Deserving economics

The Nobel Factor, by Avner Offer and Gabriel Söderberg, 2016
Economics in the twenty-first century, by Robert Chernomas and Ian Hudson

Peter Radford [USA, The Radford Free Press]

Do people deserve what they get? Or, do they get what they deserve? This is a dilemma that divides economics into two distinct sub-groups. The answer in what we can call the mainstream or majority sub-group is unequivocal: people get what they deserve. To put it in the words of Milton Friedman: "To each according to what he and the instruments he owns produce". This certainty of outcome, which bears no relation to the levels of luck, opportunity, or assets that an individual enters the economic arena with, is regarded as both ethical and natural by economists who subscribe to this majority view. In more vernacular language we are reduced to expressing this as "stuff happens" or simply "tough". There is no question that, in this view, each one of us is on our own. We are individuals who plough through life and whose welfare is entirely in our own hands. There is no greater nor lesser level for analysis. The individual is all there is, and whatever happens to that individual, in their economic existence, is attributable solely to their own efforts. There is no recourse, no assistance, no succor, and no relief. You are what you are. And you are alone.

Majority economics has taken this isolation and made it a cornerstone of its thinking. Everything inside the many theories and ideas of the majority is based upon a reflexive belief that aggregate behavior is simply that: an accumulation of lots of individual behaviors. There are no properties or behaviors of the aggregate that cannot be explained at the lower isolated individual level. Indeed, for the past few decades it has been accepted by the majority that all discussion and analysis of aggregate phenomena must be firmly rooted in what Robert Lucas called strong "micro-foundations". While to mainstream economists this stricture appears sound – they tend to think of their understanding of individual behavior as theoretically secure – it immediately introduces a bias difficult to ignore. It precludes, or at least it appears to preclude, theories that focus on aggregate phenomena: it downplays or even denigrates social or collective action that cannot be explained as the summing up of individual actions. This makes it extremely difficult to create space for a role for government in everyday economic activity.

Thus, majority economics provides the intellectual backdrop for the famous dictum of Margaret Thatcher that there is no such thing as "society" but only a collection of individuals. The coincidence of contemporary neoliberal policy making and the relentless emphasis on micro-foundations in economics with its elevation of market based thinking to dominant status is no accident. The two are obviously interlinked, and majority economics continues to impress its market bias into its students throughout the world whilst maintaining that it is "positive" or scientifically based.

Yet there is a manifest alternative, the existence of which belies this claim of the majority. Avner Offer and Gabriel Söderberg call this alternative Social Democracy in their recent book.

Unlike the majority view, Social Democracy recognizes the legitimacy of collective action and takes the position that people deserve what they get.

One practical way of understanding the essential difference between the majority view and its Social Democratic alternative is by looking at the way in which it handles the vicissitudes of life.

According to the majority view individuals have enough information, calculating capacity, and understanding to shift their income and wealth about within their lives. They can, thus, predict lean times when their earnings do not cover their expenses and compensate for the consequent deficiency by taking out insurance or by saving when times are good. So even though an average person is clearly going to experience great variations in their ability to provide for themselves throughout their lives, they have a sure method of coping. The key component of this view is that security is a commodity and that solutions to insecurity can be bought and sold in markets in the form of personal contracts. There is no uncertainty, everything is known, so the only problem is of suitable calculation and response.

In contrast to this, the Social Democratic view recognizes the central role of uncertainty. It acknowledges, too, that individuals experience periods of personal resource insufficiency, but because of uncertainty it assumes that both the period and extent of that insufficiency is unknown and unknowable. Contracting in markets therefore becomes problematic and the resulting logical response is to allow for social insurance in which all citizens receive assistance in times of insufficiency simply by being a citizen. Everyone deserves what they get.

History tells us that the Social Democratic view, articulated variously in the ideas of thinkers such as Maynard Keynes and Gunnar Myrdal, dominated in the decades immediately following World War II, a period in which many industrial countries built large social programs to cover the insecurities of health, education, and retirement. The legacy of that period lingers on in the continued existence and popularity of those programs and in the economic structure of the countries involved, but that continued existence is hotly contested and often subject to attack because of the overthrow of the Social Democratic view in economics in the late 1970s and the subsequent rise of the modern majority alternative.

