



Economic system efficiency in the history of economic thoughts: Tracing ideas from A. Smith to J. Stiglitz

Amira Hakim^{1,2}

¹LPS, FS, University of Sfax, Tunisia.

²ISIGK, University of Kairouan, Tunisia.

^{1,2}Email: hkmamira@gmail.com

Abstract

The economic system is a set of institutional arrangements used for the repartition of Resources. The economic systems are identified in function of their characteristics such as law of ownership, informational mechanisms, levels of responsibilities, authority of taking decision, and the incentive arrangements. The economic systems are considered as spectrum of arrangements for the types of economic systems such as decentralized, capitalist, incentive, social planned. The dichotomies within these systems bring us to the question to understand the differences between these types of systems and modelling the phases of transition towards an efficient system. We are using within this synthesis the historical economic thoughts analysis to diagnosis the transition towards an efficient economic system.

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1. Introduction

In Stiglitz (2003) addresses in his book « Globalization and Its Discontents » the dilemma of the importance of the neoclassical model in the new contemporary economy, writing the following: « ... Behind the free-market ideology there is a model, often attributed to Adam Smith, which argues that market forces—the profit motive—drive the economy to efficient outcomes as if by an invisible hand. One of the great achievements of modern economics is to show the sense in which, and the conditions under which, Smith's conclusion is correct. It turns out that these conditions are highly restrictive. Indeed, more recent advances in economic theory—ironically occurring precisely during the period of the most relentless pursuit of the Washington Consensus policies—have shown that whenever information is imperfect and markets incomplete, which is to say always, and especially in developing countries, then the invisible hand works most imperfectly. Significantly, there are desirable government interventions which, in principle, can improve upon the efficiency of the market. These restrictions on the conditions under which markets result in efficiency are important—many of the key activities of government can be understood as responses to the resulting market failures (Stiglitz, 2003).

Such an assertion pushes back against the contradictory troubles of modern economics with the new theory, previous theories, and the standard theory on the one hand, but also highlights the similarity between traditional theory and those that followed.

The purpose of this article is to explore some lines of reflection to interpret Adam Smith's statement when he declares the idealism of the neoclassical theory for the efficiency of the economic system, and to critique the theories that came after him up to Stiglitz: how can the efficiency of an economic system be achieved and how do the mechanisms of transition toward an efficient economic system for emerging countries operate according to theories? The ambition of this article is also to limit itself to some working hypotheses or interpretations. Furthermore, we will restrict ourselves to treating the analyses of Smith and classical theory itself, and not the new classical theories in their entirety.

We will propose five complementary lines of reflection. Starting from the theory of the firm, which considers the firm as an organization and the economic system as a set of institutional arrangements where internalized coordination has become the major tool according to Coase for the transition toward an efficient system. The economics of information as the management and manipulation of market conditions to achieve an efficient system, in which Laffont (1984) was involved, treating information problems as a policy to attain system efficiency. Continuing toward the general equilibrium Pareto-Walrasian theory and the major problem of state intervention to calibrate the market toward an optimum to reach efficiency. And finally, approaching the Kuznets curve with real cases of transition toward an efficient system in which the classical theory was applied differently. Throughout these lines of reflection, we have maintained Stiglitz's analysis for each line.

2. Classical Theory Targeting the Idealism of the Economic System

In our era, the theory of the firm opens the most progressive horizon of research as an object of study. To justify and specify the existence of the firm and its internal organization, economic theory studies the firm. Initially, the firm was considered a black box. With the consideration of actor behavior, the firm becomes an organization. Thus, economic analysis develops transaction cost theory and agency theory and assimilates the firm to a nexus of contracts.

