striking example, the game multinational oil companies, governments and oil producers are involved in.

• **Crisis of Keynesian economics**: This, as we all know, is the title of recent book written by Sir John Hicks. And, of course, you have been critical of Keynesian theories since their appearance in the thirties.

It is evident that every serious discipline faces a long series of unresolved problems that constituteare the main reason for its very existence. The issue is, to what extent is the discipline of economic passing through one of those critical periods that, according to Kuhn, might provide the stimulus for the change of the paradigm (*The Structure of Scientific Revolutions*).

What is your reaction to this introductory presentation?

Professor Hayek: All the problems you have mentioned are connected. So I prefer to treat them all from a general perspective instead of discussing one by one. Let me begin by answering your question about the crisis in economic theory. I think that the answer is that economics is recovering now from a long period of decline that was caused by the transition it attempted to make from microeconomics to macroeconomics. Keynes is clearly responsible for this change although he was by no means not alone. But he has contributed, perhaps unintentionally, more than anybody else to the spread of aggregative theorizing, which is the essence of macroeconomics. I personally believe that only microeconomics really explains anything, but it is of necessity limited in its power of explanation. And precisely because of these limitation in its explanatory capacity, economists decided to construct a new system which they thought to be more scientific: macroeconomics. This attempt, however, was based on erroneous hypothesis and has been a complete failure. I must confess that for the past thirty years I have not been interested in most of the subjects which have occupied the minds of the majority of economists: macroeconomics, welfare economics, employment theory, input-output analysis, the theory of growth, etc. I have not taken part in any of these discussions, nor have I made any contribution to them. That is why my prestige as a theorist has declined over the last decades. Many e-

conomists are now beginning to realize that their approach was mistaken and they are coming back to me.

Let me turn now to what I regard as the main problem of economic theory, which will also explain that what we can achieve must absolutely be limited. The basic task of economic theory is to really explain how we bring an adaptation to the unknown. There is no question that the constant changes in economic activity are caused by a large number of factors that nobody knows as a whole. We are therefore constantly acting in order to adapt ourselves to factors that are unknown to us and for that purpose we can use only limited and fragmented information. To put it in a more concrete form: we work in order to serve the needs of millions of people of whom we know nothing, and for this purpose we use the activities of other millions of people who supply raw materials and instruments that we need for our production. Again, we know nothing about them. This has become possible by the spontaneous evolution of a system of communications which, by means of signals, tells economic agents what to do in order to adapt to events we know very little about. The system is the market and the signals are the prices.

My whole concept of economics is based on the idea that we have to explain how prices operate as signals, telling people what they ought to do in particular circumstances. The approach to this problem has been blocked by a cost or labor theory of value, which assumes that prices are determined by the technical conditions of production only. The important question is to explain how the interaction of a great number of people, each possessing only limited knowledge, will bring about an order that could only be achieved by deliberate direction taken by someone who has the combined knowledge of all these individuals. However, central planning cannot take direct account of particular circumstances of time and place. Additionally, every individual has important bits of information which cannot possibly be conveyed to a central authority in statistical form. In a system in which the knowledge of relevant data is dispersed among millions of agents, prices can act to coordinate the separate actions of different individuals.

Given this context, it is intellectually not satisfactory to attempt to establish causal relations between aggregates or averages in the manner in which the discipline of macroeconomics has attempted to do. Individuals do not make decisions on the basis of partial knowledge of magnitudes such as

the total amount of production, or the total amount of money. Aggregative theorizing leads nowhere.

At the same time there is a strong tendency among social scientists towards scientism, that is to say, to adopt a methodology which has the appearance of being scientific and which is based on the assumption that it is desirable to replace spontaneous processes by deliberate human control. This erroneous view has led to a drastic decline in the importance adn relevance of economic theory and explains the crisis you have pointed out. (from the book "Conversation with the Great Economists" by Diego Pizano)

20.1 Some dilemmas of contemporary economics

According to Mankiw, five dilemmas are related to seeking directions for the state's action in the world economy, viewed as a whole, where several flows appeared in the economic and political activity of modern countries. These are the following dilemmas:

• Should economic policy - and to what extent - turn to stabilization, unlike some competitive goals, such as a short-term maintenance or an increase of production and fostering employment?

• In the monetary policy, should the style and the way of acting, or the task of implementing the appropriate measures, be based on clear, solid, and binding rules, or should it be discrete decision making, whereby central banks, and governments indirectly, have a maneuvering space for taking measures they find necessary and inconsistent?

• Should imperative economic policies include budget balancing or should the governments be allowed to fall into fiscal deficits when they find it meaningful and socially useful?

• Should the fiscal system be reformed in a way that will force savings on a long-term basis, thereby increasing the production potential and creating the long-term sustainable growth?

Economy, as a complex system, is inherently unstable, and it spontaneously generates cyclical fluctuations. As we have seen in the previous chapters, economic science has dealt with this problem in an effort to find and propose appropriate management tools in order to avoid the economic cycles or to reduce savings. It is known that these damages are profound and difficult to solve. In enthusiastic phases, especially in the peaks of cycles,

the economic potential is intensively used, while current consumption is raised through economically comprehensive standards. This intensity of production is not sustainable in a long run. Economic enthusiasm creates unrealistic expectations, so current consumption is raised to an unsustainable level, which reduces the accumulative capacity and development potential of the economy. This economic intensity is accompanied by inflation with bad effects that are prolonged in a long run.

In the phases of recession and depression, economic capacity is not fully used, and incomes of all production factors are potentially decreasing, as well as the standarad. This generally causes negative economic, social, political and psychological damages. If such a situation prolongs, it leads to the inevitable harmful erosion of precious human capital.

This situation of cyclical fluctuations raises the question: Should economic policy remain neutral and unencumbered in relation to events which definitely create damage in a short and long term? The question is more delicate than it seems at first glance, because the benefits from economic measures are real or apparent, but mostly short-term and fairly visible, while damages are mostly moved to a slightly longer future, and therefore can be much less perceived.

Clearly, economists must recognize the frequent lack of facts. This is because they have to deal with complex structures and numerous interdependent variables in comparison to natural scientists (e.g. physicists). Social reality is more complex than natural phenomena, not only due to a greater number of variables, but also because of higher variability, less uniformity, and greater difficulty to isolate each factor separately. Karl Popper, an authority in the field of methodological issues in science, points out that the analysis of any social situation is greatly hampered by its complexity. But, the same applies to situations in physics, and biology (According to Pizano, page 7). Hayek argues that it is necessary to take into account the distinction between the phenomena of unorganized complexity, such as those in physics, and to organize non-complexities, such as those found in social sciences (e.g. economics). He cites an example of thermodynamics, where many individual elements (molecules) are interacting, but instead of finding specific information about individual elements, it is possible to use probabilities. In other words, it is possible to replace statistics with specific information on the behavior of each molecule. However, when it comes to the social phenomena which are organized and have the high degree of

complexity, it is impossible to replace information about individual events using statistics, because the whole thing depends on the way in which the elements are related. Therefore, we can not use probabilities, as in physics, when we face the lack of information. In this context, there are problems with how these structures are built. In social sciences, complexity is a constraint in explaining things and phenomena[55]. Hayek believes that even the element of social rationality, although simplifying the subject of study, does not allow a detailed understanding of the phenomenon being investigated. We never know what kind of processes are present in people's minds at certain moments; hence, using the model as a simplified reality we can understand the cause of the process or some of its features, but not its specificity at a given moment.

The problem of knowledge, even the economic one, is its widespreadness and inability to be summed up in one mind. Therefore, perhaps the most important issue is the use of existing knowledge with any known institutional structure. This means that we should strive for the best possible useability of knowledge that we can achieve.

20.2 Monetary policy: the rules or discrete decision-making

Monetary system directly depends on the government monopoly over money supply. From money supply and monetary policy depends also the banking sector and its functioning. Therefore, governments have a monopoly over issuing money which makes them responsible for the monetary system. This area is not left to decentralization and the market.

Two most pressing issues in monetary policy are: the level of adjusting the interest rate, and changing the money supply and, in this regard, liquidity regulation. All other monetary policy issues are grouped around these two. Many instruments affect economies in several directions, as well as the interest rate, which is a key instrument. Monetary policy makers, through interest rates, money supply and other instruments, undertake certain measures in order to maintain the stability of a complex economic system. Managing these instruments in a vibrant, dynamic economy is always a challenge, especially in the conditions of depression and deficit aggregate

[55] Human brain is an example of complexity. In order to explain its functioning, we should have a structure of a greater degree of complexity (super brain).

demand. Many directions on which interest rates work raise the question about their relative strength, and the danger of getting lost in another direction what was considered to be a profit on the basic direction, chosen by a monetary policy for action. For example, the central bank, as a creator of monetary policy, in the conditions of depression and reduced aggregate demand, decides to reduce interest rates, thus encouraging investment expenditure, as well as demand for the population sector, particularly the housing construction and lasting consumption of goods. However, there is a danger that the expected effects will be diminished or completely exhausted. Namely, this monetary policy instrument has several directions of action, and one of them is in a situation of depression and reduced demand, where the reduction of interest rate makes the country less attractive for the foreign capital inflow, which also positively affects demand and expansion of money. In this case, these positive effects are lacking. Obviously, there are complex interweaves in the monetary sphere, the available economic knowledge is insufficient, and there are still harsh debates on many issues related to adjusting the interest rate, and many others.

In addition to the lack of knowledge, the effectiveness of monetary policy, in this case interest rate instruments, is also influenced by the management regimes of this policy: are the interest rates managed in the regime of clearly defined and all known rules or in the arrangement of discrete decision-making? There are reasons to support both arrangements, but it has not been established, to date, which is more effective. In the text below, we will briefly show the reasons for both regimes.

The reasons for known rules in conducting monetary policy:

- Discretion would give power to institutions authorized for monetary policy, and power is always dangerous, irrespective of to whom is given.
- The potential presence of money management (in the case of a discretionary arrangement) can cause enormous social damage (among other things, it can be a threat to democracy).
- Discretionary power allows the monetary policy-makers to favor their political sympathies in elections.
- Monetary policy-makers can increase the political chances of the governing set. For example, by reducing unemployment through the inflation policy, because in a short term there is a substitution relati-

onship between inflation and unemployment. This is especially effective if - and since - the inflationary effects of such a policy come with a noticeable delay. Hence, this improves the current image that fits the governing set, and the problems are shifted into the future.

Reasons in favor of discretionary monetary policy are also very pronounced. It allows a flexible operation as opposed to pre-fixed, rigid rules that prevent fast responses, especially in situations where they are needed, and many economic situations are unpredictable. Thus, discretionary monetary policy allows reactions and adjustments to exogenous pressures and autonomous changes within the economic system itself.

Therefore, discretionary monetary policy has a huge advantage, in this case, while avoiding the shortcomings that we have previously indicated. This avoidance can be achieved through transparency: decisions and attitudes of the central bank can be exposed to the public in a way which implies that central bank officials will take care of their moves. The literature also lists other defense mechanisms from possible bad moves of discretionary policy, such as: time debt mandate of central bank officials, the central bank rewarding system, etc.

Finally, there remains a dilemma: which arrangement is more effective, and that is precisely an indicator of economic constraints.

20.3 The question of a balanced budget

There are no areas of social life in which politics and economy are reflected more strongly than the budget. Political ambitions and economic opportunities are confronted here. If political desires are reduced to economic opportunities, as our people say – money is burning a hole in one's pocket – then we have a balanced budget and no additional problems. However, not only political but also economic forces lead to budget imbalances. Due to the opposing party, sectoral, resource, individual, and all other imaginable interests, it is difficult to achieve a balanced budget. A large part of GDP is being redistributed from the budget, why is it then a neuralgic core of every economic policy. Namely, the redistribution of funds takes place in the budget. These funds were gained through hardship, on the market turmoils, according to social groups which often get them for free.

