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Money, Markets and the Organic model of Economics

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Graphical Abstract

This study contrasts neo-classical economics, characterised by debt-driven speculation and recurrent boom–bust cycles, with an organic model that views money and markets as embedded in real economic activity. It argues that sustainable growth requires monetary reform, land value taxation, and policies that redirect credit from speculation towards productive enterprise

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Abstract: Conventional courses in economics present a fantasy world of theory that withstands the rigour of mathematics, but has little or nothing to do with reality. In *Realonomics*, Karim El-Ayoubi subjects neo-classical economics (NCE) to forensic scrutiny [1]. He argues that NCE is nonsensical. The consequences are drastic. Graduates entering the ranks of central banks, governments, and bureaucracies "have been trained to believe something that, in many cases, is the precise *opposite* of the truth, and so they end up making bad policies that hurt all of us". He provides the evidence to support his attack. His alternative paradigm, however, is based on a revised approach to creating money, and to the banking system, which is problematic.

Keywords: *Neo-classical economics, Monetary reform, Financial speculation.*

Introduction

The supply and demand theories that cloak discourses on markets are captured in notions like the Efficient Markets Hypothesis, which claims that banks are perfect calculating machines capable of assessing a company's future cash flows to arrive at the correct price for it today. Much of economic theory, and therefore of policies emanating from governments, rests on the notion of *perfect information*. In fact, there is no such thing, explains El-Ayoubi, an Oxford graduate who has worked in the City of London. His shock confrontation with reality came with the 2008 market crash, which he attributes to the "reckless lending practices in the US subprime mortgage market". In advancing his critique of academic economics, he proposes an alternative model which, in his view, offers a realistic appreciation of how the economy works. Before addressing his monetary thesis, we need to take a step back and ask: if the pre-existing classical economics was somehow closer to reality, why was it suppressed in favour of a neo-classical revision?

El-Ayoubi offers an example of the suppression. It occurred in the 19th century, and was documented in the work of Mason Gaffney (1923–2020), which El-Ayoubi cites.

Gaffney spent most of his working life teaching economics at the University of California [2]. He traced how, following the publication of Henry George's *Progress and Poverty* (1879), systematic attempts were made to counter the popular support for a reform of the fiscal system. George argued that poverty was the result of property rights and the enabling statecraft. The distribution of a nation's income was biased by public policy to favour those who owned rent-yielding assets. This process was censured by the leading exponents of mainstream classical economics, like Adam Smith in his *The Wealth of Nations* (1776). To combat the popular support garnered by George's book – it motivated the first global mass movement in history - the landed class had to react defensively. Gaffney spotlighted the support extended by the banking sector for American economist J.B. Clark. He wrote voluminously against George's advocacy of a tax directed at the rent of land (with compensating reductions in taxes on wages). Clark was hired as a professor by Columbia University, which had benefitted significantly from the generosity of banker J.P. Morgan.

The attack on classical economics was successful. As a result, statecraft in the 20th century was flawed. Why this continued to be the case, even with the arrival of democracy in its universal suffrage form, can best be illuminated by the influence of John Maynard Keynes (1883–1946), the single most influential economist in the years following World War II. He was a Fellow of King's College, Cambridge, who, in the 1930s, developed a theory of how governments ought to operate. He interrogated the problems that arose in the Depression of the '30s, like unemployment and unaffordable housing. Which issues, he wondered, should attract government remedial action? He delivered one answer in 1925.

Some will say — the Land Question. Not I — for I believe that this question…has now become, by reason of a silent change in the facts, of very slight political importance [3].

Keynes played the leading role in shaping post-war economic policy. Keynesianism excluded "land". Economics was now constructed on a two-factor model: labour and capital. That paradigm prevailed in academia.

Money Matters

One outcome was the continuation of the 18-year boom/bust business cycles. These were present in the 19th century, as documented by Gaffney, and they persisted into the second half of the 20th century, as El-Ayoubi stresses [4]. The significant drivers manifested themselves in the land market. Those manifestations, like speculation to reap unearned capital gains from land, persisted because of the failure of governments to refine their fiscal policies. This was a triumph of the NCE strategy which, in El-Ayoubi's telling, resulted in damage inflicted by the doctrine variously renamed "the Washington Consensus" or "Neoliberalism".

