

The origin of wealth

Andrew Smith reviews *The Origin of Wealth* by Eric D Beinhocker.

This is the time of year when your boss's boss, trapped for hours at Heathrow airport, decides to give copies of the management book she's just browsed to all her subordinates, with strict instructions to obey it.

These books are shamelessly marketed at executives with such titles as *10 Practical Steps You Can Take Today to Spend More Time at the Office and Less With Your Family*. So count yourself fortunate if, instead, you receive *The Origin of Wealth* by Eric Beinhocker.

The first of four sections is a solid introduction to traditional economics. It is one of the clearest, most concise yet thorough accounts I have read, and a promising start to this book. The account is refreshingly candid about the shortcomings of traditional approaches, especially in relation to equilibrium and rational behaviour. If you never understood economics, this is a good place to start.

The second section introduces complexity economics. Complexity economics is based on computer models of vast numbers of agents, each of which makes decisions on a simple basis. When put together these models can produce sudden price moves, business cycles, periods of stability punctuated by bursts of volatility – all generated from within the economy itself rather than being responses to external shocks. There are parallels in biological evolution, which also exhibits long periods of stability punctuated by rapid change. The author is a great storyteller; this section is an engaging and informative read.

At times the author overplays his hand. He enlists the support of a motley band of sceptics, including market traders, complexity theorists, behavioural economists, and evolutionary theorists, united only by their view that mainstream economics has everything wrong. Unfortunately the sceptics contradict not only classical economics but also each other, leaving the reader in despair of ever putting the pieces together.

Like traditional economics, complexity economics makes a number of unrealistic assumptions. Where traditional economics requires us to perform the difficult task of optimising utility functions under uncertainty, a model cited from complexity economics requires us each to occupy one square on a chessboard and trade

only in sugar. It is difficult to see how this could be calibrated to the real world. Analogy with computer models gives no quantitative explanation of why business cycles are measured in years rather than minutes or millennia. So, to my mind, complexity theory is at best a promising avenue for further investigation, and not yet a body of theory proven to have any predictive value.

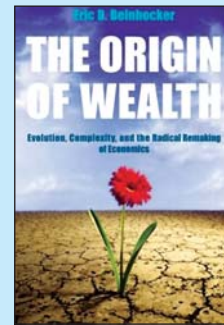
Several slips suggest a less than secure grounding in probability. For example, convincing evidence is presented that extreme share price moves follow a Pareto distribution. The book cites this as evidence that prices are not random.

The third section moves on from a literature survey to some of Beinhocker's own ideas. His ingredients are physical technologies and social technologies. These are brought together in an evolutionary market where only the fittest survive. Physical technologies are familiar mechanical inventions. Social technologies are ways of organising people to greater economic productivity: for example, partnerships, corporations and management hierarchies. The author argues that social technologies are every bit as important as physical technologies in creating wealth. Anyone working for a large organisation will appreciate the section on complexity catastrophes. It shows how growing organisations can grind to a halt, because every time an organisation doubles in size the effort of coordinating its different parts grows fourfold.

Finally, at the end of the third section we get a response to the author's opening question: what is the origin of wealth? Physics tells us that the disorder in the world can only increase; heat cannot flow from colder to hotter. This is what makes time go forwards and not backwards. The author characterises wealth as a reduction in entropy, ie the creation of order out of disorder.

The business consequences of this analogy are not intuitive. In physics we cannot reduce entropy in one place without increasing it somewhere else. In economics this implies that if someone becomes richer then someone else has become poorer. The author even suggests that strategies become more effective when we deliberately cut off our options to ensure irreversibility, thus forcing time's arrow in the direction of progress. Cortés is commended for ordering his men to burn their ships after landing in Mexico.

The section on entropy starts with Samuelson's observation that 'the sign of a crank or half-baked speculator in the social sciences is his search for something in the social system that corresponds to the physicist's notion of entropy'.



The Origin of Wealth: Evolution, Complexity, and the Radical Remaking of Economics

by Eric D Beinhocker, paperback, 544pp, Random House Business Books, ISBN 0712676619

The remainder of the section unintentionally illustrates the wisdom of Samuelson's words. The claimed relation between wealth and entropy remains unconvincing to this reviewer.

The final section of the book explains what the theories mean for business and society. Rather than focusing on producing a perfect strategy, firms must learn to become adaptable in the evolutionary fight for survival. The boat-burning commendations are dropped in favour of the conventional wisdom of keeping all options open. The key to this is deep analysis of the alternatives, in which, we are frequently reminded, the author's consulting firm is available to help. Whatever your favoured economic starting point, the conclusions of management books everywhere are reassuringly consistent.

Outlining the implications for society, the author adopts a messianic tone. The corporation is a uniquely successful institution and a vital contribution to wealth creation. At a time when corporations face vocal criticism from the anti-globalisation movement, arguments proclaiming a positive role are likely to play well with the book's intended corporate audience. A politically incorrect chart supposedly shows how Protestantism leads to greater trust and economic growth, while Islamic societies exhibit mistrust and economic stagnation. No space is given to less flattering explanations: for example, Chomsky's suggestions that the Islamic world is kept in servitude under corrupt despots propped up by Protestant western governments, or that single-minded corporate pursuit of profit exerts a malign influence on government policy and undermines democracy.

What then happened to the book your boss's boss so kindly brought back from her holiday? The first couple of chapters are read thoroughly, the rest forgotten. Such is an appropriate approach to *The Origin of Wealth*, whose first two chapters are well worth reading.

Andrew D Smith works for Deloitte; views expressed are his alone and not those of Deloitte.