Politics is included in the redistribution, but political activity over the budget do not stop here. Indeed, the budget allows politicians to manipulate public debt, particularly in obtaining additional funds through its increase. This is a good basis for manipulation. Thus, political officials can acquire significant additional resources and significantly increase (but unsustainably long-term) their living standards. This is a great way to gain points among electors and visibly raise electoral chances. Since these duties are usually long-term, the burden of repayment is borne by others (even future generations), whilst the government generates current benefits.

In addition to public debt, a lack of funds in the budget can also be financed by printing money. This inevitably causes inflationary tendencies. Inflation brings many problems: economic life is disorganized, market efficiency is considerably reduced, productive factors are destroyed, far-reaching damages are being created in the engagement of economic resources, as well as the degree of their use.

Obviously, many reasons are in favor of a balanced budget. However, this does not mean that there are no disagreements about how to solve the budget deficit. In the case of public borrowing, or inter-organizational distribution, or transferring the burden of repayment to the future generations, there is an agreement among economists: it is OK to take something from the future generations because they will be richer anyway.

In favor of abandoning a balanced budget, there are reasons that become current during recession periods. In such situations, additional public spending could trigger the use of production factors, which are incompletely exploited due to the aggregate demand deficit. This is a way to "revive" the economy, and therefore it is justified to give income to those who do not create it in order to increase demand. This is a triumphant way to elegantly recover the economy, as it is expected that, when the economy enters the prosperity phase, GDP grows along with fiscal revenues. Such a scenario also leads to the elimination of some components of public spending (e.g. transfer payments). The conditions for creating a budget surplus are also being achieved, which is the main goal of such economic recovery measures. Such monetary adjustments hide a particular kind of threats: spending habits are easy to establish, but for the opposite direction there are many other obstacles, first of all, political issues.

To the previously described way of abandoning a balanced budget can be added another one which has been discussed a lot. Due to its positive side, the burden of future repayments is not so great, especially as the expected future profits are higher. According to these explanations, the state debt differs from the private debt, because the timing of resource allocation is not taken seriously since the state, unlike the limited life of an individual, has a much longer life and a wider horizon of decision-making. In addition to all this, unlike the individual, public debt can grow indefinitely, or as long as it stays within the limits of selected debt-to-GDP ratio. However, GDP growth opens space for permanent increase in public debt, as it enables the payment of rising interest and possible repayment of principal. Also, public debt securities (bonds) play an important role in monetary policy, especially in open market operations. Without them, the capital market would not operate good, which negatively affects the efficiency of overall macroeconomic system (development potential decreases, a part of potential GDP is unnecessarily lost).

In favorizing the policy of abandoning the balanced budget, inflation emerges as a factor that facilitates the servicing of public debt. Through inflation tax, it provides additional borrowing, and, according to some, it produces other positive developmental effects. However, there is no consensus among economists about which inflation rate framework gives positive development effects. It is necessary to take into account the wider framework of the complex economic system, and to seek a solution for the price growth policy. If the state borrows to invest in productivity (e.g. infrastructure investment), and if the productivity increase is higher than the cost of servicing the debt, then it is clear that current borrowing is improving the economic situation. Transferring funds into the current consumption definitely has the opposite effect.

20.4 Fiscal stimulation of investments and savings

In the economy, it is known that the productive capacity of a country largely determines the level of future savings and investments. Let’s repeat: the productive ability of an economy is the ability to produce goods and services, which determines the living standard of the people. Income is generally accepted as a key determinant of savings. Madzar points out that the level is not the only relevant fact - in some situations - even more influential is the change (Madzar, p. 140). He notices an extremely indicative

asymmetry in the change of consumption in relation to the change of income. In periods of income reduction, demand does not decrease approximatelly as income. This asymmetry is less pronounced when income increases. However, a poor adjustment or almost no reduction in the periods of declining income shows the complexity of savings issue. In his book "Aggregate Demand" (1982), Madzar calls this asymmetric convergence the *ratchet effect*. The book is well known to his students. I have used it as a reference when writing this text.

This shows the need for a careful and studious approach to the issue of savings when the state is asked to intervene in the field of savings and accumulation. Obviously, the previous asymmetry is a result of distrust in the state. Trust is expected from a strong state, rationally organized and resistant to political and social struggles. A strong state is needed for at least two reasons: any increase in state accumulation means a reduction in current public spending; to raise taxes and other instruments through which the state receives income from those who create it. No further explaination is needed on how much these measures are unpopular.

High taxation of income destimulates savings. There are other forms of income taxation which are also destimulative: double taxation (for corporations), wealth tax, etc. However, there are ways to reduce taxes and stimulate savings. A comprehensive principle would involve reconsidering the entire basis on which the state collects tax revenue. Although, an increase in savings may be desirable, but this is not the sole objective of economic policy. Policy makers need to be sure and fairly distribute tax burden. The problem with the incentives to increase the savings is that "they increase the tax burden on those who are least able to handle it" (Mekiew, page 827). Therefore, these measures primarily reduce the tax burden of the rich. This leads to an increase in inequality.

21. THE INDIVIDUAL AND EXPECTATIONS

21.1 Multidisciplinarity of economic reality

After my initial knowledge of economics, for years I've been wandering around trying to understand different societies from an economic perspective. I thought the answer to that question is easy. However, that was not the case. I have to admit that I have often returned to writings about economic theory and economics textbooks. After many years of studying, and often boring theory, I was covered with graphs, definitions, case studies, etc. Reading economics with an insight into the practice of economic activities and businesses, certain significant patterns begin to form in the mind, although so much remains unclear.

I began to see the difference between what is being learned in the first years of college and the economic practice itself. Here's what I would say to myself after two or three semesters of economics;

- There are lots of graphics,
- I better learn them by heart
- Otherwise, I will not pass the exam.

Frankly, the economics did not help me to understand much about economic reality, because there were a lot of economically inappropriate things going on. Many macroeconomic developments and events remained unclear to me as I sticked to the course of narrowly set economic analysis based on its dominant theory and models. Despite a certain intuitive feeling that powerful and non-economic forces impact the economy, and not just economic rationality, I could not get out of the economic reasoning framework for a long time. After a long search, I began to incorporate knowledge from other sciences in order to understand some economic situations. Contemplating and focus led me to the "discovery" that economic rationality is mostly influenced by non-economic determinant - politics - which often has a destructive effect on the economy. In case of getting out of economic reasoning framework dominant in economic science, it is not

difficult to see that politics has a wide scope of action on economy. The mere fact that politicians make macroeconomic decisions suggests that they are responsible. Hence, these decisions can not be the responsibility of economists, nor even those who are advisors in decision-making process. The responsibility of an economist is reduced to accountability towards the scientific public. If there are flaws for misunderstood economic reality or for failing to diagnose objectively conditioned and important trends in economic developments by an economist, this is not attributed to him/her, since decisions are made by a politician.

There are several policy constraints as an impediment to the social rationality, and some of them have been discussed in the previous chapters. First of all, the underdevelopment of institutions and therefore the limitation of the scope of economic policy. A particularly important aspect of interdependence between economic policy and economy is the one resolved through parliamentary and bilateral interactions. In this arena where economics and politics confront, the directions of any established socially rational engagement of economic policy never coincides with directions that maximize politics, that is, electional support. The political order emerged as a product of power and interest, so it is not to be expected that the political order is based on economic rationality. The outcomes of political processes and interactions in parliaments and political institutions are dictated by interests, and redistribution of interests depends on the distribution of income and wealth. As long as they are unequaly distributed in the political process, redistributive interests will be formed the greater would be the inequality in society. The power of majority decision-making in the political order pull on their side, not respecting what is economically justified, if it is not politically correct.

The dialectics of economics and politics explains the current state of affairs in the world, which was previously described as a balancing equilibrium in favor of negative trends. On one hand, the forces of progress on wings of technology create optimism, and on other hand, the forces of interest have generated many negative tendencies that threaten to bring the world into chaos. The world is not far from chaos, unless another view is promoted. The world needs new foundation on which the turn will be created. Individual freedom, as a value that dominated the last centuries, seems to have become a constraint of the modern world, on which is not the future of mankind. To think only for yourself and your own interest is an unsustai-

nable doctrine, because it enables a huge gap and submission to the order of inequality.

The democracy that we know today has been created on this doctrine, characterized by the majority decision making. We will illustrate the flaws of this decision making on an example from the study of Buchanan and Tullock (2001). In a company that consists of three members and has a wealth of 100 units with the following schedule: one member owns 80% of wealth and other two own 10% each. If the majority decision is not regulated by the rules of the game, two members with 10% each can form a coalition and take everything from the third member, because he represents the minority in the political decision-making process. The result is that two members will now own 50 units each, and the one who has created the most will own nothing. This example illustrates the dialectics of economics and politics, showing the insufficiecy of this kind of decision making in society. This political system suffocates every initiative, the motivation for creation disappears, while entrepreneurship and innovation do not exist. In such a system the life and economy would cease.

How to protect an individual from the majority terror? Perhaps the best answer was given by the Founding Fathers of the United States. They incorporated constitutional guarantees into the political system, which protect individuals from the terror of majority decision making. They were deeply aware of this problem and the fact that democratic procedures for regulating relations, of general importance, are not sufficient, and that the protection of individuals is equally important. They incorporated this protection into the US Constitution.

The Constitution is an instrument that protects individuals to a greater or lesser degree, in all social systems. However, this protection is not perfect. From the aspect of understanding the dialectics of economics and politics, it is especially important how to regulate distribution relations, which is a key issue of the economy, as we have repeatedly said: what, how much, and to whom does it belong? How to make policy remain neutral in the distribution of revenue and wealth?

Establishing the rule of law is an eternal ideal of every society and an important element of constitutionalism. Constitutionalism has, to a certain degree, elaborated some of the principles of the rule of law and institutional forms that would be necessary to establish the rule of law. One of these aims

is the limitation of power, in order to avoid any absolute and personal authority and to mitigate its negative effects. So, this idea assumes that power is easy and often abused for the detriment of society and its members. Thus, the right is an act of political will, and trough the nature of that act, through its meaning and content, the right must limit even its own creator, the legislator.

In spite the provisions of certain laws and the Constitution, every political will, as a rule, tends to avoid or ignore the role of the law that is committement to laws, therefore it limits political will. Let's reiterate: constitutionalism defines the framework in which political processes take place. Its role is not only to limit the highly positioned centers of power in the hierarchy, but also to restrain all forms of "desire for power"; and all forms of coercion that could alienate what individuals in the community have legitimately acquired and obtained. Constitutionalism, by its nature, should regulate relations in distribution and ensure the protection of " right to acquisition through labor". The very concept of labor can be seen in this context as any legitimate form of acquiring material and financial wealth. The Constitutions usually incorporate a moral principle, which has a long tradition since Roman times, and possibly even earlier: suum cuique tribuere – to live honorably, to harm no one, to give to each his own. This is a principle that fully reflects the economic logic: if everyone is rewarded according to his total (work and other) contribution to the social product, will be asured a maximum motivation for all productively relevant activities. Thus, the conditions for efficient business are provided.

This constitutional principle, like many others, is deformed in practice. The dynamics of economics and politics did not follow normative ideals, the practice was quite different. The second issue is the development of the rules themselves in a time that is sensible to the effects of political coercion. This has all led to a redistribution of income and wealth, which is incompatible with work and other relevant contributions. Therefore, the fundamental principle was abandoned through the configuration of the corresponding rules, formalized through lower-order acts of law, which the basic constitutional consensus directly negates. This created the legal basis for exploitation. Under the influence of financial and other interests, redistributive forces are so powerful that the constitutional consensus fails to be implemented.