How, then, do we extricate the economy from the problems created by NCE? According to El-Ayoubi, we need to focus on a revised approach to monetary policy. His 10-point plan is based on a revision of policy in relation to the money system. He calls for a shift towards a realistic appraisal of money; enhancement of the role of sovereign money; protection for the independence of central banks; setting realistic targets for inflation; reforming university economics, and ending the influence of lobbyists.

Would this agenda create a sustainable framework for people working in the market economy? In El-Ayoubi's view, it would. But only if we come to terms with his claim that money is "invented out of thin air" [1, p. 50]. He supports this view by a paper published by the Bank of England, which explained: "The reality of how money is created today differs from the description found in some economics textbooks" [5]. Banks are not simply intermediaries, re-lending the money deposited by savers. They create money. Indeed, we may go further. Money would not be created, but for the demand from the users of credit. *They* create money.

El-Ayoubi sustains his money theory by referencing the work of German economist Richard Werner, a professor at a British university who, in the 1990s worked in Japan. As a close observer of the catastrophe that befell Japan in the dying years of the 20th century, Werner developed a fresh emphasis on the importance of money creation. He attributed the catastrophic collapse of the Japanese economy to the failure of policy in Japan's central bank. El-Ayoubi signed up to Werner's diagnosis. He advocates the Disaggregated Theory of Credit, which emphasises that banks create money. That brings us back to the notion that money is created out of "thin air".

The problem with the thin-air theory is that it, too, is divorced from reality. It therefore runs the risk of skewing statecraft and reinforcing the structural stresses in the macro-economy. We need a closer look at the formation of credit.

When banks extend a loan they do, indeed (as the Bank of England article notes), enter a matching deposit in a borrower's bank account. Was this an act conjured out of thin air? Or was it the result of an organic process in which the borrower, not the bank, plays the leading – the creative - role? Consider the case of an entrepreneur who needs to borrow £100,000 to buy equipment to expand his business, so that he could take advantage of growing demand within his sector of the market. He approaches his bank, and explains the purpose of the loan; he produces balance sheets, to prove that his business is viable; he commits himself legally to paying back the loan in (say) 10 years; and he offers his home as collateral, against the risk of his defaulting. The bank, for its part, establishes that the would-be borrower is credit-worthy; that the bank can make a profit on the deal; and it assesses the value of the collateral to ensure that, whatever happens, it is not assuming undue risk. To complete the deal, it is framed within the prevailing judicial system, which ensures that contracts are honoured. Combined, these players come to an arrangement whereby the borrower can spend £100,000, while others – in the community at large – are confident that the cheques drawn up by the entrepreneur will be honoured.

Is all of this thin air? Or is it tangible, hard-headed initiatives that warrant the expansion of the nation's money supply by £100,000? If any one person or agency motivated the creation of the credit, it is the entrepreneur. His needs were not derived from thin air. Others, of course, do serve vital roles in the process. So would it not be more realistic to portray the creation of credit as the consequence of an organic process?

Do the labels matter, in the end, so long as banks fulfil their roles? Yes, they do, because the emphasis on money as the means to stabilize the economy diverts attention from the policy that focuses on the role of land and rent, and the critical part that ought to be played by statecraft in nurturing the health of the macro-economy. This proposition is illuminated by the modern history of Japan.

Economic Bubbles: the Animating Force

Richard Werner derived much of his theory of money - on the roles of statecraft, and of money – from his experience in Japan. He applied his theory of money to explain the 1990 land boom that ended the post-war growth [6]. Was the catastrophe in the housing market the result of reckless credit creation by Japan's central bank?

