Economics Needs Re-focusing on Topics and Methodology: Economics of Mixed Economies as a Fusion of Markets, Authorities and Morals

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Abstract

We discuss in the paper how economics is presented to the public. Our particular concern is how introductory economics is taught, where the subject matter is subjected to a series of methodological abstractions that expose the real world and a large part of its economic problems to a forlorn realm of speculation and uncertainty, both of which are often prey to political manipulation. There is an extensive and ever-growing field of economics that deals with collective goods, whose explanation is insufficient because markets alone cannot provide them. To make them perform, the failing markets need to be complemented by politics (authorities of power) and morals (social responsibility). This raises the issue of the economics of democracy. Its role thus requires elevating democracy to the status of an economic institution of fundamental importance to explain approximately half of the economic transactions that challenge the modern world, but are marooned by economics as an instrument for their management.

Considering the current state of economics and its teaching, our research led us to three conclusions: i) Orthodox economics has markedly and unfairly underrepresented the importance of both politics and morals, particularly in explaining the functioning of collective goods and governments. ii) Doing justice to the roles of politics and morals requires refashioning a considerable part of how economics is taught, which needs to adjust the extent of assumptions that constrain the explanatory power of the models of collective goods. iii) Among other things, this requires that economics pay more attention to the mechanism of democracy and political markets where the democracy should be upheaved to a pivotal economic instrument for dealing with public choices – to an instrument socially superordinate to markets acting in the public sector.

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Edmund Phelps: “Economics is in a tremendous crisis… especially since it doesn’t know it’s in a crisis”. (Phelps, 2015).

1. Introduction

As the world reaches unprecedented levels of productivity, specialisation, diversification, and interdependence, so too are the range and patterns of consumption expanding. Innovative mechanisms for satisfying individual and public choices are needed both in theory and in practice. The opportunities for innovations lie in the design of social institutions for sustaining inter-human exchanges that operate through three instruments (mechanisms), which here, for convenience, we shall call: **economics (markets, entrepreneurship); authorities (structure of political power, law, judiciary); and morals (standards of values, extent of self-responsibility)**. The role each of these instruments plays varies over time and space, and the optimal configuration and functioning of each remain unresolved.

To better explain the above argument, it is necessary to return briefly to the building blocks of economics. That, how real economies evolve, is related to a subsequent change in their explanatory concepts. This means that the exploratory contents (scopes) and methods of economics must be open to changes, too. We would argue that the real changes in the economy since the millennium have been so profound that academic economics should revisit some of its fundamentals. Bowles and Carlin (2020a) arrived at a similar conclusion regarding reshaping the teaching of economics, e.g., by bringing inequalities, nature, financial instability, market failures, social interactions, and the limits of government into the foreground.

Primarily in conformity with traditional canon, we shall define **economics as the study of how people interact in the creation (production), distribution (exchange), and consumption (use) of limited goods and other artefacts with economic value** to satisfy their **unlimited demand for increased well-being, by sacrificing scarce resources.**[2] This is a more comprehensive approach than Samuelson´s 1948 view of the task of economics, which he said was to help explain ‘what, how, and for whom are goods and services produced, delivered and sold’ (Samuelson, 1967, pp. 15-16). Our own characterisation of the discipline intentionally broadens the target of human effort by two extensions:

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[2] This is an extended version of Marshall´s definition, which we consider too narrow: ‘Political economy or economics is a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of wellbeing. Thus, it is on the one side a study of wealth; and on the other, and more important side, a part of the study of man’ (Marshall 1890, p. 6). We prefer the definition by subject matter rather than the more common definition based on a study of methods and techniques, because this paper is focused on expanding the field of economic analysis.

(a) By specifying the objects of analysis more closely by including the term 'artefacts with economic values'. It may look unwieldy, but it offers methodological advantages over the more common but misleading (commercial) 'services' by diverting the analytical focus from the allocation of non-material artefacts.

(b) By adding the axiom that demanded human needs are derived from a choice requesting acquisition of a positive artefact that is deemed missing – "it ought to be provided"; Or from a request for a negative artefact that is deemed ineffectual – "it ought to be discharged". Both demands are derived from a subjective strain: from a sentiment of deficit of something good or a surplus of something bad.

These two crucial extensions will allow us to focus on the provision of such abstract 'products' as, for example, institutions, policies, capital goods, peace, entrepreneurship, security, health, equality, or biodiversity, which have high positive economic value on the demand side but no or distorted market value. They are usually undersupplied. There can also be artefacts with negative economic value, such as war, theft, hatred, infection or pollution, which are oversupplied and the economic system should eliminate them. All mentioned are the objects of public coordination (e.g. dis-production), which have opportunity costs and require political bargaining over their costs and benefits.

Turning back to the above definition of economics, where there is a crucial role assigned to the "distribution" of artefacts. As we already deal with the question 'for whom', it is also necessary to ask 'by whom and when'. Then we should extend the question of 'how to produce' to that of 'how to exchange'. The latter question must be asked because no economic value is a windfall or godsend, and every benefit (or harm) has its costs. Our extensions are required to guide us in treating the economics of collective goods, which will lead us to the quest for the economic meaning of democracy.

Staying with Samuelson (1947) and the neoclassical orthodoxy following his Foundations, it is now increasingly clear that Samuelson´s stress on methodological abstraction and individual agents constrains the development of economics in certain areas by embedding them in a cage of preselected topics. Here, we shall concentrate on how the reductionism in orthodox economics constrains its explanatory potential in one crucial area: **how to organise and coordinate the exchange (distribution) of demanded artefacts with economic value in a society.** We shall speak of '**exchange transactions'** for the sake of brevity.

Exchange transactions are part of the allocation of resources and products associated with the decision-making about alternatives. Economics has rightly focused on how choices are made. However, the methods chosen to study this have been constrained by limited data availability, leading to a focus on topics that are measurable and confirmatory. This cherry-picking in the axiomatic approach to economics was criticised early on by Hayek (1953) and was later discussed, e.g., by Backhouse and Medema (2009).

To shift the outlook of economics, in light of the methodological weaknesses mentioned above, this study raises the following research question: What topics and methods in economics can most contribute to understanding the sources of well-being in current-day economies? Our answers will have to consider the following modern economic trends: globalisation, oligopoly and oligopsony in a variety of markets, entrepreneurship's conflict with bureaucracy, the rising importance of public (collective) goods, expanding externalities, the link between inequality and regulation, and scale effects from the rising complexity and immobility of human capital.

As discussed by Bowles and Carlin (2020b), Naudé (2022) and Collier and Kay (2020, such factors are altering the nature of market capitalism. Capitalism must also cope with rising transaction costs, opaque ownership and property rights, and politically determined economic choices. These considerations underscore the importance of public economics, particularly public choice theory. Political markets and democracy are becoming more important in socioeconomic governance. Democracy can play a pivotal role in the allocation of public resources only if markets, political authorities (power), and morals (e.g., social responsibility) act in coordination.

In this contribution, we do not discuss exchange transactions in perfect markets for private goods as described by orthodox neoclassical economics – a topic, which we consider completed. Instead, we concentrate on transactions involving public and collective goods closely related to political processes, and on the behaviour of political agents in two specific markets, both of which are related to the functioning of democracy: the market in political goods and the market in collective goods. For simplicity, we focus on the mechanism of governance in the public sector. Another detour, however, is required first.

2. The Bias towards Reductionism in the Scope and Method of Economics: The Limitations of Economic Orthodoxy

There is a consensus in the academic community that ontological and epistemological reductionism is an intrinsic aspect of all scientific inquiries. The explanatory cuts (reductions) are not just made for pragmatic reasons, as a way of simplifying natural complexity and avoiding a descent into an unending chain of explanatory recursions. There is a widespread conviction among economists that rationality is at work and that statistically significant causal factors are not unlimited, and they can be separated from processes that are merely random. Friedman (1950) proposed a scientific justification for reductionism: the goal of economics is to make predictions that reduce decision-making uncertainty. In contrast, Hayek (1964) argued that the predictive ability of the social sciences is constrained by the limits of human cognition in grasping complex phenomena of economic behaviour. In any event, changes in real economies and in the epistemological world of economics should proceed side by side. Our main focus here is the evolution of the discipline itself, especially a possible transition away from the ossifying orthodoxy of economic teaching and the excessive simplifications of reductionism, which are its essential features.

Following the trailblazing inquiry by Bowles and Carlin (2020a), we will focus on teaching at the introductory economics level, with a focus on microeconomics and institutions. The main contribution of the authors is the quantitative comparison of the evolution of key topics presented in the most frequently used textbook in the US in 1930, 1948 and three from the post-financial crisis 2008 era, published in 2009 and 2015. Their study affirms that as the world evolves and stumbles over “black swans” imposing new challenges, so should economics shift its scope of topics. The study discloses that even the most recent textbooks still continue to teach the standard benchmark model set by Samuelson´s classic of 1948 and ignore too many new topics. There is a need to introduce a different set of benchmark topics, grounded in methodological pluralism, by integrating government, power, civil society, policies, and moral sentiments with market and off-market resource allocations. This implies de-reductionism in modelling.

