

The value of “thinking like an economist”

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Abstract

In a recent Facebook posting by masterclass.com, Nobel Prize laureate Paul Krugman invites the public at large to his master class where he will teach you how “to think like an economist”. This raises the obvious question, what is the value/utility of this masterclass, priced at \$120.00? In other words, what is the value of the information/knowledge that is provided? In this essay, we ask and attempt to answer the following question, namely what is the value of thinking like an economist? We argue that based on economics’ track record in its many sub-fields (micro, macro, international trade), its value is seriously in doubt, to the point of questioning the legitimacy of its sticker price. We argue that a more appropriate masterclass (i.e. one worth the money) would be one offered instead to economists (scholars and professionals) entitled: “Learning how human beings actually think/ behave and how physical systems actually behave.”

1. Introduction

In a recent *Facebook* posting by masterclass.com, Nobel Prize-winning Columbia University professor Paul Krugman invites the public at large to his masterclass where he will teach you “to think like an economist”.

For Nobel Prize-winning economist Paul Krugman, economics is not a set of answers, it’s a way of understanding the world. In his Master Class, Paul teaches you the economic principles that shape political and social issues – like access to health care, the tax debate, globalization, and political polarization. Heighten your ability to read between the lines and decipher the underlying economics at play (Masterclass.com).

This raises the obvious question, namely is there any value in thinking like an economist? After all, as the prospectus seems to indicate, economics is not a set of answers, but rather a way of thinking, a way of understanding the world around us. As the old adage goes, the proof of the pudding is in the eating. If thinking like an economist does not necessarily lead to good or right answers, then why even bother?

This essay takes a critical look at the track record of economics in a number of key fields, in search of a metric with which to measure the value or worth of “thinking like an economist.” This will then be followed by a critical discussion of the bedrock of modern economics, namely the axiomatic underpinnings of consumer and producer theory.

2. The value of thinking like an economist by field

In this section, we examine, in summary form, the contribution of economics by field, in search of questions and answers. After all, the ultimate purpose of science is to ask and answer questions. We begin with the question of economic growth.

2.1 The value of thinking like an economist: the case of economic growth

Growth is, by far, the bread and butter of modern economics, and indeed of all of the economics from Adam Smith to the present. It is noteworthy to point out that *The Wealth of Nations*, whose complete title was *An Inquiry into the Nature and Causes of the Wealth of Nations*, was first and foremost about growth, the growth of material wealth.

This raises the obvious question, what has 250 years of growth theory produced? After all, that's an awfully long time to be working on a problem. The answer is, not much. As Krugman himself argued in a 2014 *New York Times* piece, new growth theory, introduced in the 1980s with much fanfare (and a recent Nobel prize), has so much as fizzled out. In a nutshell, growth economics (old and new) has been a monumental failure, with paradoxes and puzzles galore, and no clear path for the future. For example, there's the Solow Residual, the Productivity Slowdown, and the Information Paradox. In short, not much to show for centuries of work, and even less to merit accolades and/or prizes.

2.2 The value of thinking like an economist: the case of macroeconomics

Truth be known, modern economics is largely the by-product of what we refer to as the gilded age of economics, namely the Keynesian epoch (1936-1976), when the profession had a set of policy tools that, in the eyes of the public, were efficacious – that is, that actually worked. As a result, governments invested heavily in information collection, and universities throughout the world created economics departments, offering newly-minted undergraduate and graduate programs. Economics had arrived so to speak, largely as the result of its success, of its new track record.

As it turned out, the resulting glory proved to be premature, as it lacked a consistent set of micro-foundations. Keynesian policies appeared to work, but no one knew exactly why. Moreover, as far as the Great Depression was concerned, the jury was still and is still out. So, we were left with a set of policy measures that appeared to work, but we knew not why? Nor did we know the underlying cause(s).

This fragile state of existence came to a screeching halt with the precipitous fall in growth in the 1970s, known as the productivity slowdown. The resulting use of fiscal policy failed to restore prosperity, and in little time, the bottom fell out of Keynesian economics, being replaced by the neoclassical consensus. In a nutshell, the government was powerless, and should as such, stay out of the affairs of the nation. Instead, it should balance its budget and pursue policies that are conducive to price stability.

