

# Chapter 16

## Economic Theory and Economic Reality: A Continuously Dialectic Relationship

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### **ABSTRACT**

*The necessity of searching for deeper roots plays a significant role in the evolution of the economic development and growth. This issue arises from the complex globalized world, the understanding of which requires an in-depth analysis. This issue is born again in the aftermath of the Great Depression of 2008, which highlighted the inability of economics to address it. The need to turn to the deeper roots is reinforced by the individual empowerment and the increasing need to understand economic and social phenomena. Thus, the relationship between economic theory and reality is under new foundations. The cultural and institutional background stand out as the deep roots affecting the way economies operate and raise questions of effectiveness in implementing economic policy when applied in the same way across all economies. For these two factors to be taken into account in economics, a more general and integrated view of economic development and growth is required. It is an attempt at an evolutionary perspective of economic science that illuminates the meso- and meta-economics approach.*

### **INTRODUCTION**

An integrated concept of economic development and growth is directly related to the comprehensive concept of human action. One of the challenges of economic science is approaching the multidimensional reality, as expressed by the action of Homo Holisticus. This definition, which is consistent with an evolutionary view of economics, more clearly approaches the real nature of the individual as it includes his biological, social (political) and economic origins. In other words, it is a combination of Homo Sapiens (a creature whose characteristics are based on genetic change and the principles of Darwinian evolution), Homo Economicus (an intelligent but one-dimensional being based on individual liberation and pursuing personal well-being) and Homo Socialis (which incorporates the cultural and institutional

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dimension of the individual as part of the society to which he belongs, expressing elements of altruism and cooperation). This is the “heart” of the reflection and the general perspective of the present chapter.

The structure of the chapter is the following. Section 2 presents the connection of economic theory and economic reality under the new conditions that prevail in our complex economic systems. Section 3 presents institutions and culture as the deep roots of economic development and growth, and Section 4 the role of special conditions of economies and societies for economic policy making. Lastly, Section 5 presents the new theoretical architecture that is needed in order to better connect economic theory and reality.

## **THE CONNECTION OF ECONOMIC THEORY WITH REALITY UNDER NEW CONDITIONS**

The theoretical thinking of the individual is correct to be developed beyond methodological, theoretical dogmatisms based on the real issues he is called upon to solve on the basis of the human intellect. Thus, developments in the real economic world activate correspondingly theoretical searches. Under conditions of complexity, however, the relationship between theory and reality is laid on new foundations.

The main fathers of classical political economy (Smith, Ricardo, Malthus, Mill, Marx) initially embraced the concept of political economy. It is a comprehensive conception of economics as a social science involving references to human nature but also to the general evolution of social phenomena. However, these works of the main fathers of science were criticized as more philosophical theorems (Papadogiannis 2012).

The later era was marked by the remarkable successes in the positive sciences. Thus, the belief was created that everything could be captured and predicted with equations, even the behavior of the individual. In this light, the core of economic theory was thought to be expressed in simple mathematical terms. The perspective of economics, which was moving away from the original character of the political economy, had now changed. The Marginal Revolution of the 1870s referred to the end of the prevailing classical political view of value theory (Hodgson 2001).

In the late 19th century, Marshall, Walras, Edgeworth, Jevons, and Pareto attempted to rebuild economics to the standards of classical physics, emphasizing the laws of the market. However, this neglected complexity of the economic systems and led to a great simplification of economic theory, as it has ignored parameters such as uncertainty, expectations, society, politics, etc. As a result, the Neoclassicals perceived the economy as a simplified system in which individuals have predetermined relationships and homogenized behavior. Under this way of thinking, the economic phenomena have moved away from social phenomena. Menger’s debate with Schmoller (Methodenstreit) was critical for the dominance of methodological individualism and homo economicus (Hodgson 2001).

The neoclassical model, however, cannot be universally accepted as it does not correspond to reality - at least in most cases - which is characterized by the complexity of economic systems. This is the point of concern regarding the fundamental differentiation of the general equilibrium model and the approach of the economy as a complex system.

The issues analyzed above highlight the deeper problems associated with the foundations of economic theory but also with the view that economies are complex systems that cannot be adequately described through a simple theoretical conception.

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