

## **HOW DOES ECONOMICS FIT THE SOCIAL WORLD?**

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### **ABSTRACT**

This paper considers the present state of applied economics and the difficulties of integrating its findings and insights with those of other social sciences. The philosophical basis of social science is re-considered as a route to resolving these difficulties. Without a more integrated narrative about how our social systems work, applied economics, and all applied social sciences, run the substantial risk of being considered part of the world's problems, rather than offering serious routes to their solution. Some possible strands of a more coherent and integrated framework are outlined, which indicate some potentially fruitful avenues for further development. The paper concludes with illustrations of this outline for the food chain and land use agenda of the Research Councils' Rural Economy and Land Use (RELU) initiative.

**Keywords:** Economics, applied social science, social theory, methodology, rural economy and land use

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## **Introduction**

It is, of course, a great honour to be invited to address you as President of the Agricultural Economics Society. It is, though, somewhat dispiriting to be in such a position at a time when the society, and the profession it represents, faces a major challenge. It is this question I choose to address here.

## **The Problem with Economics**

Most of the world can be placed on a spectrum with the following two extremes:<sup>1</sup>

- *Economics Rules OK.* We already know enough economics to be able to solve most of the major policy and market problems. The devil is in the detail. “In the general equilibrium system, the content of the historical discipline of theoretical economics is practically exhausted” (Samuelson, 1947, p.8)). All we have to do is put the theory into practice. There is little serious evidence that this condition has altered in the last 55 years. The principal problems of commerce and policy are associated with misconceptions or ignorance of basic economics, or with mistakes about property rights or transactions costs and information or incentive asymmetry problems, or are problems of distribution, and hence of justice and equity, about which positive economics has nothing to say.
- *Economics is Marginal.* Economics is a necessary evil or a malignant distraction. The devil is in the conception. Get everything else right, and then make the necessary economics fit. Economics ignores too much that is obviously important, especially justice and equity. Even Keynes (1931) thought so.

*“When the accumulation of wealth is no longer of high social importance, there will be great changes in the code of morals. We shall be able to rid ourselves of many of the pseudo-moral principles which have hag-ridden us for two hundred years, by which we have exalted some of the most distasteful of human qualities into the position of highest virtues. We shall be able to afford to dare to assess the money motive at its true value. The love of money as a possession - as distinguished from the love of money as a means to the enjoyments and realities of life - will be recognised for what it is, a somewhat disgusting morbidity, one of those semi-criminal, semi-pathological propensities which we hand over with a*

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<sup>1</sup> Since drafting this, another task has drawn my attention back to Hayami, 1989, who makes exactly the same distinction, though in different words: his are ‘community yoke’ as the thesis that the free market will release peasants from their serfdom *versus* the “evil market” antithesis that the market undermines the moral codes of the pre-market traditions on which the market is founded – a different version of the Marxian antithesis that capitalism contains within it the seeds of its own destruction.

*shudder to the specialists in mental disease. All kinds of social customs and economic practices, affecting the distribution of wealth and economic rewards and penalties which we now maintain at all costs however distasteful and unjust they may be in themselves, because they are tremendously useful in promoting accumulation of capital, we shall be free, at last to discard.” (p 369 – 70)*

Following Keynes, the richer and more secure we become, the less will economics matter and the lower will be its intellectual and phenomenal appeal. Evidence supports the proposition. Economists do not command enough attention from either students or peers to generate sufficient income to sustain their output. Applicants and class numbers for applied economics are dwindling; research capacity is crumbling. Defra and other traditional agencies have ceased to fund postgraduate studentships, and the vacuum has yet to be made good by emerging agencies, such as Food Standards or regional development. Traditional economic data collection and analysis (e.g. Farm Business Survey and National Food Demand Analysis) are being squeezed of resources.

Home PhD students in economics have fallen to dangerously low levels. Neither the LSE nor Nuffield College Oxford attracted a single UK doctoral student in 2000. At Warwick, the proportion of first-class honours students staying on for further study dropped from 80% in 1983-5 to 33% by 1995-7. The number of entries for economics A level fell from 32,000 in 1993/4 fewer than 20,000 in 2000/1. American Economic Association research suggests that declining undergraduate enrolment (which peaked in the US in 1990) is not simply due to discontent with the economic rewards, but also with disillusionment with the way in which the subject is structured and taught (and researched).<sup>2</sup> Mainstream economics is increasingly dismissed as being too quantitative and rigorous to be relevant or reasonable. Yet we are encouraged to be even more rigorous, and thus generally less relevant, in order to get gold star funding or 5\* publications. Economics is becoming marginalized, which is an ironic state for a discipline that relies on marginal conditions.

While the closely related and relevant disciplines of management and marketing are better able to attract students and funds, their science has been seriously questioned. The Commission on Social Sciences (2003) concludes: “*Our greatest concern in regard to social science research is on that carried out in business and management studies. The average quality level and utility of university research in business and management studies is unacceptably low and must be enhanced. On all the evidence available to us, this is on*

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<sup>2</sup> These general indicators of decline in economics are taken from Alan Shipman, THES, May 2.2002, p 22.

*average well below the calibre of other research we studied; its practical utility was also strongly questioned by supposed beneficiaries. There is a growing crisis of supply of top quality academics in economics and in business and management studies but also in other social science. Many economists are in despair about what they see as the progressive decline of their subject's international standing and quality."*

Yet these applied disciplines should be the pinnacle and cutting edge of social science. These are major problems. We need to re-assess the fundamental capabilities and distinctive advantages offered by economics (Kay, 1993). Even more importantly, we need to be much more careful about how we represent economics within a more general systems of social behaviour, so that more people can find and live with a sensible position on the spectrum between those (few) who think economics is all that matters and those, apparently richer, possibly more thoughtful, and rather more numerous, who think it shouldn't matter so much. This challenge, I believe, lies at the heart of the current Rural Economy and Land Use (RELU) programme, ESRC, 2003, with its justified emphasis on interdisciplinary research.

### **Re-assessing Economics: what does it do and how does it fit?**

The core principles of economics are simple, and apparently very powerful as a consequence. Economists reduce the complexities of life to the fundamentals: how to earn a living (supply) and how to live a life (demand). There are no choices involved in these basic questions unless resources (otherwise known as capitals) are finite. As specified in the current sustainable livelihoods framework (DfID, 1999, Ellis, 2000, Chambers and Conway, 1992), our scarce resources can be categorised as natural, social, physical, human, and spatial.<sup>3</sup> Rational use of these scarce resources to satisfy near infinite desires generates the enormously powerful notions of opportunity cost and comparative advantage. General equilibrium concepts are the consequence, which show that real supply curves necessarily slope upwards, and real demand curves slope downwards. Trade, and associated specialisation in production, are the rational corollaries.

People of all cultures have learned this through trial and error. This evolving trading system generates the quasi-physical balances of the circular flow of income and the associated flows

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<sup>3</sup> The Sustainable Livelihoods framework does not separately identify *spatial* capital as a dimension of the overall resource base. Instead, it refers to *financial* capital. However, finance is the major means of converting both income streams and different resource bases into each other, rather than constituting a logically separate sort of real capital. Finance is a transformation system, while the remaining capitals are structures. Positional (spatial) capital, on the other hand, includes a critical feature of much of the resource base – where it is in relation to other people and other capitals, including its temporal relationships - where things and people are in relation to their histories.

of funds, and the parallel homeostatic monetary system, determining the value of money in terms of real goods and services, through the quantity equation of exchange. Those societies learning these lessons best will develop more than those that don't. As Winter, 1988, notes: *"natural selection and evolution should not be viewed as concepts developed for the specific purposes of biology and possibly appropriable for the specific purposes of economics, but rather as elements of the framework of a new conceptual structure that biology, economics and the other social sciences can comfortably share."* (p 614).