The resulting ideology held sway for a quarter century, until the Financial Meltdown of 2008, when the profession was once again confronted with its past failures. The public reaction was predictable. Even the Queen of England entered the fray, asking England's leading macroeconomists why was it that they had failed to anticipate anything close to the crisis. Now, ten years after the fact, the underlying causes of the Meltdown remain shrouded in mystery.

2.3 The value of thinking like an economist: the case of international trade

The Productivity Slowdown did more than reawaken interest in growth, it also led to a series of policy heuristics, the purpose of which was to restore growth to post-WWII levels. One such

heuristic was free trade, which was touted by many as the answer to slow growth. More trade would be growth increasing, or so it was argued.¹

Unfortunately, most if not all of the trade-related policy measures enacted in this period were without any basis in science. Being a trade economist himself (and having won a Nobel prize for his contributions to the field), Paul Krugman should know that the scientific track record of international economics (trade and finance) is dismal, bordering on shameful. Despite two centuries of theories and hypotheses, not one has been proven scientifically, including his own work. In short, trade theory teaches us nothing useful about the real world. Which is not to say that it is not elegant and logically appealing. The problem lies with its usefulness.²

The recent rise of nationalism in the U.S., Britain and elsewhere, is a testimony to bankruptcy of international economics and a good measure of the immense costs of our ignorance. Free trade was supposed to work wonders for all concerned. Post-WWII growth rates were supposed to return. Clearly, it has failed to deliver.

2.4 The value of thinking like an economist: the case of microeconomics

Microeconomics is the systematic study of resource allocation in a world in which needs and wants are assumed to be unlimited, and where resources or the need to meet them, are limited. In contemporary microeconomics, the emphasis is on a particular institutional form, namely free markets where prices are called upon to “do the job” so-to-speak. As such, it stands to reason that price theory would be not only front and center, but be the standard against which success, or lack thereof, would be measured. After all, if prices are a mystery, so then is the whole process of market-based resource allocation, and thus all of microeconomics.

This then begs the question: do we have a good theory of prices and by good, we mean one that is tried, tested and true? In other words, do we understand prices beyond the obvious, namely that excess demand can lead to higher prices, while excess supply, to lower prices? Unfortunately, the answer to this question is an unqualified no. Despite decades of theorizing, the introduction of game theory, the advent of experimental economics, big-data and unparalleled computing facilities, prices remain a mystery to us. In short, while we have many models/theories of prices, we have few that actually work, as evidenced by the fact that non-economists resort to rule-of-thumb pricing models such as simple mark-up pricing techniques.

Nowhere is this “deficit” more obvious than in macroeconomics where, from the Keynesian revolution onwards, short-run price formation has been at the center of the debate, with the majority of scholars simply assuming that they were fixed. Another “price hotspot” is competition policy where price lies at the center of the debate over market structure and social welfare. Again, the lack of a good model of price formation makes the task of evaluating the social welfare implications of market structure difficult, if not impossible. On a broader level, it has contributed to a debate over the effects of industry structure (efficient

¹ An informal survey of regional free-trade agreements (FTAs) revealed that “promoting growth” was by far the most common objective, with no mention of greater gains in welfare from lower trade barriers. As such, trade policy is about growth, while trade theory is about welfare.

² Another glaring problem is its focus on final goods and services, when in actual fact, trade is fundamentally about value added, something the WTO-OECD has recently acknowledged. Value chains have, from time immemorial, been global in scope, with Britain’s 19th century trade flows being a perfect example (imported cotton, exported textiles).

structure versus Mason/Bain concentration) which has never been, nor will be resolved without a good understanding of prices. As such, analysts are unable to judge whether any given price (especially in concentrated industries) is excessive relative to the associated cost.

It goes without saying that the very core field in modern economics has a questionable track record, scientifically speaking. While it is elegant in its axioms and construction, logical in its reasoning and exhaustive in its breadth, it has been less than successful where it counts, namely shedding light on real-world phenomena.

