David Simpson, *The Rediscovery of Classical Economics: Adaptation, Complexity and Growth* (Cheltenham: Edward Elgar, 2013), pp. 215, $114. ISBN 978-1-78195-196-5.
doi: 10.1017/S1053837215000280

Most economists would probably see classical economics as dead since the 1870s or at least since the end of the nineteenth century. This is because the marginal revolution replaced its main theoretical core (labor value theory) by a new one, thereby making the old edifice irrelevant. Another view holds that classical economics metamorphosed into neoclassical equilibrium theory. David Simpson disagrees with these two views, and explains why in *The Rediscovery of Classical Economics*. In an anti-Whig approach to history, Simpson argues that the main conceptual framework of classical economics has not only been left out of contemporary economics, but also presents the only way to solve the shortcomings of modern economic science.

These shortcomings are such that Simpson sees mainstream economics as fitting Imre Lakatos's "description of a degenerative research program" (p. 192). In his view, neoclassical economics assumes away too many important aspects of reality in order to obtain mathematically tractable results. It has become non-operational. In other words, Simpson contends that contemporary mainstream economics cannot explain much of reality, starting with the ideas of change and growth.

This is not a new song. Periodically one can hear critics voice their concerns about the lack of relevance of the neoclassical equilibrium paradigm. What is different in this book is the solution that Simpson proposes. He explains that the defects of mainstream theory can be solved only by a return to the fundamentals of economic theory as they were developed by classical economics, principally Adam Smith and Alfred Marshall. The three tenets of classical economics Simpson brings forward are: a focus on growth, an understanding of social change as self-organizing and evolutionary, and the centrality of the human factor.

WHAT IS CLASSICAL ECONOMICS?

A first problem occurs with the definition of "classical economics." In Simpson's view, it appears that classical economics boils down to human complex adaptive systems. It may be entirely true that contemporary research on the subject is the direct heir of classical economics, but this view may also proceed from a selective reading of history. Until the 1830s, "political economy," as it was called then, was seen as the science of wealth and material welfare. It then became the science of exchange, the science of avarice (getting the most for the least), the science of money, and, eventually after the marginal revolution, the science of scarcity or economizing (Kirzner 2009). As one can see, it may be difficult to capture the essence of classical economics, considering its diversity.

Simpson adopts three tenets but does not give much explanation as to why these are the only relevant representatives of classical thought. He doesn't refer to contemporary works that are regarded as the modern incarnation of classical economics. Beyond Alfred Marshall, Allyn Young, and Simpson himself, the reader doesn't know who bears the classical economics torch.

Simpson's fundamental claim is that the modern incarnation of classical economics is complexity theory. While we are willing to follow him on that path, Simpson

assumes some basic knowledge that the reader may not possess. This at times makes the book less clear than it could have been. For instance, one would like to see an explanation of the "non-linearity" concept (p. 76).

AUSTRIAN ECONOMICS

Austrian economists should be pleased with this book, as Simpson views their school as perhaps the only one that has kept the teachings of classical economics alive. Austrian economics has an overlapping research program with Simpson's classical economics, and many Austrian economics scholars, starting with Carl Menger, have shown a deep understanding of the nature of classical economics. There is a lot that Austrian and classical economics have in common: a focus on explaining social change in an open-ended universe, uncertainty, purposeful action (p. 17), subjectivism (what complexity theory calls "agent-based reasoning," p. 23) and interpretation, the creative aspect of the human mind, the market as a process (p. 90), the limitations of macroeconomics and especially aggregation (pp. 82–83), the impossibility of point prediction (p. 83), and, of course, spontaneous order (complex non-linear systems).

On the other hand, Simpson and the Austrians may part ways on a few subjects. He seems to be rejecting optimization entirely (p. 52) and he replaces it with "adapting," which boils down to rule updating—although he defines "adaptive behavior" at the end of the book both as innate creativity and response to one's own changing environment (p. 180). But rule updating is simply a weaker form of optimization. Austrians agree that reducing human behavior to optimization is limiting. Israel Kirzner (2013) argues that optimizing is not sufficient to explain human behavior and the social order because it cannot explain genuine change. The more fundamental issue is whether rejecting strict optimization also means throwing rational choice theory (which Austrian economics calls "purposeful action") out of economics. Simpson doesn't go that far, but his discussions of purpose and rational choice are underdeveloped in the book.

While Austrians do agree with the misuse of the equilibrium concept, Simpson seems to be throwing it away entirely. But if one is to understand genuine change, then the notion of equilibrium (or its related concept of evenly rotating economy) can be a useful analytical tool. Equilibrium can be used as a contrast or as a foil against which one understands change. The main issue, therefore, is the abuse of equilibrium as a description of the world. If one assumes, the way Chicago price theory does, for instance, that the world is in an equilibrium-always situation, then one can never explain genuine change. This is also the limitation of Joseph Schumpeter's theory of creative destruction, for there is no fundamental reason for the entrepreneur to disturb the initial equilibrium.