To begin, I would like to invite you to emphasize the basic assumptions of neoclassical thought. Since time immemorial, we have been taught that neoclassical theory rests on a set of assumptions such as: market atomicity, product homogeneity, freedom of entry, perfect transparency, and mobility of production factors. Therefore, traditional theory considers the firm as a black box, one "that was long refused to be opened" (Rosenberg, 1982) a profit-maximizing agent by assuming its internal conditions. It supposes that transaction costs are zero, technological opportunities are known, forecasts are perfect, and information is complete, free, and perfect (you did not pay a price to obtain information about relevant market prices). Once these assumptions are verified, full employment, price stability, economic growth, etc., are ensured. Stiglitz (2012) advocates that the efficiency of a system depends on market functioning, and any market intervention alters equilibrium; in other words, the efficiency of a system can be altered by other organizations. Citing the example of unions, the neoclassical model tells us that social divergences are resolved by the market through Exit-Entry mechanisms, and thus an efficiency regime is attained. Others say that to resolve the problem of divergence, recourse to unions is necessary. However, for the classical economists, unions are imperfections, distortions... So how can one make the union a collective body expressing individual preferences? The solution is the following: since for the classicals the union is a monopolistic entity opposing efficiency and an exogenous intervention that prevents efficiency, if we consider the union as a collective body expressing individual preferences and therefore a source of efficiency under certain assumptions, we come to solve the problem of externalities and Free-Riding and lead to efficiency under certain assumptions. Thus, the neoclassical model leads to efficiency if I inscribe it in another theoretical universe. So, with reference to Arrow, the conclusions of neoclassical models are obviously valid only under particular assumptions, and may well be far too simplistic regarding the economic world and individual preferences. So, the neoclassical assumptions are overly simplistic; must we still take this into consideration? According to the reference model, economic efficiency means that the invisible hand works; that is to say, referring to the invisible hand, the market represents a regulatory model spontaneously leading to optimal efficiency based on market coordination. Moreover, market coordination is realized through the conflict of individual interests (egoisms) which result in the general interest from a system of prices: in the neoclassical market, there are thousands of sellers who do not know each other's existence; what attracts entry to this market is the price system (Price-Signal) through the game of supply and demand. In fact, Smith tells us in his major work *The Wealth of Nations* that «.. It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages» Thus, for Smith, the invisible hand is a sine qua non condition for the efficiency of the economic system. However, for the invisible hand to function, the underlying assumptions must be verified. But do the underlying assumptions of the invisible hand hold? Nevertheless, this model has limits, including that some transaction costs are positive and the degree of uncertainty is significant. As long as the assumptions are unrealistic, then why consider it as a referential framework for the analysis of an economic system? There is no better theoretical model and scientific approach in the 20th century infallible than the neoclassical model. However, it is disconnected from its object of study. When the neoclassical model talks to us about resource allocation, theoretical assumptions are required although it is unclear what optimal resource allocation means; it is independent of its object.

3. The General Equilibrium Theory and the Efficiency of the Economic System

General equilibrium theory is based on normative analysis. More precisely, it concerns specifying the behavior that consumers must adopt to maximize their utility under budget constraints, and producers to maximize their superprofit. But is this distribution good or bad, efficient or not? Pareto's contribution was to provide an answer to this question after defining an evaluative criterion. This criterion allows multiple optima to be identified but cannot decide between them. We use the Edgeworth diagram which allows choosing which optimum among all Pareto optima is preferable, meaning it allows selecting the best among better states. Pareto optimum¹ is analyzed by welfare economics and is defined as the state in which one cannot improve the situation of one individual without simultaneously deteriorating the situation of another. Pareto (1917) states his criterion as follows: When a community is at a point Q from which it can move to increase the well-being of all individuals, it is clear that, from an economic perspective, one should continue to move in that direction as long as everyone benefits. Only upon reaching a point P, where further improvement for all is impossible, must other, non-economic considerations be taken into account». Point P corresponds, for Pareto, only to the social state ensuring the maximum welfare for the community. More precisely, provided certain conditions are met, the mere play of market mechanisms animated by agents who only have their self-interest in mind leads to a situation satisfying this efficiency criterion, meaning that the market equilibrium without the state constitutes a Pareto optimum, so the state appears as the one disturbing the ideal order of the market.

The Pareto optimum changes depending on the initial feasible state, but this initial feasible state is a certain distribution of resources. It should be emphasized that the question of resource allocation is intimately linked to the question of resource distribution. This means that efficiency and justice are connected. However, the question of justice and equity is not taken into account by the reference model: productions are remunerated at their marginal productivity, which is the marginal calculation principle. More precisely, according to Simonet (2006) for Pareto, it is appropriate to separate questions related to the efficiency of the system, which can be studied subjectively according to him, from questions concerning equity or social justice, which require value judgments that the economist should not impose.