The preceding chapters explained strong long-term redistributive tendencies and their conspicuous consequences. I will add that there is

almost no country in which the share of public spending in GDP does not show a marked long-term upward trend. "The bulk of the non-profitable income is increasingly being absorbed in societies around the world, regardless of labor or any productive contribution" (Madzar, p. 389, 2011). We have seen earlier that the redistribution process, even in the United States, has reached disturbing and virtually devastating proportions. Many analysts have pointed this out, even Stiglitz in his book "The Great Divide". Increasing inequality in income and wealth in the US and Europe is also illustrated in the previous chapters. A good deal of consideration is devoted to the idea that politics has deployed destructive violence against business flows and the entire economy, from the first surpluses in the agricultural society. We have noted that the relationship between economy and politics has been developed in the direction of strengthening political forces that have destructively influenced macroeconomic flows, moving them to a wider plan and in a global sense far from constellations that would reflect economic rationality and the possible imperative of efficient allocation and use of resources. It has been shown that the analysis, based exclusively or even predominantly on economic criteria, can not explain, nor reliably predict, global economic tendencies in a modern world. Such approach does not allow the understanding nor the preparation for the future.

21.2 Major elements of the economic way of thinking

The economic way of thinking is very important. It is the first step to understand reality. It is the foundation for a scientific approach and recommendations based on economic reasoning. This book has no ambition to present a wider knowledge of how economists think and what resources they use, because there is already enough literature about that. Due to the development of the book’s concept, the mainstream of economic reasoning has been encompassed. However, the recommendations and opinions of economists can not be effective unless major non-economic constraints are taken into consideration.

This chapter will synthesize the economic way of thinking. It is an important part of everyone’s life, especially if we visualise the economy as a desire to improve individual's well-being. In addition, every individual must learn a lesson about survival, so economic principles are needed in this respect. According to ideas presented in this book, the discussion will include the understanding of key categories of economic activities, through the

identification of the main and other principles of the economy. In the development of economic ideas there has been a lot of confusion, that is, the development was not straight-forward and progressive, and some economists have caused incomprehension. This suggests that it is important to develop an economic way of thinking as subjective knowledge, and to improve the daily understanding of the economy; to organize ideas about production, exchange, consumption, supply, demand, crises, prosperity, rises and falls, and to form one's own vision within a consistent economic perspective. Here's how people see the economics in day-to-day behavior:

• There are so many things in the world, and only the tiniest part belongs to me;
• Work is not paid enough;
• Every business is a crime
    - Sellers are thieves,
    - Mediators are macros,
    - Manufacturers exploit workers;
• Wealth in the world is the result of a criminal conspiracy between:
    - Jews,
    - Japanese, and
    - Pirates of Wall Street.

This is a way of interpreting economics by socialists, but also by many others. I repeat: this may be a consequence of a confusion created by the reading of works written by professional economists. For example, this is how Keynes's followers understand the economics. The famous Keynesian equation shows the connection between autonomous costs and an equilibrium level of income. The equilibrium level of income (Y) is equal to the sum of autonomous expenditures [Consumption (C) plus investments (I) plus government expenditure (G) plus total exports (X) minus imports (M)] × 1, all divided by marginal savings mps), where mps is equal to 1 minus the marginal propensity of consumption (mpc). Hence, it reads:

It's hard to imagine the application of the above formula in every day economic question. For example, should I put money on a fixed deposit or should I buy a laptop for it? Considering the economy in general, most people are intimidated by this formula. They have a feeling that they are confronted with a complicated machinery, which they can not understand, nor they know how it works. In fact, they feel like they have been caught by that machinery in its flywheel, and that their future is uncertain. Simply, they do

not know what will ultimately come out of it.

Still, life forces us to forget this feeling and get involved in daily economic activities, when we buy, sell, spend, save ..., and each of us behaves as if we knew what we are doing. If we are even involved in politics, we may gain a value of $1 billion (like Fidel Castro, for example). However, do we understand what is behind our decisions in the economy, that we are not superficial in deciding on economic activities? So I began to think about the economics and politics, after all the knowledge I acquired, and presented in this book.

What do economists say? They study production, exchange, and consumption. Production requires skills which cannot be learnt from the professor of economics. Spending is a very personal thing. Therefore, the economics must focus on exchange.

When economists say "the exchange," it means the exchange of everything, not just finished products, such as pizzas or computers. There is also the exchange of raw materials - seeds and fertilizers needed for agriculture. Then, there is the exchange of labor needed for production (e.g. manufacture of computers). Also, the exchange of capital - money for which it is necessary to buy equipment and machines in order to organize production. There is the exchange of ideas (Whose idea was to manufacture this computer?). There is even the exchange of space and time, shops and warehouses, and so on. The exchange actors were not neutral, politics got involved and became a powerful participant.

All these things that we exchange are called "economic goods". For an economist, everything is economically good if it can be defined by the concept of "rarity"! However, the definition of rarity is so broad that, practically, everything can be rare. The air is an economic good. If the air is contaminated, we have to purify the air so that we can breathe again. Although the air is free, our lung capacity is limited. The air is an economic good, and we hope that our bodies use the air economically - by supplying our bloodstream with oxygen.

From an economic point of view, everything is rare, except the desire. Goods are limited; desires are unlimited. This observation leads economists to the conclusion that the primary purpose of economics is to find the best way to fulfill the endless desires of the consumers.

While trying to find a way for to satisfy infinite desires of the consumers, economists spend a lot of time thinking about something they call "efficiency." They explain efficiency as a situation in which an economy can not produce more than one good without lesser production of another good. An example of efficiency that economists usually cite are rifles and butter. The company can manufacture both, rifles and butter, they say, but if the company wants to produce more guns, more resources will have to be allocated there, and then will produce less butter. Where does this reasoning lead us?

In fact, efficiency has never been fully achieved. Economists actualy don’t know much about efficiency, noone knows. In the 18th century, citizens of England thought they were producing as much coal and knitted socks as possible. One miner more would mean one weaver less. Then James Watt invented the steam engine. Soon they had far more coal and more socks (production was automated). Technology has changed efficiency, and it is constantly changing; economists can not keep up with it because they do not study innovations and technologies, they simply can not predict them. The lesson is that economical reasoning should not be ignored. Our preferences are changing, as well as technology and demographics. We tend to make our situation better tomorrow than it is today...

One thing economists know is that the study of economics is divided into two fields: microeconomics and macroeconomics. Microeconomics studies economic behavior of individuals and it exists in real reality, while macroeconomics studies how the economy behaves as a whole, and it does not exist in reality, only in abstract models. Microeconomics deals with specific things, while macroeconomics refers to things that economists have invented. Or, technically speaking, microeconomics is about the money you do not have, and macroeconomics is about the money that the government does not have. These two issues make chaos in the lives of individuals and the collective, therefore I tried not to intertwine them in this book as they are in reality. For example, in traditional textbooks, studying how an individual, interested in buying a car, reacts to the price increase, or how big is his/her purchasing power, that is a microeconomic issue. Conversely, the general tendency to savings as a response to the widely present concern about the living standard at the old age would be a macroeconomic issue.

I believe that micro-macro separation can be useful in order to draw the line between the explanation of individual decision-making, and descri-

bing what happens when more individuals are involved in decision-making, and they are the subject of the same stimulus, show similar reactions, and are significant at the social community level. However, I agree that micro-macro dichotomy is often confusing, since explanations and descriptions of different activities are more than two versions of the same logical task. It should be noted that decisions, ultimately, are made by individuals rather than by some abstract entity as a "group". Therefore, the separation line between "micro" and "macro" is necessarily arbitrary and, in my opinion, it does not help the conceptual clarity.

Economists also make a difference, for good reason, between "inputs" and "outputs."

Two additional economic terms are the "supply" and the "demand". Rarity explains them. There is a lot of demand and few supply. Economists measure supply and demand curves on charts. When supply curve goes up, demand curve goes down.

The demand curve is almost an abstract concept that hardly represents human behavior. Nevertheless, it provides a "region" of possible decisions made by an imperfect person in an imperfect world. In other words, we do not know whether person A will really buy a combination of goods X described by demand curve, but we know that if the price of these goods rises, a person A will reduce the purchase of goods X. Also, if we know how much goods a person A bought for the price P1, and if we have some rough idea about the shape of that person's demand region, then we can formulate a fairly reliable conclusion about his/her behavior – to determine the amount he/she can ask for when the price rises, if the other variables (say, his/her taste) remain the same.

Supply and demand in the free market determine the price of goods. The offer is determined by the cost of production, while supply curve behaves contrary to the demand curve. The quantity grows with the price rise. If the price of an item increases in the market, consumers will buy it in smaller quantities. On other hand, manufacturers will be willing to supply the market with a larger amount of this goods, since the increased price means that it is more profitable to produce that goods. Motivation of buyers and sellers is different. Market prices harmonize their actions. If the amount that customers want to buy goes beyond the amount that sellers are willing to provide, prices will rise. A higher price will discourage consumption and

encourage the production of particular goods or services, thus balancing the quantity of demand and supply. Conversely, if consumers are not willing to buy the goods, stocks will accumulate and pressure the price drop. On the other hand, lower prices will stimulate consumption and reduce production as long as the quantities requested by consumers are not equal to the quantities produced. The market is the place of meeting supply and demand. Certainly, the previous mechanism works in time, and the process of change does not happen instantaneously.

Basically, this mechanism dictates the motivation of participants in the economy. People want to satisfy their needs in the best way, at a given level of their income and assets, with the current prices on the market. If the benefit of a business venture increases, an individual will be more inclined to opt for that business venture and vice versa. Ultimately, profit and loss direct the business investment towards projects that stimulates economic progress, and divert them from projects that waste limited resources. Profit is realized when the product is sold at a price that is higher than costs. Farmers, furniture manufacturers, construction companies, and many other manufacturers, look for the best combination of resources and the most efficient production methods, because lower costs mean higher profits. This applies to free markets. Prices are best signals for the resource allocation. It is in the interest of each manufacturer to have the lowest production costs and the best quality of the product. In fact, they are not alone on the market, they already have competitors. Manufacturers with high production costs will not be able to survive on the market. Consumers will take care of that, because they seek the highest value for their money.

Economists explain that higher income and living standards depend on higher productivity. There is a direct relationship between GDP and GNP. Basically, production and income are the two sides of the same medal. Production represents the value of manufactured goods and services measured at market prices, that is, the prices paid by customers. Income is the revenue that all the owners of the resources receive for the given production, including the residual income of the entrepreneur, i.e., profit. The total income is, by definition, equal to the selling price of goods. Let's consider the following example: suppose a car company engages workers and acquires other resources for the car production. When the car is finished and sold, the selling price is a measure of the product value. At the same time, the sum of all revenues received by workers, owners of other resources, and the

rest of the income that a car company has received (i.e. profit, which can be positive or negative) is a measure of income. Both the product and the income are equal to the selling price of the product. This actually represents the value of what has been produced. Obviously, without the increase of real product, after excluding the effects of inflation, there can be no increase in income or better living standard. Creating new jobs is not a source of economic progress unless the real production increases. There are four sources of income growth: 1. improving the skills of workforce, 2. capital accumulation, 3. technological progress, and 4. better economic organization.

So far, we have learned the basic principles of economics, and how the economy works. In navigation through this complex world we need a corpus of economic organized knowledge, but the author of this text considers that to make good economic decisions and to understand the determinants of economic development and social well-being, it is necessary to go beyond the strictly understood economic realm, and beyond economy as a science. We could look for them in the political system, institutional setting, culture, and patterns of behavior that have been inducative in the long tradition. What could be more useful to successfully position ourselves in a business or the state, apart from the principles of economy, we will see below.

21.3 More specific elements of the economic way of thinking

1. Market Is Never Wrong. A thing is worth what people give for it, and it isn't worth anything else. We have all been convinced in this principle. On the market, in free trade, both sides benefit. Let's take a simple example: When you pay 2 euros for a kilogram of grapes, it's a win-win situation. The seller has got 2 euros, which he appreciates more than grapes, and you have got grapes, which you appreciate more than 2 euros. Both sides are happy because everybody has got what they wanted. The price is determined by the market, so you cannot buy a kilogram of grapes for a price lower than 2 euros. Both sides have voluntarily agreed on the transaction. Obviously, this exchange is free. It is similar to other cases of trade, in general, and all cases of free exchange.