Some weaknesses in the presentation of Austrian analysis can be found in chapter six on markets, competition, and entrepreneurship. The introduction to the economic calculation debate lacks the important discussion of the role of property rights, as elaborated by Ludwig von Mises. Simpson's discussion of monopoly is fairly standard when the reader could have expected a presentation of what complex adaptive systems mean for monopoly theory (e.g., both Israel Kirzner and Murray Rothbard provide important insights into the theory of monopoly that perhaps could be reinterpreted

from a complexity theory point of view). Finally, the discussion of entrepreneurship is very short (pp. 99–101) and rather descriptive, emphasizing the importance of small rivals. Here as well, the reader remains somewhat unsatisfied, as entrepreneurship plays a key role in the Austrian theory of the market process and is almost inconsequential in Simpson's classical economics (more on this below).

THE INSTABILITY OF THE MARKET ECONOMY AND THE BUSINESS CYCLE

Another theme of the book is the problem of the instability of the market economy (e.g., pp. 2 and 77). Simpson seems to be saying that the (pure) market economy is inherently unstable because the market does not succeed completely in its role (p. 137). As a result, recurring crises occur. This is because human beings act imperfectly, which creates disturbances in the market. Simpson argues that complex adaptive systems create negative and positive feedbacks because market adjustments are not instantaneous. This can also lead to economic cycles.

With the exception of chapter eight, there is no discussion of the influence of money and credit on business cycles. The reader is left with the idea that the capitalist system is inherently unstable; an idea shared by Karl Marx and a few other classical economists. One wonders if the author is not carried away by his application of the theory of complex adaptive systems. It is possible that, theoretically, such systems can experience cycles, and perhaps this has been shown to be the case empirically in physics. But this does not imply that a pure market economy would be inherently subject to cycles.

This gives rise to another potential divergence between Austrian ideas and Simpson's classical economics. Austrian economics sees the market as a self-correcting system. Errors happen all the time, but in the normal course of action, they are corrected and eliminated. There cannot be clusters of errors and thus there is no source of cycles that one can find in the pure market economy. If entrepreneurs are free to enter any market they wish to seize opportunities for profits, then self-correction takes place and there is no innate source of disturbances that would create cycles (Rothbard 2009, pp. 851–854). Periodic fluctuations in total output and employment are not a part of the nature of a pure market economy. They are features of a hampered and regulated market system.

The danger is that Simpson sets up a theory of systemic market failure. His view basically means that markets can fail to coordinate individual activities on a large scale, and we are not sure why. This is an inherent drawback of markets (p. 137).

But then the author proceeds to explain the business cycle using artificial credit expansion as its main mechanism (pp. 138–139). Similarly, in his explanation of the 2008 financial crisis, Simpson carefully explains that "new derivative instruments created an enormous bubble of credit within financial markets which not only dwarfed the supply of bank credit but lay outside the traditional measures of the money supply" (p. 143). Throughout chapter eight Simpson seems to be saying that cycles cannot occur without monetary disturbances. Therefore it is unclear to the reader whether Simpson argues that artificial credit expansion is always necessary to the existence of business cycles or not. He implicitly agrees with the Austrian position in chapter eight but not elsewhere. The book lacks a clear discussion of the monetary sources of

business cycles. (The same is true of Simpson's discussion of asset bubbles [p. 88]. He contends that complexity theory explains the recurrence of periodic bubbles in asset prices. But it is unclear to the reader whether these bubbles are independent of monetary conditions.)

Moreover, in making his claim about cycles, Simpson ignores the debates that took place among classical economists in the nineteenth century, for instance between representatives of the Banking School such as Thomas Tooke and John Fullarton and those of the Currency School such as Lord Overstone and Robert Torrens. They discussed the role of monetary expansion and note redemption in the financial crises of 1825 and 1837 in England. It is simply not true that before 1914, governments had little influence on the course of economic events (p. 147). Banking regulations in England in the nineteenth century, especially banking privileges given to the Bank of England, created monetary distortions and business cycles. By contrast, and as Philippe Nataf (1990) argues, in places where free banking systems operated, such as New England and Scotland, cycles were limited if not absent. Nineteenth-century classical economists such as Charles Coquelin in France and Henry Carey in the United States made similar points.

Among other things, Simpson proposes that banks and other financial institutions should not be allowed to establish as limited liability corporations (p. 154). Scottish banks during the free banking era (1716 to 1845) were established as partnerships. The number of recorded bank failures during the era of free banking in Scotland is very small. But, while the partnership structure had an influence on the quality of the management of banks, the major factor that disciplined credit issuance was the competition of banks under the free banking regime.

SPECIALIZATION AND INCREASING RETURNS AS THE SOURCE OF GROWTH

Chapter seven presents a good discussion of the process of specialization and economic growth. It argues that specialization is the major phenomenon explaining the cumulated increases in trade surplus over time. Without specialization (and the subsequent division of labor and knowledge), sustained growth cannot occur. Simpson sees specialization as primary over capital accumulation. As he states, "it is the nature and extent of the process of specialization that determines the amounts and the type of capital and labour required" (p. 126). He further states that "the single most important explanatory factor [of economic growth] is surely increasing specialization" (p. 127). In other words, specialization leads to capital accumulation, as well as the introduction of new technologies and new skills.