Any modelling is logically dependent on its guiding paradigm. In economics, the role of a paradigm is played by neoclassical theory. However, paradigms tend to make research path-dependent and embed it in principles deemed central. This guides the research toward a foreordained selection of topics that may wrongly exclude many others (Kuhn, 1962). Inspired by the methodology of physics, mainstream economics seeks to explain reality through axiomatic models that limit the number of variables to manageable, quantifiable entities. In contrast, many others are deactivated as exogenous or omitted as irrelevant. This is because real socioeconomic systems are particularly sophisticated black boxes with incalculable degrees of freedom. They cannot be analysed directly, i.e. without reducing their causal interaction through abstraction. Let us mention the most common methodological abstractions in mainstream textbooks that tend to restrict rather than expand economics' explanatory and predictive powers. As a criterion, we view the requirements of economics shaped by our compounded definition noted above and compare them with the most common methodological abstractions and the challenges imposed by the current reality:

(a) The orthodoxy’s preference for ‘**goods and services**’ as the objectives of human exchanges. It suggests that exchanged objects should be visible, as if the invisible products of abstract origin (e.g., peace, pollution, monetary policy, cooperation) could not stand alone and must feature in exchange transactions. Replacing ‘goods and services’ with ‘artefacts with economic value’, as we do here, is one way of overcoming this bias.

(b) The prevailing custom is to view multifaceted socio-economic exchange transactions in terms of their **intermediation by markets only** and preferably by self-sustained, complete markets. Nevertheless, the majority of real markets are not complete, and they are not the only allocative instruments. Bowles and Carlin (2021) discuss the allocative mechanism in terms of three poles: markets, government, and civil society. We will later explain why we modified the mechanism to markets, authorities representing power and morals representing responsibilities.

(c) Economic orthodoxy, echoing Marshall and early capitalism's deemed role in supplying 'material requisites', essentially assumes that economic agents are **businesses targeting profits and equity values**. The non-profit businesses and non-material bearers of exchanged values, and their functioning, are thereby sidelined and, with that, important considerations such as the creation of institutions, state administration, the provision of security, or felicity, are sidelined as well.

(d) Giving theoretical preeminence to markets implies that **prices guide exchange transactions** because it is the price mechanism that conveys the necessary information, and this is a defining feature of the market. Since monetary prices are observable and quantifiable, marketable goods are the preferred building blocks in economic modelling. However, numerous exchange transactions in real economies occur without the intermediation of money or prices, such as different forms of barter.[3] Such transactions then escape academic attention, regardless of how much they may actually be contributing to national welfare and wealth. **Estimates of national welfare are then biased towards transactions in money only.**

(e) Despite recent efforts to move beyond the **emphasis on easily quantifiable measures of economic performance**, GDP being the most prominent, economics as an academic discipline continues to struggle with finding the best way to deal with many economic values that are generated and exchanged outside of quantifiable GDP. One prominent example is the distinction between environmental "services" that are positive and those that are negative (Dasgupta, 2021).

(f) Tacitly, the orthodox approach to **public economics assigns the responsibility for determining the policies and laws that facilitate exchanges to the State only**. This constrains the space for studying the agents of power, such as autocrats, cronies, or corporations large enough to impose their vested interests on resource allocation. Monopolies and oligopolies, for instance, can shape informal policies through sheer economic power or factors such as 'superior IT smartness'. In this way, they influence the behaviour of the captured part of the public economy.

(g) **Topics close to political judgements,** such as inequality, unemployment, discrimination in wages or trade, wealth redistribution, marketing price distortion, decisions by voting, political market failures, or policies that serve private interests, have been in the mainstream textbooks

[3] Think of the prices of such basic products of wellbeing as love, trust, honesty, humour, efficient markets, enlightened rulers, or impartial courts. Similarly, on the negative side, there are 'liability products' such as hatred, cheating, anger, pollution, failing markets, debts, bureaucrats, wars, despots, or mobocracy. Positive or negative, all these artefacts with economic value are exchanged or shared, and all are subject to social negotiations and opportunity costs in the quest, e.g. for a wealthier or a more egalitarian society.

either ignored or brought in as immaterial deviations from the axiomatically standardized benchmarks, instead raising empirically much more characteristic opposite for the benchmark. See Bowles and Carlin, 2020a, pp. 196-197, for a list of examples. Political topics have migrated to the revived field of political economy and public choice theory, which we do not consider mainstream.[4] Similarly, by analysing the frequency of keywords in economic literature, Fix (2021) found that it systematically avoids words related to power, politics, bureaucracy, authority, or religion. Political and moral considerations nevertheless need to be given their due in the teaching of decision-making in economics.

(h) Descriptive economics even demands that its methodology be strictly **free of value judgements**. It deals with "what is" and what is testable and verifiable. However, economics does not study natural processes as physics does. However, economics is not only about transforming nature (e.g. material inputs) into products, but also inventing new products, techniques which "are not but ought to be". Thus, **morals, politics, and autocracy versus democracy** are left outside the purview of the orthodox mainstream, thereby strengthening the axiomatic methodology but narrowing its explanatory scope.

(i) The narrow focus on exchange transactions involving private agents favours a type of decision-making that prioritises **private costs and private benefits** at the expense of **externalities and social costs or benefits**. The latter should not be made irrelevant just because their natural claimants do not exist or can be easily excluded from private contracts.

(j) Orthodox theory's undervaluation of **nature´s goods and services** is considered by many as perhaps the single most significant weakness of the economic discipline. Dasgupta (2021, p. 23), for instance, argues that this neglected part of the world economy could have a greater accounting value than all the world's GDP. Of course, accounting values are mere intellectual proxies "guestimating" the value of externalities, the cause of which many cannot be involved in human action (e.g. in opportunity costs), and thus could not become a part of economics.

(k) The axiomatic methodology of economic research leads to it being viewed as '**descriptive'**, i.e. to discover primarily how the exogenous natural world "is functioning" in reality, which can be tested and verified empirically. Deductive reasoning in economics can have practical meaning only if all its theoretical premises and modelled causal links lead to conclusions that are not refuted not only by logic but also by empirical tests of observed reality, thereby enabling

[4] Separating public choice theory from the mainstream may sound incorrect since the methodology of utility maximisation by the egoistic rational individuals that public choice frequently employs makes it appear neoclassical. However, its non-market decision-making, dependence on institutions, excursions into normativity, and the subject matter of political science – these all speak in favour of filing the public choice into a heterodox pluralist kind of economics. Tresch (2022), an authority on public economics and finance, affirms: 'The theory of public choice developed by James Buchanan and his followers challenges virtually every tenet of the mainstream public sector theory' (p. 17).

prediction. Nevertheless, axiomatic and econometric economics all too often present the conclusions they derive from their model as universally applicable patterns of real behaviour. By observing regularities in the past, they make a short-cut implication by assuming that therefore the same behaviour ought to continue also in the future.[5] This is the case even though no predictions from econometric models can be perfectly deterministic (i.e., tautologically complete), since their stochastic nature and incomplete specifications are always subject to some degree of empirical falsification. This is not to argue that economic modelling is unfit for studying socio-economic reality or making predictions.[6] The point, instead, is to highlight the risk of such **reductionist economics becoming a normativity in disguise** or even a sheer ideology. That is not a real science! For example, the statement 'agents maximise their utility in a Pareto optimal way' can be descriptive or normative depending on the circumstances. The crucial statement of microeconomic orthodoxy, "wage equals marginal product of labour x price," is more akin to metaphysical rhetoric than to a testable descriptive hypothesis. Such allegedly descriptive statements can serve the politics of vested interests and become normative, even ideological. Axiomatic reductionism often bars the understanding of the real world by alternative methods.

(k) Alternative methods in economics are related largely to normativism. We position the ultimate aim of economics into Hayek´s (1973) distinction between cosmos (spontaneous orders and actions) and "taxis" (consciously planned orders). Economics aims to explain and design social mechanisms to improve the quality of life for all individuals. This proceeds in a situation of varying degrees of information uncertainty, where public preferences are revealed through collective confrontations among concerned economic agents in processes of asking and bidding by various means: by markets and auctions, by democracy and voting, or by dictates and revolts. In the centre, there is the contest of producing, distributing, and consuming an artefact with economic value. The value of such artefacts is created by a process: by the removal of certain dissatisfaction, something missing that strains for a better life. It is something "what is not" and what "ought to be". This is the origin of normativity in economics. The entrepreneur is still the pivotal agent of the economics and the economy because he/she drives value creation forward by bearing the risks of innovation, financing, production, and sales. Economics is thus about the dynamics of new moves of free agents who design, invest, borrow, hazard, form coalitions, build institutions, and "vote" with money, ballots, feet, fists, information and disinformation. **Normativity associated with "taxis", i.e. policies, politics and morals, should be as regular a part of economics as is the**

[5] Many meta-analyses of different economic studies of a shared research question, after testing the studies for congruity, have yielded an incoherent spectrum of ambiguous results. If the findings cannot be replicated, the validity of the underlying theory must be in doubt. A related problem is the enticement to get published by yielding to intentional publication bias.