The proposition that economic systems are essentially evolutionary casts a different light on the conventional economic concept of competition and efficiency. The correspondence between natural selection and competitive economic behaviour is well recognized in the joint development of ecological and economic models. Both explain how natural systems, which do not care, nevertheless contrive to be prudent by default - Adam Smith's invisible hand in a nutshell. Treated as well-defined games, there is one optimum strategy. Both natural ecologies and competitive economies end up minimising purposive effort to best effect - by innovating better fits with a local environment that is partly their own making. Economies might use more sophisticated tools, and appear to follow human rules, but the motives are essentially animal - survival and growth (consumption) and replication (income and profit, providing the wherewithal to continue growing). Even the basic evolutionary strategies are the same - in conditions of uncertainty, breed as fast and prolifically as possible and take no care of the offspring; in more secure conditions, limited reproduction and family care make more sense.

This correspondence has two important implications. Firstly, the typical benchmark of pure economic competition is not a natural climax condition of the economic world. Competition, specialisation and trade thrive on and self-generate diversity, not homogeneity. Trade and specialisation (the foundation of economics) cannot happen in a uniform and undifferentiated world. A uniform world does not trade. A level playing field is a thoroughly misleading metaphor for the real world. The more differentiated and diversified become the products and the associated ideas, the more niches are opened up for competition. The richer the ecology (and the economy), the more diverse are its species and the more niches it contains. Winners do not and cannot take all in a sustainable evolutionary system.

Monopolistic competition is the climax condition of rich economies. It is the product differentiation or quality dimensions that enable elements of care and commitment to be

incorporated within conventional contracts.<sup>4</sup> The supposed inefficiency of this market structure compared with perfect competition is merely the price we are willing to pay to be different, and thus exercise choice. Perfect competition with homogenous products is indeed nasty, brutish and short, as marketing experts and consumers well know, and which producers, as well as policy makers and analysts, ignore at their peril.

Secondly, the sophisticated calculus of our economic models representing the optimum allocation of scarce resources does not represent the actual behaviour of participants, a fact that our textbooks and erudite analyses frequently forget. The marginal conditions for an optimum, and the supposed production and utility functions to which they refer, simply define the conditions that characterise the optimum allocation. They are derived from severely reduced forms of the actual relationships and processes that produce these (so far) best possible outcomes. The underlying structural equations (even if they exist) are currently far beyond our ken, and we do ourselves no favours to pretend otherwise. Even so, there are two major *but*s to the assertion that even a naturally (rather than perfectly) competitive market can achieve a genuine social optimum.<sup>5</sup>

*But One: Who Chooses?*

The choices underlying the economic equilibrium are determined by economic power as income and wealth, with the driving motivation as consumption, which in turn is supposed to satisfy personal utility. Investment is only a means to an end – more consumption in the future. The richer we become, the less pressing are these resource constraints and the greater are our feasible sets of choice. We face the curious paradox: the poor have very little choice, survival is all; the rich have so much choice that any given option carries very little salience, which makes actual choices both difficult and likely ephemeral.

Furthermore, the logic of the market encourages the agglomeration of resources, at least in the medium term, since markets are driven by rent-seeking behaviour. Adam Smith's free market relies on the freedom of individuals to pursue their own welfare, both as consumers and producers, competing with each other for necessarily scarce resources. The equilibrium

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<sup>4</sup> The same point is made, in a different way, by Antle (1999) who reminds us that there are critically important quality dimensions to both demand and supply functions. However, the common preoccupation of economics modellers with the theory of oligopoly as the relevant model of imperfect competition typically misses this point.

<sup>5</sup> There is a huge literature on socially optimal patterns of production and consumption that there is neither reason, time or space to deal with here. Van den Doel and van Velthoven, 1993 is an important reference.

outcome, under a freely competitive market, is a Pareto optimal allocation of resources, given the initial distribution of these resources. However, even under this simplified system (absent any public goods and externalities, or complications of transactions and organisation costs) the inevitable dynamics of the pursuit of an ever-changing equilibrium (as technologies and tastes change) must result in temporary accumulations of super-normal profits, as the signal for market adjustment. Makowski and Ostroy, 2001, provide an exceptionally insightful analysis of competition along these lines, emphasising the fundamental information flows and transformations.<sup>6</sup> Super-normal profits manifest as pure rents in excess of transfer earnings, and accrue to the underlying resources. Economic theory cannot explain initial endowments of wealth and capital (of all forms), but it relies on the continual pursuit of profit and rent, and on the happy accidents of well-fitted inventions, each leading to temporary accumulations and differentiated distributions of wealth, which become augmented by life-cycle and inheritance effects - the accidents of birth.

Here, it should be noted, is a clear but seldom remarked distinction between the free market and capitalism. Capitalism involves one important additional step in the argument. It divorces the ownership of capital from its operation and deployment. Capitalism depends on trade of capital stocks and assets, thus facilitating the transfer of value from the declining to the growing sectors of the economy, and the balance between savings and investment. The dynamics of these transfers of ownership and associated adjustments in the purchasing power of the assets generate additional agglomerations of wealth, and thus of economic power, as margins are shaved from the mere transfers of asset ownership and continual stock revaluations. Any economies of size in capital and organisation aggravate the agglomeration.

The system may be economically sustainable, in the sense that the resulting equilibria are neither explosive nor degenerative, but the tendency for initial distributions of wealth (resources) to become more concentrated through the processes of both market and capitalist transactions is socially unsustainable. The rich become richer while the poor remain at least relatively poor. As Marx (1887) observed, naked and unrestrained capitalism contains within it the seeds of its own destruction.

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<sup>6</sup> This focus on information transfer and transformation has some potentially interesting parallels with some of the developments elsewhere in applied social science, especially in network theories. See, for example, Achrol and Kotler, 1999.

*But Two: Collective Interaction & Public Choice*

But the poor do something about it, and the rich recognise that they will, and take steps to preserve their power by doing just enough to dissuade the poor from doing too much. Competition for resources now becomes competition for the rights to social control, either as a means to individual prosperity and reproduction, and/or as a means of social enhancement.<sup>7</sup>

The anarchy of an ungoverned market economy is insufficient to be socially sustainable, for two major reasons. First, the long arm of the law is necessarily attached to Adam Smith's invisible hand: to protect the specie; to enforce market contracts; define and protect property rights; and outlaw theft (e.g. Bromley, 1997).<sup>8</sup> To implement and enforce authority, government must coerce society to conform to social laws and choices. As Dunn (1999) observes: "coercion is the core of states." Equal first, expectations are frequently frustrated and confidence in the market is misplaced, so we seek redress. Collectively, we try to manage the arbitrary distribution mechanisms of the market to achieve a more stable, sustainable and humane society.

In short, we choose whether or not to accept the social outcomes of trade and exchange, and their associated income and wealth distributions. These choices are necessarily made through the coercive state apparatus. We inevitably concede the power to make social or communal decisions (including the definition of property rights) to government. And, for the state to be sustainable, we have to respect this authority and its arbitration of disputes. Williamson (2000, p 598f) notes that the market theory of property rights, following Coase (1937), needs to take account of the costs and difficulties of organising and implementing the associated transactions. However, even these theories necessarily presume that the arbiters and organisers themselves have the confidence and trust of the people involved, otherwise neither the rules of the game, nor its various plays, will be legitimised by the participants. We choose which games we play, so long as we are rich enough to have the choice.<sup>9</sup>

If producers cannot win control over their market conditions, due to atomistic (perfectly competitive) structure, then they can be expected to pursue these ambitions through the political machinery of the state. Here, the marginal net returns to political action for producers

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<sup>7</sup> This assertion is little more than a rational extension of Becker (1974).

