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Why Economists Are Part of the Problem

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I am one of the last members of an anomalous generation of economists who came of age in the period from the Great Depression and World War II to the antiwar movement of the 1960s. What made this generation anomalous was that its leaders — including such Nobel laureates as Jan Tinbergen, Paul A. Samuelson, James Tobin, and Kenneth J. Arrow — included a disproportionate number who were aware not only of the virtues of a market system but also of its limitations. Of course, even anomaly is relative; the generation that came of age between the 1930s and the 1960s also included Milton Friedman and Robert E. Lucas Jr., both Nobel winners who held to a faith in the market and eventually came to dominate the profession.

But for a time, students of economics were exposed to substantive debate about the economy by teachers who were sympathetic to the case for government intervention to manage the ups and downs of the business cycle and who believed there was a case to be made for planning, especially in the context of underdeveloped countries trying to escape endemic poverty. There was even room for a minority disposed to the case for democratic socialism. What characterized the anomaly, in short, was the large grain of salt that accompanied the abiding lesson of economics before and since: Markets are good.

For the youngest members of this generation, like myself, the student-led antiwar movement of the 60s provided a refresher course in what had attracted us to economics in the first place — apparent precision and science linked to the possibility of a politics that would transform real-world economies to better serve the interests and aspirations of real-world people — only to have it drowned out by the siren song of technique for the sake of technique. At the same time, the antiwar movement alienated the older members of the anomalous generation, especially those with vivid memories of a student movement in the service of Nazism in 1930s Germany.

Both the Depression and the antiwar movement sparked attempts to change economics, but with very different outcomes. And the differences are instructive for the present: It is a good guess that out of the present economic crisis will come many ideas for changing economics, but it is less certain whether the outcome will mirror the positive changes in economics that came out of the Depression or will reflect the unsuccessful attempts at change that came out of the antiwar movement.

The Depression gave us the Keynesian revolution, a new economics based on the denial of one of the most important premises of mainstream economics: that if markets are left to themselves, the price mechanism will generally adjust supply and demand, so that every potential buyer and seller willing to accept the going price can find a trading partner. The older generation of economists had been more or less unmoved when unemployment in the United States, as a fraction of the nonagricultural labor force,

hit 33 percent in 1933, but younger economists, particularly students, found it hard to credit the idea that the labor market was adjusting as the theory said it should. They flocked to John Maynard Keynes, whose 1936 book *The General Theory of Employment, Interest and Money*, provided a theoretical framework with which to understand the huge breakdown not only of the economy but also of economic theory. More important, it provided a convincing — to the anomalous generation — intellectual justification of the need for government intervention to manage aggregate demand and thereby mitigate, if not eliminate, the excesses of the business cycle.

This is not the place to tell the story of that revolution, a long and complex story in which both the novelty of Keynes's approach and whether or not it constituted a revolution are disputed. Suffice it to say that what started out as a fundamental critique of the mainstream has been absorbed into the canon. Over time Keynes's insights have come to be regarded as minor aberrations, sand in the wheels of the juggernaut of markets rather than a fundamentally new way of understanding the economy.

The present crisis has brought renewed interest in Keynes, and one of the consequences for economics, I dare say, is a long overdue revival of *The General Theory* as a critique of mainstream economics. Some of the insights that have been lost in the absorption process will be taken more seriously, particularly the difference between decision making in a world of radical uncertainty, where probability calculations avail little, and in a textbook world, where all decisions are made by optimizing agents equipped with, at the very least, the ability to meaningfully calculate probabilities.

Even without waiting for an updated Keynes, it is clear that the mainstream now takes seriously the idea that sand in the wheels may impede forward economic motion for a considerable period of time. As a result, the policy debate in 2009, as President Obama begins his term of office, is very different from the policy debate in 1933, when Franklin D. Roosevelt became president. Fiscal stimulus — increasing government expenditure and cutting taxes, the heart of the Keynesian policy message — is accepted as appropriate and necessary to limit the contagion of financial crisis. That is real progress.

The attempt of the 60s generation to make further inroads into the mantra of markets, however, made much less of a mark on economics. Like the Keynesian revolution, the effort was largely in the hands of young economists, just one side or the other of 30, who examined a host of issues ranging from the economic determinants of imperialism (the term "globalization" had not yet been invented) to the role of education, not only in imparting skills but also in shaping attitudes and beliefs appropriate to capitalism. I was one of those who focused on what was called in Marxist jargon the "labor process," the organization of work in capitalist enterprises. We generally accepted the Marxist idea that relationships among the participants in the production process are central to shaping society more broadly — its politics, its culture — but we questioned the determinism of Marx's idea that technology and resources in turn shape those so-called "social relations of production." At the same time, we questioned the related emphasis in mainstream economics on efficiency as the driver of history.

The purpose was political as well as intellectual. We believed, along with Thomas Jefferson (a more respectable forefather than Karl Marx), that "dependence begets subservience and venality." We took, as did Jefferson, wage labor to be incompatible with genuine freedom, and we challenged the concept that, in a world of complex technology, wage labor made for more efficient production than alternatives at once less hierarchical and more collaborative. (One might well wonder why we didn't focus the critique on whether efficiency itself should be the central focus of economics. Perhaps somebody, somewhere, did just that. For most of us, it was unthinkable. We were radical, but not that radical.)

Our work on work did not go unnoticed. But it is fair to say that, like other initiatives in so-called radical economics, we had much more impact in allied fields like sociology than in economics itself. I remember a younger colleague remarking, probably in the early 80s, that he had had to read a paper of

mine four times in various social-science courses as an undergraduate but had never encountered it in an economics course.