2.5 The value of thinking like an economist: the case of income distribution

The field of income distribution has been a contact sport since a German political economist by the name of Karl Marx declared that because labor and labor alone was physically productive, any part of the final product allocated to the owners of capital was a form of theft. Invoking the most basic principle of property law (i.e. that of enjoying one's property), he went on to construct a model of social behavior based on class conflict.

Mainstream writers (classical political economy) responded in kind with what became known as neoclassical distribution theory, based on very non-scientific developments, namely the decreeing of capital as physically productive and thus deserving of its share of the proverbial pie. From this point on, anything and everything was or could be productive, and its remuneration would track its marginal product. The pinnacle of its success came with the KLEMS approach in the 1970s where capital, labor, energy, materials and services were deemed to be physically productive.

Despite its simplicity, this approach held sway for over three-quarters of a century. However, its usefulness, not to mention, relevance, has come under increasing fire, in response to (i) excessive executive compensation (ii) worker-less factories and (iii) falling wages despite rising productivity. One could go as far as to argue that the field of income distribution is currently in a full-blown crisis, as evidenced by the popularity of Thomas Piketty's *Das Capital*-inspired best seller, *Capital in the Twenty-First Century*.

2.6 The value of thinking like an economist: the case of economic development

For over three-quarters of a century, the economics profession concerned itself with one of the most pressing questions of the modern era, namely how to close the gap between the rich and the poor, between the first world and the third world. Riding the Keynesian wave of optimism in the post-WWII period, it was felt by many that having resolved (purportedly) the problem of the business cycle, the West could now bring an end to poverty. In other words, the lessons learned in the North could now be used as a guide to pulling the South out of its poverty.

While laudable, success in mentor-mentee-type relationships (which this was) in general requires a good understanding on the part of the mentor of his/her own past and factors that contributed to his/her success. Unfortunately, this is where things came unhinged. First and foremost was the fact that the West had not understood its past, its own rise out of poverty, and its industrial revolution(s). However, equipped with what it felt was a good understanding of wealth creation (neoclassical production theory), it set went on its merry way, focusing for the most part on capital. In keeping with the Solow-Swan model of growth, the key was believed to lie with a rising capital-labor ratio.

The end result was as disappointing as its central premise was simplistic, if not fallacious. Economic development as a field has been a complete and utter failure. Various measures of poverty have shown the lack of any gains over the course of the past half-century (China excluded). The lack of success has ushered in the current rhetorical approach, based in large measure on slogans. A good example is the multilateral organizations' (WTO, IMF, and World Bank) slogan of "freedom" as a solution to virtually every problem. Free trade has now become the universal panacea to poverty.

If by "learning to think like an economist," it should be understood, learning and integrating the aforementioned microeconomics, macroeconomics, economic growth, income distribution and economic development into one's thought patterns, then the question of value or worth is very much real, and one that deserves to be discussed in more detail. Clearly, if the proof of the pudding is in the eating, then the value of thinking like an economist is very much in doubt. If it leads to more questions, or equivocal outcomes/conclusions then its value is questionable, to say the least. If it is motivated by its track record (that is, ability to solve key societal problems) then again, its value is very much in doubt.

This raises the question, why? Why has economics as a field of inquiry performed so poorly? Why has thinking like an economist failed to provide answers to these and other pressing questions? Why have economics and economists in general fallen from grace over the past three decades – roughly from the productivity slowdown in the 1980s? In the next section, we attempt to answer this question.

3. The problem of weak first principles

Economics is both a social and non-social (pure and applied) science, social in its quest to understand human behavior in the realm of goods and services, and non-social in its understanding of material processes – that is, the way in which goods and services (our bread and butter) are produced. It therefore stands to reason that for it to be successful, it must decipher how human beings think, and second, how inanimate material processes behave. It must understand the mechanical and physical laws that underlie production processes. In short, before it can begin to say anything of value, it must understand its subject(s). Has it?