[6] Friedman´s (1953) essays, as a manifesto in positive economics, remain the frontrunner among pragmatic interpretations of economics as an intuitive vehicle for the real behaviour of economic agents and for predictions.

descriptivity associated with "cosmos". Disenfranchising normativity, set into a role of an exogenous political or moral input to mainstream models, is a form of reductionism that shies away from the more essential, but methodologically more complicated, fundamental social challenges.

(l) Heckscher-Ohlin theory of factor proportions in comparative advantages, absolutely crucial for explaining the economic development of countries, enterprises or even individuals, is modelled on merely two factors: capital and labour. It is somehow skipped that there are also other crucial forms of capital, such as monetary, human, trust, solidarity, political, cultural, democratic, constitutional, legal, institutional, entrepreneurial, moral, religious, natural, biological, ecological, organisational, informational, digital, AI, effective markets, infrastructural, signal and symbolic, geographic, linguistic and historic. All of these can be used to create new spinoffs of the endogenous theories of development and growth. However, how do we explain their co-acting simultaneously? Will econometrics offer some clues?

(k) Last but not least, the methodological contraction that gives prominence to **private exchange transactions and individualism** discriminates against collective exchange transactions. It is an approach that reduces the scope of economics by omitting the power of social capital networks, communitarian choices, collective action, the corporatist structure of businesses, intra-enterprise trading, and the dominance of global value chains in exchange transactions. The list of what is omitted or under-represented in orthodox economics goes even further and includes collective goods,[7] which to varying degrees encompasses **public goods, the commons, and club goods, as well as diverse phenomena such as natural monopolies, externalities, social costs and revenues, and merit and demerit goods**, where markets stumble in doing their job. We can conclude that the teaching of economics should revert to the strategy and assign the topics mentioned above the status of the norm rather than an exception.

Let us admit that social studies cannot emulate physics in the rigour of their premises. Social systems are too complex and subject to evolution. Of course, there are agents, like entrepreneurs or consumers, who feel free to choose among alternatives. However, was their decision in line with the optimal theoretical suggestions, which are normative? Their behaviour is prone to subjective endogeneity, trial-and-error, and disequilibria. Social systems are more akin to a stochastic black box than to a deterministic clockwork. Massive reductionism and reliance on

[7] The term 'collective consumption goods' was coined by Samuelson (1954) as a term for his new welfare economics, a field he declared largely incompatible with the "… ´simple´ properties of traditional economics" (p. 389). We can add another feature of 'collective goods' by considering their collective procurement, i.e. the provision of public services by the government and its public agents. For simplicity, we can assume that all products and economic values provided through government funds or organised by the public administration are collective goods.

comparative statics remain inescapable features of the discipline. Turning economics into a holistic science is either a theoretical impossibility or not science at all. Storm (2021) has illustrated this in the case of macroeconomic dynamics. Current quantitative economics is much better at explaining the past than at predicting the future.

How best to overcome the existing weaknesses in the mainstream textbooks of microeconomics? Bowles and Carlin (2020a, 2020b and 2021) have pointed to the leeway. Our approach, derived from points (a)-(k) above, calls for greater weight to be given to the study of market and government interactions akin to systemic inconsistencies. Alternatively, more concretely, by focusing on such benchmarks as **externalities, collective goods, information asymmetries, price discrimination in products and wages, imperfect contracts, transaction costs, missing markets, the powers of dictators, politics and morals, and the dominance of agents endowed with the powers of authority over thousands of uncoordinated principals locked in multiple principal problems**. There needs to be a shift in how we look at the allocative mechanisms in economics. The traditional focus on allocative instruments of markets guiding the distribution of private goods, labour, and capital, should be expanded to encompass the coexistence of private markets alongside markets in collective goods, including political markets, and to take into account the role of institutions and policies, as well as the functioning of democracy, politics, authorities, power, and moral values. Our contribution targets the political economy of democracy, which was not explicitly covered by Bowles and Carlin (2020a), and we cannot find a trace of it in such a progressive textbook as Varian (2019). Methodologically, mainstream economics should integrate more aspects of public choice into its teaching, as public choice theory is now shaping the research frontier. Textbooks cannot cover everything, but explaining "what is" functioning in an abstract model and pretending that it also functions in reality is an infringement on science. It is hiding the confusion between "what is" and the wishful "what ought to be (arranged in reality)". Similarly, hiding that modelled propositions are not testable and thus falsifiable by empirics – such a practice is akin to an ideology of religious scholastics. University economic education should concern not only what functions well, but also what in society does not function well. This is economics: the science of the choices and preferences about artefacts that ought to be delivered or rationally dismissed. Economics should make people aware that its fields are still with niches concerning the central questions of human well-being and individual development.

3. Methodological Adjustments to Generate New Insights

There are two legitimate objections to points (a)-(k) outlined in the section above:
(i) Each of the simplifications characteristic of the teaching of orthodox economics can be useful for explaining some particular problem;
(ii) Economic theory has been already on the path to freeing itself from the most extreme simplifications.

As Bowles and Carlin (2020a) note, many economics textbooks and teaching still uncritically follow the restrictive assumptions mentioned above. But a lot has been done to move things in a less reductionist direction. Stiglitz (2017) illustrates the progress that has been made in point (ii) above. The bottle is now half full, and economics does not need a shattering methodological shift. It needs to take further steps to align its assumptions with changing reality. To build on Kuhn (1962), proponents of mainstream axiomatic constructs should admit their provisionality and accept that many of their theories do not satisfy the Popperian falsification test. Also, too many aspects of economic reality remain unexplained. The economics of AI, with its myriad of externalities, is a good example.

Let us briefly return to the question of how the real world functions and how its socio-economic governance is and could be managed. Here, we can retain the traditional objective function of economics, focusing on optimisation and efficiency, and assign it to different economic agents: individuals or collective agents such as firms, NGOs, political parties, or governments. They maximise the most diverse benefits – utility, profit, rent, stock value, market share, macroeconomic stability, political power, or even a sense of happiness and responsibility. The central decision-making problem of each polity must then be to coordinate the myriad of heterogeneous individual and communitarian objectives to achieve a socially acceptable allocation of limited disposable resources. Such coordination also depends on the institutionalised mechanisms of constraints and incentives that guide the organisation and operational power of the economic agents striving to make the most of the existential economic desideratum: 'needs – production – distribution – consumption'. The standard answer of a neoclassical economist to this existential problem tends to be: this all can be done best by well-functioning markets. But this cherry-picking solution is not scientifically honest. The problem is that people live in societies where billions of interactions must converge to harmony. This needs coordination, meanwhile markets are not the only coordinating mechanism. We cannot pretend we do not see these other mechanisms.

The question of how to solve the latent discord in satisfying human needs at the level of polity as a whole has occupied humankind since at least the time of Aristotle. Thomas Hobbes proposed its modern secular solution in 1651. To avoid the evil and discord in societies ruled by the arrogance of power ('Leviathan'), he proposed establishing a contract between the civil society and the absolute sovereign. Thus, the primary instrument of coordinating human choices was the power embedded in social negotiation and confirmed by a contract of authority that is *a priori* valid for an indefinite period. The trick is how to make such a contract enforceable.

Let us first consider coordination through the power of constitutional autocracy, where the law is **part of the authorities.** It is hierarchical by definition, and its weakness lies in the polity's feedback control over the contract. Such contracts are dominated by the top echelons of the hierarchy, where Leviathan is always at the door. Coordination by autocratic authorities can easily turn into dictatorships, where the incentive to take is stronger than the impetus to make. For an authority to make real decisions to serve social needs, it requires a great deal of bureaucratic and institutional checks and balances, which can be costly and uncertain.

In 1776, Adam Smith proposed a second coordinating mechanism, suggesting that contract negotiations be settled directly between the parties. This is done by having stakeholders in the exchange of artefacts of economic value negotiate every transaction themselves, assuming that price-based negotiation is terminal and that transaction costs are nearly zero. Typically, it is the bargaining at the level of supply and demand where price, quantity, quality and contract conditions are agreed upon individually, turning the initial motives of selfish greed into cooperation and enrichment in a Parto improvement.