The market implies competition. Monopoly or lack of competition does not create an incentive for resources to be used well. The market is the best mechanism for allocating rare resources: it gives the best measure of resource allocation, it reduces the risk of over-or under-spending of resources for

some goods and services. "However, what works best and is most beneficial for consumers – the market – is generally under the great pressure by those with special interests, and those are various interest groups, and their associations, politicians, bureaucrats, and others" (Prokopijevic, 2010, p. 42).

Free exchange stimulates the social benefit - realized income and production will be greater than without exchange. When the state imposes a blockade, which restricts cooperation through exchange, it hinders economic progress. Let's see how the state hampers the exchange:

- Many countries make regulations that restrict the entry into certain economic sectors and occupations;
- There is a discretionary political authority instead of a law;
- The state introduces price control;
- The state stimulates monopolies;
- The state raises tax rates.

Particularly important is the marginal (limit tax rate) - additional income that is deducted through taxation. An increase in marginal tax rate decreases the share of additional earnings that an individual can keep for himself. There are three reasons why a high marginal tax rate reduces production and income: 1) it seems demotivating, 2) it reduces the level and efficiency of capital accumulation, and 3) it reduces the purchasing power of individuals.

2. So You Die. Things Still Cost What They Cost. It's no use trying to fix prices. To do this, you must have a product that can't be replaced, and you must have complete agreement among all the people who control that product. But that does not work! Someone will not respect the deal. Monopoly does not help either! Government also does not have the power. For example, the French government can buy wheat at higher prices than it is in the market. Suddenly wheat floods the market. It turns out that people had the hidden supplies. Conversely, if the price droped below the market, wheat would disappear from the market.

This means that every state intervention that distorts prices must have adverse consequences. The state raises prices and taxes to provide the revenues. When it behaves populistly, the state freezes prices at a level below the market, and sometimes even below production costs. With price intervention, the state alters the incentives for individual's behavior in the transaction, both the manufacturers and the consumers. This is not good for the

economy. Violently introduced prices will disrupt the supply and demand relationships or create losses for manufacturers. If the market did not react, the price change is violent and unnecessary.

3. You Can't Get Something for Nothing[56]. Everybody remembers this except politicians. They promise to cut income taxes, while government subsidies and transfers remain at the same level. However, this must be done the other way. A government can give to the people something for nothings by printing money. This usually doesn't work, because it makes the money worth less, as it did Wiemar Germany, Carter America, and Yeltsin Russia. Inflation will consume the value of savings, assets, bank accounts, and bring the economy to bankruptcy. Finally, the government can give something for nothing by creating a deficit, by borrowing money from everyone and then giving them their money back with interest. This is obviously stupid, but it is precisely what many countries do. Deficits are less painful than high inflation and high taxes, although in the end they lead to one or the other, or both.

So, nothing is free. The basic reason that nothing is free, or that everything costs, is because the quantity of goods is limited; and that quantity does not meet our desires. The price of goods is a consequence of its limited quantity. If the quantity of goods were unlimited, the goods would be free. Thus, prices harmonize our desires, on one hand, and shortage of goods, on the other. When we want something, we are ready to pay more money to get it. Manufacturers produce what we would like to buy, not because they love us, but because they want to make money. They are driven by the profit. If many manufacturers make the same product, that is good for us, because the price of that product will fall due to the high supply. And if the supply is higher than demand, a given product will remain unsold and the manufacturer will be financially damaged.

Inflation hinders the rational resource allocation. It creates a false

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[56] In other words, there is no free lunch. Allegedly, the legend of this saying was created at a time of golden fever in the American West. Gold-diggers spent their spare time in bars and saloons. When drunk, there were often violent which ended with fights and damaged saloons. One proprietor came up with an idea how to prevent fast-drinking of guests: everyone who orders more than two drinks, gets a lunch. The owner of the saloon financed this seemingly free lunch through a higher price of drinks. When gold-diggers discovered that, they came up with the phrase "no free lunch".

picture of the business balance. Do incomes grow because sales is better or because there is more money? Many answer to this question too late, only at the end of the business year when the loss is evident, although they nominally earn more than in the previous business period. Inflation also increases business risk, which leads to higher prices of money and loans, which adversely affects investment. Smaller investments reduce the overall performance of the economy.

In addition, inflation is also a form of taxation. Inflation tax, which reduces all monetary amounts, creates redistributions that are not justified. This redistribution is not legitimate, because it is not formalized in parliament, and therefore is considered unjustified.

Inflation also influences the creation of inventories above the levels needed, and this creates additional costs in the business.

Furthermore, inflation weakens the money, affects the price growth, the value loss, and brings many other losses.

Opposite to inflation is deflation. It is the situation when most prices fall. There are two models that cause deflation. According to one, deflation is based on productivity growth, and according to other, deflation is based on fall in the money supply, which ultimately leads to a decline in investment, employment, and income. In the first case, deflation is useful for the buyer, and in the second case, deflation is very harmful and leads to a recession.

4. You Can't Have Everything. If you use your resources to obtain a thing, you can't use the same resources to obtain something else. This is called fraud. In economics it's called the *opportunity cost*. When you employ your money, brains, and time in one way, it costs you the opportunity to employ them in another. Opportunity costs fool people because they are unseen. When we observe money being spent, the state invests in luxury buildings, we are impressed. But we do not see that other investments were more important for the state and the community (schools and hospitals in a miserable state).

5. Break It and You Bought It. Being fooled by hidden costs is the source of a lot of economic confusion. War is often spoken of as an economic stimulus. The World War II "pulled America out of the Depression." Germany and Japan experienced "economic miracles" after the war. The hu-

ge cost of killing and destruction was not counted.

6. Good Is Not as Good as Better. Almost as bad as costs that go unnoticed are benefits that get too much attention. It's great that everybody has a job. Computers are taking jobs away. We could guarantee full employment if we remove computers. But we forget the advantages that computers and communications provide to the economy.

7. The Past Is Past. Another thing that gets too much attention is money that's already been spent. In economics, this is called *sunk cost*. It doesn't matter if you've blew everything you made selling Apple for $1,000 a share on a scheme to geneticcally engineer squid. What matters is whatever you can make any money off those squid now or convince people that the squid will make money in the future, so that these people will buy the "fool" company. This is called "marginal thinking".

8. Built It and They Will Come. The underlying notion is stated formally in economics as Say's Law (after French economists Jean-Baptiste Say, 1767-1832): "Supply creates its own demand." More is better. Any increase in productivity in a society causes that society to get richer to buy the things that are produced.

9. Everybody Gets Paid. People want to get something for what they do, although what they want to get may not be money - it may be sex or salvation or an opportunity to apply Marxist theory to rock and roll. Everything is business. This is the "public choice" theory of economics. One of its founders, James M. Buchanan, won the 1986 Nobel Prize in economics for his work on understanding politics as an economic activity. Politicians don't measure profit in cash. The gain that they want is an increase in power.

In order to increase their "power income", politicians have to pass more legislation, expand bureaucracies, and broaden the scope of government power. Politicians behave according to the principle: "You have to give something to the voters". Certainly, this can be if you want, measured in money – your money, the money that your government fines you through taxes, deficits, that is, inflation. In any case, a politician who claims he's going to cut the size of government is saying he's going to creep up on himself and steal his own wallet.

10. Everybody is an Expert. Of all the principles of economics, the

one that's most important to making us richer (or more powerful or whatever) is specialization, or "division of labor". Milton Friedman uses a pencil as an example. A pencil is a simple object, but there's not a single person in the world who can make one. This person would need to be a miner to get the graphite, a chemical engineer to turn graphite into pencil lead, a lumberjack to cut the cedar trees, and a carpenter to shape the pencil casing. He'd need to know how to make yellow paint to spray on it. He'd have to go back to the mines to get the ore to make the metal for the thingy that holds the eraser, then build a smelter, a rolling plant, and machine tool factory to produce equipment to crimp the thingy in place, for woodworking and a metal bending tool maker. And he'd have to grow a rubber tree in his backyard. All this would take a lot of money. Yet, a pencil sells for nine cents.

Free trade encourages specialization. Someone produces grapes, the other one manufactures computers, the third one holds lectures, and the fourth makes pizzas. Individuals can do a variety of things, but everyone who has more that one professional activity will lose. The more various activities, the greater loss. Adam Smith explained this in a well-known example of pin factory in his brilliant work "The Wealth of Nations". Every individual should professionally work only what he/she does the most successfully. This means that he/she is the best in doing that in relation to all the others things he/she can do. In econimics, this is known as a rule of comparative advantage or greatest relative efficiency. There are three main reasons why trade is productive, that is why it increases the wealth of people. First, trade moves goods and services to those who value them most. Second, trade allows partners to benefit from specialization in the production of those products in which they are the best. Third, free trade enables us to generate profit from joint efforts, from the division of labor, and acceptance of mass production methods. However, one should not neglect the certain negative consequences of the division of labor.

The implications of the division of labor are surprising, but only if we don't think about them. If we do think about them they are, like most economic principles, a matter of common sense. There are, however, a few things about the economy that don't seem to make sense at all. There are also important rules that are extremely applicable. One is Ricardo's Law of Comparative Advantage. The English economist David Ricardo (1772-1823) postulated this: If you can do X better than you can do Z, and there is a second person who can do Z better than he can do X, but can also do both

X and Z better than you can, then an economy should not encourage that second person to do both things. You and he (and society as a whole) will profit more if you each do what you do best.

Let's illustrate this with an example. One novel is equal to one pop song as the Benefit to Society (one novel or one song = 1 unit is BS). The first person (A) is a better writer than another person (B). A is also a better musician than B. Say A is a 100 times better writer than B, and 10 times a better musician. Then say that A can either write 100 novels in a year or compose 50 songs. This would mean that B could write either 1 novel or compose 5 songs in the same period. If A uses 50% of his time to write a novel and 50% to compose songs, the result will be 50 novels and 25 songs for a total of 75 BS units. If B spends 50% of his time to write a novel, and 50% on a song, the result will be 1 half-completted novel and 2.5 songs for a total of 3 BS. The grand total Benefit fo Society will be 78 units.

A & B spend equal time writing and composing			
	Novels	Songs	BS
A	50	25	75
B	5	2,5	3
Total BS			78

A spends all his time writing, B spends all his time composing			
	Novels	Songs	BC
A	100	0	100
B	0	2,5	5*
Total BS			105

If A spends 100% of his time writing a novel, and B spends 100% of his time composing music, the result will be 100 novels and 5 songs for a the total Benefit to Society of 105 BS. (Note that B loses 40% of his productivity by splitting his time between writing and music, while A loses only 25% of his productivity. B has the "comparative advantage" in making music because his opportunity costs will be greater if he doesn't stick to what he does best).

Ricardo applied the Law of Comparative Advantage to questions of foreign trade. The Japanese make better CD players than Montenegrins (they

can make wines, but worse than Montenegrins), and Montenegrins make better wines (they make CD pleyers, but worse than Japanese), but both Japanese and Montenegrins profit if Montenegrins buy CDs from Sony, and sell wine to the Japanese.

All this means that economically most advanced are the countries with high specialization. After the World War II those were Japan, Taiwan, South Korea, Chile, Singapore, Hong Kong, Ireland, Iceland, and many others. These countries had high exchange with the world, especially with already developed economies of America and Europe. Unlike the countries that encouradged specialization and free exchange, economically underdeveloped countries are dominated by self-sufficiency policies. Specialization enables individuals to take advantage of their skills and expertise. It also allows an employer to determine work tasks depending on the ability of the worker. More importantly, the division of labor allows the acceptance of complex production techniques in mass production and technological procedures, which could not be imagined in individual arrangements. Specialization, the emergence of money, and the acceleration of transactions, increase productivity, but also the complexity of the economy.