The theory of correspondence between general equilibrium and the Pareto optimum tells us that there exists an equilibrium price system that renders the behaviors of all agents compatible. This is based on the two welfare theorems which constitute the foundation of liberal thought. The first theorem states that a competitive equilibrium of private property, if it exists, is a Pareto optimum. J.J. Laffont explains this theorem as follows: It is sufficient that the signals represented by equilibrium prices coordinate decentralized economic activities in a manner that is satisfactory according to the Pareto criterion. Each economic agent, through their individual maximization behavior, adjusts to the price system by equating the marginal rates of substitution and transformation with the corresponding price ratios. Since all agents face the same price system, at equilibrium all marginal rates are equal to one another. These equalities, together with market equilibrium, effectively characterize the Pareto optima within a convex framework. More precisely, prices are sufficient signals to coordinate decentralized economic activities satisfactorily according to the Pareto criterion. The second theorem states that if the usual convexity assumptions are verified, and if Q is a Pareto optimum, then there exists a price vector P such that Q is an equilibrium at price P. This theorem is explained by Laffont (1984) as follows: Regardless of which Pareto optimum corresponds to a given criterion of justice, it can be decentralized as a competitive equilibrium, provided that agents' incomes are appropriately assigned; that is, in a private-property economy, conditional on the implementation of suitable lump-sum transfers among the agents. The optimum can be decentralized; we can find a price system p and incomes R such that each consumer maximizes utility choosing respectively the vectors X corresponding to the optimum. So, if there is correspondence, this system leads to an equilibrium price system characterized by uniqueness, stability, and existence, and this point corresponds to a situation that society collectively optimizes. Therefore, the welfare theorems are proof that Adam Smith's invisible hand indeed exists and that the market is the most efficient way to allocate goods among individuals. This is the formal and rigorous proof that neoclassical authors have provided to justify the non-need for the state in the economic sphere of the neoclassical model. It is the foundation of liberal ideology and the incontestable superiority of the neoclassical model. So, what justifies the intervention of the State in economic decisions? Nothing—if there is no longer this correspondence, there is no longer justification for sidelining the State. When we consider a group of individuals, each optimizes by maximizing their individual interest; if there is no maximization, then there is room for the State.

However, the neoclassicals did not completely close the door to the State. This is what economists have acknowledged—that the State must intervene under certain conditions.

What are the situations identified by the neoclassicals in which they break this correspondence? When a hypothesis is not verified. These hypotheses lead to insufficiencies. Moreover, these lead to the short-sightedness of agents in their ability to foresee the future (Pigou).

¹ Vilfredo Pareto did not introduce the concept of Pareto Optimum under this name in his own writings. However, in his work *Manuale di Economia Politica* published in 1906, he developed the foundations of what would later become the concept of Pareto efficiency. Pareto was interested in the manner of optimizing the allocation of resources and in maximizing social welfare. "Si una parte degli uomini trae da un dato cambiamento un utile, mentre nessun'altra ne riceve danno, c'è un aumento della funzione collettiva del benessere".

In fact, all decisions made by economic agents are projected into the future—yet the future is uncertain. Situations of indivisibility of goods and externalities (positive or negative) are cases in which the market fails. In other words, we accept to see that there is a part ignored by the Walraso-Paretian model, such as indivisibility of goods and externality. In the presence of these two situations, there is a divergence between the private TMST and the social TMST, and between the private TMST and the social TMST; and the general equilibrium does not correspond to the Pareto optimum. Moreover, external effects—defined as « any indirect effect of a production activity or a consumption activity on a utility function, a set of consumption, or a set of production » (Laffont, 1984)—do not pass through the market. Similarly, indivisible goods do not correspond to the principle of marginal calculation, whereas the model prevents non-marginal calculation.

There is no contradiction among the hypotheses forming the axiom of construction of the neoclassical model. Let us take returns as an example; if returns are increasing, we cannot define a single equilibrium. So, the model is coherent—but to what extent does the model capture the entire economy today? If the model captures only part of the real world, then the model is not relevant. In fact, the hypotheses are unrealistic: Rationality is limited, information is imperfect, capacities are heterogeneous... So why this model? Why construct this model as long as it ignores a real part of the economy? There is no more flawless theoretical model or scientific approach in the 20th century than the neoclassical model. Economists have understood that neoclassical theory produces an elastic neoclassical model. Samuelson (1955) state that we can make an extension of the neoclassical model». Marxism is a critique of the neoclassical model and not a school of thought. In fact, from these critiques they created the regulation school. The Keynesian widened the capitalist economy and exposed the shortcomings of the neoclassical model and justified exogenous state intervention. Neoclassical theory represents 99.99% of today's economic theory. Let us return to the notion of correspondence. Market mechanisms are failing because they only take into account the monetary dimension, leaving aside everything that escapes the logic of profit—this characteristic of the market, in addition to the already mentioned market failures, would justify State intervention. The State can intervene to restore this correspondence, to compensate for market failures—everything that causes general equilibrium to deviate from the Pareto optimum. As a consequence, there is no correspondence between GE (general equilibrium) and the Pareto optimum. Everything that deviates from the Walraso-Paretian norm is an imperfection and causes a break between collective optimum and the Pareto optimum.