Now, let us assume that the Hobbesian *a priori* social contract with the authorities, covering relations between citizens and the State, could also be split into decentralised individual contracts negotiated by two equal parties on the demand and supply sides, without forming any hierarchies. In this case, **the markets would take over a substantial part of the social coordination** and give birth to economic capitalism within political and civic libertarianism. Such perfect markets need just a few institutions: the enforcement of private property rights and freedom of information and contracts underpinned by no transaction costs. Indeed, markets brought a revolution in economic exchanges of private goods by slashing transaction costs and increasing the rationality of transactions. The weakness of markets is that they are not always sufficiently free and remain open to numerous flaws, as Stiglitz (2017) has shown. As we will see later, some markets are heavily distorted by political power and information debasement.

We see that the economic decisions made under a system of autocracy (coercive authority; compulsory compliance by force; planning commands) and by markets (negotiation; consensus; auctioning) also have their limits and even flaws. However, how can we judge them? We cannot do it without making value judgments that are grounded **in morals, including ethics, religion, and cultural traditions**. Morals are shortcuts and anchors in an overly complicated decision-making process, to be applied even at the expense of rationality (Kahneman, 2011). They epitomise a unique human upgrade of animal instincts, determine what is good and evil and what is a priority, and establish the value of such notions as fairness, equality, unselfishness, truth, empathy, solidarity, altruism, and virtue. Morals are an indispensable aspect of human coexistence and survival, as well as an instrument for analysing real decision-making.

We conclude that there are three instruments for coordinating the exchanges of artefacts with economic value in society, including the management of the economy: markets, authorities, and morals. Our first deliberation about them is whether they could be mutually exclusive.

Markets without authorities and morals are not viable because they depend on the powers that enforce contracts, impose punitive actions for default, build trust, and safeguard the contestability of markets and the freedom of entrepreneurship. Autocracy without markets and morals descends quickly into a police state, violence, and vassalage. This is what we had in ancient times, e.g., from Gilgamesh to the North Korean Kims. Ordinary people are required to conform to programmable collectivism, i.e., an egalitarianism of interchangeable workers akin to robots stripped of individual and economic power. That is contrary to their biological nature and psychology, which are what make people unique individuals. Their creative ability to exercise free individual decision-making, provided by economic, political, and civil freedoms, defines them as humans. In the long run, hard-core dictatorship becomes an unattractive, bureaucratised option for all, including the top autocrats. Bureaucracies cannot foster creative entrepreneurship but tend to free-ride and redistribute wealth, failing to make people authentic masters of their lives. Why would communist totalitarianism have otherwise been so spontaneously abandoned in 33 countries of the world? The question is: did the people in all these countries understand how to build a democratic alternative?

The existence of morality without markets and authorities can be modelled on altruistic societies that maximise empathy in belonging to a community, such as a monastery or a kibbutz. Their principal drawback is that they are open to a similar instability to that of pure authority-driven societies. The soft power of exogenous morals can easily be turned into the hard power of dictatorships. The bigger the community, the faster its demoralisation. Sooner or later, the eternal personal sacrifice one makes for an anonymous ‘humanity’ is crowded out by one’s selfish concern for one's own well-being and, perhaps, that of one’s friends and family. Everyone then becomes suspected of opportunism, selfishness, and free riding.

Many volumes of literature deal with the stylised properties of markets, autocracy, or morals, each in isolation. There are close proxies that offer good insight, even though their assumptions may still tacitly rely on the remaining two. As far as markets in their pure form are concerned, the Arrow-Debreu model of general equilibrium and Kornai’s critique make a good contrasting pair (Kornai, 1971; Móczár, 2020).

In reference to the management by authorities (central planning) practised in command economies, there is the seminal microeconomic model by Hlaváček and Hlaváček (2013, pp. 87-97), which describes the behaviour of a producer under central planning. The agent in this system, branded as ‘*homo se assecurans*’, i.e. the man securing his own survival, offers a contrast to ‘*homo oeconomicus*’ in that he/she replaces personal risk-taking with bureaucratic risk-aversion. Unlike pro-active capitalist entrepreneurs, the captains of socialist corporations exercise their ‘entrepreneurship’ by hiding their potential for innovative growth. Their main objective is to outwit the planning principals by minimising their exposure to the risks of a revealed capacity for higher production (or lower costs), thereby maximising their personal survival. Such economies are not competitive internationally, and unsatisfied domestic demand becomes their principal aim and weakness (Kornai, 1980).

Parallel to that, Hlaváček and Hlaváček (2013, pp. 147-192) constructed several models of altruistic allocations that replace self-interest-based models, namely those of pure markets and pure autocratic commands. Altruism builds on collective empathy and elevates the importance of moral mechanisms and the psychology of thinking (Kahneman, 2011). Morals are fundamental to collective decision-making because they prioritise four objectives: equality, justice, responsibility, and trust (Sen, 1987; Acs, 2015). These challenge the criterion of profit maximisation and the selection of the efficient that characterise economies controlled by effective markets. Markets and capitalism can thus be judged by some as tainted by individualism, elitism, possessiveness, and greed, which are moral, not economic, arguments.

To conclude, the weakness of allocations based on morals is that they undermine the principles of equivalence in exchanges, merit, and leadership, which can easily be subverted by autocratic power. Moral sentiments alone can deliver the cornucopia and harmony only if humans are egalitarian angels who are free of evil, opportunistic redistributions, theft, free-riding or moral hazard. Adam Smith concludes The Theory of Moral Sentiments by defining the character of an authentic virtuous person who should embody the qualities of freedom, prudence, justice, beneficence, and self-command. But why has the real world not been guided exclusively by them?

4. Tackling the Exchange Dilemma by Pluralist Allocative Approach

Table 1 presents the properties of three theoretical models of allocative decision-making, each of which could stand logically on its own, given the implicit assumptions that remove their theoretical functioning from real economies. Each model has its own unique characteristics. One has to agree with Samuelson that capitalist economies must be mixed because markets best settle private transactions for products, labour, or money, and public transactions involving collective goods are handled by authorities that also make use of the less well-performing political markets. Both types of transactions must have moral underpinnings. In their turn, unilateral models of allocative decisions all too easily violate the optimality conditions of second-best theory and sink into a suboptimal path. **Considering these drawbacks, there is no alternative but to attempt to explain reality by involving all three allocative instruments in parallel.** For example, the management of a private firm may be subject to the principal´s authority (Coase, 1937), the firm's selling price is determined by market bidding, and contract details may be left to the morals of trust. **The shift to methodological pluralism is about understanding how the roles ascribed to these three instruments are related. A special case occurs once the focus shifts to collective decision-making.**

Table 1: The functional characteristics of the three pure-form instruments of allocative decision-making

Instrument	Bargaining consensus	Demo-cracy	Transac-tion costs	Objectives	Aiming equality	Active agent	Thinking fast vs slow	Empa-thy *
Markets	High	YES	Often high	Profit maxi-misation	Marginal	Entre-preneur	Slow	Low
Authorities (autocracy)	None	NO	Low	Risk minimi-sation; maxi-mal power	Primary	Dictator	Fast	Some
Morals	Some	YES	Low	Social survival maximisation	Conside-rable	Altruist	Mixed	High

* Empathy can be considered the opposite of selfishness.

It would be naïve to expect all three instruments to carry the same weight. The specific nature of exchanged artefacts with economic value will largely determine which mechanism will dominate the exchange transaction. We will examine three instruments (markets, authorities, and morals) in relation to the different objectives of their agents. For example, markets generate the objective of maximal profit or market share. Hierarchies generate the objective of maximal risk aversion at the lower tiers of hierarchies and maximal dominance at the upper tiers. Morals generate maximal self-sacrifice in all actors, except for free riding in those who are not morally firm. This can give rise to clashes between agents and cause a switch from the moral to the autocratic mode of social organisation. At the same time, each instrument has a different marginal efficiency in achieving different objectives.

How to manage different objectives followed by societies simultaneously? This is made possible by what Mundell (1993) calls the principle of effective market classification, which holds that there should be as many instruments as there are goals. Each instrument should be used according to the objective upon which it has relatively more influence. In the majority of cases, all three of our allocative instruments must be applied simultaneously. Naturally, once these instruments are used by different agents representing different beneficiaries and payers, a conflict must arise between the classes, pressure groups, and individuals involved. It is democracy that reveals differences in aims, not dictatorship.

The first way out of these conflicts in the case of collective goods is to deploy collective action (Olson, 1965) and assign morals an important role. Collective action is most likely to succeed in exchange transactions when it involves only a small number of bargaining stakeholders (Ostrom, 1990). If the collective action fails because negotiations collapse under prohibitive transaction costs, e.g., caused by bureaucracy, or because interested agents cannot reach an agreement, the only solution is for a decision to be made by an authority with power, such as a court of justice or a dictator.