<sup>8</sup> Colman (1994) deals with the associated observation that many of our economic relations are also strongly influenced by *invisible handshakes* (Okun, 1981, p. 82) as well as by the invisible hand.

<sup>9</sup> See Barrett, S., 2003, for an exemplary exposition of the insights afforded by a game theory approach, especially to international environmental conventions and treaties.



are more concentrated than for consumers, because of specialisation in production. Consumer dominion over the market place is thus over-ridden by producer (or factor ownership) domination of public intervention in the name of fair and just distribution or of prudent economic management. Developed country agricultural policies are the archetypal examples (e.g. Harvey, 2004), typically resting on arguments about just farm incomes or contributions to economic activity and trade balances, or, more recently, environmental (even social) care.

It follows that income and wealth distributions under any political economy general equilibrium, even under ideal competitive conditions, are determined by political influence and authority, typically manifesting as an uneasy balance between labour and the owners of capital. Left and right are thus natural manifestations of capitalist state politics. The latter believes in the supremacy of the market, which apparently generates the factor incomes. Paid labour and atomistic sectors, on the other hand, are apparently at the mercy of the market and capitalists, and seek remedy through the political system. Arrow's impossibility theorem (see, e.g. Heap *et al.*, 1992, p 209ff) demonstrates that such systems, even if defined as perfectly as possible, will frequently generate inconsistent public preferences, and will thus cycle over different political control of the negotiating agenda, depending on rhythms of conviction about the social desirability of unrestrained markets.

In short, the apparently neat and self-contained theory of general equilibrium is not self-contained. It requires and exploits government – the critical social constraint on the animal magic of the invisible hand. Figure 1 illustrates the story so far – the structures of our social systems. Through these systems we augment or abuse our finite resources through a process of choice, which is necessarily constrained, otherwise there is no choice.

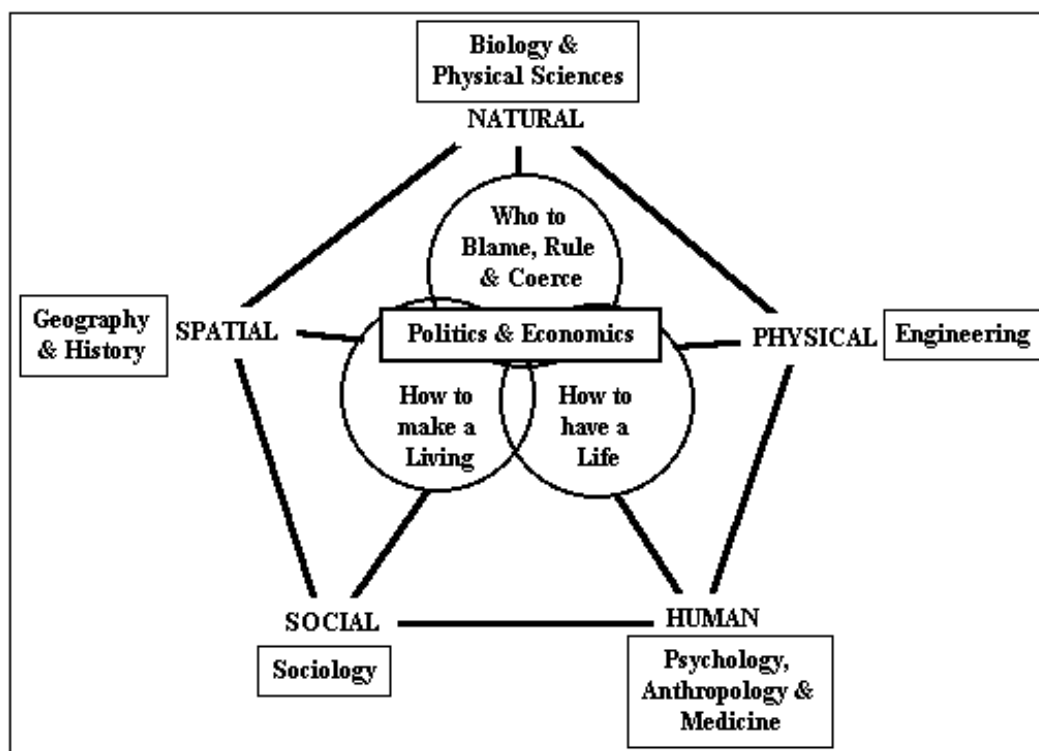
The development of our human systems for making these choices is subject to a fundamental evolutionary logic – those that fit best with the surrounding social environments and political climates will survive, prosper, reproduce and perpetuate. Ill-fitted systems will fail to survive. But the critical difference between social evolution and its natural counterpart is that we get to choose who lives and dies – we try to govern ourselves, rather than submit to the exogenous authority of bio-physical laws. We cultivate and try to civilise our own selection systems. Our institutions, the social codes, realities and authorities (North, 1990), are the manifestations of the ways we choose to do this – our governance structures.<sup>10</sup> These are, however, also subject

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<sup>10</sup> Harvey, 2001b, provides an outline of where this strand of thought might lead.

to continual competition with each other, and thus subject to re-invention and adaptation in a blind pursuit of better fits. Social science, if it is to make any difference, must be focused on providing insight to this blind pursuit. How might social science more profitably pursue this ambition?

**Figure 1**      *The Structure of Social Systems – from an economic perspective.*



### **How should we do Social Science?**

Figure 1 illustrates an approximate structure of our social (and natural) systems and the sciences we use to explore and understand them. It provides a first answer to the question in the title: political economy is central. But it does not provide any clue about how these systems work, or how we might profitably study them. It is here, amongst our methodologies, that we face the most critical internal fractures of our modern social sciences. These fractures, and the factions they generate, are fundamental to the development of social science.

At the opposite extreme from conventional positive economics lies relativism. The principal relativist notion - there are no facts, there is no objectivity: all realities are conceptual constructs, and thus subject to inevitable and continual re-interpretation and contest - is an alternative theory: it all depends. But, on what and how does it all depend? If postmodernism

or relativism is “right”, what does this mean for policy analysis and advice, for management strategy and tactics, and ultimately for leadership and governance?

Policies (and, equivalently, business strategies) are the outcomes of these disputes and associated negotiations. The fundamental aim of policy (or business strategy) is to generate a consensus for and pattern of social and organisational authority. Such a consensus necessarily implies a ‘meta-narrative’ of some form - a story or discourse,<sup>11</sup> as a common understanding of the way the world works, notwithstanding the post-modern view that such meta-narratives are merely figments of possibly over-heated imaginations (e.g. Midmore, 1996). It is by imagination that we survive and, if possible, progress.

It is these narratives that provide policy and strategy with their coherence and legitimacy (or not). Clearly, economics has not yet achieved this consensus. Perhaps it cannot (e.g. McClosky, 1983; Randall, 1993; Bromley, 1997). For post-modernists, the *common model* (individual liberty, fully enfranchised democracy, and free markets governed by common laws) is either a chimera, or else a facade for ulterior, even malignant motives. But, as Tweeten and Zulauf (1999, p 1170) remark, “*postmodernism is the antithesis of the Anglo-American analytical thesis. Out of the resulting dialectical synthesis, however, an enriched new philosophy of science could, and we believe, will emerge.*” As Dahrendorf (1995) observes: “*There remains a common theme for a science of human society, and that while much progress has been made in developing its various facets and aspects, it is still important to try and tie the parts together - not in search of a ‘world formula’ but to make sense of the social habitat in which we live, have lived and are likely to live*”. This challenge has still to be met. It is especially relevant to the current major research initiative on the rural economy and land use (RELU, ESRC, 2003), as it seeks an integrated and interdisciplinary account of the ways our worlds work.