The State intervenes to correct this correspondence or to bring general equilibrium back.

It will intervene according to the Walraso-Paretian logic. Its instruments must be Walraso-Paretian instruments and coherent with the microeconomic instruments of the reference model.

What type of intervention is consistent with the Walraso-Paretian model?

The price must equal marginal cost. If the price is not equal to the marginal cost, its intervention will not be coherent with the Walraso-Paretian rules and will further deviate general equilibrium from economic optimum. In fact, it is enough that one agent does not apply the rule for us not to reach general equilibrium and, as a result, the correspondence between general equilibrium and the Pareto optimum is broken. Let us pause on the example of public goods.

The State will produce the goods that are not marketable; it will price these goods using the same rule $P = MC$. If we do not apply this rule, this will deviate from the correspondence.

Faced with this failure, the State will intervene by introducing a tax intended to finance this good. General equilibrium is normative—this is how the State intervenes without necessarily asking whether it can actually achieve that in practice. Some economists tell us that the costs generated by public intervention to compensate for market failures may sometimes exceed those arising from the free functioning of the market. Thus, both the State and the market constitute imperfect organs for regulating economic activity.

4. Coase: The Theory of the Firm and the Efficiency of the Economic System

Stiglitz (2012) stipulates that public authority, like markets, is subject to a range of imperfections, resulting in state failures that are as significant as market failures. This underscores the necessity for the state and markets to cooperate and complement one another, with each offsetting the weaknesses of the other while leveraging its respective strengths. Others say that a failing state, instead of correcting market failures, adds to them, and consequently disrupts market efficiency.

When we define efficiency, is it the totality of macroeconomic objectives? Is it the total utility? Assuming that efficiency is the sum of utility, then humans and animals are endowed with the same utility. In fact, it is generally accepted that « Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses » (Robbins, 1935). However, according to Coase (1937) in reality, since humans are not the only animals capable of choice, it should not be surprising that this approach can also be applied to rats, cats, or octopuses, all of which, without a doubt, are engaged in maximizing their utility, just like humans. The fact that it has been shown that price theory is applicable to animal behavior is therefore not accidental. Thus, the neoclassical model resides more in its epistemological approach than in its object. It is enough to relax a single hypothesis for individual interest to no longer lead to the social optimum. In this logic, individual interest runs counter to the general interest, as demonstrated by the prisoner's

dilemma in game theory. Coase² tells us: “You are not dealing with the real world; you are dealing with a blackboard model.” Substantive rationality, one of the foundations of the classical model, is too disconnected from reality. Coase wanted to inject some realism into the neoclassical model. More precisely, Coase sought to minimize the distance between the blackboard economics and the real world by highlighting the operating cost of a general price system and the social cost.

If we relax the hypothesis that the firm is a black box, we enter the box. According to Samuelson, “It takes a theory to kill a theory”; another conceptual theory was needed to open the box. Coase introduced “transaction costs” — the key to opening and entering the box. To do this, we must consider that information is not perfect, technological opportunities are unknown, the level of uncertainty is high, and agents’ capacities are heterogeneous.