Social power is the capacity of an agent to influence the actions or behaviour of others. Regarding our three instruments, we can distinguish three types of power: economic (money, wealth, markets), political (coercive, hierarchical, governmental), and moral (cultural, soft, ethical). Arrow's impossibility theorem (Arrow, 1950) reveals the limits of satisfying social preferences through voting. The power of authorities is often the ultimate mechanism for settling conflicts in politically complex exchange transactions typical of collective goods. Hobbes' dilemma looms again over how to tame autocratic power and make it a servant of the people who prefer accords to commands.

The exchange stage is the perilous part of socio-economic management because it is highly open to incomplete information and thus to incomplete contracts. The transfer of ownership of artefacts is a process particularly prone to discrimination, predation, corruption, and the pursuit of political interests.[8] It matters little if the exchanges concern traditional products, mental activities, or production factors such as land, labour, or capital of any sort.[9] The quintessence of voluntary exchange is the expected Pareto improvement in utility that the transaction is supposed to bring to both parties. This requires acquiring as much information as possible about alternative allocations, plus much negotiation and Kahneman's rational 'thinking slow'. The decision to engage or not in an exchange transaction when the information is imperfect can be called 'an exchange dilemma'.

The market is defined here as a social mechanism based on free price bargaining, often constricted to "take it or leave it". It is a sort of Walrasian auctioning. This allows buyers and sellers to voluntarily exchange any tradable products and obtain information about the opportunity costs of their transactions. There is a behavioural difference between markets and authorities: markets require individual participation in negotiations over buying and selling at varied prices and individual responsibility for decisions at the grassroots level, while authorities rely on hierarchical command. In the latter case, agents at the grassroots level bear no

[8] Sowell (2005) escalated the conflict in exchanges by outsourcing exchange operations to specialised middlemen. A successful middleman must master an empathetic psychology, a way of thinking, and a culture, making him/her dominant over the other party. This denies the meme "the customer is our master". According to Sowell, history suggests that middlemen class was often subjected to severe dislike by the population.

[9] Since generic 'capital goods' have become a part of the confusing wider lexicon, let us mention again the principal ones: physical, monetary, human, trust, solidarity, political, cultural, democratic, constitutional, legal, institutional, entrepreneurial, moral, religious, natural, biological, ecological, organisational, informational, digital, AI, effective markets, infrastructural, signal and symbolic, geographic, linguistic and historic capitals. All of them take the form of durable assets accumulated in the past through investment. The value of the given ´capital´ endowment is derived from future expected yields generated from its contribution to the higher value of supported exchange transactions. For example, democratic capital allows society to achieve higher social well-being, and information capital allows the enterprise to achieve higher sales. The economic impacts of a given capital endowment on the economy are theoretically explained by the Heckscher-Ohlin-Samuelson theorems and, to some extent, are the domain of institutional economics (Acemoglu and Robinson, 2008).

responsibility, while middle-level hierarchies tend to hide behind superordinate power. The humour of the Dilbert comic cartoons draws heavily on such situations. The system then becomes paralysed by widespread responsibility shifting, bureaucracy, enforcement, and information asymmetry, as Hlaváček and Hlaváček (2013) have shown in their models.

It is easy to see that perfect markets offer a simple optimal solution to the exchange dilemma because of their fundamental property: a free, participatory auction mechanism that coordinates the behaviour of an unlimited number of agents. Its single equilibrium price selects the first-best in a Pareto sense. Here, the market price alone leads to the selection of the lowest unit-cost producers, the lowest price, quality safeguarded by competition, consumers who can bid (and pay) for the highest consumer surplus, and the highest profit accruing to the most efficient producer.

The problem is that real markets are seldom perfect. Each exchange transaction carries some risk, and its agents must incur additional costs to offset the uncertainty. Parallel hedging by a costly insurance contract is often required. The extent of market transaction inefficiency can thus be measured by the length and the cost of a complete contract. Many markets still perform close to perfection, but some are so complex that their transactions must rely on incomplete contracts, incomplete markets, inefficiencies, and high-risk margins. Thus, the second-best disruption arises, leading to the entry of authority (commands) or morals (trust to mutual responsibility) into such exchange transactions. Our crucial conclusion is that whatever allocative instrument is used to conclude an exchange transaction, its proper functioning must always supersede the role that market coordination failed to arrange. Thus, markets, though highly ineffective, remain pivotal benchmark instruments in all transactions. Economics teaching should shift its focus to how the specifics of exchange transactions relate to the three alternative instruments for their completion.

Let us now once more return to section two and its list of abstractions (a) through (k) that dominate mainstream economic models, and let us attempt to identify those abstractions whose modification or disappearance would most contribute to a better academic understanding of human wellbeing. **This study suggests that the answer rests in topics in (b), (k) and (i) dealing with authorities and morals complementing markets; collective goods and choices related to public goods, commons, institutions and governments; externalities, and social costs and benefits**. Summing up, there is a consensus among economists that markets alone cannot secure an optimal social solution to exchange transactions in these specific cases, and a mix of markets, administrative powers and morals must be summoned for help. But what kind of superordinate economic mechanism needs to be at work to harmonise the action of the three diverse factors? We reached a point where we will have to go beyond the new shape of economic teaching proposed by Bowles and Carlin (2020a, 2020b, 2021) and focus on the coordination of social choices through democracy. We consider democracy a crucial economic mechanism, even though it is not mentioned in the majority of orthodox economics textbooks, meanwhile in political science, it is a paramount topic but stripped of economic fundamentals. Next, we must provide sufficient arguments to explain why the most important turn in teaching economics concerns democracy as an instrument for allocating collective goods.

5. Democracy as an Economic Mechanism Based on Participatory Auctioning

The above analysis offers an opportunity to place liberal democracy at the centre of economic exchanges because democracy is an institution of socio-economic coordination that uniquely combines the allocative instruments of markets, authorities, and morals, typically balancing their strengths and weaknesses. The function of democracy in our economic model is four-pronged:

I. to pass on the information about the potential public choices between citizens, politicians and administrators;
II. to select the political representatives by electoral auctioning, establishing thus public authority, which promises to generate the best administrators of public services;
III. to maximise the social welfare from a given state budget;
IV. to keep the citizens in control of the provision of collective goods.

Below, we shall see that democracy can be challenged by systemic suboptimality in its performance of these four essential functions.

A brief detour to Schumpeter´s definition of democracy may be helpful at this point: "The democratic method is that institutional arrangement for arriving at political decisions which realized the common good by making the people itself decide issues through the election of individuals who are to assemble to carry out its (i.e. people´s) will" (Schumpeter, 1942, p. 250). In other words, through elections, democracy selects, via a political market auction, the following authorities: parliamentary parties, political representatives, their proposed policies, and governmental responsibilities. We stress that this allocative process is done by the 'markets for political goods' or, in short, political markets. The unique property of these markets is that they give parties and their agents access to economic and political power. The elected authorities are tasked with resolving issues related to exchange transactions for the provision of collective goods. This is achieved by exercising their powers as agents for procurements in markets for collective goods.

Several things need further clarification: the markets for political goods and for collective goods are separate, though they are, or should be, functionally interrelated. The specific concept of a political market was introduced by Downs (1957). The microeconomic background of a political market, conceived as an institution of democracy and government performance, was further developed by Khemani (2017), among others. Let us quote her message: 'While we may have made serious advances in understanding how to get market institutions right to promote trade and exchange in private markets, we have not made advances in understanding how to get market institutions needed for public goods, addressing externalities and accomplishing redistribution goals. This is the frontier area of our times' (Khemani, 2017, p. 46). The academic task is to transition from the well-understood and functioning economics of private goods to explaining how collective goods are provided and how, in contrast to their present underperformance, they should optimally function. That is the area where economics must focus its quest for new knowledge. There have been many articles published on this issue, concentrated mainly on the technical voting and aggregation problems, which do not have straightforward solutions. We must thus be satisfied with second-best, suboptimal solutions that converge to a socially satisficing state of stability.

All collective goods provided by government services are related to externalities. We can make a rough estimate of the share of non-private goods in GDP by considering that government spending as a percentage of GDP in the EU averaged 48.4 per cent between 1995 and 2020. In addition, many collective goods are not included in GDP. However, they are part of wellbeing, such as the net social costs and benefits of environmental services, healthcare, education, security, and infrastructure... Indeed, the majority of their economic value lies in the category of collective goods. It is then disquieting to observe how microeconomics textbooks continue to poorly explain this omission by introducing a chapter on public goods but omitting the links to arrangements for their market; a failure. For example, it is perplexing to see how the real provision of collective goods differs in (in)efficiency by countries (World Bank, 2022). We doubt that such failures are natural phenomena and beyond the reach of correct policy.