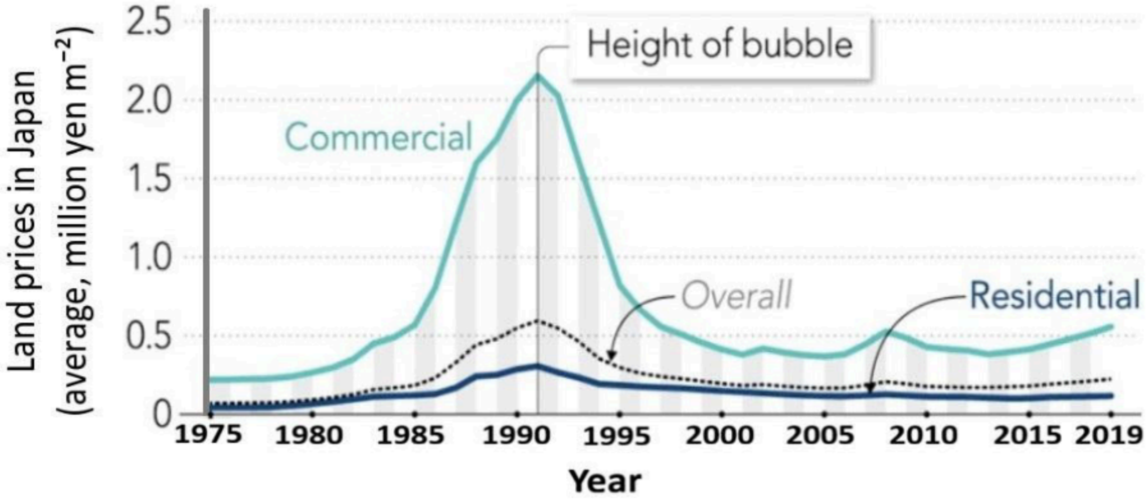

Figure 1. Land prices in Japan (average, in millions of yen per square metre), showing commercial, residential and overall trends, 1975–2019. Source: Ministry of Land, Infrastructure and Transport (Japan).

From 1980, the price of land took off. Commercial land went stratospheric, as documented by Japan's Ministry of Land, Infrastructure and Transport (Fig. 1). In the 1970s, land prices in Tokyo and Osaka doubled or more within a decade. Owning land came to symbolize wealth, which encouraged speculation in land and buildings. As governments funded transport and other forms of infrastructure, the value of commercial locations adjusted accordingly to capture the net gains from tax-funded public investments. Banks advanced credit to the speculators, thereby enabling the astronomical rise in commercial land. Residential property was more muted. Even so, as Fig. 2 illustrates, home owners were confronted by dizzying increases. As the bubble expanded, the media on both sides of the Pacific reported that, by 1990, the total land value of Japan was estimated to be worth more than four times that of the entire United States. The land beneath the Imperial Palace in Tokyo was estimated to be worth more than all of the real estate in California. That history continues to fascinate observers to this day [7]. Unfortunately, the real lessons as to what enabled the bubble to appear have still not been learnt.

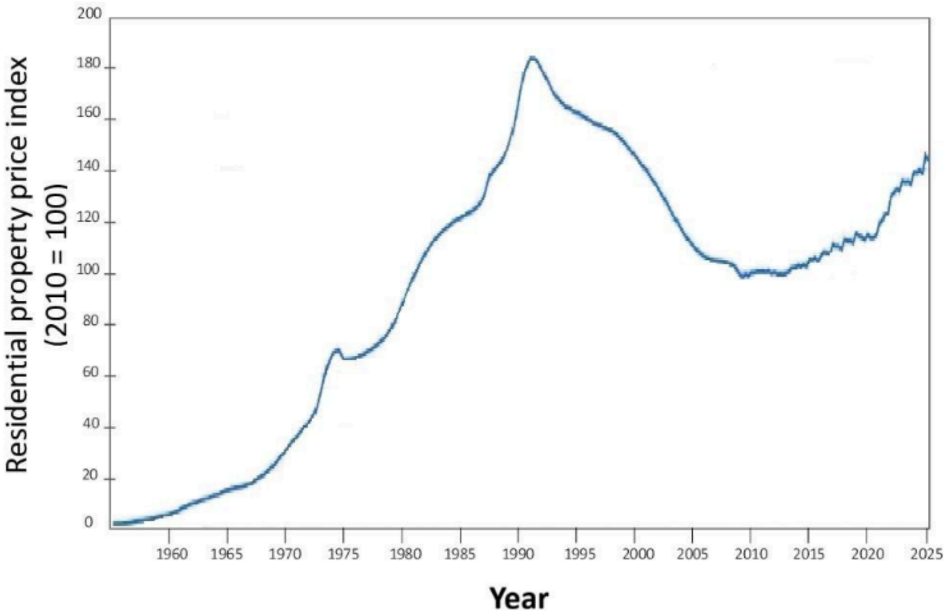

Figure 2. Residential property price index in Japan (2010 = 100), 1950–2025. *(Source: Bank for International Settlements (BIS), via Federal Reserve Economic Data (FRED))*

House prices serve as a proxy for the value of land. Dwellings diminish in value (through depreciation), while location values of the space beneath dwellings increase, in response to the growing value of the locality. Figure 3 shows Tokyo's land prices, following the bursting of the bubble. The values crashed, just managing an upturn towards the end of the 1992-2010 global land price cycle; and slumped again, as part of the global downturn now characterized as the Global Financial Crisis (GFC).