According to Coase, transaction costs are the costs that allow mutually beneficial exchanges between two or more individuals. These transaction costs generated by coordination can be classified into three categories: information search costs, negotiation and decision-making costs, and monitoring costs, which he supports by stating: When one wishes to carry out a transaction in a market, it is necessary to search for one’s counterpart(s), to provide them with certain necessary information, to set the conditions of the contract, to conduct negotiations thereby establishing a genuine market for concluding the contract, and to put in place a structure to monitor the respective fulfillment of obligations, etc.. This approach assimilates the firm to “a nexus of contracts.” It is analyzed as a form of organization to substitute for transaction costs. [Azariadis and Stiglitz \(1983\)](#) tells us: earlier theories simply assumed that redirecting and enforcing contracts incurred no costs. All of this is far from the real world: contracts are often ambiguous, they give rise to countless disputes, legal procedures are extremely costly, and most economic transactions are not governed by any formal contract. Under these conditions, it is often implicit contracts, tacit agreements, or social norms that allow society to function properly. Coase wanted the firm to evolve while being based on his well-known theorem, which advocates: « ... a firm tends to grow until the costs of organizing an additional transaction within the firm become equal to the costs of carrying out the same transaction through a market exchange or to the organizational costs in another firm.» ([Coase, 1937](#)). This means that replacing the market with an organization is only relevant when transaction cost savings exceed organizational costs. Therefore, the theory of transaction costs strengthens the neoclassical model and corrects market coordination because market coordination is costly. It relies on a central idea: the chosen institutional arrangement will be the one that minimizes both transaction and production costs. Hence, « Markets appear as institutions designed to facilitate exchange, that is, their function consists in generating savings on the costs of carrying out transactions. » ([Coase, 1937](#)). For Coase, efficiency is not just about the price mechanism. He emphasized positive and negative externalities. One cannot imagine an economic reasoning that assumes the absence of externalities. In fact, by considering these externalities, what was once a flaw in the neoclassical model becomes a factor. Let us return to the example of trade unions. Because unions become a collective organ for expressing individual preferences, the free-rider problem — which is costly to the economy in terms of efficiency — can be resolved. Thus, Coase’s contribution regarding social cost is to integrate law into the functioning of an economic system, meaning that what is exchanged on the market is not physical entities, but property rights.

Coase also spoke about the role of the entrepreneur in the efficiency of the economic system. This idea is not new. Schumpeter³ discussed the entrepreneur’s role in efficiency, stipulating the following idea: for a firm to survive, it must manage intangible resources internally. As our knowledge becomes obsolete, it must be adaptable to an unpredictable economic environment, requiring responsiveness to generate competencies — in which the entrepreneur plays a major role in the process of innovation and competence creation. According to standard theory, system efficiency involves the existence of two Siamese twins: Privatization and competition. If I privatize in the textbook sense, we simply move from a public black box to a private black box — as if nothing has changed. So, where is the efficiency? If I privatize on the assumption that efficiency is the archetype of the market, I give no role or existence to the firm in coordination. In fact, the neoclassical model does not theoretically imply the existence of the firm.

According to Stiglitz: “Standard neoclassical theory argues that for a market economy to work well (to be Pareto efficient), there must be both competition and private property (the ‘Siamese twins’ of efficient wealth creation). Both are required, and clearly, if one could wave a magic wand and instantaneously institute both, one would presumably do that. The issue, however, concerns choices: if one cannot have both, should one proceed with privatization alone?”. So, Stiglitz aimed to explain that, to achieve Pareto efficiency, the system must include both Siamese twins. And if one is missing, can the system reach efficiency on its own? Looking closely, privatization is not about transferring assets — it is about transferring wealth. Where wealth is involved, profit is involved, and the state may lead to “Regulatory Capture” — a corruption mechanism. According to Coase, if we consider privatization through the neoclassical lens, it does not lead to efficiency.

² “It can, I think, be assumed that the distinguishing mark of the firm is the supersession of the price mechanism. Instead of the allocation of resources being determined by the price mechanism, it is the entrepreneur who directs production. [...] The fact of direction consists in deciding the movements of the resources concerned and in deciding the terms on which this is done. The operation of a market costs something and by forming an organisation and allowing some authority (an entrepreneur) to direct the resources, certain marketing costs are saved.”

³ “Innovation is the key to economic efficiency. It is not limited to the introduction of new products but also encompasses new methods of production, new markets, and new forms of organization. [...] It is through innovation that companies increase their productivity and improve their competitiveness.”