The mechanism of democracy is a market-like way of allocating authority to state administration. It requires selecting agents who will represent citizens as principals. Elections are an institutionalised form of collective action in which decisions are taken by the combined powers of markets, authorities, citizens and morals. Coase (1960), Olson (1965), and Ostrom (1990) explain how collective action in small communities could lead to the mutually agreed and socially efficient allocation of collective goods. If the scope of a community widens (e.g., by becoming a nation) and transaction costs increase exponentially, the effects of collective action sharply decline, and the democratic order degrades into anarchy or autocracy. Olson (2000) even argued that there is a built-in tendency in dictatorships (akin to rational 'stationary bandits') to morph into pro-participatory, "friendly" rule. That is the situation of democracy *à la* Orbán or Xi.

Liberal democracy operates in two stages: the electoral and the executive. In the short electoral stage, political representatives are elected. This is done through a competitive auction of packages of political goods that parties (acting as political firms) intend (or pretend) to supply, where voters on the demand side bid for their preferred packages by casting votes. In contrast to private markets, individual preferences converge into collective choices. The party or a coalition with the most votes wins the right to form the government and manage the public administration and treasury. The actual provision of the demanded collective goods proceeds during the long executive stage. In this stage, the authority that the political powers have acquired becomes the dominant instrument of governance, characterised by granting the winning party a dominant position in the mostly imperfect markets for collective goods. Unfortunately, the provision of collective goods is thus open to the well-known duality of market and government failures.

There are situations where the incumbent party´s power can reverse the positions of agents and principals. Voters lose their political power as principals once the elections are over and the political representatives are empowered to rule. Voters lose the power to act as principals until the next elections. Their political plenipotentiaries can now discard the role of agents and adopt the role of principals. This will allow them to decide unilaterally who will be the beneficiaries of their policies and ignore the voters' choices. In the aftermath of this, liberal democracy can slide back toward 'illiberal democracy', which is a form of autocracy.

We will argue that the design of democracies is too fragile and prone to systemic failures. The term 'incomplete democracy' describes a system of public choice in which some of the necessary conditions for democratic performance are present, but not all. Democracies function formally, but they do not maximise a collective good. The flaws can be related to various operational failures: market capture, flawed information transfer, adverse selection of representatives, vested interests of governors, weak checks and balances, corruption, etc. **The common denominator for them is that citizens lack a strong instrument of their own for disciplining political parties over time.**

Next, we must explain why democratic governance, which accounts for approximately half of GDP, is intrinsically an economic agenda, and why its failure is related to failures in the associated markets, authorities, and morals. Economics textbooks should accord democracy the appropriate economic importance and turn Cinderella into a princess.

6. Limits of Democracy in Action

Let us concentrate on the problems of incomplete democracies observed mainly, but not exclusively, in the post-communist countries, as outlined by Benáček and Frič (2023). Here, we will stay close to the Schumpeterian interpretation of democracy, which views it as an economic-political-moral institution whose objective is to satisfy public preferences and provide collective goods. Democracy is primarily a product of economic freedom. It involves the free participation of citizens in political markets, where negotiations are over political goods. Political goods include all items of human demand whose bid for provision must be negotiated through the participation of citizens (as political principals) in bargaining with political parties acting as citizens' political agents. In this bargaining, the inarticulate, incompatible public choices demanded by citizens must interact with parties' supply of political promises. Achieving their common objectives requires the citizenry's engagement in collective action, mediated primarily through elections. It is the elections which bear the dominant weight of political markets. At the same time, political markets are notoriously failing: they do not meet the conditions levied on perfect markets for homogeneous, reproducible, and privately consumable products.

We raise the following hypothesis: In the mechanism of political markets, the institution of parliamentary elections could restrict citizens' role (as sovereign principals) to their disadvantage, thereby stripping political markets of their social power. Let us make a list of the main weaknesses of political markets and elections that will support the validity of that hypothesis:

(a) The **duration of the electoral campaign** limits the performance of political markets to a very short period. The future provision of concrete collective goods, the elections' main purpose, then takes place outside the control of the citizens.

(b) The focus of elections is to grant the electorate's full powers to their political agents until the next elections. The **parliamentary opposition has limited powers** to enforce the implicit contracts agreed in elections. Here, the elections rely primarily on the morals of the winners.

(c) The social contracts on policies that the citizens agreed with the winning party are opaque commitments that are not legally enforceable. They are typical **incomplete contracts**, with future commitments that are deficient or outright absent.

(d) The supply-side of political products in elections includes mostly **hazy outlines of the party programme crowded** out by other political goods: the retouched portraits of the proposed political leaders. Elections are thus more about the choices of representatives than about the choices of collective goods. Most **citizens receive collective goods they did not vote for, and their consumer losses are** ignored.

(e) The supply of political goods (i.e. collective goods, public policies, and political candidates) is always offered as a basket of **heterogeneous composite products** where each political party is offering its own basket. Competing baskets are then auctioned *en bloc* in elections, even though their concrete contents are uncertain. The ensuing evaluation of alternative baskets in the 'political market competition' must proceed without knowing the quantifiable prices or their total contribution to social welfare. Therefore, **social opportunity costs cannot be calculated**. The problem of market incompleteness looms again.

(f) Frequently, there is an **information asymmetry** between the supply and the demand sides. The supply side is distorted by the parties' barrage of political marketing. In contrast, citizens on the demand side have no other platform to advance their individual claims on public choices but to cast a vote. The aggregation of individual choices, as proved nearly impossible by Arrow (1950), is bypassed by **delegating the choice of delivered public goods to the winners of elections**. This is the moment when democracy fundamentally differs from market fundamentalism, autocracy, or moral communitarianism (e.g., tribalism, monasticism, Moore´s Utopia, anarchism, communism, etc.).

(g) Grossman and Helpman (2001) explain how the power elite can manipulate public preferences to cater to its vested interests by persuading ordinary citizens that its future policies will be in their interest. On top of this, power on the supply side of the political market is bolstered by its oligopolistic or duopolistic **structure and weak contestability**. Negative marketing campaigns undermine the objectivity of rival competitors' market information to the extent that voters cannot identify the parties' actual positions and programmes. The ambiguity of electoral campaigns, where populism dominates, also allows the winning party to **obscure the links between its electoral promises and the real policies its leaders actually practise** (Wray, 1981). Information asymmetries and manipulations of the election agenda bound voters' rationality (Holler and Skott, 2005), distorting the performance of markets for both political and collective goods.

(h) The pay-offs to parties competing in the political markets are also highly specific. Votes, as 'payment units' delivered to parties, are converted to three gains: seats in parliament, access to the powers of government (that include control of the treasury, policy-making and personnel hierarchies in public administration), and government political funding of parties (as it is now in most countries in Europe). The latter constitutes an institutionalised 'advance payment' for largely unknown future public services, the selection of which is beyond the control of citizens. **The position of voters as principals in control is inactivated** once the elections are over.

To conclude, political markets are highly imperfect because their incompleteness opens them to underperformance. The real provision of collective goods is carried out through government procurement, either via standard markets for products, services, information, and policies, or directly through government commands issued to the public or private sectors. The functioning of virtual political markets, with promises on the one hand and real collective goods markets on the other hand, lacks a coordination mechanism. They are two separate institutions that the public administration tends to divide and dominate. Both markets are prone to socially inefficient exchange transactions, as they are not optimised for the public interest but are captured by vested interests of political insiders (Khemani, 2017). Democracy is a fragile mechanism of governance through consensual participation because it lacks a natural, exogenous stabilising mechanism, as perfect markets have. Democracy is the fusion of three instruments of governance: markets, authorities (including the legal sector) and morals.

7. The Risks of Democracy Defaults

During the short electoral stage, parties get access to political funding for the election term (e.g. 4-5 years) irrespective of their future performance. In the executive stage, the roles of the actors are reversed: the strongest parliamentary party forms the government, and this former agent becomes the principal supported by the parliamentary majority. The incumbent party´s public administrators (i.e., bureaucrats) become powerful agents, and citizens become uncertain petitioners of politicians and bureaucrats. If the backsliding democracy has weak control mechanisms, then the new principals can raise *carte blanche* to manage the public sector like a firm in the Coasean sense.

Thus, democracy can metamorphose into a negation of itself: democratic deconsolidation (Facchini and Melki, 2021) or even a kleptocracy (Åslund, 2019). Freedom House (2021) reports that democracy has been in steady retreat worldwide since 2007. Political parties, initially designed as vehicles of collective action, can turn into political firms, often managed by economic or political oligarchs, whose objective is to maximise private gains from public governance. They aim to manage the State through authority and to dominate markets for collective goods. This leads to the informal privatisation of public administration and to the 'democratic' capture of politics by big businesses. Power exercised by the political command over the public treasury is thus legally secured for economic principals in the government, their incumbent agents-bureaucrats and aligned private firms.

