In the writings of the predecessors of Adam Smith, it is possible to distinguish two basic laws of economics: the Law of Competition and the Law of Circulation. Both laws are well established in the “maxims” of the Physiocrats¹ who receive a highly favourable mention from the “father of economics”:

They have for some years past made a pretty considerable sect, distinguished in the French republic of letters by the name of, The Economists”

[Smith (1776) vol.II, p.176]

Their Law of Competition is central to Smith’s Wealth of Nations written after his visit to France during the mid-1760s. If the economic maxims of the Physiocrats are imagined to have been inscribed on two tablets of stone, the one containing the Law of Circulation, having been left behind by Smith, seems to have disappeared from modern economics.

The consequences for economic policy are critical.

The Lost Commandment

The origin of what may be described as “Single-Gear Economic Fundamentalism” can be traced to the neo-classical consensus of the late 1970s. This signalled a truce between two rival sects – the Keynesians and the monetarists – after decades of controversy. Very broadly, the terms of the truce involved acceptance of classical theoretical foundations with a Keynesian empirical superstructure. The result

¹See Quesnay (1758).
was the resurrection of Orthodox Classical theory as the New Economic Fundamentalism. It re-established the classical belief in free competition, not only as necessary for the achievement of full economic potential, but also as sufficient.

In the previous volume, this is exposed as a fundamental theoretical error. It is described as the “single-gear fallacy”, because it mistakenly treats the economy as a single-gear machine requiring only the “lubrication” of competition to operate at its full employment potential. Nevertheless, it has been elevated to the status of a religious principle of the New Single-Gear Fundamentalism.

The reason for the bankruptcy of modern economic policy is the failure of the New Fundamentalism to recognise the Law of Circulation.

The Importance of the Law of Circulation

The contrasting multi-gear view is that, although freedom of competition is necessary to enable an economy to achieve its full employment potential, it is not always sufficient. The economy is a multi-gear machine. In order to operate at its full employment potential it needs to be in top gear. In addition to the Law of Competition, the Law of Circulation, which requires freedom of circulation, must also be obeyed.

From a multi-gear perspective, the obsession of Single-Gear Fundamentalism with freedom of competition to the exclusion of freedom of circulation is the overwhelming reason for the bankruptcy of modern economic policy.

What’s Wrong with Single-Gear Economics?

Single-Gear Fundamentalism is essentially an up-to-date version of the Old Classical Orthodoxy. An ideal classical world of genuinely free competition in perfectly flexible markets is mistakenly believed to guarantee that there can be no such thing as unemployment. Any unemployment actually experienced is therefore wrongly assumed to be a “natural rate” determined by imperfections and frictional resistances in the market structure of the real world.

Policy mistakes inevitably follow from the false belief that the sole guarantee of a long-term fall in unemployment is structural reform to remove market imperfection. Other measures – like monetary expansion – are accepted as short-term expedients which can give no more than a temporary boost to employment so that the long-term result is a rise in the