Thus, we need an institutional architecture supported by legal rules; otherwise, we face corruption, and thus a loss of efficiency. Therefore, the argument that privatization inherently leads to efficiency falls apart. Privatization should lead the firm toward the economy of organizations. Hence, the economic system would be, by definition, a set of institutional arrangements (contracts, relationships, firms). If we stop at this definition, we step outside the neoclassical framework. We cannot use it because institutions have no place in the neoclassical model — and because the model itself poses an analytical problem. But that does not mean rejecting the neoclassical model altogether, because efficiency requires coordination. But is it market coordination? We will graft another type of coordination onto market coordination — internalized coordination: Contracts between workers and executives, between hierarchy and employees. However, with internalized coordination comes problems of observability, supervision, control, and authority — hence the need for agency theory and incentive theory. According to these theories, for a firm to be efficient, it must manage issues of supervision, adverse selection, moral hazard, opportunism, and hold-up. Let us consider two types of problems. Akerlof³ tells us that information asymmetry is a source of blockage and generates two major problems in economics: adverse selection and moral hazard. In general, these informational problems prevent the optimal allocation of resources unless all information is common knowledge. Thus, to allocate resources optimally, the contract must make the agent reveal private information, and consequently, the agent must receive informational rents, which are generally costly for the principal. Stiglitz (2012) tells us: « The Smithian logic seemed to suggest that morality had no role to play, that virtues such as loyalty and good faith carried no weight. Adam Smith, aware of the limits of markets, knew that this was not the case. Modern economics has shown why economic systems in which these virtues prevail function better in the real world than those in which they are absent». Thus, agency theory emerged as an application of the neoclassical analytical framework in which information asymmetries appear between agents, while retaining the assumption of substantive rationality. In fact, this theory is needed within the firm because Coase's individual is endowed with bounded rationality. This theory is based on the principal-Agent principle, in which the relationship is defined as follows: There is an agency relationship when one person, called the agent, acts on behalf of another person, called the principal, who is imperfectly informed. The theory of the firm is central to this relational approach. In practice, since managers are better informed than shareholders about the firm's quality, a transmission mechanism must be established to allow risk-takers to engage in various business projects. How can we ensure proper transmission of this information? By formulating incentive mechanisms that lead to the truthful revelation of project quality. The agent must be incentivized to send an informative signal about the value of their firm. According to Maskin and Laffont, for an incentive mechanism to be effective, it must also include rewards and penalties to discourage the agent from sending unfavorable signals (e.g., unemployment as a threat for workers).

5. The Contemporary Process of Transition Toward an Efficient System According to the Standard Model

In general, it is admitted that the neoclassical model is a weak tool for analyzing economic systems. However, in theoretical terms, the neoclassical model is infallible if all its underlying assumptions are verified. What are the empirical conditions of efficiency? One must still ask: does the real world conform to theoretical assumptions? To answer these questions, Stiglitz provides us with two examples of successful and failed economic systems: Russia and China.

To understand these two experiences, we will first present a brief summary of the main economic crises since 1975, alongside the nature of these systems. Since that date, the socialist regime, either Soviet-style or Chinese, was the most dominant worldwide. During the same period, the Western world experienced two oil shocks, recession, and stagflation. The rest of the world tried to generate economic growth and then development. Latin America, Africa, and Asia did not achieve the expected growth rates. However, Japan stood out during that period in terms of growth and development.

In 1995, the Soviet empire disintegrated, the two Germanies reunified, the communist bloc no longer existed as an external control organization, China became a growth champion, and markets in Asia and Latin America turned into global investment hubs.

To understand the two examples presented by Stiglitz, China and Russia, we will make a comparison of how both economies attempted to use the neoclassical "recipe" to transition toward an emerging economy. In fact, in the Chinese experience, one must refer back to comparative systems to grasp the system change. The disparity between failure and success is so large: here are two systems that attempt to apply the neoclassical recipe at the same time—one manages to make the invisible hand work, and the other does not.

China and Russia were characterized by centrally planned economies. These countries moved toward the market to decentralize their economies, following recommendations from the neoclassical framework. China succeeded in its transition. In fact, there was a significant increase in its GDP, from 300 billion USD to 700 billion USD between 1989 and 1997. Meanwhile, Russia experienced a dramatic decrease in wealth during the

³ " Information asymmetry is a fundamental problem in principal-agent relationships, where the principal cannot observe the efforts or actions of the agent. This creates an imbalance that can lead to adverse selection, where the principal struggles to distinguish high-quality agents from low-quality ones. Furthermore, moral hazard arises when the agent, due to the absence of effective monitoring, may take excessive risks, knowing that they will not bear the full consequences of their actions. To address these issues, it is essential to design incentive-compatible contracts that align the interests of the parties, while accounting for information costs and the necessary incentives to ensure that the agent acts in the best interest of the principal."

same period. Russia managed to privatize most of its economy. However, Coase tells us that privatization does not mean self-regulation, but rather transaction costs and organization. Therefore, an efficiency indicator is absent.

