I’m responding here to a request for a summary of what I consider the main points in chapters 1 to 8 of Cassidy’s book (i.e. the Part titled “Utopian Economics”), where he’s setting out and discussing the views of economists who have strongly upheld the efficiency of the free-market system. I’m organizing this as a summary of the views of the main historical figures discussed by Cassidy.

Adam Smith (1723–1790): Emphasized the productivity-enhancing effects of the division of labor, and the way in which the division of labor is coordinated via market exchange—not by means of any agreed plan but as if by an “invisible hand”. According to Smith, the market translates the self-regarding pursuit of individual gain into an overall benign social effect: firms end up producing what people want to buy, and with a high degree of efficiency. However, Smith accepted an economic role for government, notably in the provision of public goods (such as lighthouses and education) and in the regulation of the financial system, which he saw as particularly subject to disturbances. He also saw monopoly as a problem, in that it blocks the beneficent effects of free competition.

Friedrich Hayek (1899–1992): Was noteworthy in the 1930s for his espousal of a theory of the Business Cycle according to which recessions are periods when the market system “heals itself” following episodes of excessive or misdirected investment. The corollary was that governments should not attempt to mitigate recessions via policies to raise overall demand. These views were not widely accepted and were eclipsed by Keynes’s macroeconomic theories. In the postwar period he argued vigorously (against the tide of the time) that the development of the Welfare State represented the “road to serfdom”. Nowadays Hayek is mostly recognized for his critique of central planning, and the associated argument that the system of market prices is a finely tuned “telecommunications system” that transmits just the economic information that people need to those who need it. These arguments gained a lot of traction following the fall of the Soviet Union and the disintegration of the Soviet bloc.

Léon Walras (1834–1910) and Vilfredo Pareto (1848–1923): Walras was the founder of General Equilibrium (GE) theory, a theory which expresses the complex interdependencies of a market economy in mathematical form. The “holy grail” for many advocates of this theory was a demonstration that the market system automatically homes in on an equilibrium that is efficient in Pareto’s sense—that is, a state in which it is impossible to make any one person better off without making at least one other person worse off (meaning that there is no “slack” in the system). The modern development of GE theory, however, has effectively shown that such a demonstration is not possible—or at least, is possible only under very restrictive and unrealistic assumptions. Key figures in the development of GE theory after Walras include John von Neumann (1903–1957), Kenneth Arrow (1921–) and Gerard Debreu (1921–2004).

Milton Friedman (1912–2006): A monetary economist—and leading figure in the “Monetarist” school—who argued that blame for the Great Depression should not...
be placed on the supposed frailty of the market system, but on misguided policy on the part of the US Federal Reserve. Friedman was noteworthy for attacking the notion of the Phillips Curve as a trade-off (between unemployment and inflation) that the government could exploit: rather, the Phillips Curve was vertical in the long run, at the economy’s “natural rate of unemployment”. A government policy of monetary stimulus might lower unemployment temporarily, but in the end, he argued, would just lead to inflation. Besides his macroeconomic work, Friedman was well known for his polemics against all forms of government regulation (including the FDA) and his claim that “self-regulation” was always superior. His views were highly influential during the Presidency of Ronald Reagan.

*Louis Bachelier* (1870–1946): Bachelier’s conception of financial markets and asset-pricing (developed in 1900) was long overlooked, but in the 1960s and 70s formed the basis for the Efficient Market Hypothesis (Eugene Fama) and the associated “random walk” theory of asset prices. The basic idea here is that all relevant information is taken into account in the market pricing of financial assets. So prices will change only when new information becomes available. But new information is by its nature unpredictable, so changes in asset prices must also be unpredictable (and therefore the exertions of stock-markets “Chartists” are a waste of time). Bachelier’s idea was that while particular price changes are not predictable, they nonetheless follow a stable probability law: the “normal” bell curve. This notion underlies modern “risk management” strategies. It has been strongly contested by Benoit Mandelbrot, who points out that “extreme” price changes are far more frequent in real financial markets than they ought to be according to the normal curve.

*Robert Lucas, Jr.* (1937–): Well known as the theorist who introduced the Rational Expectations Hypothesis (REH) into modern macroeconomics, and as a founder of the “New Classical” school. At its simplest, the REH says that while people make forecasting errors (of course), these errors should not be *systematic*—they should be random, if people make the best use of the available information. New Classicals hold that Keynesian economics—according to which recessions should be countered by a policy of monetary and/or fiscal stimulus by the government—is dead wrong. Keynesian policies have a real effect on the economy, they say, only if they are unpredictable, random; but then they can only be destabilizing. This “policy ineffectiveness proposition”, it turns out, does not follow from the REH alone; it depends on the idea of continuous market-clearing (supply = demand in all markets, all the time), a claim which Keynesians regard as quite unrealistic. Lucas is also well known for his claim that the problem of depression-prevention has long been solved, a claim that sounds a little odd in 2010.

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