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THE FOUNDATION OF REAL-WORLD ECONOMICS: WHAT EVERY STUDENT NEEDS TO KNOW

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The third edition of *The Foundations of Real-World Economics* updates the two earlier editions published by Routledge,[1] including new chapters on the rise of populism, hidden racism, and the Covid-19 pandemic. The earlier editions were translated into five languages.[2]

Within the vast economic literature, the book opens alternative research horizons, providing an innovative look at economic theory which advocates for a major revision of seemingly immutable mainstream economics.

The author, Professor Emeritus at the Ludwig Maximilian University of Munich (Germany) John Komlos,[3] demonstrates the weaknesses of conventional economic theory, emphasising the need for a paradigmatic change to what he calls *Humanistic Economics*, in which people and quality of life count instead of focusing primarily on money, income, or GDP and, moreover, where the economy works for everyone, instead of a select few. Offering the reader another perspective on economics and advancing an alternative approach to standard textbooks, he explains why this paradigm shift should focus on the creation of a better society, the improvement of people's lives, and increased life satisfaction.

The intrinsic value of the book is its accessibility by a wide audience, including

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[1] Routledge (Taylor and Francis Group) is considered one of the most prestigious publishers in the world in the field of social sciences.

[2] The Romanian translation of the book (*Principiile economiei într-o lume post-criză*, CIDE-INCE, Bucharest, 576 pages), published in 2019, represents an updated and adapted version of the books *Principles of Economics for a Post-Meltdown World* (2016, Springer) and *Foundations of Real-World Economics: What Every Economics Student Needs to Know* (Routledge, 2nd edition, 2019).

Russian translation of the 1st edition: Что должен знать каждый, кто изучает экономику, и о чём не написано в обычных учебниках, 2018.

Hungarian: https://pallasathenekiado.hu/konyvesbolt/a-valojaban-letezo-gazdasag-es-az-emberarcu-kapitalizmus-alapjai/

German: *Ökonomisches Denken nach dem Crash: Einführung in eine realitätsbasierte Volkswirtschaftslehre*. Metropolis Verlag, 2015, https://www.metropolis-verlag.de/Oekonomisches-Denken-nach-dem-Crash/1083/book.do.

Chinese: http://product.dangdang.com/29362173.html

[3] For more on his background, see: https://en.wikipedia.org/wiki/John_Komlos

teachers and students of economics, laypersons, and real-world decision makers. Moreover, it can be used as a reference for all researchers engaged in the provocative rethinking of the foundations of the economic canon.

The author explores the nature of real-life markets and the causes of their failures, which include opportunistic behaviour, imperfect competition, multinational oligopolies or monopolies, asymmetric information, and the influence of corporate power, as well as income and wealth inequalities. The real impact of the minimum wage is also explored in detail. Attention is paid throughout the book to the circumstances of continuous changes in the economic, social, and political environment, sometimes under the pressure of regional shocks and sometimes on a global scale.

Komlos pleads for an economy that works for everyone in the real-world, beyond mainstream abstract models. He argues that economics should become an experimental science, that is, an inductive discipline that starts with evidence instead of assumptions. Furthermore, he suggests, after Richard Feynman, that economists, including teachers, should be held to ethical standards of "scientific integrity" and "utter honesty" (p. 11). In his conception, economic analysis should integrate empirical evidence and value judgments, rather than relying on theories and assumptions created in ivory towers. Therefore, in order to understand the world around us, theories based on real-world evidence is needed. These theories need to be effective when transferred from classroom blackboards to the realities of today's economy.

Using creative thinking combined with evidence-based, logically founded arguments, along with narrative interpretations viewed through multidisciplinary filters, the author illustrates the errors of mainstream economics, including some persistently false principles that have been proved wrong when applied in the real world. These principles, which have misled millions of students in dogmatic textbooks, include the irresponsible idea that markets are perfect only if they are left to work based on their own mechanisms.

Even more problematic is the mainstream's stubborn support for mistaken economic policies that feature significant adverse developments without moral considerations. That is exactly what happened during the Great Recession of 2008–2009: macroeconomists in key policy positions, including among the academic elite and the mainstream establishment, were incapable not only of foreseeing and preventing the financial crisis but utterly failing to provide adequate solutions to the problems facing the global economy.