It is the supplanting of the older system with the later individualistic market-based system that Offer and Söderberg seek to explain. Their primary question is: how did the market-based view come to acquire so much credibility that it has effectively eclipsed all other forms of economic thinking? One answer they provide is the legitimacy given it by the introduction in 1969 of the “Prize in Economic Science in Memory of Alfred Nobel”. This prize, colloquially known as the Nobel Prize in economics, becomes the centerpiece of their discussion of the rise in influence of market biased economic thought.

The majority view within economics needs support in asserting its legitimacy because it often appears more a body of fantasy than a serious attempt to understand actual economies. Whilst it is rich with arcane and hard won insights that are of immense value to economists it is also difficult to believe its credibility. Its many components require a mastery of what sometimes feels more like make-believe than science. It has the air of a religion rather than a field of genuine scientific study. One acute observer within the world of economics was reduced to describing economics, not as the study of economies, but as “what economist do”. While that comment was made in the context of the methodologies economists apply to the subject we can take it in a broader setting: majority economics is very much concerned with itself and not with real world economies.

Take, for example, the great swathe of majority economics that involves the search for “general equilibrium”. This search has its roots in a few almost carelessly uttered words of Adam Smith who wondered out loud how it was that the apparent order we see around us could possibly co-exist with the equally apparent selfish pursuit of personal goals. How, in other words, did all that selfishness contrive to end up as a socially beneficial whole? It was as if, Smith opined, an invisible hand organized our economic affairs and turned greed into good. Lead into gold. Alchemy. Whereas modern chemistry has moved on from alchemy, majority economics has not. It is still deeply immersed in the attempt to turn lead into gold.

Some of the greatest names in the history of economics, from Walras on, dedicated themselves to the question of general equilibrium, so when, in the early 1950s, Ken Arrow and Gerard Debreu produced a proof of its existence the entire profession gasped in pride. This was, surely, a massive step forward. That the proof was based on truly absurd assumptions that could never be realized in practice was set aside, and general equilibrium whatever its ridiculous foundation was moved into the majority view’s intellectual arsenal. The reality was, however, that the contortions necessary to arrive at the Arrow-Debreu conclusion stood as an indictment not a validation. Even the authors of its proof have, along the way, said as much. Yet, nothing daunted, and immune to criticisms of its other-worldliness, most economists accept general equilibrium as central to their theorizing. This ability to deny reality at any cost to hold onto an intellectually fascinating notion bedevils economics. Apparent magic and supernatural powers abound in its textbooks.

Another example is more practical: the sheer computational power needed by an average consumer to perform in the manner that most economists argue they do. Lurking inside the theories economists use to describe individual behavior is a series of assumptions that defy any observation of real people. Consumers, according to such theories, not only have access to all information, from everywhere, about everything, and for all time, but they have the amazing capacity to use this information in instantaneous, and we must admit, spectacular feats of calculation. That no computer exists to match these feats is not a barrier to most economists carrying on the argument and extending the discussion of economic transacting to include such prowess.

Reality, however, does intrude, but rather than retreat and come up with ideas that match the cognitive skills of actual people the majority view in economics persists and, instead, adds new wrinkles as if two acts of folly produce one insight of value. Milton Friedman, an early father of the majority view, argued that consumers “act as if” they were doing these prodigious calculations. After all, he said, billiard players do not articulate the mathematics of hitting ball into the side pocket, so why would we expect consumers to be aware of their ability to undertake the kind of calculation economics ascribes them? Economics is riddled with this kind of special pleading. Subsequent, but related, efforts to reduce the amount of calculation needed to make economic models tractable produced an even more odd assumption. This was the heroic reduction of the world into a combination of “representative agents”. One such a household doing the consuming, and another doing the producing. So, rather than engage reality, economists trying to mimic economic behavior created a caricature so simple that it eliminated reality entirely. All this to preserve the pre-eminence of clever and appealing intellectual wizardry.

If an economics of this sort was to compete with and then replace the existing Social Democratic view it needed bolstering. A Nobel Prize was just the trick.

Getting a Nobel Prize was, however, a complicated problem, and here Offer and Söderberg provide us with invaluable information. The establishment of the Nobel Prize in economics was a result of political conflicts in Sweden.