### **Some Philosophical Foundations**

The essence of any science is to discern the nature of the underlying systems that generate the data we observe and the conditions we experience. The synthesis and integration of social science implies a consensus about the general nature of our human social systems. We are far from such a condition. At root, there are fundamental disputes over our philosophical conceptions.

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<sup>11</sup> See, for example, Dryzek, 1997.

As social scientists, we have to believe that there are some discernable and reliable patterns and associations in our social behaviours and systems. We all live our lives (and conduct our research) according to certain expectations about how our social worlds behave. Of course, we make mistakes and are confounded. But, sometimes, we learn from these mistakes and adjust our expectations and attributions. How do we come by these working rules and expectations: our social institutions, our social authorities?

*The Nature of Social Authority*

Authority is the capacity of ideas to influence and, in the limit, control our behaviours. Without a common idea shared between source and subjects, any authority (whether of theory, ideology, person, office or organization) is empty. Our working truths, as our world-views, are the ideas by which we govern and regulate our lives. How and why do we generate our authorities as practical, workable and acceptable sources of social truths?

There are four principal dimensions of social truth (Edwards, 1967) as follows:

- a) Veracity: what will sell to constituents, either through market places or governing bodies, which establish the accepted social *reasons* for behaviour, whose correspondence and consistency with social responses is continually tested by repeated behaviours – the correspondence theory of truth;
- b) Validity: what can be established through logic and science, or which are enshrined in the laws adopted and accepted by societies, which establish the *rules* accepted by societies, and ensure their coherence, both within themselves and between themselves and bio-physical world – the coherence theory of truth;
- c) Value: what are taken as articles of *faith*, as self-evident truths, established as what works and should work, and analogous to the performative and pragmatic theories of truth;
- d) Vernacular: the village, urban, or street *myths*: the habits and conventions inherited from the past and neighbours, which seem to work without direct or explicit reference to either rules, reason or faith – the expedient theory of truth.

There is a mapping of these different dimensions of truth with the major branches of philosophical enquiry: veracity concerns the epistemological nature of our data (our social observations) – do they fit with or correspond to our experience; validity concerns the ontological nature of our social world – does it correspond to our perceptions of the logics or

relationships we expect to find when we look; value concerns the ethical aspect of our world-view – is the phenomenon or event good or bad, worth preserving and pursuing or not; vernacular concerns the moral aspect – is this practical response (attribution or perception) right or wrong? Positivists (the classical sciences) are largely concerned only with veracity and validity, while relativists need to be concerned with ethics and morals, even though they seem reluctant to admit to phrasing the pursuit of knowledge in this fashion, preferring to suppress the principal motive powers of social relativity (morals and ethics in this categorisation) as essentially and fundamentally unknowable, and therefore beside the point for practical science or social enquiry. But, if this is true, then social science is impossible, and all we are left with is commentary – we become part of the problem, and not part of any solution.

Consider how our data (behaviours and events) are generated. A little introspection appears to confirm that our behaviours are ultimately sanctioned or grounded on one of three critical cornerstones: *rules* – our given outside determinants (g.o.ds) establishing our permission to get away with it, granted by bio-physics and the codes of our neighbours and peers; *reason* – what makes sense to us as being coherent and valid; *faith* – what our personal belief and value systems determine to be worthwhile. Of course, most of us, most of the time, behave largely out of *habit*, rather than waste valuable time and effort continually appealing to these cornerstones. However, as and when habitual behaviour turns out to conflict sufficiently badly with any of the three cornerstones, we adapt and adjust our habits. When rational ignorance or apathy fail, it is sensible to search for more knowledge and understanding. The correspondence between these cornerstones and the fundamental bases of social truth provides a coherent basis on which to found a more general social science.

*Transactions and Negotiations of Social Authority.*

Since objectivity is fundamentally denied to social scientists, we need a better definition of its surrogate - social acceptability through persuasion and conviction. Our own survival requires consent from others for our continued prosperity and freedom. Our self-respect requires permission from society for us to practise persuasion, emotional conversion and intellectual conviction.

If we are determined to be subjective, then we ultimately need to persuade a substantial number of others to agree with us, otherwise they will deny or ignore our right to exercise our individuality. In so doing, we either need to be a dictator or a prophet, or make a profit.

Unless, that is, we can otherwise convince others through reason and argument to accept (and thus compromise) each others' subjectivity, thereby transforming it into consensus. These are our only routes to sustainable authority - the continued and defensible power of an idea to command respect.

We persuade and convince ourselves of social truths through social transactions and negotiations. Apart from the basics of cognition and communication, the principal forms of social transactions have been identified by Boulding, (1973) echoed by de la Mothe and Paquet (1996) and also, apparently unwittingly, by Strange (1994) as: gifts from those who love us; tributes from those who fear us; or exchange with those willing to trade with us. In addition, though, many of our social transactions are practically autonomic: governed by habit, routines, customs and traditions. We use these four basic transaction systems in different mixes and balances, to govern and organize our businesses and societies.<sup>12</sup>

These four principal negotiation systems – which I label: consent, coercion, contract and convention - are each concerned with social interactions and transactions that co-establish accepted practices and expectations of mutual behaviours and responses. Each helps to continually reconstruct working concepts of social truth - as a common view of the ways the world works, without which our social worlds cannot work.

Each of these transaction systems is founded on and defined according to its reliance on the three cornerstones of faith, rule and reason. Unless agreeably based on these pillars, any society or community will eventually question and undermine the social organizers through which we generate consensus and social authority. The balance of reliance among the cornerstones shapes the organizing plane or negotiating agenda, and thus moulds the reflection and refraction of social truth produced through each transaction system.

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<sup>12</sup> Manski (2000) in addressing the issues of economic analysis of social interactions, deals with a much larger set of transactions or negotiations. These more detailed and specific interactions may, however, be thought of as species or genus within more fundamental or general phyla of transactions. In the interests of parsimony and of generality, this conjecture is confined to the primary divisions or sub-kingdoms of social interactions. However, Harvey, 2001b offers some conjectures about what other transactions systems may be thought of as primary.

The *consent* transaction system involves informal social interactions, carried out on the basis of trust or faith in our friends and neighbours, as well as the reason from our own intellect (the head) and the rules of emotional empathy (the heart).<sup>13</sup>

*Convention* captures the more formal social rules and rulers which communities and societies establish through political interaction, which become enshrined in the various forms of 'ocracy we develop to manage our public or collective affairs: plutocracy, autocracy, theocracy, and finally, in despair with all the rest, democracy, and all the bureaucracies that are associated with them. As far as democracy is concerned, this transaction system is founded on faith in the democracy, the reason of rhetoric and debate, and the rule of the majority.

*Coercion* applies the force of law to enshrine the most salient of our social contracts and behaviours in formal codes, based on faith in the legislature, the rule of the law and the reason of jurisprudence and the courts. It is this transaction system that ultimately defines and identifies the state (Dunn, 1999).

*Contract* is at the heart of our economic transactions systems – the basis of trade, specialisation and comparative advantage, based on faith in self-interest and the resulting invisible hand, the reason of economic logic (including rational ignorance) and the rule of the market.