Figure 3. Tokyo Land Price Index, 1989-2024 (1990 = 100). Source: Based on Japan Ministry of Land, Infrastructure, Transport and Tourism data.

How could a creative, work-motivated population end up with such an economic disaster? For the answer, we have to go back to the Meiji restoration.

Discussion

In 1867, the feudal class of landowners (250 *daimyo*, or lords), were rendered redundant by a simple device: the switch of government revenue onto the rents of land. Land tenure was reconstructed through the Land Tax Revision Act (1873) [8].

The reforms were consistent with the doctrines contained in Henry George's *Progress and Poverty*, which became popular reading in Japan at this time. The economic implications were clear: by relieving peasants of the tax burden, people were free to work to their heart's content. As for those who possessed land, rent lost its lure as the "transfer income" (as now characterized in the economic literature). Much of it would be drawn into the public purse to fund social services. In the markets, there would be no incentive to speculate in land; investable funds would be focused on enterprises that added value to the wealth of the nation.

But, then, Japan introduced democracy in 1889. Their model was based on the British and German mixture of constitutional and absolute monarchy. The electorate would be composed of those who owned property. The samurai re-acquired power and began to reduce the tax rates on rent until the revenue was trivial. So, the standard fiscal regime of exploitation persisted in Japan through two world wars.

Following the detonation of atomic bombs over Hiroshima and Nagasaki, the defeated people of Japan began to rebuild their nation. For the first three decades, they were focused on adding value by reconstructing their economy. Then, in 1972, Kakuei Tanaka was elected Prime Minister. He had a plan for accelerating growth [8, 9]. The economy boomed – along with the real property (land and buildings) sector. Now, the nation's net revenue (economic rent) could be transferred with no fiscal constraint to the owners of rent-yielding assets. Taxation, far from deterring the speculation in land, enabled the diversion of investable resources into land and buildings. The rest is history.

The evidence, drawn from countries across the globe, is overwhelming. There is a structural flaw in the market economy which the authorised discourse fails to identify. The monetary system does need to be revised, but so does the statecraft which amplifies the pathologies that disrupt people's lives at so many levels. The problem is not with market economics *per se* (capitalism), which so many people now label as "broken". China's Communist Party, when it decided to adopt a measure of market economics, failed to adopt the fiscal safeguards to prevent what is called, in the literature, "free riding" – the transfer of net incomes, or economic rent, to private use. The inevitable happened. In 2021, Evergrande, the country's largest property company, defaulted on its offshore bonds; and collapsed into bankruptcy in 2024. The only way that the Politburo could avoid an economy-wide recession was to boost the export of cheap products, which created trading deficits for importing countries.

Conclusions

Combined, the monetary and fiscal mechanisms constitute the information highway servicing the market metabolism. For the market to operate at optimum levels – enabling people to work to achieve their aspirations – these two mechanisms need to function smoothly. At present, they cannot do so; mainly because the social structure is distorted by the nexus of property rights and public policies that privilege the income channelled to rent-yielding assets [10].

To achieve a healthy society, one that serves as an honest steward of the natural environment, all parts of the systemic network need to function organically. The monetary system does need to be revised, as illustrated by the confused state of governance in the UK in 2025. Law-makers sought to encourage small and medium sized businesses to borrow more money, to reverse the downward trend in productivity. But new investments in production and service delivery were not warranted by the level of demand in the markets. Why not? Rising house prices "mean that lending against residential property now accounts for over half of all bank lending" [10]. In other words, banks prefer the low-risk strategy of deals in which they take property deeds as collateral against the risk of defaults by borrowers. The value-creating entrepreneurial heart has drained out of the British economy, in favour of the culture of free riding. The combination of these forces is making homes unaffordable to many; and it squeezes incomes to the point where home owners have to cut spending on the goods and services they need.

Karim El-Ayoubi is correct in calling for a root-and-branch review of how the system works. The challenge is to overcome the obstacles created by the vested interests, who resist such a public discussion.

Disclosure Statement

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