On the contrary, Ben Bernanke continued to preach the virtues of the Great Moderation shortly before the Meltdown, predicting macroeconomic stability and denying the occurrence of any possible disruption. This was due to the Panglossian ideology he and his colleagues had subscribed to, according to which markets are efficient and self-regulating, competition is perfect, and the behaviour of economic actors is rational, as described by most conventional economics textbooks. Analysing the context of the crisis and unveiling the confluence of thirty-two causes of the Meltdown, the author emphasises that "The collapse of the house of cards built on the erroneous neoclassical dogma of laissez-faire finance with lax regulation and substandard oversight culminated in the subprime mortgage crisis… The impact of the crisis was exacerbated by the tsunami of hyperglobalization and the absurd levels of inequality" (p. 265).

Thus, under the circumstances of global interconnectedness, through its rapid contagion effects, the financial crisis extended throughout the world, generating huge macroeconomic shocks and social adverse effects and making obvious the instability of markets, the fragility of financial and monetary balances, and the volatility and unpredictability of structural change. The crisis increased populations' and governments' indebtedness, deepening both poverty and inequality. As the author concludes, "The neoliberal dogma that assumed that such a financial crisis could not possibly occur… was a mistake of historic proportions" (p. 291). The Meltdown of 2008 thereby made it obvious that the ideological commitment to free-market fundamentalism had suffered a fatal blow (Stieglitz, 2008).

Komlos emphasises the challenges of today's real economy, including the increasing complexity of global economic processes as a major constraint for our ability to investigate the functioning of the economic system, while stating that the multitude of possible evolutions of unstable situations make it difficult to prevent unacceptable adverse results.

The standard introductory textbooks ignore too many aspects of the actual economy, including imperfect information, heterogeneous cognitive skills, time-inconsistent preferences, externalities, trading costs, moral hazard, uncertainty, too-big-to-fail monopolies and oligopolies, systemic risk, power imbalances, non-rationality, transactional costs, and the unequal distribution of wealth. All these real-world problems render illusory the dogmatic belief in the perfect functioning of democracy and free market mechanisms.[4]

While market failure is considered exceptional in mainstream economic theory, Komlos shows that it is actually the norm in the real economy of the 21st century. His conception is the exact opposite of the doctrinal approach to economics, which is often illustrated by the arrogant statement that "we know that the markets work". Economists should admit that the markets work well only in exceptional circumstances

[4] This recent quote by Daren Acemoglu (2023) is relevant in this context: "The late-twentieth-century assumption that democracy and markets would ultimately triumph everywhere has since been met by an intellectual backlash that is even more wrong-headed. To chart a better path forward we will need to revise our thinking in several policy domains at once".

within an optimal institutional framework. Therefore, the author advocates for the exploration and delimitation of situations that make real markets work more like their theoretical counterparts and find remedies against failures. If the market's imperfections would be considered and remedied, the markets' resilience against external shocks and instability would increase and contribute to the building of a fairer and more equitable society.

As Komlos highlights, most of the mainstream textbooks typically omit the discoveries of important economists, including Nobelists such as Herbert Simon (1978, Rationality Limits), Amartya Sen (1998, Welfare Economics), George Akerlof, Michael Spence, and Joseph Stiglitz (2001, Asymmetric Information), Daniel Kahneman (2002, Behavioral Economics), Paul Krugman (2008, New Trade Theory), Oliver Williamson (2009, Transaction Costs), Robert Shiller (2013, Financial Economics), Thomas Shelling (2016, Game-theory), and Richard Thaler (2017, Behavioral Economics).

A significant deviation from the main model of demand and supply examined by Komlos is that of increasing prices which can create a positive feedback loop, as happened during the US real estate bubble. In this case, the assumption of investors that housing prices would continue to increase generated false expectations, eventually leading up to the largest speculative bubble in world history that ended in the Meltdown of 2008. Therefore, the laws of supply and demand often fail to lead to a "utopian" free market state, as presented in textbooks that describe the theoretical principles of economics.

As Komlos emphasises, the standard approach is based excessively on the dynamics of demand and supply in a perfectly competitive market without transaction costs and with innumerable rational producers and consumers who know all about the generic product so that, in an equilibrium, the correct price would be determined. In reality, the current economy is not composed of perfectly competitive companies but is made up of multinational monopolies and oligopolies, and the competition between them is completely different from the perfectly competitive model. Instead, these supercorporations use strategic behaviour to increase their profit. Therefore, in such market structures, an efficient equilibrium is rarely achieved. Komlos' analysis of the interaction of demand and supply in terms of fuzzy logic led him to results according to which the intersection of the supply and demand functions, given by a normal probability distribution, yield the equilibrium values of price-quantity pairs (Komlos, 2022c).

From a different perspective, Komlos emphasises that political and financial power is of crucial importance in the economy, although this is completely neglected in standard economic theory. Thus, as he points out, the power to influence the thinking or actions of others is decisive in determining the institutional framework, which has a major impact on the distribution of income, wealth, and privileges in the economy, with significant feedback effects on political outcomes.