The structure of the central government´s procurement market resembles both a monopsony in purchases and a monopoly in deliveries, offering a distinct market power and soft budget constraints. On the procurement market, citizens have to "buy" – they have no choice, and very few means to register a protest. We consider this the weakest part of the markets for collective goods used for government procurement. The consumer´s sovereignty is not a part of their game. The principle of spending anonymous 'other people's money' for anonymous 'other people's benefit' in public administration is confronted with a well-known administrators' dilemma: 'to embezzle or not to embezzle' the entrusted funds. Public procurement becomes an arena of neglect, rent-seeking and asset stripping. Capturing control over the media, legislation, and the judiciary closes the loop of 'illiberal democracies'. We can conclude that electoral participatory democracy alone is a necessary but insufficient condition for a well-functioning public economy.

Democracy is the socially most complex institution, i.e. a product in the category of collective/public goods. It needs the cooperation of millions of actors. As a social mechanism, it is neither naturally self-sustaining nor resistant to authoritative capture. If citizens do not continually support it in the role of supervising principals, democracy can easily transition from a public servant to a private commander (Mueller, 1998, pp. 310-311; Acemoglou *et al.,* 2021, p. 22). The critical question remains: How can democracy be collectively managed so that citizens can prevent it from backsliding? This question is as up-to-date today as it was when Alexis de Tocqueville raised it in 1840 and investigated the tendency of democracy to degenerate into "soft despotism" (de Tocqueville, 2000).

8. How to Defend the Liberal Democracy?

Once the illiberal power controls the first two instruments of collective action coordination (i.e. markets and state authorities – executive, legislative and judiciary), morals can be mobilised as the third and remaining instrument. This instrument faces a problem in selecting actors: how to choose independent, depoliticised elite bureaucrats as agents subject to a strict ethical code? Moreover, how to impose stringent ethical constraints on the contenders for policy-making powers? This depends on the history of local civic culture. We can see this in examples such as Scandinavia and Japan, where the civic-moral instrument serves as a natural key to social prosperity. On a global scale, however, this is more an exception than the rule.

Therefore, suppose that even morals fail and the adverse selection of public administrators dominates. In that case, the second instrument crawls into action: governance by punitive authorities. This is a must, since corruption and passivity at the lower tiers of the administrative hierarchy weaken yields at the top. Democracy can then backslide into totalitarian rule (e.g. like in Russia). Countries with a democratic legacy will probably rely on Olson´s (2000) strategy of the 'settled bandit', in which the autocrat´s selfishness turns into an encompassing care for the public. So, the bandit pretends to be a saviour of the toiling proles at the bottom and even keeps winning the quasi-democratic elections. That can become the terminal state.

Nevertheless, autocracy can transition back to democracy (Acemoglu and Robinson, 2012, 2021; Ringen, 2013). There can survive civic forces at the grassroots, able to revive the performance of the derelict but key market: the market in political goods.[10] However, it alone cannot secure collective goods that correspond to citizens' public choices if they are left prey to monopolistic practices in markets for collective goods that aim at rent-seeking. There is thus a need for some powerful institutional 'nudging', which involves beefing up the side of participatory control actions on the part of citizens and new governments. Crucial action is needed to align the performance of political markets with the control over markets for collective goods. This is a trinity of amalgamated political, economic and legal transitions (Roland, 2002).

According to Hirschman (1970), the duality of voice (politics) and exit (economics) is an intrinsic mix for the management of social systems. We argue that the weak 'voices' of unorganised citizens in the political market, trying to express their demands for the provision of collective goods, are crowded out by the much louder commanding 'voices' of concentrated political marketing that dominate the political market on the supply side. Let us outline some policies for boosting the voice of citizens and their control over the political markets:

(a) The asymmetry between the powers on the supply and on the demand sides of political markets should be countervailed by placing strict constraints on marketing expenditures and by

[10] Let us mention the unexpected waves of "velvet revolutions" in 1989-91, "colour revolutions" throughout Asia, Africa and Europe since 2003 or Euromaidan in Ukraine 2013-14.

enhancing the electoral discourse, which can be achieved by imposing formal requirements on the political programmes of the parties.

(b) Improving supply-side information: Each proposed policy in an electoral programme should be examined in quantifiable terms to assess how much of a benefit it is to the broader public versus to its liability to private vested interests (Khemani, 2017, pp. 9-10). Ideally, this should take the form of a comparison of social costs and benefits. It would also be possible to estimate the opportunity costs of the proposed policy by measuring foregone private consumption. Unfortunately, these are the most difficult tasks in public decision-making, which underfinanced political parties are unable to perform. Thus, often no more than a cursory 'guesstimate' exists to justify decisions about public projects and policies.

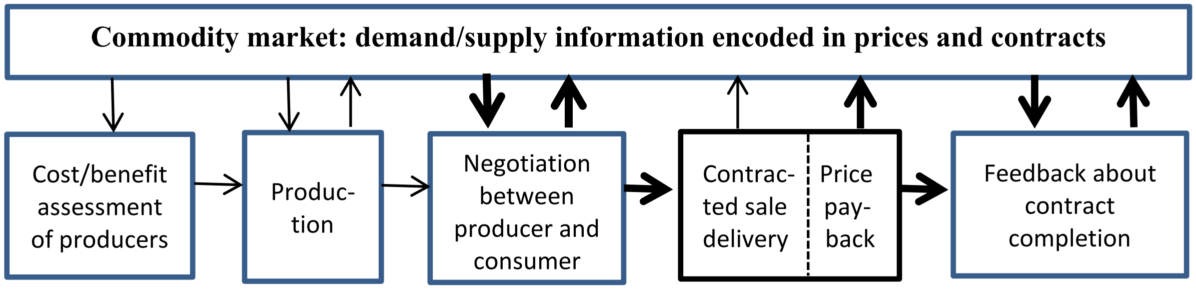
(c) Improving the demand-side information in voting: Instead of people casting one vote, the voting could be extended to multiple choices so that the voter can vote on various main items on the political agenda – for example, using quadratic voting to choose between multiple parties or multiple groups of political goods. The proposal was reviewed in *The Economist* (2021). Nonetheless, we should be aware that no voting system is perfect.

(d) Next, improvements in the government's procurement policies should be open to public scrutiny, whereby the political market becomes linked to the markets in public and collective goods. This implies implementing the principles outlined by Laffont and Tirole (1993) for improving the efficiency of the procurement process.

(e) Last but not least, there is an option that is the option of last resort but also the most powerful one: to **introduce a direct financial link** between the political market, as exercised in elections, and the governmental performance of the winning party in the collective goods market, as it will be explained below. This is the culmination of our discussion on which new topics pluralist teaching should introduce in introductory economics.

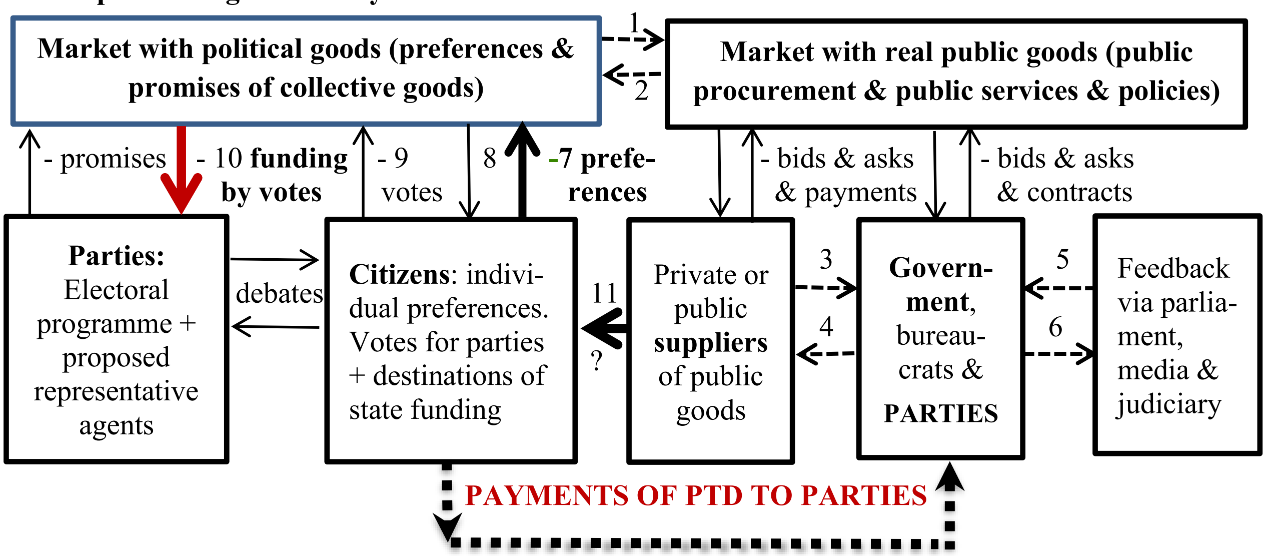
As we argued above, markets for political and collective goods are incomplete by nature and cannot operate in a conventional market way. Conventional markets for manufactured commodities follow a sequence of five steps, as shown in Figure 1: cost/benefit assessment of potential demand and supply – production – negotiation between producers and consumers – sale, delivery, and the contracted price payback – contract completion and feedback.