In this section, we argue that it hasn't on both counts, namely consumption and production.³ In short, modern consumer and producer theory is vestigial in nature, dating back to the mid-19th century, to a time when social sciences were virtually unknown and our understanding of production was devoid of science altogether. That this was the case back in the 1860s and 1870s is not the issue. Rather, what is at issue is the failure of economics to evolve, whether it be internally, or via the other related scientific disciplines (psychology, sociology, process engineering, applied physics). It is worth noting that all of these related fields have witnessed great progress over the intervening time period (e.g. the laws of thermodynamics)

3.1 Weak first principles: the case of consumer theory

For a college freshman, or any layperson for that matter, taking their first microeconomics course is akin to traveling to another planet or universe where the inhabitants are less

³ By consumption and production, it should be understood, mainstream consumer and producer theory.

evolved (more primitive), and where the laws of physics are, for all intents and purposes, suspended – in short, a case of social science fiction. It is a voyage back to a simpler time, a dark ages of sort, when behavior was ascribed to spirits, and motion, to something referred to as *vis visu*.

In short, s/he learns that we as a species are concerned uniquely with something we call utility, measured in utils. There is no reason given as to why we are so intent on maximizing it, but instead are told that it has to do with our fundamental nature. While simplicity and reductionism do have a place in formalization, it is not and should not be seen as the end result. Unfortunately, this is where consumer theory comes up short for this is precisely where the analysis ends. Everything and anything is and can be a source of utility.

While we can forgive the likes of William Stanley Jevons, Francis Ysidro Edgeworth and Alfred Marshall their simplicity in formalizing behavior in the 19th century, it becomes a matter for discussion/debate whether we can do the same in the 21st century, given the advances made in the related behavioral sciences of psychology and sociology. For some reason, the profession has remained impervious to outside influences, with the result that today, despite having similar interests and concerns, economists and psychologists/sociologists do not see eye-to-eye, and have little-to-no common ground. Reducing Homo-sapiens to a mere utility maximizer/automaton has not earned economics any brownie points in the rest of the social sciences.

In the end, it boils down to one thing, namely that the ultimate purpose of the social sciences is to learn how members of our species think—or attempt to understand the way they think and hence, behave. Given its track record in so far as consumers are concerned (or economic agents), it is not at all clear that we economists have succeeded in that part of our mission.

3.2 Weak first principles: the case of producer theory

The same criticism applies to producer theory where output is modeled as an increasing function of capital and labor. While this may have been acceptable to mid-19th century political economists, it is orthogonal to our (non-economic) current understanding of material processes. Broadly-defined physics has shown us that all material processes, bar none, are energy based, and that modern-day labor and capital, not being sources of energy, are organizational inputs (read: non-physically productive). In short, the laws of physics (kinetics and thermodynamics) are what govern production processes. There can be no exceptions and no violations. Again, the role of the economist in so far as production is concerned is to understand the behavior of material processes. Once more, it is not at all clear that we have succeeded.

4. Why are economics' "fundamental axioms" archaic?

This is an interesting question and one that I don't have the answers to. What I do know however is that despite major advances in its partner fields (related fields), it has remained impervious to incorporating these advances. Not surprisingly, this has created a rift between it and the other social sciences, not to mention the pure and applied sciences. On a personal note, in numerous interdisciplinary faculty meetings, I have heard more than my share of barbs aimed at economics and *homo oeconomicus*. I suspect that were I to be in an applied science faculty, I would have heard similar barbs directed at production theory.

So here goes. First, I believe that one of, if not the most important reasons has to do with the very history of capitalism, specifically with its ability to self-correct (avoid collapse) and more importantly, achieve full employment. The mid-19th century was plagued by recurrent recessions and depressions, leading many to argue that it was fundamentally unstable.⁴ Not surprisingly, this led to a quest on the part of classical political economists (read: the mainstream) to prove to the world that free markets were not flawed, and that capitalism could and did lead to first-best outcomes.

The task was daunting, to say the least. Any proof had to be bullet-proof, given the fact that the evidence seemed to show/point to the contrary. Unfortunately, what was lost in the exchange were the very principles that govern and guide scientific inquiry. In short, the theorists of the time had to engage in a form of reductionism – that is, reducing complex phenomena to simple ones, all in the name of proving their conclusion. Enter neoclassical consumer and producer theory. Only by stripping *homo oeconomicus* of his humanity and production processes of their underlying laws of physics could a system of equations be derived/formulated in order to prove existence and stability.