Economic policy in Sweden had, since World War II, been informed almost exclusively by the Social Democratic tradition. Social programs had been developed to cover the consequences of the uncertainties of life. Taxes were high enough to provide for these programs, with such taxation being recognized as a necessary aspect of social cohesion. Per Albin Hansson, a member of the Swedish Parliament, called Sweden "The People's Home" arguing that "The basis of the home is commonality and mutuality … In the good home you find equality, compassion, cooperation, helpfulness." Contrast this sentiment to that of Milton Friedman when he was asked about the establishment of the Mont Pèlerin society that he and Hayek created as an early conservative think tank. He said: "The threat to a free society that we envisaged at the founding meeting of the Mont Pèlerin Society is very different from the threat to a free society that has developed over the intervening period. Our initial fear was of central planning and extensive nationalization. The developing threat has been via the welfare state and redistribution." The clash between the two views is stark, with Hansson arguing for a collective perspective and the apparatus needed to support it, with Friedman condemning that apparatus as an intrusion on individual liberty and an anathema to the efficiency based miracle-working machinery of what has become the majority view.

Swedish business interests and the Swedish Central Bank objected, for less theoretical reasons, to the levels of taxation and the activity of government implied by Social Democracy and hankered for a way to give more market-centric ideas sufficient credibility that Hansson's home could be shrunk, if not eliminated. Serendipity presented them an opportunity: the three-hundred-year anniversary of the Central Bank could be celebrated in a typically Nordic way with the establishment of a prize in economics.

The struggle within Swedish domestic politics to roll back Social Democracy exactly mirrored the efforts to achieve the same objective within the economics profession. The coincidence in timing was perfect. Both sets of insurgents would benefit. Swedish business interests and the Central Bank would receive the backing of newly celebrated and suitably honored ideas, and economists seeking to further the cause of those market based ideas would add the embellishment of worldwide recognition to their intellectual revolution. The rest, as they say, is history. Economics is saddled with a prize that adds luster largely to its majority market based view, thus aggrandizing and embedding that viewpoint within the profession, whilst creating an additional obstacle for those seeking to attain credibility for alternative ideas.

This is not to say that the prize has always gone to mainstream thinkers. Indeed, the prize-giving committee has had to balance its ideological bias with a substantial number of awards to heretics. Offer and Söderberg go to great lengths to analyze the predispositions of the award recipients and one of their book's great contributions is to highlight just how balanced the award giving has been. Combatants on either side of the divide will recognize the names of many foes from the other in the award winners list. This balance has allowed the prize committee to retain credibility within the profession hence enhancing the award's prestige. There are oddities of course, such as when the urge to balance ended up with perverse outcomes. More than once have awards been given to two economists with contradictory ideas in the same year. The most recent example of this was in 2013 with the awards to Eugen Fama and Robert Shiller: the former an advocate of the purity of markets, the latter being a well-known critic of that purity.

So, if the origins of the prize were in the fight between Social Democracy and the market based majority view, and yet the prize has been awarded frequently across that divide, is there a different, subtler, message that having a Nobel Prize conveys to the public at each annual award time? Yes, there is. The prize confers scientific stature on the entire enterprise of economics, and here Offer and Söderberg end their book with a more profound question: is economics more like physics or more like literature?

Unlike the rest of their book the last chapter is a meditation on the state of economics, its manifest problems, and its ethical stance with respect to society. Up until this point the book is more a history and background to the establishment of the prize, accompanied by a standard recapitulation of the defiance the majority view has for the constraints of reality. By concluding in this way Offer and Söderberg give us all a great deal to ruminate on.

The establishment of a Nobel Prize in economics, albeit a prize that the Nobel family objected to and which is not conferred through the same channels as those for the physical sciences, was not simply a matter of creating an honor for the enterprise of economics in its entirety. It was, at least in part, an effort to give the then insurgent market-based faction the imprimatur of intellectual and scientific superiority. It was designed to give extra license to the increasing formalization of economics and to downplay the Social Democratic thinking that the insurgents wanted to overthrow. This was necessary because much of the work and opinion of the insurgents took a remarkably anti-democratic turn. To impress these ideas onto society it was essential that these anti-democratic principles be sanitized as being immutable "laws" akin to the laws of physics. Society had to be led to believe that resistance to these laws would be futile. And so the clockwork like predictability of those laws is said to grind on relentlessly banishing choice and dehumanizing key social relationships, and any attempt to mitigate the result of the operation of the market place is doomed to be a failure.