Money is particularly important. Money itself is an immaterial concept and is impossible to define. Nevertheless, economic theory is about value. But value is something personal and relative, and it changes constantly. Money can not be valued. And value can not be expressed in prices. Therefore, the economic theory remains undetermined. Yet. Politics is affected by this inconsistency. But in economic practice, we need some economic principles, and they, again, can not be understood without analysis and practice. My aspiration to continue to understand the economy shows me that there is no "ideal" economy, and there are various types of economics, good and bad, capitalist and socialist. Economic activities take place under conditions of either anarchy or democracy or totalitarianism ... Lawmakers have a lot of power, therefore politics dominates over economy, and that is not good either for the economy, nor for politics, nor for society.

21.4 Policy-makers and economic stabilization

In addition, individuals should understand that economics and politics are dynamic. The very fact that technology is constantly changing and that it dictates this dynamics speaks of the constant impact of changes on the lives of individuals. This means that we are constantly faced with crises.

Individuals can expect governments and central banks to anticipate and minimize the effects of crisis. Let's look at how much of that can really be expected.

Capitalism is far from perfect, and one of its basic problems are the so-called boom-bust cycles (a series of fast-growing bubbles, which eventually burst), recessions and depression. These events have happened so many times in the past that it is safe to predict that they will happen again. Therefore, there is a widespread view that policy-makers need to be compelled to prevent such insecurity and reduce their impact.

However, the prevention of these events is a difficult problem: they never understood the reasons for their creation. The reasons for the growth and burst of bubbles in the economy are multiple, and their understanding requires human reflection - on people's motives, their patterns of thinking and changing political environment.

Predictions based on economic and financial models are limited. Predictions are somewhat good when it comes to the period of average crises, those short-term fluctuations that we have seen many times. But they are not accurate in predicting rare and severe economic crises, such as the one in 2007 - a crisis that, by its intensity, has not happened since the Great Depression in the 1930s.

Hence, there are small chances that predicting stabilization of economy can be reduced to science. However, we shouldn’t underestimate the results that have been achieved in economic science. Based on these results, the model-creators have learned to design economic data; moreover, their models is much more than just designing a data diagram; It seems that the economic theory on which they are based is also reliable. Predicting the future and economic stabilization requires much more than formal models, especially the non-formal static models. It is also necessary to use intuitive estimates. In addition to science, policy-makers must use political assessments and knowledge, given that economic forecast is limited by politics, it also depends on social and political forces. An additional aggravating circumstance for policy-makers is that it is difficult to verify and quantify the success of professional assessments in a social and political sphere. There is also an issue of assessing the efforts of policy-makers responsible for economic stabilization.

21.4.1 Monetary policy-makers

Central bankers are the first line of defense against economic fragility. The role of central bankers is essentially an attempt to manage the key driving force of the economy, business trust, or loans (by analogy), which have been discussed in the previous chapters. Business trust is rapidly lost in the crisis situations, so handling suspicion and panic is a difficult task for everyone; economic and financial science can not help much because no model can predict the ways people respond, which is the domain of psychology. Walter Bagehot, editor of The Economist magazine, in his book *Lombard Street: A Description of the Money Market* (1896) stated: "Credit, the disposition of one man to trust another, is singularly varying. In England, after a great calamity, everybody is suspicious of everybody; as soon as that calamity is forgotten, everybody again confides in everybody... The Bank of England in time of panic must advance freely and vigorously to the public out of the reserve" (Bagehot, p. 131).

Central banks have been failing in stabilizing crisis situations, and the most recent example is the inadequacy of their policies to prevent a major financial crisis in 2007. The interweaving of global financial systems sparked a chain reaction around the world, fueled by a housing market crisis and the subprime mortgage loan market in the United States.

This crisis was not foreseen, so there was no preparation for the crisis. The Federal Open Market Committee of the United States Federal Reserve System - which represents the board of the US Central Bank that is directly in charge of stabilizing the economy through its control of interest rates and loans – in its press release (May 10, 2006) did not give any indication regarding the upcoming crisis: "The committee sees growth as likely to moderate to a more sustainable pace, partly reflecting a gradual cooling of the housing market and the lagged effects of increases in interest rates and energy prices... The Committee judges that some further policy firming may yet be needed to addrress inflation risks."[57]

In his July 26, 2006, introductory statement to the European Central Bank's interest rate announcement, bank head Jean-Claude Trichet wrote: "Global economic activities remain strong, providing support for euro area

[57] Federal Open Market Committee, press release, May 10, 2006, p. 1 (http://federalreserve.gov/newsevents/press/monetary/20060510a.htm.)

exports. Investment is expected to pick up, benefiting from an extended period of very favorable financing conditions, balance sheet restructuring and accumulated and ongoing gains in earning and business efficiency."[58]

The International Monetary Fund, an international agency that closely cooperates with central banks, also overcame the problems that caused the crisis. The Bank for International Settlement (BIS) in Switzerland, which also works closely with central banks, in its Quarterly Report of May 2006, said that "there are hints of possible trouble ahead. In some markets, the optimism that had driven up the prices of higher-risk assets waned as the rally."[59] The fact is that none of the central banks predicted the crisis, not even before its very beginning. A 2006 study by Martin Čihak of the International Monetary Fund of the then-most-recent financial stability reports issued by forty-seven central banks around the world concluded that "virtually all (96 percent) have started off with a positive assessment of soundness of the domestic system, characterizing the health of the system as being, e.g., ’in good shape’, ’solid’ or at least ’improving’" (Čihak, 2006, p. 19).

The complete failure of central bankers in predicting the crisis is astounding and may be linked to the political nature of their jobs, the importance of political assessments for their jobs, and the difficulties that political predictions have always encountered.

The seriousness of the global crisis suggests that the efforts of central banks, albeit far too late, have nevertheless been successful in preventing a real catastrophe. However, they are not sufficient to prevent serious dislocations arising from economic contractions. Another important tool for the stabilization of modern economies is fiscal policy, tax and government policy.

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[58] Jean-Claude Trichet and Lucas Papademos, "Intoroductory Statement", June 6, 2006, p. 1 (http: /www.ecb.int/press/presconf/2006/htm/iso60706.en.html.)

[59] The Bank for International Settlements, Quarterly Report, June 2006, p.6.

22. CHALLENGES FOR INDIVIDUALS

22.1 A general view

We have seen that there are different opinions on what comes first: individualism or collectivism? Society consists of individuals, therefore, individuals are atoms of the society. It is logical that institutions and politics depend on their nature and behavior. Individual decisions are driven by motivation and self-interest. Accordingly, Madzar rightly says: "Therefore, it would be difficult to live and still believe that interest does not generate an influence what we propose and what we ask from the authorities and other institutions empowered and responsible for conducting economic policy" (Madzar, p. 203-204).

According to North (2005, pp. 23-57; 116-126), individuals form their perception of the image of the world in order to function. "This image is immensely important in understanding all the actionally relevant aspects of the environment in which an individual survives and in which he/she realizes his/her social role" (Madzar, 2011, pp. 113-114). Taking into account the previous views, the individual image of the world is crucial in determining the collective attitudes and values. It impacts the evolution of institutional order, the use of resources, the forms of their allocation ...

In economic theory, it is generally clear that typical dualism manifests itself in determining who comes first in economic and political life. Methodological individualism puts the individual at the forefront and that is the basic unit of economic analysis. That is the only "elementary unit of consciousness" (Buchanan, 1977, pp. 1, 14-20, 15), because there is no social phenomena, nor changes related to it, which do not apply to an individual. Behavior of individuals determines patterns of behavior of the whole society and participants in economic activities. Even in the most elite societies, key decisions are made by individuals, therefore, an individual is the key, an elemental decision-making unit. I think that the suppression of individuality (if not the complete abolition, as happened in socialism), is the best proof

that societies, which do not pay attention to the individual and insist on collectivism, have economically failed. This is a sufficiently strong reason to seriously considere the methodological individualism, where economics deals with the perspective of individuals. Recently has been published the book "Identity Economics" which casts a clearer light on the role of the individual in economics. In short, this chapter will highlight dilemmas and depths of individual effort, the fate and the commitment, without which modern economics and politics can not be understood. Finally, and especially important, without individual progress, without achieving the natural tendency of individuals to live better every day, there is no elimination of inequality and poverty as key challenges of economics and politics.

22.2 Individual as a basic unit of analysis and economic policy

Individuals interpret the world on the basis of their insights, creating their visions of economic reality, or groups of processes through which they create, exchange, and distribute economic goods.

Man acts in the context of individual freedom limited, above all, by scarcity of available resources. There are many other limitations, intertwined with politics, and other non-material factors. Within these frameworks in the individual world, an individual must extend the walls of constraints, and face the crises of various types: personal or collective, physical or psychological, material or subjective, economic or emotional... The recent global economic crisis (GEC) is nothing but manifestation of numerous challenges that individuals face. Times are gloomy, and traumatic. Millions of people live under the poverty line. Many things that represent the survival are being questioned. The existential drama has two - general and heterogeneous - groups of patterns. For one group, the individual is not responsible, because it arises from the general social and economic situation; a vast mass of individuals is also not responsible, because they have no influence on social events.

There is, however, another group of causes, which are absolutely dependent on individuals, and are being ignored in a scientific communication. That is what individuals have failed to do for themselves. Self-criticism, evidently, is not embedded in human nature. Namely, when we have hard times, we rather search for some external causes of our troubles instead of analyzing our own behavior, which possibly contributed to this unfavorable situation. We would rather demand of others to solve our problems, instead

of doing it ourselves. We often blame the government for bad situations. We are always glad to hear that the responsibility for our pain and suffering is not ours but someone else's (institutions, forums, politics or, possibly, other individuals).

To avoid misunderstanding of these attitudes, a multitude of external factors, including institution building and policy-making, strongly contribute to the deterioration of people's lives, and are typical producers of innumerable human misfortunes. But I do not think that people should abolish themself for the sake of responsibility. "The life mill does not depend solely on these various external determinants. If the bitterness of the mill is shedding, which has been devolved to us, we must have contributed to it, at least to some extent, even in the past," (Madzar, p. 397).

When faced with crisis, many people are indecisive, some are not able to lift the ramp and stop, which sometimes ends badly. There are those who think they have been doomed. Some suffer and wait for things to get better. Some decide to act in order to survive; to bear their fate and to be useful to others. These people know that they cannot expect help from others.

Every culture, past or present, is defined by the way it faces such misfortunes (traps). Every economy and politics are defined by individual abilities – with fatalism, resignation, celebration or revolt ... Each of us struggles to overcome the storm! For me, this is the main lesson in economics, the lesson of survival. The lesson of life and progress, action and motivation. Today, the change is permanent, and we live in a constant crisis generated by technologies. In response, and for our own resilience, we must learn a few basic economic lessons: wanting to survive, planning in the long run, putting yourself in the shoes of others, dedicating yourself, transforming threats into opportunities, becoming different, and ultimately the more extreme - rebelling against all stigma. This economy is real and necessary to every individual.

I persisted in applying these lessons in my professorial work, although that was a difficult task. Tolstoy said that everyone is talking about changing the world, but no one is ready to change himself. I think that the basis of the change of society is exactly the change of an individual. It gives importance to lessons on survival, because they are powerful if applied. And I have pointed out these lessons as the universal material of economics, for students, for masters, for doctors, for all those who want to become diffe-

rent. Because each of us must independently find the principles of behavior necessary for a fulfilling, free, dignified life, either in our personal environment or in an enterprise or in a country. Without freedom, there is no democracy.