This interactive complex can be pictured with each of these four transaction systems as one face of a quadrilateral pyramid. The reflection and refraction of these four cognitive planes (agenda) on the ground where we live then forms our socially constructed vernacular. We use this 'consensus' to build and grow our institutions - our social codes, realities and authorities (North, 1990). The outline logic is illustrated in Figure 2.

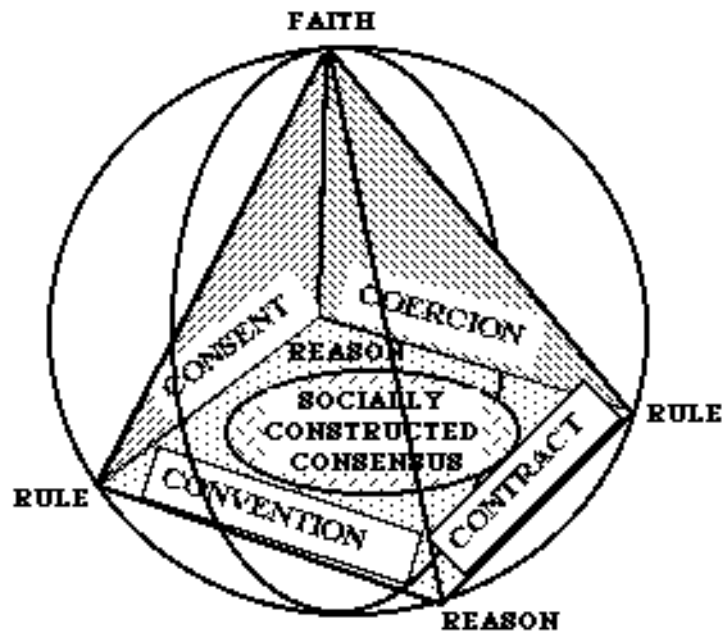
The character and the culture of our communities and societies will affect the ways in which we construct our social realities. So, too, will the contexts and circumstances in which we find ourselves, as the product of our own unique histories, and the accidents of our geographies. These ever-changing four Cs (character, culture, context and circumstance) will cloud and obscure the essential systemic, so the picture implies a continual spin and revolution of our vernacular authorities, as illustrated in Figure 2. Furthermore, the orientation

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<sup>13</sup> Frank (1988) provides a substantial and compelling account of the role of emotions in the conduct of social (especially economic) transactions. Hayami (1989) outlines the same transactions system as community relations in village economies.

of this construct depends on where you stand. Faith may not be your apex. As the postmodernists argue, give it any spin you like. And, as life replies, then see if you can get away with it. Figure 2 is an illustration of the logic of post-modernism, with the single and important exception - it conceives of a system, a metaphysic, which 'explains' the post-modern condition.

**Figure 2**      **A logic of authority**



Take the case of the World Trade Organisation. Economic arguments are here defined to lie on the south-east baseline. Spin it to become the north-west baseline, if this fits better with your world-view. Economic faith consists in belief in the rules and reason of economic logic, which leads to competitive markets, free trade and voluntary contract. This view of the world remains somewhat removed from some vernacular consensus, as well demonstrated in Seattle and since. There, the demonstrators exhibit a variety of perspectives more or less identifiable as being north-west of the establishment consensus, (or south-east, with a different spin) complaining that at least their consent to the WTO's largely economic perspective is not to be taken for granted. Meanwhile the international lawyers have us all caught in the vice between the north-east and south-west baselines - the interplay between convention and coercion, with consent and contract squeezed out of the consensus.

Figure 2 represents a second answer to the question in the title: economics (as contract) is far from central, and is inexplicably intermingled with convention, coercion and consent to



generate our ever changing and contested ground truths. But this answer is impossibly complex for sensible science. Economical minds, at least, need a simplification.

### **So What? Reconsidering Government and Governance**

Governments exercise social authority. Governance, in contrast, is how we choose our governors; how we erect our authorities and elect our leaders; how we breed and cultivate our ideas and institutions - our social selection criteria and rules for behaviour. Up to now, our history suggests that we have been lucky in allowing the social evolution of governance to take a natural, unmanaged course, apparently culminating in economic liberty, universal suffrage and democracy, and common law - the common model.

But now we have run out of room for mistakes. There is no longer uninhabited or sparsely populated territory to escape to or expand into. We have to live with, and, if at all possible, from our own waste. And we cannot rule without also being ruled. We run the substantial risk of being ruled by an uninitiated and frequently mis- or under-informed majority, or of repeating the past in seeking to impose minority rules and rulers. Is the common model up to this challenge? Convention says yes: free-trade, liberal democracy and associated coercion and common law are necessarily inefficient, but better than all the rest. And surely we can make them better. But to do so requires that we admit to their shortcomings and understand better what it is we are trying to do. Which is what?

### *The Trade-off between Private and Public Interest*

In essence, we are balancing private and public interests, where each interacts with the other. We are driven by *gilt* (self-interest) and *guilt* (public interest), which may be simply *gilt* with a you in it. Our human free will consists essentially in making this choice. And, the richer we become, the greater the scope and responsibility we have for this choice (Margolis, 1982).

Self-interests can be roughly characterised by the simplistic Maslow hierarchy: physiological; safety and security; belonging.<sup>14</sup> Social science literature is more reticent about a corresponding characterisation of public or social needs.<sup>15</sup> Strange (1994) asserts four

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<sup>14</sup> The Maslow hierarchy is frequently regarded as overly simplistic. However, it suffices here for illustration of the argument. For a discussion of the psychological understandings of egotistical needs and self-interest, see, for example, Steers *et al.*, 1996, p 13ff.

<sup>15</sup> The social psychology literature does deal extensively with 'helping behaviours', though these explorations are typically restricted to individual behaviours and actions towards other specific individuals, rather than with a generic notion of the public good. However, Banyard and Hayes (1994, p 477) note that

fundamental social goals: wealth, security, freedom, justice. However, her representation mixes aspirations and fulfillment with underlying needs and motives. The security and stability of a social system is inherently dependent on the processes used to achieve balance between private and public interest, and on the capacity of the system to resist internal fracture and external threat. In turn, freedom has to do with the extent to which private interests are given free rein within the social system. Since the fundamental role of (collective) free will is to achieve a sustainable balance between private and public interest, it seems sensible to characterise the goals of governance directly as a balance between the two (again following Margolis, 1982).

Efficiency and effectiveness (the primary focus of mainstream economics) is a basic or primitive social need, if not natural inclination. Once secured, however, our history suggests that we become more concerned about justice and equity, if only to assure the reproduction of our society without major internal fracture, about which our formal economics has nothing to say. Indeed, it is these concerns, and our beliefs that we can and should do something about them, that fundamentally distinguish us from our animal cousins and ancestors. The naive economic assumption that allocation questions can be divorced from issues of distribution, though powerful, is a critical shortcoming of conventional policy analysis and management strategy.

Over and above justice, we become concerned about sustainability and coherence, as reflected in present heightened anxiety over the long-run sustainability of human organizations and exploitation of the planet's limited resources and waste-disposal capacity, not to mention our continued search for the meaning of it all - for a more common model. Our social goals, as Strange's, quartet of wealth, security, freedom and justice, can thus be seen as the harmonious and simultaneous satisfaction of both self and public interests. Human progress, such as it is, can now be pictured as the growth along these two axes, and of the associated field over which we choose and continually adapt our governance systems, as illustrated in Figure 3.