Nowhere does Simpson explain, however, how specialization comes about. The reader may assume that it is part of the trial-and-error process. This is again an area in which Austrian economics and Simpson's classical economics may part ways. According to the former, behind the specialization process is always entrepreneurial discovery. It is clear that Smithian specialization is crucial to growth and productivity gains, but without entrepreneurial discovery (i.e., Schumpeterian growth or Kirznerian growth) there is no specialization that takes place. Simpson's position is somewhat unexpected, considering the classical economics view of the entrepreneur as the fourth

factor of production (in addition to land, labor, and capital). Without the entrepreneurial function, the only way to explain the source of comparative advantage and specialization is through trial and error.

Indeed, trial and error (guided by market prices) is, in Simpson's view, one of the mechanisms by which complex adaptive systems exist. This position also may leave the reader unsatisfied. Trial and error per se is either a random phenomenon or it is the result of purposeful action. But if it is purposeful, then the important point is not trial and error, but the fact that individuals have hunches about the future and act. Individuals may try different things until they come across something that works, but they don't do it randomly. At some fundamental level, individuals are alert and tend to discover what is in their interest to discover. In other words, yes, trial and error is present, but it is only the step that follows the discovery of new ends and means.

Another important theme of the book is the concept of increasing returns (e.g., pp. 76–81 and p. 111). Along with specialization, Simpson sees increasing returns as the main conceptual tool in the explanation of economic growth. It is a classical idea, as one can understand Smith as emphasizing increasing returns that result from specialization and exchange (Boettke and Pritchitko 1998, p. xi). Marshall also saw external economies as a source of increasing returns. It is true that with a few exceptions such as Allyn Young, and more recently James Buchanan, as well as the literature on endogenous growth theory, modern economics has shunned increasing returns. This may have to do with the theoretical robustness of the law of diminishing returns. Simpson is right, however, in saying that dealing with the notion of increasing returns in an equilibrium framework is difficult, if not impossible.

While he states that it is knowledge in the market economy that gives rise to increasing returns, Simpson appeals to the evolutionary process at work in the economy to explain their source. The danger is that the evolutionary process becomes a black box that scholars use to explain everything. Clearly it exists, because the market is a selective mechanism. The goal of theory, however, is to explain how the market process works. Here, Simpson should again bring the entrepreneurial discovery process into the picture.

CONCLUSION

Whether one agrees that classical economics needs to be rediscovered, Simpson's book is a timely reminder of the limitations of mainstream economics. But what new knowledge do we possess once we have said that the economy is a human complex adaptive system? This touches upon Simpson's criticism of Marshall's partial equilibrium analysis (p. 79), which he sees as profoundly limited. It is true that Marshall's analysis does not capture the complexity of the system, but it is not meant to do so. All it does is give us the tools to surmise what would happen if all else were equal. This is exactly the object of science in a complex world. Moreover, one may see two levels of analysis. At a micro level, comparative static analysis is used whereby one explains the details of the entrepreneurial market process, for instance. At a macro level, the notion of complex adaptive non-linear system or spontaneous order is used to explain the emergent social order, which is the result of individuals' interactions but not of their design.

An interesting implication one can draw from Simpson's insights is that Austrian economics, to paraphrase Roger Garrison, can be seen as a middle of the road between neoclassical equilibrium and complex adaptive system theory. Indeed, while Friedrich Hayek, Kirzner, and others recognize the importance of seeing the economy as a spontaneous order, they also see the rational choice framework of purposeful action as a tool to understand individual behavior. Demand curves slope downward in the real world of complex adaptive systems. In that sense, Austrian economics already offers a richer alternative to the neoclassical framework.

Despite some reservations the reader may have, *The Rediscovery of Classical Economics* is an important and welcomed book, which challenges the reader to contemplate what modern economics has so far accomplished and to consider in what way the classical paradigm may help replace it.

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Angeliki E. Laiou, *Economic Thought and Economic Life in Byzantium*, edited by Cécile Morrisson and Rowan Dorin, Variorum Collected Studies Series (Farnham, UK: Ashgate Publishing Ltd., 2013), pp. xiv + 332, $170. ISBN 978-1-4094-3205-0.

doi: 10.1017/S1053837215000310

The author of this book, Angeliki Laiou (Athens 6/4/1941–Boston 11/12/2008), late professor of Byzantine history at Harvard University (1981), director of Dumbarton Oaks, Washington DC (1989), member of the Academy of Athens (1998), member of the Greek Parliament (2000–2002), and state secretary of the Ministry of Foreign Affairs (2000–2001),[1] studied several decades ago issues concerning the field of Byzantine economy and Byzantine economic thought. She devoted herself to this study not only with deep interest, but also with a critic mind.

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[1]Cf. the Proceedings of the conference held in her memory in *Πρακτικά της Ακαδημίας Αθηνών* 84, 2 (2009): 243–293.