Fig. 1 Functioning of the perfect markets for private goods in the time sequence



The functioning of the markets in political and collective goods is very different from that of a private commodity market, as is explained in Figure 2. Not all markets are the same once their agents, organisation, and the rules of the game differ. Our two markets used by democracy are bizarre. They share some features of proxy 'markets' built for exchanges between value chains, which are dominated by a master corporation that, to some extent, behaves like an administrative Coaseian firm. They are a crossbreed of markets, combining free negotiation among equal partners with authoritarian power games.

Fig. 2 Functioning of the markets for political and public goods, and the mechanism of an underperforming democracy



PTD = Political Tax Designation

The dashed arrows highlight specific aspects of public goods provision intermediated by democracy and representative political agents. Arrow 1 describes the unpredictable impact of political promises on the real governance of the winning party and the nomination of representatives to parliament and the government. There are no legally enforceable contracts arising from policy accords in political markets that could discipline politicians' actual performance in public procurement. Arrow 2 symbolises the uncertain impact of public administrators' current behaviour on the political market in future elections. Arrows 3 and 4 depict the off-market illicit relationships of corruption and favours. Arrows 5 and 6 illustrate the public discourse on the procurement of public goods, where citizens' voices in feedback may be subordinate.

Compared to the perfect performance of the market mechanism presented in Fig. 1, the fundamental difference in Fig. 2 is that there is a chasm between the political market and the public goods market, where arrows 1 and 2 cannot achieve the mutual adjustments of these two markets, leading to the optimal level of social welfare from the deliveries (11). Each of the two markets is fulfilling a different role, thereby dissecting the democratic process into two disjointed procedures. Democracy concentrates on the moves in the political markets where the voters´ preferences (7) are confronted with parties´ promises and marketing (8), and where votes (9) are converted into parties´ funding (10). The political market is also auctioning public representatives, who become actors on the public goods market. These former agents of the voters become principals, wielding monopsony power in public procurement contracts through bidding and asking. These two markets can become autonomous in their information flows and operative contents, which undermines their social efficiency.

The vertical bold arrow 10 highlights what is crucial to our argument: the official remuneration for parties' political services, which is prepaid for the years of their incumbency and cashed automatically as a windfall rent from the government, with **no relation to the parties' actual performance**. This is a crucial failure of incentives that contradicts the market principle of agreed-upon equivalent exchange and anchors the dominance of politics over economics. As a political firm, the party receives advance funding for its unknown future public services (e.g., for the governance in office or the work in opposition); meanwhile, the citizens must accept the procured deliveries (11) as a command. Deliveries are monopolised by public administrators, who often capitalise on their power to their advantage. That is why so many citizens feel sidelined and antagonistic to politics. The deliveries are usually not following the preferences (7) they expressed in the voting (9). The systemic failure results from the incapacitated horizontal feedbacks 1 and 2 between the political and public goods markets, along with missing information flows between producers and consumers in specific (public) goods markets, which should complement arrow 11. The functions in the last three blocks in Fig. 1 that impose the efficiency in markets with private goods, as represented by their seven bold arrows, are missing in Fig. 2.

Benáček and Frič (2023) propose a radical institutional change in the mechanism of democracy that aims to remedy the flawed financial incentives (10) that create no incentive for efficient performance by parties. Their idea is to connect the two markets by financial links between citizens, as political and consumer principals, and parties, as their political agents and procurement principals. **The proposal seeks to cancel the flimsy method of government funding (i.e. subsidising) of parties and remit the party funding entirely to the citizens through much**

richer political tax designations (PTDs). PTDs thus become an institutional market-like instrument that enhances citizens' participation in democracy by making them the dominant, or even exclusive, funders of political parties. The payment would be in the form of a tax levied on a voter's annual income at a fixed percentage (e.g., 0,10 %), payable as PTD in a year. The payment, once a year (or optionally in instalments), could be assigned to any party the payer prefers at the given time. It could be divided among multiple parties, in which case this 'financial ballot' would retain the properties of the fractional and cardinal voting systems. The payment would thus be directly linked to the quality of the public policies the parties are currently providing.

Thus, PTDs act as complements to elections, extending the political market's leverage continuously over time. PTDs act as permanent leading indicators of current citizens' policy preferences. Their role is to simulate the stock value of individual parties as political firms. The parties then get continuous information about how attractive they are to citizens. **The balance on the party's account acts, therefore, as a sort of instant price of its social valuation. All citizens, not only voters, thus remain in contact with the parties' performance and reward or punish them with PTDs for their conduct continuously over time**. The two formerly autonomous, incomplete markets get vital market feedback, and the scheme in Figure 2 becomes more compatible in its performance with the conventional perfect markets in Figure 1. The power of democracy, as a social mechanism of decision-making in collective goods, can thus be substantially increased. The citizens regain the status of principals, and the increased economic competition of parties contributes to the disciplining role of political markets. PTDs can thus serve as the missing governance mechanism that aligns principals' interests with those of their agents.

8. Conclusion

Our treatise on the methods and topics in the teaching of economics began with studies that highlighted recent factors that have altered the nature of market capitalism. Current mainstream "benchmark" economics textbooks have missed those factors or treated them superficially. They called for a new approach to the teaching of economics, each from its own point of view. Our call for a new approach began by focusing on the crucial problem: how societies organise and coordinate the exchange (distribution) of demanded artefacts with economic value. We also identified the twelve most common methodological abstractions used in mainstream textbooks, some of which do not pass the pragmatic tests.

There is a paradox of choice in teaching economics: on the one hand, there is the momentum to teach topics that are well covered by research. They are repeated in all mainstream textbooks and function relatively well. On the other hand, there is poor coverage of less-known topics, especially those characterised by "failure" or whose functioning is still left to metaphysics.

In this contribution, we posited that the current traditional textbook microeconomics is excessively constrained by its assumptions, which were generated by the need for axiomatic and econometric models. The mainstream pre-selects markets and private individual bargaining as privileged mechanisms for organising and coordinating the exchange of values in a society. We argued that in an analysis of the exchange transactions of collective goods, possibly the constitutional element of modern human well-being, many of the standard assumptions used in economic modelling must be eased. The normative exclusivity of markets should be replaced by the more flexible triad of Markets – Authorities – Morals. The triad will better reflect the real decision-making in social processes. With that, the mechanisms of power and responsibility take on a more prominent role in economics.

The institution of democracy, which is not even mentioned in most microeconomics textbooks, emerges from the mist as an economic instrument of fundamental importance. Persson and Tabellini (2009) assign it the role of democratic capital, which ranks on equal terms with physical capital. Mainstream microeconomics should therefore allow for a fusion with the theories of public choice, law and economics, and constitutional political economy. In a democracy, a key focus is the quality of markets for political goods and collective goods, along with the rising role of political parties as competing political firms. **The objective function of democracy is then allocative: to select such entrepreneurial administrators of collective goods who could maximise the social value of allocated public resources.** This can only be achieved if positive externalities are spread across the broadest number of citizens. Democracy is then the antithesis of state capture and authoritarian (autocratic) rule and an antipode to the widespread provision of private benefits from public administration and finance to a narrow circle of political insiders.

The success of democracy rests on the validity of the following five hypotheses: (i) Citizens can recognise the social benefits of potential collective goods and compare them with alternative deliveries; (ii) Citizens can transfer their preferences to voting in elections without those preferences getting 'lost in translation'; (iii) Citizens transfer their preferences continuously also to the funding of parties according to their assessment of the parties' current contribution to effective public deliveries; (iv) The parties hold to their pledges once elected; (v) Responsible democratic governance is valid if the combined political and collective good markets have the power to discipline the efficiency of public procurement.

All five pre-requisites mentioned above are not without risk of failure. The issue of 'democracy that delivers' then depends on reinforcing two frail markets to fulfil their mission of optimally selecting representatives of citizens' choices. Otherwise, political markets and collective goods markets are easily captured by politics. It should be the task of economics to study the design of the institutions that underpin citizens' capacities to engage in democratic collective actions. Such actions must be more than a match to the established power of vested economic and political interests that do not yield to minor power, be it economic, political or moral. This is a matter of citizens' civil courage and their sense of responsibility for upholding the values embodied in economic, political, and moral freedoms. In order to have a democracy that ‘delivers’, the role of responsible citizens is fundamental. We can conclude with a paradox: democracy as a social product can exist only if democracy already exists in the people’s minds, and they are willing to exercise their social responsibility. People should be willing to incur their own private costs as a civic investment into democratic procedures to enjoy the widest consumption of positive public externalities.

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