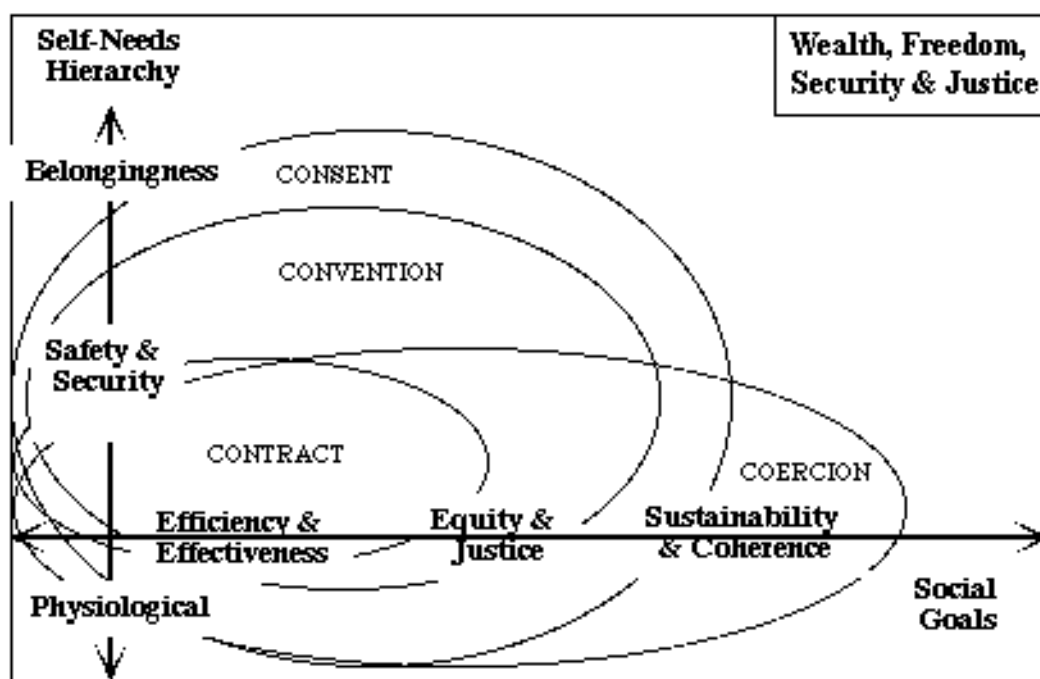
This figure, the third answer to the title's question, includes a conjecture about the relative efficacy of each of the major transaction systems in achieving our social goals. According to this representation, the present common model, dominated by contract, convention and

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"there is a growing body of evidence which suggests that altruism may be an important and frequent form of social behaviour which serves to ensure social cohesion", while Margolis (1982) develops an economical theory of altruism, and Frank (1988) explores the roles of passion and emotion in shaping our transactions.

coercion, has no hope of achieving social harmony.<sup>16</sup> Dissatisfaction with both government and markets is obvious, and is illustrated here. The common model should be fragmenting and decaying as we speak. Meanwhile, the advocates of a more socially just and coherent world have little to offer than coercion. This representation also illustrates the popular response to markets (contracts) failing to provide for public goods or deal with externalities. The answer is government regulation and coercion, despite the economic arguments in favour of contract solutions through altered incentives and adjustments in property rights.

**Figure 3. Conjecture of Transaction Systems & Private vs. Social Interests**



*The common model in practice*

The common model in practice is still evolving. Markets are already learning that organizational survival and prosperity requires much more than simply convention, contract and coercion. The fashionable notion of stake-holding means, if anything, that successful

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<sup>16</sup> You may object that consent is also included in the common model - that being the point of universal suffrage and democratic control. But convention is a more accurate description of our present democratic transaction systems. The ubiquitous resort to pressure groups, protests and social disobedience are the exact responses to be expected from a lack of general consent or to the means of continually granting it. If such protest does not reflect a widespread lack of consent, then it will wither and die - it will not command sufficient popular support to be tolerated. It is not obviously withering; the very opposite. If we are not sufficiently antagonised by our conventions to be antipathetic to them, we lapse into apathy, which is the chronic condition of our present conventional democracies. One cross, on one piece of paper, once every four years or so, hardly qualifies as an information system for consent.

business requires the continued consent, if not commitment and care, of all involved in the market or policy chain, from raw material supplier through labour and capital owners and users to final consumers, both present and potential. The final product is no longer, if it ever was, the only thing produced. Ideas about the way the world might be and should be are also produced and sold, inevitably and necessarily packaged with the products, and with their production and transaction processes. It is these ideas that provide the basis for trust (or not) that commerce (or government) are behaving themselves, being socially as well as privately responsible. The rules by which business governs itself are continually adapting and developing. Multinationals can only get away with pursuing demonstrably anti-social practices and behaviours if their customers and labour forces allow them, as the Brent Spar and genetic engineering episodes well demonstrate. Indeed, public embarrassment (complete with the simplistic rhetoric of the popular media) may well be more powerful than conventional regulation and coercion in breeding consent.

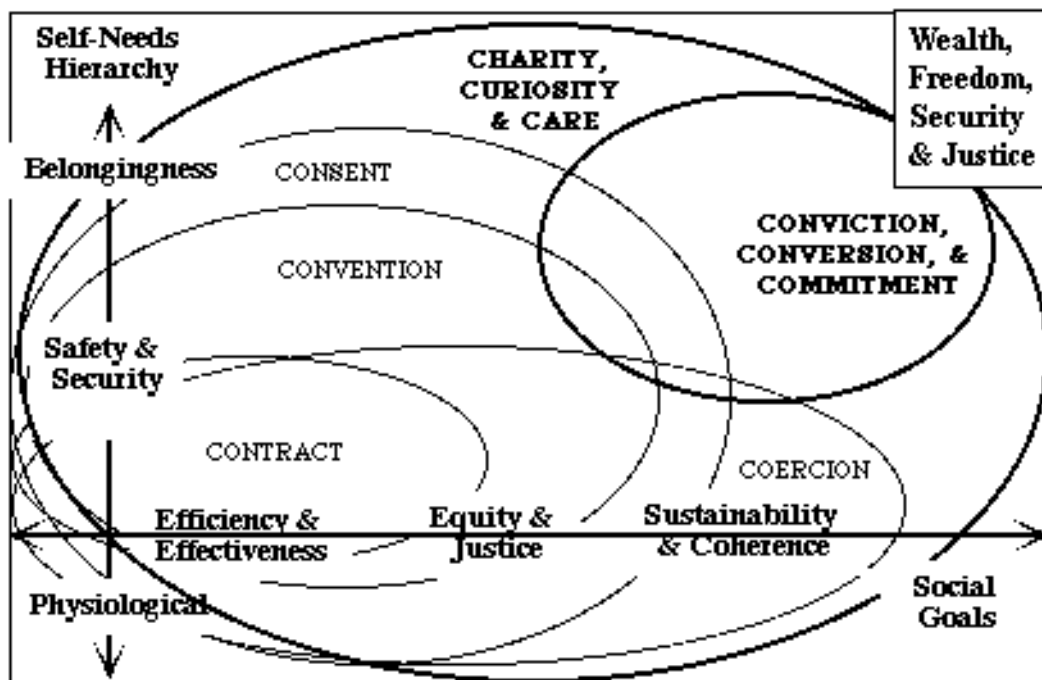
Apart from choosing governments, and trying to seek out those governments we would prefer to live under, we also erect and subscribe to non-governmental organizations to assuage our guilt and satisfy our human social instincts - not solely on the basis of contract but on the foundations of care, commitment and charity. The growth of 'clubs': charitable organizations, interest and pressure groups, NGOs etc. (and all the public-interest dominated and thus altruistic economic activity that goes with them) are expressions of the spokes and species of transaction which are missing from our common model. The richer and more secure we get, the more important and widespread these activities become, and the more they are likely to conflict with the established rules and rulers. Fragmentation and alienation are necessary cohabiters with globalisation, a conclusion which is well evidenced in the bulging literature on globalisation.