(Stiglitz, 1999) tells us in *Whither Reform* that gross investment is a key and crucial indicator of an emerging market economy, and it is the State that provides the necessary investment conditions, such as a sound legal system. In fact, without a legal system, the economic system collapses, as clearly shown during the subprime financial crisis.

Referring to Russia, the volume of investment dropped dramatically, and Russia became a late-developing economy. The failure in Russia was so significant that the Kuznets model⁵ was reversed. It is generally accepted that income distribution during economic development follows the inverted U-shaped (Kuznets, 1955) according to which inequality increases in the early stages of development and then declines. Therefore, the key to Russia's efficiency lies in improving living standards and establishing a foundation for sustainable and inclusive development with fewer social disparities. Coase (1937) states that « These formerly communist countries are encouraged to adopt a market economy, and this is what their leaders desire; however, in the absence of appropriate institutions, even a minimally functional market economy is impossible. ». The results of these transitions are mixed. The neoclassical model does not apply universally. Its universal character is not confirmed—it is essential to consider geopolitical positions, ethnic compositions, and natural resource endowments. The neoclassical model cannot be used as an intellectual framework for evaluating the efficiency of economic systems in countries with different physical capital endowments. It is a weak tool for analyzing efficient economic systems. "A failure arising in part from the neoclassical model itself" (Stiglitz)—this sentence alone shows that the inefficiency of an economic system is partly attributable to the neoclassical model itself. Stiglitz raises the following questions: « What type of market economy do they wish to create? American-style capitalism or a more humane, softer Swedish-style capitalism? On a globalized planet, must we all march in step? What room is there for diversity? ». Drèze (1985) responds to almost all of Stiglitz's questions. In fact, Drèze (1985) tells us that a market model does not imply a market economy, meaning that a market economy is not the absence of the State—but rather, what kind of State? It is a regulatory State. If the neoclassical model's precepts were the recipe for efficiency, one would wonder how an economic system in which the State's share of GDP exceeds 70%—namely Sweden—could be considered the most efficient market economy.

Drèze (1985) affirms that the State plays an essential positive role in development, stating: We cannot expect the market to provide social security, ensure universal education, manage urban planning, protect the environment, reduce social inequalities, guarantee children's vaccination, preserve the integrity of the legal system, or even ensure effective regulation of private enterprises. I am tempted to add that we also cannot expect the market to ensure the transition to a market economy ». Stiglitz (2012) argues that « A battle of ideas is underway: some wish to reduce the state to a minimal role, while others recognize its important function, even with its limitations, in correcting market failures and advancing social justice. I count myself among the latter, and I intend here to show that markets, even if they are at the heart of our economic success, do not always function properly on their own, that they do not solve all problems, and that the state will always be an important partner for them ». He adds that in the context of globalization, economic conditions evolve, and the State must abandon old tasks and take on new ones. However, Pigou asserts that public intervention only appears as a corrective and regulatory action if—and only if—the economic system is marked by dysfunctions. He adds: « We cannot indeed hope that any public authority will achieve, or even sincerely strive for, this ideal. Such authorities are equally subject to ignorance, to pressure from a class, and to corruption of individuals by private interests ». In *Whither Reform: Ten Years Later*, Stiglitz asserts that if the AD (Aggregate Demand) model were correct, we would expect the market to self-regulate (provide social security, ensure universal education, engage in urban planning, protect the environment, effectively regulate private firms, etc.). Thus, all countries transitioning to market economies would have succeeded and should, for instance, have reduced poverty. However, looking at a system like Russia's, we observe that the market did not guarantee the transition to a market economy—just the indicator of market economy performance decreased. This means that without State intervention, one cannot successfully transition to a market economy.

Nevertheless, I firmly believe that the neoclassical model remains a valid and infallible reference point—if there is a failure, it is because of an externality that distorts equilibrium. It is not the neoclassical recipe itself but the circumstances of transition.

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⁵ "The relationship between the level of economic development and income inequality can be understood by considering that, in the early stages of development, investments and economic opportunities are concentrated in specific sectors, leading to increased inequality. However, as the economy diversifies and education improves, broader segments of the population begin to benefit from growth opportunities. This ultimately leads to a reduction in income inequality, thereby illustrating a cycle of economic transformation."

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