I have come to these ideas through a long process of learning and studying life and books, through the synthesis of knowledge. I would say that every man is the creator of his happiness. In my books "Entrepreneurial Business - From an Idea to Success", "Effectiveness and Time Management" and "The Ray of Creation" I have dealt with an idea that we all must fight for our place under the sun, to have dignified life. In order to avoid repetition, I will mention only the philosophy of economics as a ground on which the economy can be built, including several disciplines, particularly finances, important in economic knowledge and economic life. This building takes a long process of struggle for all life lessons, despite many storms, especially those of collective, such as we have endured in the Balkans.

I fought and learned from my early days. However, in pre-school age I did not go to kindergarten. I was helping my parents to keep the cattle, but I yearned for games and societies. I was expected to constantly watch the lambs, to bring them food, at least once a day, and water which was a couple of miles away. That was a great effort for a little boy; I was constantly tired, and under the great pressure to do the job well. The livestock had to be fat and healthy in order to be sold in the autumn. And the whole summer was ahead of me. When I was older, the housework grew and became more and more demanding; plus my school education. I studyed at night, because during the day I had to work. But there were some pleasures and pride in it: I was helping my family, I was doing the jobs of adults, I was contributing to the increase of family income. By selling lambs and other livestock, my family earned four or five times more than my father's salary, which, at that time, was considered above average. In addition, my work influenced our home economy: we produced meat, cheese, milk, potatoes, cabbage, which we did not have to buy. That was significantally cutting costs. During the winter we used that food to survive, when our village looked like a beautifully frozen and inaccessible desert. The meaning of *rare resources* I learned then, in the long winter nights, when the snow was falling for days, increasing my anxiety. I felt good knowing that the stocks of our household were sufficient for several months. The country life is hard, but also very idyllic. Like many other, my village had that particular charm of innocence and pu-

rity, often described in the literature by great romanceians, poets and painters. Yet, the country life is not as idyllic as it seems in artwork. "The picturesque rural nature is not a source of enjoymeng and satisfaction for the peasant soul, but a place of hard eternal work, scarcity, and renunciation" (Blagojevic, p. 45). Indeed, country life is a merciless and irrational wearing of enormous physical and mental forces. An extraordinary economic lesson in my childhood proved how important each resource was. My sister, a small girl at the time, had the most frequent task to peel potatoes for preparing dinner. However, my sister did the job a bit carelessly; besides the potato skins, she often peeled off the good parts. Our mother noticed that and began to criticize the girl. I remember my mother's anger and disappointment. My sister learned her lesson and never repeated that mistake.

Thus, we were educated in our everyday activities. Our parents were great teachers of the economics. They gave me the first lesson that I could later distinguish as universal: resources are scarce, there is no wasting, we must work hard to create something, because creating is the meaning of life. I highlight another lesson, which I learned from an American rich man. At that time, I worked in a big company, in the city. An American expert came to visit us. We went for a walk. We talked about a lot of things. In the middle of the conversation, this American paused to buy a little something at the newsstand. The salesman did not give him change in coins, because it was worthless (less then five cents), so he did not even pay attention to it. But the rich American, the capitalist, the owner of factories, asked for his change. He stood there, waiting! I was really surprised, because our people in most cases don’t take such a small change.

Everyone has urge to survive. Is cruelty the main principle of evolution and do only cruel people survive?

22.3 Is there room for altruism?

Marxism is an ideology that has marked my youth. This ideology emphasized the class struggle between the bourgeoisie and the proletariat, portraying the capitalism and economists of the Western world in a black and white picture, that is, as a society of inhuman people and exploitation. Boldness prevented me to agree with such a picture. In spite of ideology, in which I developed my knowledge, I tried to figure out the conceptual and theoretical inheritance of capitalism in order to discover the truth about that society. I often wondered how much humanity was in that system, and was

there room for altruism? I have long sought the theoretical foothold for that! Game theory has helped me a lot, as well as Pareto efficient. Nash equilibrium[60] led me to seriously reflect on the rational interaction of participants in economic activities. Somehow, I intuitively realized that in this rational behavior there is concern for others. I later found that Jacques Attali defined it as "rational altruism". Thanks to him, I opened up a window for new views about the economics. It was not difficult for me, because I already had insights that confirmed my thoughts.

Also, I was greatly surprised when I realized that the well-known names in the Western economics actually emphasized altruism and collective interest. Adam Smith, the father of Economic Science, wrote a book about it ("The History of Moral Feelings"), and that has been somehow neglected. On the other hand, "An Inquiry into the Nature and Causes of the Wealth of Nations" was highlighted in order to foster the story of egoism. This story of egoism really dominates, even today. It has been favored by both economists and politicians, while the story of altruism was almost hidden!

In 1714, Bernard Mandeville explains that egoism is socially useful because "private vices yield public benefits". In "An Inquiry into the Nature and Causes of the Wealth of Nations," Adam Smith writes about the economy of liberalism. He explains a similar idea, saying: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."

According to liberal doctrine, an individual interest is the basic engine of labor effort and human rationality.

In his "Manual of Political Economy" (1906), Vilfredo Pareto writes: "It’s the same mistake when political economy is accused of not taking morals into account; it is as if one were to accuse the theory of chess of not taking account of the culinary art." Much later, in the same line of thinking, Milton Friedman claimed that " the sole responsibility of business is to make a profit," and in this spirit is the famous phrase of the President Calvin Cooldge: "The business of America is business." In such reasoning, morality and economy are two completely different spheres. Instead of putting a morale at the forefront, an *invisible hand* leads the economy to the greater wel-

[60] 1Superbly portrayed in a film Beautiful Mind.

fare of the community, regardless of egoistic behavior of individuals, whose actions lead to a harmonious balance. Reality, however, shows that it is not so, and that numerous imperfections of the market lead to inadequate use of the production factor, i.e. unemployment and crises.

Is there room for altruism? Is it enough to think of our own interest, without taking into account other participants in economic activities? Can society be in harmony if interests of all participants are not met? Is not there a balance in the economy when everyone tries to realize his/her own interest, also making others happy? Is it not rational to be an altruistic person?

The idea of "rational altruism" is not new. In "The Theory of Moral Sentiments", the work probably greater than "The Wealth of Nations," Adam Smith says: "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it" (Smith, 2008, p. 79). Similarly, the game theorists have demonstrated altruism, applying an illustration known as the *Prisoner's Dilemma,* that it is optimal for everyone to cooperate.

In his book "The Great Divide", Stiglitz speaks of the need for rational altruism. He believes that inequality is harmful to economic performance. Rational altruism would enable higher GDP and greater equality, which means that nothing should be sacrificed. There are measures that can increase the equality of unpaid income and transfer payments, as well as redistribution measures in a way that increases overall performance. One of these measures is taxation - taxes for capital gains on the basis of land – which can lead to productive investments (instead of speculating on real estate), and to the creation of jobs. An increase in overall economic performance would not only benefit society as a whole, but also many members of the richest population. This would create balance, which makes all participants in economic activities happy, because this balance is based on cooperation, and even one percent of the richest will become part of a unique society.

Modern economy requires "collective action". The role of the state is to take care of infrastructure, education, and technology. "The more divided a society becomes in terms of wealth, the more reluctant the wealthy are to spend money on common needs. The rich don't need to rely on government for parks or education or medical care or personal security" (Stiglitz, 2015,

p. 94). Wealthy people keep away from ordinary people, losing their altruistic feelings. They are against the strong state, because they are not for the common good; however, the state could take a part of their wealth, and use it for the common good.

Alexis de Tocqueville described the principle of "self-interest rightly understood". This means that everyone has personal interest in the narrowest sense: the right of association with the virtue to do what is right. However, a "properly understood" personal interest is to take into account the interest of everyone else. In other words, the common good is actually a prerequisite for personal well-being. It's a completely altruistic philosophy that comes from the fact that, when you take care of others, it's not only good for your soul - it's also good for your business.

Wealthy people in the 19th, and even in the 20th century were wise. They knew their position would not be good if the society was not good. Henry Ford, a generous man by nature, gave his workers a decent salary because he wanted them to work hard and buy his car. Ford realized that selfishness jeopardize his business. Franklin Roosevelt was not a member of the working class, but he fought to expand welfare by restraining capitalism through regulation, taxation, and social programs. All this caused the revolt among capitalists, although later came to light that it worked equally in their favor. Some US presidents focused on increasing taxes and investing in education, public works, health care, social security, and so on. Even if altruism is left aside, if these programs are seen in the light of personal interests of the rich, capitalists have no reason to be revolted by such programs. Nevertheless, the world is not perfect, so we can not expect rapid progress towards altruism.

However, the dominant paradigm of egoism and personal interest is constantly on the scene today, incarnated into tyranny of money and capital! It culminated in negative tendencies in politics and economics, as we have stated earlier. This paradigm has brought us into the instability and crises that threaten every individual, every company, every nation. In such a world of uncertainty and constant crises, an individual must concentrate his/her efforts, knowledge, and experience in order to survive. So, today, in the world that goes into chaos, the basic lesson is how to survive. More generally, this lesson has always been topical in the long history of the human race, in which good and bad events shifted.

22.4 Survival strategies

Here are remarks of some reflections about what can be expected in the coming years: a certain development as a continuation of previous years; possible crisis; both can go for better or worse, which will be in line with today's actions of people. Crises represent innumerable threats to the survival of individuals (unemployment, backwardness, deprivation of life, epidemics, loss of sense of life), to the survival of enterprises (bankruptcy, lack of finance, technological lag, loss of competitive ability), to the survival of nations (reduction in birth rates, reduction in savings, natural resources, loss of desire for existence). All of them also represent a significant potential for the development of freedom and joy of life for everyone.

All of the above, whether positive or negative, affects the life of individuals. Every individual, every enterprise, every nation, and entire humanity must assume that the crises will happen, both personal and collective, and that they must find the means of survival in the best possible way. It will not be easy: the great man-eater of our world has the urge to devour his creators, without exception. Let’s reiterate: technology, which is the carrier of progress and goodness, has a dimension that we must not neglect – it constantly produces crises.

Some people, enterprises, or nations, amazed by the scale of turmoil, deny its inevitability, rely on hazard; others seek to act in order to change the state of the world and thus the direction of their existence; yet, some decide not to count on anyone other than themselves, ready to carry the main burden of future development. Only those who count on oneselves, who are neither naive nor disappointed, find themselves under the influence of pessimism or deceptive optimism. In order to succeed, they must, above all, analyze events and understand them. For the application of adequate strategies, which mankind developed over the millennium, principles outlined below should be highlighted. Let me remind you, this book has a mission to help an individual in navigating through the whirlpool of modern economics and politics, in order to find his/her harbor of salvation.

22.4.1 Passive strategies

Regarding what awaits us (as individuals, enterprises, nations), many think that bad things are inevitable and that human actions cannot change anything. Those are only viewers, observers of their own destiny, and they behave in one of the following ways.

Self-denial. Faced with a natural disaster (epidemic, massacre, economic crisis, individual crisis, sentimental breakup, sickness, sadness, and the like) many - people, enterprises, nations - lose their lucidity. They are deprived of the ability to analyze what is happening, to anticipate and act, and they surrender to the course of events.

Also, in the economic crisis, either collectively or personally, some people think that certain developments are inevitable. They deny the risk, the facts ... And then, when the worst happens, they are miserable and helpless, believing that there are no means of action, either individually or collectively. They remain passive, like wrecks.

Renunciation of the world. Some people think that the origin of dangers that threaten us is deeply rooted in the nature of the world, and that nothing good can be expected from the material world. Thus, for example, even if economic growth is renewed, it still does not allow them to achieve their well-being, to release their suffering, to improve their relationships with others; in their view, the material world does not help the change of their situation. They decide to remain passive and not to act. Some of them retreat into virtual reality.

Repentance. Another form of behavior is the feeling of guilt for belonging to such a bad world, with so many misrepresentations and murderous destruction. Before accepting the guilt, those people apply the strategy of fasting after the carnival. They eat less, live more uncomfortably, forget about the possibility of desire, joy ... They do not see progress and are simply left to purge off their imaginary guilt.