This unpalatable core message of the majority view runs directly counter to the more hopeful and optimistic notions of Social Democracy where society is quite able to deal with the uncertainties of life by acting as a collective and offsetting life's insecurities through cooperative rather than competitive means.

This dismal core message, laden as it is with a dismissive attitude towards democracy, is not some inconsequential sidebar to the whole of economics. On the contrary: it is the centerpiece. Take for example what is known as public choice theory which is antithetical to democracy precisely because of the fear that majority rule might encourage the invasion of the rights of the minority. It is built from the ground up as a repudiation of democracy. As Offer and Söderberg note, the ideological passion with which notable anti-democratic economists such as Friedman, Stigler, and Hayek is breathtaking, with the latter having been quite clear that he would trade away democracy to preserve what he called freedom – by which he meant the sanctity of private property.

Once this ideological driving force is exposed all the absurdities of economics and its ability to turn a blind eye to reality become easily explained. Its willingness to crush individuals into a rational straight jacket whilst pretending to give them choice; its deliberate ignorance of human cognitive limitations; and its stubborn loyalty to its core ideas despite those ideas having been demonstrably disproved, all make sense. It is a narrative not a science. It more akin to a religion than anything else. It is what mainstream economists would prefer the world to be like rather than an attempt to describe the world as it is. It is "what economists do".

So, is there any hope for the future?

This is the subject that Robert Chernomas and Ian Hudson attempt to tackle. We need briefly to touch upon their discussion because it fits neatly with that of Offer and Söderberg. Published last year, their book is a study of the work of younger economists all of whom have been awarded one of the other big prizes in economics: The John Bates Clark Medal. This prize is given only to young economists and is thus a guide to the future of the discipline. After all, the current crop of younger stars is likely to be a fertile source for future Nobel Prize winners.

The first thing we notice in looking at the list of Medal winners is their depressingly similar concentration in the same corners of the academy as dominant in the professional literature. Whether this concentration reflects the quality of the universities the young guns teach and research at, or whether it is some vestigial pecking order reflecting bygone power and prestige rather than performance we can leave for another day.

The second is that the work that they do is slightly away from the core base of economics and more often in topics of great contemporary interest. Things like income inequality, health care systems, and development seem to have captured their attention and they steer assiduously away from tackling those central elements of the majority view that so vex Offer and Söderberg. On the contrary, with varying degrees of explicitness these young stars export and utilize most of the equipment required to build the majority view. Rarely do they stray away from an individual perspective, rational behavior lurks in the background, and nowhere are the major influences of power relationships in society clearly built into their analysis.

So, at least in this group, there is little evidence to suggest a willingness to look inward and question openly the anti-democratic structure of mainstream economics. This is true even when they advocate social welfare policies, aggressively progressive taxes, or take a view on the role of institutions.

These two books, taken together, leave us contemplating mainstream economics as an often contradictory and other-worldly web of theories, more ideological than scientific, internally focused rather than facing the real world, and increasingly unwilling to face up to its anti-democratic core. Its younger stars appear uninterested in correcting that taint and yet simultaneously express a desire to think about issues of great social consequence.

We leave the tour these books give us more skeptical than ever that the mainstream in economics has either earned the right, or can be trusted to be objective, in the provision of advice to public policy makers. The conclusion in economics that outcomes are deserved and that we are powerless to invert them, or that we deserve more, is a matter of faith not science, let alone social science. Once we recognize this we are open to include other narratives in our thinking about the economy. Mainstream economics thus forfeits its exclusive grip on public policy making and becomes one of many competing narratives all equally important and valuable. Many of those other narratives benefit from not having the yoke of prizes weighing them down and preventing the importation of both novelty and open enquiry.

Perhaps economics would benefit from being free of its prizes while it re-acquaints itself with reality.

This is not a message of denigration of the efforts of economists, far from it. As Offer and Söderberg argue: let economists do what economists do. Let them theorize and ponder the arcane inner workings of economics. Rather, it is a message of humility and the recognition that economics is still in its infancy and that it cannot answer fully many of the questions its sets itself. Not least because it asks those questions only after having answered them. Ideology dressed as science is merely narrative. The full story of economics is yet to be told.

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