Majority rule, or the rules of the presently powerful, cannot resolve these differences, since such rules imply unanimity and homogeneity, denying the engine and motive power of evolution and selection. Both markets and governments can only go so far, and not far enough. We need more competition in our governance systems - more scope for differentiation and adaptation, and more freedom of selection, more freedom to choose. This is the principal point of this argument. We are missing the nature of the patterns that brought us to our current state - there is no common narrative to go with the common model. According to this outline logic, there are several transactions and negotiations systems missing from the present common model. These missing elements, I suggest, capture the

fashionable and apparently popular notions of stakeholder consent and third ways of governance (Giddens, 1999, 2000).

A conjecture about what we are missing is illustrated in Figure 4. Harvey, 2001b, provides an outline explanation of why these particular transactions systems might be regarded as fundamental. Hofstede (2001), on the basis of extensive empirical research, proposes that different cultures solve these fundamental social problems of harmonising personal and social ambitions, with their associated attributions and transaction system mixes, in identifiably different ways. He detects five principal axes of cultural difference, where cultural differences can be measured according to the balance particular societies chose along these principal axes. The axes are: individual/collective, the major axis identified in Figures 3 and 4, and, as noted by Hofstede “positioning itself between these poles is a very basic problem all societies face” (pxx); uncertainty avoidance (the extent to which society tries to control the unknown and uncontrollable); power distance (the degree of inequality the society is prepared to accept and expect); male/female (the emotional dimension of society’s accepted practices); long term/short term (the extent to which society accepts delayed gratification of ambitions). The suggestion here is that these differences actually manifest through different framings and mixes of the basic social transaction systems.

**Figure 4. Conjecture II of Transaction Systems & Private vs. Social Interests**



## **Two Examples from the Rural Economy and Land Use Agenda.**

The RELU programme focuses on the food chain and the multi-functional use of land. Consideration of the above outline framework as it applies to these two aspects of the rural economy may illustrate its potential.

### *The Food Chain*<sup>17</sup>

Kay (1993) argues persuasively that corporate success depends on the harnessing of the competitive advantage of products, as opposed to commodities, (that they be differentiated - rare, inimitable, un-substitutable and valuable to the consumer) with the distinctive capabilities of the firm (or marketing chain). This is competitiveness – the ability to survive and replicate, to create added value. He identifies four key elements to distinctive capability. Only one of these (*strategic assets*) comes as no surprise to conventional economists.

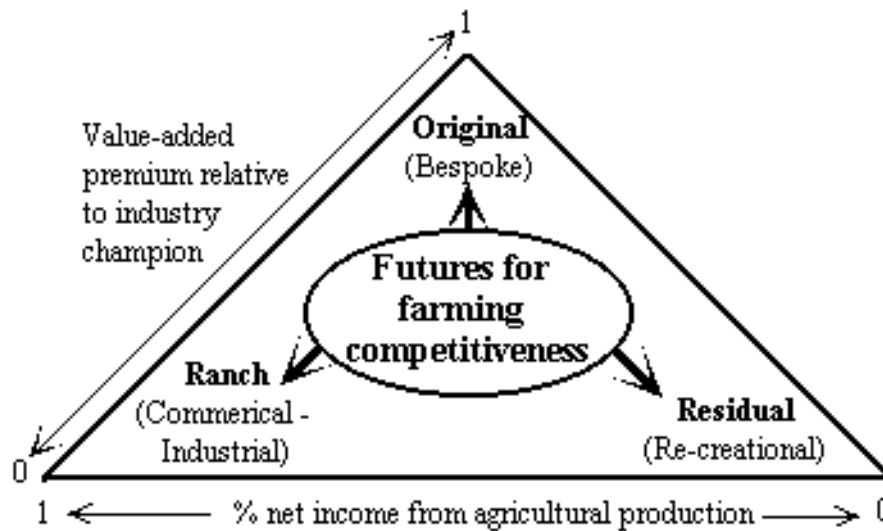
Kay's other three distinctive capabilities echo the missing transactions: i) the network of relationships the firm has with its suppliers and customers, as well as the internal networks the firm uses to keep its parts and people working together and trusting each other (charity – the willingness to take the other's point of view) which together Kay calls *architecture*; ii) *reputation* of the firm or chain, which is clearly of vital importance in signalling to the customer the quality and reliability of products (and the commitment and care taken over their provision); iii) *innovative capacity*, the curiosity and conversion, which is frequently and strongly associated with architecture, since it involves continual and accurate transmission of final customer requirements back up the marketing chain. Two important implications of this richer framework of competition follow for the food chain.

First, the key distinctive capability of farming is location, which cannot be duplicated or imitated by rivals in other parts of the country or world (echoing the importance of spatial capital identified in Figure 1 above). Presently, location (and associated atomistic fragmentation) is frequently seen as being a commercial weakness of the farming system. This weakness can be turned to competitive advantage by being original, by developing the architecture of the marketing chains to deliver an enhanced reputation of the origin - the craftsmanship and socio-environmental care of the production and processing systems. Figure 5 illustrates the three strategic extremes outlined here for the future evolution of agriculture and, by implication, for land-based rural development.

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<sup>17</sup> See Harvey (2001a)

**Figure 5: Diagrammatic representation of agriculture's strategic options**



In turn, this requires innovation and imagination in developing new information, promotion and marketing systems, with an emphasis on increasing consumer perceptions of the authenticity and originality of the product package (Kusnesof, *et al.* 1997). Any value to the consumer reflects the contribution to the preservation and enhancement of original environments, and the care and attention to detail and quality throughout the marketing chain. The originality of the final product is a package of the whole chain. It is useless to look for the value of organic foods, or for GMOs (for instance) through conventional science – their value lies in their originality, and the signals they incorporate (or not) from the missing transaction systems. Similarly, a brand is useless unless it is an accurate signal of these values.

Yet the development of a genuine original option for many rural areas is fragile. Most of the apparent trends within the agro-food sector appear to be antagonistic to personalised craft, personal trust and commercial relationships which are closer to family and community networks than to business practices of stock control, national distribution systems, hazard analysis and critical control point (HACCP) protocols, and international sourcing strategies. In particular, the market power of the major supermarket chains seems certain to condemn original products to the status of up-market commodities - in direct price competition with internationally sourced brands and labels - rather than to encourage their marketing as a product/concept-bundle of authentic craft and production practices and community

relationships, combined with a strong perceptual flavour and colour of the production location and culture.

But, as a second example, consider the apparent hegemony of the supermarket chains from this perspective. Their initial strategic assets (their stores) are fast becoming liabilities, especially if and when electronic shopping and customised home delivery become major realities. Their distinctive product – one stop shopping – has now become the norm, a commodity rather than a product, with effective price elasticities of demand at the store level being close to perfectly elastic, at least within major conurbations. While there is some security in shopping where everyone else does and buying what everyone else buys, the increasing differentiation in retail markets shows that as people become richer and more secure, so they seek to differentiate themselves from their crowds.