On a more general level, Komlos argues that accurate economic data is a prerequisite for formulating valid theories and adequate economic policies. The author brings important methodological contributions to the calculation of significant economic indicators, such as the real unemployment rate, which support deeper understanding of the relevant statistical data.

Komlos (2021a) also draws attention to the erroneous measure of labour market conditions in the US that rely on the official unemployment rate, pointing out that its current definition is obsolete and also creates incompatibility problems regarding international methodologies and comparisons. He calculates that the real unemployment rate in the USA in 2019 was 7.8% instead of 3.7% (the official figure), due to the erroneous exclusion of discouraged workers, people who do not have the financial or psychological resources to search for jobs. Another reason the official figures are biased downward is that they omit those part-time workers who would like to have a full-time job. Komlos argues that the official US unemployment rate can no longer indicate the relationship between labour supply and demand in the economy and this error has direct implications for economic, monetary, and fiscal policies that have obviously been misguided by erroneous statistics.[5]

Komlos continues by exploring the limits of rationality and the importance of emotion, intuition, and mental prejudices and their economic consequences. He argues that the model of maximising rational agents should be replaced with limited rationality models that include human cognitive deficiencies which often lead to inefficient results. Consequently, the book offers valid foundations for a new micro- and macroeconomics, complementing the usual approaches and representing the auspicious prerequisites for deepening our ability to understand real-world challenges.

The policy recommendations stemming from mainstream economics which have failed to consider their social and political implications “resulted in the severely flawed policies that culminated in political dysfunction and a polarised society” (p. 299). The author argues that the right-wing populist movement, including the 6th of January 2022 insurrection that was an attack on the U.S. Capitol, is driven primarily by anxieties associated with huge income inequalities, the transition to a post-industrial economy, globalization’s impact on poorly educated people, and the hollowing out of the middle

[5] In the context of COVID-19 crisis, a labour hoarding phenomenon emerged that posed other serious problems to unemployment rate estimates. The U.S. BLS recognised challenges, never encountered before, that were induced by the pandemic: "People who reported zero hours of work... should be counted as unemployed on temporary layoff. As it turns out, a large number of people – we estimate about 4.9 million in May – were misclassified" (US Bureau of Labor Statistics, 2020). That would have increased the real unemployment rate by 3 percentage points.

class.

Komlos demonstrates that the general impression that the 6th of January insurrectionists were “average people” does not correspond to reality. Instead, he found that their income, a crucial variable in determining their socio-economic status, indicates that they were mostly from the lower half of the income distribution. Hence, the logical solution promoted by the author that only economic policies can reverse four decades of middle-class battering and reverse fundamental discontent among the population.

He shows that the unrealistic aspects of fundamentalist economics impact disadvantaged minorities the most. This becomes the basis of the hidden systemic racism of economic theory. For instance, according to the mainstream, consumers do not need protection because they know what they are doing, but this policy recommendation mainly hurts the disadvantaged because they are most vulnerable to the manipulation of powerful corporations and are affected by monopoly drug prices the most. Underlining the need to remove the fifteen Achilles’ heels of mainstream economic theories and open the road for their major revision, Komlos pleads for the transition to a post-racist society with an economic theory based on honesty and integrity, providing real, equal opportunities for all subsets of the population. To do this, above all, the institutional structure of power should be reset based on democratic values, as he justifiably highlights. In this way, economic and social discrimination against people, nations, and firms will end and be replaced by fair competition, which would alleviate global inequalities.

Quoting Warren Buffett’s idiom “it’s only when the tide goes out that you learn who’s been swimming naked” (p. 339) and exploring the impact of the Covid-19 pandemic on humanity, Komlos ascertains that much of the world was tragically unprepared to face the vicissitudes induced by the virus. He emphasises that this type of low-probability, high-impact disaster (or “black swan” event, akin to other recent disasters: the dot-com bubble, 9/11, the financial meltdown of 2008–09, and, more recently, the Ukraine war) exposes “the deep fissures, endemic imbalances and precarious nature of the US economy” (p. 346). These developments should make clear the need for creating a black-swan-robust economy that is more resilient to unanticipated shocks.

This implies that much more attention should be paid to social welfare policies, creating a strong social safety net, decreasing competition, introducing fail-safe strategies, running the economy at less than full throttle, introducing universal health care, and improving education, thereby enhancing human flourishing. At the end of his provocative book, Komlos concludes with his personal credo: “Capitalism with a human face, advocated in this book, would be such an economy”.

Conflict of interests

The authors declare no conflict of interests.

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