The need to do so was heightened by the events of the early 20th century, namely WWII and its aftermath (especially in England) and the Great Depression. Again, the onus was on showing that capitalism was fundamentally stable, and that recessions and depressions were of man's doing (read: government).⁵

Post-WWII developments did little to change this general direction. Two however stand out, namely Paul Samuelson's Principles, and Game Theory, both of which served to increase the formalization of what was an archaic base. Introducing static and dynamic optimization techniques (Lagrangians, Hamiltonians, etc.) borrowed from thermodynamics only made matters worse, sucking up all the oxygen in the room. Ibid for game-theory, which despite much fanfare, has failed to be a game changer.

While Keynesian economics provided the profession with its finest hour, public relations-wise, it had a deleterious effect on our understanding of investors, markets and the economy as a whole. Animal spirits, beauty contests, sunspots and rigid prices became the order of the day. Instead of being the opening salvo of more detailed analysis, these became the rallying cry for a greater role for government in all matters economic.

And last, the development of computable general equilibrium techniques, while a welcome development in any other setting, has further entrenched what are archaic axioms in economic analysis, owing again to its ubiquitous need for simplicity. The result is a quest to mimic the data with what are parsimonious models, the value of which is very much in doubt.

In conclusion, our need and/or desire for answers to the pressing question of the existence and stability of market economies has de facto prevented us from developing more realistic and complex models of behavior, both for human behavior and physical systems, making for the current "scientific" underdevelopment in economics as a social science. Advances from related fields have been and continue to be ignored, all in the name of the formalization needed to demonstrate the viability of a system which continues to be characterized by

⁴ The bulk of what can be defined as radical political economy (Owen, Sismonde de Sismondi, Malthus, and Marx) was motivated by this issue.

⁵ In this period, the proofs moved away from solving systems of equations, to topography (i.e. fixed-point theorems).

periodic crises. Put differently, formalization has retarded economics' evolution as a more complete social and non-social (pure and applied) science.

Summary and conclusions

As the ad puts it, Paul Krugman can teach you how to think like an economist. The question, however, is whether anyone would truly want to, given what is a questionable track record in key areas, and second, what is a set of fundamental axioms that serve not science, but a class of scholars who, for the last two centuries, have put ideology ahead of knowledge. One wonders, what is the value of proving that a system is stable, if its underpinnings are and continue to be orthogonal to the world it seeks to explain?

In closing, it could be argued the very notion of "learning to think like an economist" is a direct contradiction and violation of the purported nature and purpose of social sciences, namely that of understanding human behavior, or put simply, understanding how *homo oeconomicus* thinks and behaves. It therefore follows that if economists think any different from their subjects, then there is something blatantly wrong. Economists, like other social scientists, are charged with the task of showing how the way we as a species think and behave, affects the world (aggregate) around us.

As the old adage goes, the proof of the pudding is in the eating. And, increasingly, few are eating. Economics' heyday, as far as a way of thinking, came to an end with the demise of Keynesian economics. In the current context, much of that which economists have to offer invariably turns around the question of freedom versus government intervention. And for most of the post-Keynesian era, the former became the dominant ideology. Today, a decade after the Financial Meltdown, the profession is equivocating between both positions. The unfortunate part of this debate is the lack of bullet-proof fundamentals, making it more one couched in hunches, prejudices, heuristic principles and beliefs, personal anecdotes, etc. – in short, not the stuff of science.

Given the conclusions of this essay, we feel that more could be gained by turning the tables on masterclass.com and Paul Krugman by proposing a masterclass for economists on "how human beings think and behave" followed by a second course on "how material processes behave" – that is, are organized and operated. For only when we economists have a better understanding of human behavior in the field of consumption and the behavior of physical systems in the field of production, can we begin proselytizing to the world – that is, begin to ascribe a dollar value to it.

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