Growth areas of the business are likely to be the differentiated and specialised segments of the market. In the case of food, the specialisation includes very considerable elements of service and added-value. The distinctiveness of these services, however, is that they are not replicated on every corner - each is different and personal. Supermarket chains, by their very nature, cannot provide such bespoke product/service mixes. A possible response is to introduce more regional and local variation (and hence more differentiated sourcing and procurement systems). Through franchising or sub-letting store space to independents, they might turn their supermarkets into genuine super markets, exploiting the real distinctive capabilities of the chains (logistical and inventory organisation, information processing and billing, and marketing information) as a common service to the stall owners and operators. Thus, the development of in-store franchises could lead to greater differentiation of the product/service through more transparent and trustworthy competition within the store, and hence to new opportunities for the local farming sector and its originality. The development of farmers' markets within supermarket car parks, and the response of Marks and Spencer to their collapse in fortune (opening up their store and reputation to franchised independents) are current examples of these evolutionary developments. This may never happen, in which case, which of our social sciences can explain why not according to their present theories? If it does happen, can they explain why it does?



*The Rural Environment and Land Use*<sup>18</sup>

There are two key policy problems posed by public conservation, amenity, recreation and environmental (care) goods (McInerney, 1986). First, markets for public care goods and externalities are incomplete (exhibiting only as opportunities to contribute to trusts), so people are not provided with natural opportunities to signal their willingness to pay. As a result, the signals (both incentives and penalties) to actual and potential suppliers are weak and confused. Second, the care goods themselves are highly differentiated. They are subject to highly specific and localised production systems. Their value depends on their location and context. This fact makes specification of the activities to be pursued to ensure their provision equally specific, individual and differentiated. The necessary signalling and transactions systems are complex as a consequence. Care markets are said to fail as a result. However, this is not market failure. There are limited markets for care goods and services simply because the benefits from making the necessary markets more complete are more than outweighed by the costs of the necessary negotiations and transactions. The market, rightly, judges that the effort is not worthwhile. It is only as societies become richer that the benefits begin to outweigh the costs. The problem is the costs and effort of organisation and exchange of information on willingness to pay for care goods and services with the costs of providing them. The problem is one of collective choice and the systems we use to make these choices.

Bureaucracies and typical government policy directives are not well-suited to solving these problems. The presumption that government can and should be responsible for public care good provision rests on the same theoretical grounds that government can plan economies to achieve a socially optimal outcome.<sup>19</sup> While it may be true in principle that a benevolent dictator could plan an economy to achieve an efficient allocation of resources, given sufficient reliable information, it is demonstrably true that this central planning is impossible in practice, not least because of the difficulties of organising and exchanging reliable information.

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<sup>18</sup> A more complete account of these arguments can be found in Harvey, 2003, from which this section is taken.

<sup>19</sup> I refer here to the Lange-Lerner version of market socialism, which argues that public ownership of the means of production is not necessarily inconsistent with economic efficiency, and may even be preferable (Lange, 1936-7, Lange and Taylor, 1938, Lerner, 1936). However, even under this model, consumers are assumed to be allowed free choice to express their demands as demand prices, the all-decisive criterion for both production and resource allocation.

In the case of public care goods and services, the situation is exceptionally difficult for a would-be central planner. Here, the demand prices, as the prices people are willing to pay, have to be estimated, since their markets are incomplete. Estimates necessarily include non-market evaluations, for which people have no direct trading experience. It is well established that, unless people are asked to “put their money where their mouth is” when expressing preferences and rankings, their choices tend to be inconsistent, non transitive and irrational (Shogren, 2002). These estimates, however professional, will be politically contested and unreliable.

A possible route to reconciling these difficulties is to make more use of the emerging conservation, amenity and recreation trusts (carts, as Dwyer and Hodge, 1996, term them). The voluntary contributions are an indication of the public willingness to pay for countryside and care goods, while their diversity is an indication of the differentiation of these goods. The activities of the trusts themselves are directed towards providing the care goods, either directly or through contracts negotiated with individual farm or land using businesses. Why not use these quasi-market (that is, voluntary) systems to deliver the public goods associated with the multi-functional use of land? Public policy could be confined to encouraging further development of the private market for care good provision, as represented by the trusts.

Comparison of the existing voluntary contributions to trusts with estimates of the general willingness to pay for these goods does provide an estimate of the free-rider shortfall. Public policy could then be restricted to top-loading voluntary contributions by this shortfall, as a grant-in-aid payment. Voluntary trusts could then be given the responsibility of providing the care goods.

The signals provided by this approach seem more likely to reconcile the twin difficulties of valuing care goods and allowing for their differential and specific provision. As far as the consuming or benefiting public is concerned, not only are they required to actively signal their own willingness to pay and thus commit to provision of the goods, they are also encouraged to trade between the several trusts available, and also to promote their own new versions, if they consider the existing ones insufficient or inefficient. Furthermore, if the members become dissatisfied with the levels and types of care good provision being offered by the trusts, then their own active participation can be used as an effective remedy.

The trusts would be largely self-policing, in the spirit of the Lange-Lerner model, through competition between themselves to provide what the public are prepared to pay for, in the

amounts and qualities for which they are prepared to pay. The contests over both valuation and provision would become endogenous within the system, rather than as at present remaining exogenous or external to the system, relying on government as a benevolent dictator.<sup>20</sup> In this way, the missing transactions systems of charity, care and commitment can be added to the market contract system, increasing the potential of the overall social organism to be sustainable. Exactly similar arguments could be applied to many issues of animal welfare. Once again, can our existing social sciences rationalise why this does not happen, or argue coherently that it should?

**So, in conclusion, what's the use of Economics?**

The point of economics, as still told in the introductory texts, is choice under scarcity, which is actually ecology by another name, prudent by default and not by design. It is still about making and living and having a life (microeconomics) and also about the basic income flows and transactions involved in the common model hegemony of contract, convention and coercion (macroeconomics and political economy). The words and perspectives outlined here may be novel, but there is no argument here about the content or logic of economics. There is, however, a very strong complaint that, although necessary, economics as presently conceived is far from sufficient to cope with the science of human society. It does not tell us how we choose and re-choose our rules and rulers. By the same token, neither does any of our sister social sciences, which also tend to ignore the necessary income and spending flows and balances dealt with by economics. For a serious social science we need an integration of our present disciplines – a way of getting them to trade and breed ideas, concepts, evidence and experiments. Evolutionary theories offer this possibility.

This integration is even more essential for social science than for natural science. We can expect natural science to become more general (Deutsch, 1997). The more we know and understand about the way in which the bio-physical world works, the more general our understanding will become, given the veracity of our epistemology and the validity of our ontology. But, for social science, we construct our own realities – we choose our own human rules for selection and reproduction, progress and elevation. We choose our own morals and ethics. So we also need a coherent and consistent account of how we suppose we do this. It

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<sup>20</sup> Some ombudsman service would be required to act as arbiter for internal or inter-trust disputes which could not otherwise be settled. Trusts would also need to be licensed and regulated to ensure that they operate as genuine carts.

follows that rhetoric (McClosky, 1983), as persuasion and conviction, is a critical element in what we do. This paper has outlined such a framework.

The application of this framework to two current themes of the RELU agenda leads to suggestions which are neither deducible directly from close intensive research, nor can be derived from current versions of the single-disciplinary theories of social science. I suggest that the development of a more common framework can assist in providing both rigour and relevance to what we do. In short, I suggest that our future depends on us forgetting the agri in our society's title, and developing a practice of cultural economy. Finally, there is only one route to testing these ideas – to subject them to the critical appraisal of one's peers. I look forward to hearing from you, and thank you for your attention so far.

Newcastle, March, 2004.

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