Hope in others. There are people (individuals, companies, or states) who hope for the actions of others. Some of them estimate that they themselves cannot change anything, and therefore they do not change their behavior, expecting from others to change things; they hope that a powerful person or the market or some external power, like a gentleman from the

Western film, will regain the lost equilibrium. Among those individuals and nations are also those who hope for the intervention of some force outside the world; for them, the earthly life is nothing but transitoriness or temptation which allows immortality.

22.4.2 Active strategies

Individuals, enterprises or nations can also apply collective strategies to jointly solve their problems and modify the rules of the game. Some are bitter, others are prone for political action, the some demand fundamental changes ...

Indignation. Some people are indignated by the world, which, in their view, produces so many inequalities, as the elites continue to increase revenues, while poverty is growing. People are dissatisfied with: egoism of the powerful, blindness of the rich, technical progress, vanity of human glory, pressure to work, etc., They investigate who gets, who loses, and who reveals only bad things, conspiracies, and the like. They devote themselves to political or diplomatic attempts, but they are not that eager to change the reality.

Political action. Hoping to be guided by others - individuals, enterprises, and nations believe that their survival depends on changes in the world order, or, at least, the leaders of their countries. They engage in political parties or associations that are struggling to overcome the crisis through reforms or, at least, to equally distribute the burden.

They have different answers on the topic of altruism, and compatibility of individual freedoms of everyone in present and future generations. These answers – particularly in the form of an altruistic interest - advocate for the prevention of pandemics which affect the poor, in order to avoid degradation of the climate and other adverse situations. Altruists help the helpless and those who pollute less.

After all, Karl Marx's theories are being actualized, as well as the memories of his predictions: globalization, class contrasts, borrowing, workers' pauperisation, technological progress breakthrough, market growth, economy financing, increasing egoism, decreasing profit margins, crisis amplification, etc..

This clash of altruism and socialism can open up new forms of political utopia.

Revolution. When they realize that the results of those political actions, supported by the government, have not been successful, and when they realize that nothing can change in the framework of local democracy and the market, the advocates of the revolution conclude that "nothing is new under the sun", at least under those conditions . That's why they move to a new strategy – the revolution – believing that it could change the world.

22.4.3 Current strategies of personal character

None of these behaviors is sufficient to survive and overcome all threats. Survival is the first goal of all living beings; without survival, nothing else is possible, not even the political action.

Therefore, a crucial question needs to be answered: How can individuals, enterprises, nations, or society as a whole, survive in conditions of crisis, threat, and aggression of every kind? There are common points of strategies that apply to various actors of survival (e.g. tsunami, religious conflict, economic crisis, etc.).

In this context, survival is understood by its meaning in English language. However, in some languages survival means life after death or life now and here. German language has the term *uberleben* (live now) and *forleben* (continue to live). In psychoanalysis, these terms mean to imagine immortality.

Prosaically, "to survive" means "to live" as long as possible - for a person it means nearly 120 years old, for an enterprise it means several centuries, for a nation it means several millennia, for humanity it means infinite. Below are explained some important values that need to be nurtured in order to better navigate through political and economical vortex of the modern world.

Self-appreciation. In order to survive, to deal with threats and turmoils, people should have self-awareness and self-appreciation, they should determine their goals, define their values, give concrete meaning to everything, and implement all this. Megalomania is an extreme form, but many people or organizations lose the sense of real self. Therefore, they do not last long.

The first principle is to be precious in our own eyes, not to hate ourselves, but to rely on the importance of our own existence and our own values; hence, we need to want to live, to establish the reason for existence, to awaken energy that gives purpose and brings essential importance in our lives. This energy and vitality allow us not only to survive, but also to live better. It requires constant work on ourselves, to develop our constant growth, excellence, intelligence, and enlightenment, and to rely completely on ourselves. To appreciate ourselves means to appreciate others.

To live intensively. For an individual, as well as for an organization, the most limited resource is time. Once we become aware of ourselves, we should carefully use the time resource; it is necessary to live every minute as if it were the last one, to think constantly that we must overcome the circumstances and to achieve more than just survival.

To develop empathy. It is necessary to develop the capability of assessing the risks fDor projects we dedicate ourselves to. It is the ability to predict the future, to create a future image of the world (speculatium). That's what businesses and nations use under the meaning of the word intelligence. Hypochondria and paranoia are extreme forms.

Empathy leads to recognizing partners, creating networks, making arrangements, accepting others, identifying enemies, etc.

To develop resistance. Once the hazards are identified, there is the fourth principle of survival - for individuals, enterprises or nations – which consists of equipping with tools that prevent those hazards. This is called resistance, and requires the ability to manage assets in order not to lose everything in case of catastrophe, political quake, economic crisis, war, disease, breakdown, etc..

Developing this ability aims to achieve a state of mental and material resistance in case of shock. It helps to survive the disappointment after the failure, whether professional or sentimental. For a person or a company, this ability means to have a firmly established basic behavior, especially in the event of economic crisis. Some of the suggestions are: do not entrust all your funds to one bank, do not invest everything in one project, do not rely on one building, one person, one salvation...

To be ubiquitous. If previous survival tips are not sufficient, an organization or an individual must have the power to change the pace of life. If a

person can not change his competitors and allies, if a competitor intends to take everything and destroy our efforts, we (individuals, enterprises, nations) must decide to seek for neutrality or benevolence.

To think revolutionary. In the end, when no other solution is possible, we start questioning our goals and values, and seek for their transformation.

Creativity. Last but not less important is developing creativity. These skills are crucial in the struggle to improve our situation, regardless of incentives and threats. We should learn to be creative if we want to turn our problems into our opportunities.

22.5 Creativity

Appendix 14: How the idea arises?

Who are the creators of ideas? How do ideas arise? Do we create or do we copy the ideas of others? We need to recognize what is creation. It brings personality into what we are dealing with. Creativity depends on the personality development, its strength. Only strong personalities create new ideas, they do not copy others. Powerful individuals take time as given, and use the time frame in the best possible way. Unfortunately, only a creator can recognize a creator! It is therefore a paradox that imitation is widely recognized. Not everything creative is also innovative. Creativity begins with an idea. Creativity is recognized only by understanding the idea at which it has been created. Knowing who is the creator of an idea is very important. Realizing someone else's idea is not the same as realizing our own idea. The idea is created in a certain way and under certain conditions. If we do not recognize the creator and the idea on which something is created, then we are left to imitate, to play life. In that case we spend our time irreversibly in the theater of life! Theater is an imitation of life, it is not real life. "Who doesn’t live now, he never lives," says Jostein Gaarder in "The Orange Girl".

What is the importance of the idea? Ideas are the creation of mind and soul! Human thought is like a flame of fire! Ideas arise in the process of intelligent work. If there are many different ideas, we seek for ideas of creation, which carry the materialization of power. Our overall action and orientation in life depends on how we recognize ideas and how we create them. This process is time-determined, and that is why the effectiveness of intelligent work is essential. Seeking for ideas requires sincere dedication to

intelligent work, professionalism, morality, concentration ... Also, it is important that we are evolutionists.

Behind every action is a thought, an idea! And ideas do not come alone! Ideas arise from communication with the environment, with life. If you look in front of you, in order to move in that direction, you need new skills and knowledge acquired through experience. Knowledge always opens the mind. When you know a foreign language – the endless space is opened before you! Same is when you know computer technology. Yet, the spark of an idea should be sought in the individual. If there is a spark in an individual, all other obstacles can be overcome.

Creativity is related to the development of an individual and his/her knowledge. Creativity relies on efficiency. You reap what is sow! There is no success without hardship! Effectiveness implies action, work, effort, renunciation! It requires energy. Nothing is free! "There is no free lunch."

Creativity is deep in the nature of man, therefore it comes from individuals. "The key question is not *'What fosters creativity?'* But why in a God's name isn't everyone creative? Where was the human potential lost? How was it crippled? I think therefore a good question might not be why do people create? But why people not create or innovate? We have got to abandon this sense of amazement in the face of creativity, as if it were a miracle that anybody created anything" (Maslow, p. 39).

Creativity is the ability of a man to create concepts, to think. I must point out that thinking is a vast human resource. Due to the complexity of life, if we think about all of its aspects at once, we will surely be confused. Emotions, information, logic, hope, creativity, they all heap up. I think it's important to differentiate some areas in human creativity, to separate emotions from logic, creativity from information, and so on. I think creativity is related to putting together the peaces of knowledge in time drawers. It is the harmony of human nature, human knowledge, efficacy, and time, sorting of chaos in the cells of time.

How to free your creative potentials? Without spark, without intention, without creativity. Intention is enormously important. If you choose to become someone, then you must behave that way, think that way, which means that you must do things better, you must master your work, you must seek better ways to do business, to offer new products and services, new ways to meet customer needs. It all starts with thinking.

Tibetans pronounce their prayers while spinning the prayer wheels filled with many mantras. By rotating these prayer wheels on a spiral direction Tibetans elevate their prayers to divine heights. Indeed, if these cylinders are properly balanced, one person is quite sufficient to encourage the rotation of prayer wheels. During the prayer, Tibetans are probably allowed to think of something completely unimportant. What is important is the intention to pray, rather than emotional or spiritual excitement which many Christians demand from themselves. There is, however, another Christian view, much closer to the Tibetan: performing prayer activities even when they are completely emotionally excluded. Over time, your emotions will be adjusted to your activities. That's exactly what I think you're doing when I recommend you to *role-play* the person you wish to be.

The idea does not come by itself. It results from a critical observation of reality and intelectual engagement of an individual. An idea requires intention and action. Action raises the necessity, the need, which produces an idea. Passivity, lazyness, and resentment will not foster ideas. Only those who have intention can have ideas.

You see, everyone can run, but a true athlete runs deliberately and for this purpose he/she trains.

There is no easy way to send a signal to ourselves that we want to start thinking about the action, despite everyday inactivity and leisure. We have to change our mindset. Thus we develop our intent. We no longer think passively and absently, but deliberately. I recommend the book "Psychophilosophy of Business" by Veselin Vukotic to help you develop intention. The book is written in the form of discussion and dialogue. But, unlike western habits and debates, this dialogue-book does not neglect generativeness and creativity, which makes it exceptional. Critical thinking is not enough. When your thinking is a reaction to a task, it does not contribute to the creation of a proposal. Thinking must create an initiative and plan its actions. That is "active thinking" or, better yet, operational thinking.

However, the intention is not enough. You need to take certain actions. The intention of a Tibetan to pray is not enough: he must spin the prayer wheels. If you intend to become a good chess player, will it be enough to masters the figures on the board? The answer is: no, because you need to have an exceptional ability. For some jobs that is not required.

Therefore, the first step is the intention, which is both easy and difficult. I would say - it's easy to make rules, but it's hard to practice them. (Jovovic, 2008, pp. 87-88)

We can develop our potential in democratic conditions, where individuals have dignity, where individuals are free of coercion. But democracy is not sustainable if it is accompanied by poverty and inequality.

23. FUTURE CHALLENGES

23.1 Introduction

Science is the most beautiful human activity. Broadening spiritual vision, however, depends on practicality to a great extent. Clearly, accumulated knowledge (i.e. written in books), is not sufficient to solve the problem. Knowledge in books is knowledge of the past, and about past, but we are now preparing for what is ahead of us. Scientific papers and academic literature generally interpret how something happened, how knowledge has been acquired – how it was. That is a valuable knowledge and should not be rejected, because certain tendencies from the past continue to occur. They allow us to design a future scenario with greater certainty. However, this knowledge does not help to explain the future. General knowledge about the past will not help us determine the problem.

It seems increasingly important to define the real problem, which requires a situational knowledge. Accumulated uniform knowledge will not help us in solving new problems that life creates. Textbooks are full of descriptions, charts, models, figures, and other formulas, focused on the past. But, with each new day, they are further away from reality in which we live, and which we can certainly not see and understand through the lens of the past. It takes practicality of the moment in which we solve the problem. Trying to overcome the previous deficiency by so-called "cases of best-practice" is not effective enough. Circumstances change and the former "good practice" does not exist today – therefore, the current problem can not be applied to diagnoses from the book or texts of former economists and politicians. Evidently, textbook or uniform mind does not contribute to the development, because it does not give originality, and without originality there is no development. We can hardly talk about contributing based on already known reports, or finding out what is already known. That is the case when an individual joins the majority (mass), and loses his/her individuality.

Dissolution of individuality is the problem in any society, organization, enterprise, and family. Dissolution of individuality is dissolution of life. Development is enabled by individuals who don't follow the majority opinion. Have not Reformation and Renaissance shown it? Reformation began in 1517, with the changes brought by Martin Luther. According to many, that reformation was larger and more important than all the previous religious reforms and political movements. It gave new postulates on nature, life, and space. The center of this historical movement was Basel. A democratic institution at the time was the University of Basel, with a diverse academic community, mostly professors who abandoned the uniform approach to education and had their own individuality. By nurturing their personality, they also portrayed their own visions, facing reality in a new way.

Equally good example is Nicolaus Copernicus, who changed the paradigm of thinking about celestial bodies (1543). In his book "On the Revolutions of the Heavenly Bodies", he concluded that the Sun is the center of the Universe! This discovery was truly revolutionary, because it fundamentally changed the understanding of the cosmos, and the solar system. Imagine how many centuries people lived in delusion about the solar system. The development of natural sciences was based on such a paradigm. Suddenly came the enlightenment: the eternal myth that the Earth is the center of the universe was changed, and new paths were opened in science. These discoveries and many others appeared in accelerated dynamics. The year 1543 is symbolic, because two important books were published: "Anatomia" by Andreas Vesalius, and the first translation of Archimedes' "Mathematics". This year and the 16th century are a crucial period for abandoning the so-called collective experience, i.e. the discovery of hidden structures of matter through collective practice (e.g. the discovery of stone tools, metals, fire, animal domestication, plant cultivation, etc.). Earth's revolution around the Sun could not have been discovered by the collective.

In the West, Humanism, Renaissance, and Reformation brought an individual to the forefront, while the organization of society, companies, and groups protected the individual. Another deep change was achieved thanks to the changes in mindset, and economic and cultural progress. The fundamental change, which happened thanks to the discovery of Nicolaus Copernicus, coincided with Martin Luther's view that God is not only a Creator, but also a Man. Luther established an individual on Earth in the faith, he put the Creator among us. The individual returned to his essence, Cosmos was lowered into the microcosm. Strong church bureaucracy failed to stop the ti-

de of change; despite persecution of Nicolaus Copernicus, inquisitions and opressions of individuals who supported the changes. This means that a religious paradigm was abandoned. The West abandoned collectivism and opened a space for individualism.

Many societies which did not experience the Renaissance continued to ignore science, research, innovation, entrepreneurship, and creativity. They did not understand the necessary transformation that knowledge is individual, although the religious paradigm itself rests on individual - God. The consequence is visible: such societies are underdeveloped because they simply did not catch the wave of individualization, and remained largely in the vortex of collectivity. Humanism after the Renaissance through industrialization reaches modern capitalism. However, modern capitalism faces the neglect of individual and pessimistic reality.

23.2 The state of modern capitalism

Modern capitalism, unfortunately, has neglected individuals, forgetting all other values, except the selfishness and value of money. Modern capitalism, according to its definition, has only two basic assumptions about the man, i.e., humanity:

1. human beings are primarily economic entities, which, according to Adam Smith, have a natural tendency to trade, exchange, and barter among themselves,

2. human beings will always follow their own rational interest or, at least, the hints of what can benefit them.

At the business level this is manifested in the principles of profit-seeking for profit, as well as in the assumption that every business tends to maximize its own interest and profits of its shareholders. These essential and all other assumptions are strengthened by intellectual trends, such as Newton's mechanics and its accompanying technology, as well as Darwin's struggle for survival. The capitalist original laws on competition, profit, and capital accumulation have grabbed today's capitalism and transformed it, as Zohar Danak points out, in a ruthless search for a competitive advantage in the world whose resources are being reduced by its own actions. This raises a frequent question of the system sustainability. There are resource exhaustion issues and its devastating consequences on the environment. Such a system has led to the pessimistic situation of today's mankind.

23.3 Changing the paradigm

We need to think about economics and politics in a dynamic context. It is logical to argue that events in the modern economy cannot be understood, nor predicted, on the basis of a static approach to economic reality. The dynamic concept of economics is a platform on which it is possible to build an understanding of the economy today, and its use in predicting the future. Economic science has the ambition to describe the past, but also to foresee the future. It is a connection of economic visions with the real world.

The complexity of economic reality is a challenge for contemporary economic science and politics. Reality is changing: in the modern world, change is the only constant. This changes the philosophy of economy from the basics!

All this becomes more relevant after the last global economic crisis (2007-2009). Economic science did not predict this crisis. Thus, confidence in its scientific approaches to the creation of economic policies has been lost. How to explain all this? In my opinion, it is necessary to study economics as a dynamic system of ideas and creativity. This means that the time factor plays a dominant role in the economics.

In previous chapters we have seen that hope in the happy future of mankind is very debatable. The weight of failure faced by the world economics and history has outweighed the balance in terms of successes, which, too, can not be denied. Bad forces look stronger than good ones. More precisely, although success is significant, the failure evidently establishes an unbearable reality for most of mankind. It is manifested in many negative tendencies, where inequality of all kinds dominates. Also, it carries an ominous dynamics for the future: the world is obviously moving towards poor economic, social, environmental, political and military state. Something has to be done!

Due to all this, there is no explanation for the state of misery and disturbances in which are the economy, society, and politics today.

For some, the main reason is the power of money that created frustration and violence; others consider it to be a lack of spirituality, which disrupted the normal functioning of society. Some blame the unexpected return of fundamentalism, intolerance, and religious wars. Others, yet, claim it is the beginning of a war between civilizations for the control over natural resources, and the richest zones with the mildest climate. According to some opinions, Western civilization has caused the revolt of all those who have no

access to the rich world... Although these explanations have solid reasons, it seems to me that they are not sufficient to explain the current situation in the world, especially not its dynamics.

First, it's hard to believe that money itself was a factor of violence. Practice has shown the opposite: since the invention of money 3,000 years ago, it was meant to avoid or reduce violence. In addition, I don't believe that the apologetics of poverty or poverty alone could create harmony in the world. We are not in the religious war, because religious leaders or religions have never called for such a thing. We are not in a situation that a great war of the Muslim world has begun against the Western civilization; this is not the case, not only because this war was not announced, but also because the world is extremely diverse. Also, our world is not without spirituality, quite the opposite, there has never been a greater search for transcendence, yet not so diverse and intense; demand for the meaning of the world and of life has never been so energetic.

In the end, neither the theory of Marxism, nor the liberal theory, can explain the state of the world; we do not participate in any planetary struggle between the united bourgeoisie and the class of workers, nor in the confrontation of free choice in a single market, pure and perfect ...

Simply, general explanations are not satisfactory. The tendency, which can be quantified at this moment (weakening of economic growth in the world), does not have any explanation: for some, the tendency of weakening is the result of the lack of broader technological progress, which seems completely contrary to the facts; others think that the main reason is low real interest rate (even negative), making investments risky. It is so in the United States, even in Europe, but no one has proven that the current situation is the result of negative interest rates. There is also an explanation that everything is caused by the attitude of man towards death. Therefore, the mankind has, since ancient times, made it somewhat more acceptable, organizing rituals and sacrifices to create conditions for financing all of this.

In my opinion, this explanation should be extended by the attitude of man towards scarcity. After the 12th century breakthrough, death was no longer seen the same way, and man was no longer searching for the meaning of life after death. He turned to searching for freedom in managing the rare goods, especially the time, which should be maximally used during the day, the year, the earthly life. More freedom means more opportunities to increase the amount of available rare goods.

In such a society of freedom, managing rarity is based on two instruments: the market for private goods and democracy (or rules of the game) for public goods. Both mechanisms have been established to give the illusion of freedom, since it is ultimately limited by the rarity of goods and death. These mechanisms have functioned progressively, as they have been able to reduce scarcity. Constitutions incorporate a moral principle according to which the distribution of income belongs to each of the contributors. Realizing this principle enables respect for economic efficiency and resource utilization in the most efficient manner. However, politics has enabled abandoning this principle and turning into violence against the economy.

The dialectics between the market and democracy, that is, between economics and politics, explains the reality in which we lived, and the reality we live in. In other words, during the development of capitalism, the dialectics between economics and politics has been established at the level of equilibrium. The market has strengthened democracy and vice versa. The market has created the middle class, and democracy has created stable rules of the game. New wealth was created, the growth of the economy was increasing. However, the balance of economics and politics, or the market and democracy, was disturbed, and dynamics of relations have changed. Namely, individual freedom provoked disloyalty and uncertainty, which led to a search for some other attitude towards rarity. This led to an unequal revenue and wealth distribution, and a vicious circle of increasing inequality. Restoring religion or other movements is only an actual response to the violence of politics over the economy.

In order to understand this change, and the theory that has been put forward, we will analyze six elements of this view on the market, democracy and the causes of change in the dialectics of their relationship.

1. The social organization based on economic and political freedom has been established, and today it is present as the best system in the world.

a. The desire for freedom inspires the man to create, to experiment, to innovate in order to increase the available ideas, goods, and works of art, that is, to broaden the walls of rarity. The man is particularly focused on innovation, striving to create free time and to fight death.

b. The pursuit of freedom has spurred the generalization of the market in all sectors, among all individuals, and in democracy (the least stable rules of the game).

c. The desire for freedom has led to an interdependent world in all dimensions: economic, political, cultural, ecological, and other.

2. Nevertheless, this system has failed today and it leads the world into misery.

a. Freedom, both economic and political, has led to the reversibility of choices of all, to uncertainty, excessive egoism, disloyalty, and tyranny of rapid action. Debts are rising, current generations are shifting the burden to the future generations, environmental destruction occurs, education is neglected.

b. The market is generalizing much faster than democracy.

c. The market is becoming progressively world-class. It is becoming global and affordable for all countries. The state control is being avoided.

d. Democracy remains local because it is not global by nature. In addition, the original democracy yields to the interests of politics.

e. The man is treated as a slave.

3. The world market is the first market without the rule of law in the history of mankind.

a. The market, therefore, has become global without the rule of law and without the state that will organize the transfer of information or compensate for the lack of information.

b. According to economic theory, such a market can not provide full employment of factors. It can not avoid: explosion of inequality, high unemployment, environmental degradation, and much more.

c. In such a market without the state, consumers and shareholders dominate over employees and voters. Neither of them can exercise their rights. Social rights and individual rights are no longer respected.

d. In such a market without the rule of law, innovations provide wealth to its initiatiors, which increases inequality and frustration in society.

4. Democracy within national borders is increasingly empty in content and has little power to affect reality.

a. Democracy loses its strength in dealing with enterprises that no longer hold to national sovereignty, nor to the nationality of their shareholders.

b. Democracy and markets are becoming more and more occupied by short terms, creating public debts and neglecting the issues of natural resources and the environment.

c. Democracy loses its meaning because it less and less believes in it. Improvement is not at sight.

5. Faced with stagnation, many feel anger.

a. For many, the future is uncertain and disappointment is complete.

b. Some seek freedom and become nomads. Migration is encouraged.

c. Many search for a long-term solution, hoping for protectionism, nationalism, ecology, or fundamentalism.

6. In order to overcome this situation, without giving up freedom, there are two solutions:

a. Continue to hope that the market will resolve this situation.

b. Introduce altruism as the main value of humanity.

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