Why so little impact? For one thing, we lacked a leader of the older generation with the stature of a Keynes; student activism had scared off at least some of them. Far more important, the political movement from which we drew sustenance died out very quickly once American military involvement in Southeast Asia began to wind down. We had thought, or rather hoped, that we were witnessing the beginning of a movement that would change the economic, political, and social order. It turned out to be more like the peasant rebellions that the great French historian of the Middle Ages, Marc Bloch, compared to a conflagration of a heap of straw, producing a bright flame but petering out quickly.

Keynes once suggested that economists aspire to the level of dentists: "If economists could manage to get themselves thought of as humble, competent people, on a level with dentists, that would be splendid!" At the time, the idea of a humble economist might have seemed plausible: Alfred Marshall, Keynes's teacher and longtime professor at the University of Cambridge (at a time when students had just one economics professor), began his canonical text, *Principles of Economics*, which went through eight editions between 1890 and 1920, with a definition of economics as the study of "mankind in the ordinary business of life." But shortly thereafter, Lionel Charles Robbins, in his *Essay on the Nature & Significance of Economic Science*, redefined economics as "a science which studies human behavior as a relationship between ends and scarce means which have alternative uses." Ever since, economists have pushed the frontiers of the discipline to the study of scarcity — within the family, the political arena, and myriad other places. Sometimes the fresh perspective of the economist has provided real insight. Mostly it has pre-empted a possible dialogue among various disciplines of social inquiry with an intellectual presumption that stifles other voices.

The most glaring instance of that presumption is how economists have intervened in the debate on global warming. Typically they model global warming as an investment decision: to stabilize levels of carbon dioxide and other greenhouse gases would impose costs on the economy from now into an indefinite future, but would show benefits only after some 50 to 100 years had elapsed. So to decide whether stabilization is economically worthwhile, we must compare two trajectories for the world economy: a "carbon stabilized" trajectory, which incurs significant upfront (and continuing) costs, and a "business as usual" trajectory, which incurs no stabilization costs but eventually produces economic losses because of global warming.

It turns out that stabilizing carbon levels is at best a mediocre project when subjected to normal investment criteria. A key determinant of the merit of any investment project, including investment in preventing global warming, is the rate of interest "charged" on upfront costs incurred to provide future benefits. No interest need actually be paid, but it is customary to figure in its costs, or what amounts to the same thing, to discount future benefits. Much hinges on the choice of interest rate. The lower the rate, the more attractive the prospect of preventing global warming, for which the upfront costs are large and the benefits a long time coming.

Businesses often use interest rates of 10 percent or more to screen projects. Consumers often pay more than 6 percent on mortgage debt and much higher rates on credit-card debt. In poor countries, interest rates typically run into double digits. At such rates, the future benefits of preventing global warming fall far short of the costs. Indeed, at any rate around 5.75 percent, the *present value* of the benefits is less than the present value of the costs, even if the losses were ultimately 20 percent of global gross domestic product. In short, in terms of mainstream criteria, the case for incurring the costs of carbon stabilization is underwhelming.

The only problem is that such analysis pretty much misses the point. The important issues are not

intertemporal — consumption forgone today versus more consumption tomorrow — but inter-regional. The likely impact of global warming will be very different in the rich countries, situated for the most part in the temperate North, than in the tropical and subtropical South. For instance, rising sea levels may inundate small areas of the coastal United States but wipe out much of Bangladesh. And the rich countries are better placed to mitigate or adapt to the impact of global warming. For the rich, global warming may be damaging; for the poor, a catastrophe.

The influential *Stern Review*, a report published in 2006 and named after Sir Nicholas Stern, its principal author, then chief economist in the British government, takes note of that difference. For him, a world stabilized at a level he regards as about the best that can realistically be achieved "would be a dangerous place." Dangerous indeed: "Deaths of hundreds of millions of people (due to food and water shortages and extreme weather events)." Stern adds: "Social upheaval, large-scale conflict and population movements, possibly triggered by severe declines in food production and water supplies (globally or over large vulnerable areas), massive coastal inundation (due to collapse of ice sheets) and extreme weather events."

Distributional issues are thus at the heart of climate change, but in a very different sense from the one implicit in the standard economic model. The question is not, What is our obligation to our progeny? It is, What is our obligation as citizens of the rich North to inhabitants of the poor South? That ethical issue takes on added bite because of the disproportionate contribution the North has made since the Industrial Revolution to the increase in atmospheric carbon. (China has recently overtaken the United States as the largest emitter of carbon dioxide, but that fact is misleading for two reasons: first, because a significant fraction of China's emissions results from the production of goods consumed by Americans, and second, because on a per-capita basis, China's emissions are barely a quarter of U.S. emissions.) Surely we who have benefited so greatly in material terms from our ignorant and offhanded treatment of the environment owe the people who are most threatened by the consequences of global warming.

How do we reconcile that obligation with standard economic computations? The economist once again has an answer: We should keep our eyes firmly fixed on the prize of efficiency, and take the course of action that maximizes the size of the economic pie rather than take preventive measures against global warming. If the pie is larger because we do nothing to prevent global warming, there is more for everybody. The winners can compensate the losers.

There is significant sleight of hand there. Transfers from winners to losers may not be sufficient compensation — how do you compensate people for the loss of their way of life, as distinct from their way of making a living? But that issue aside, compensation is problematic even within a political entity like the nation-state, which has both the power and the legitimacy to redistribute wealth and income. But the "global" in global warming makes the notion of compensation totally implausible. In the international arena, there is no institution with the authority necessary for redistribution. Only by preventing, or at least limiting, climate change will vulnerable populations be protected — even if doing so is not "efficient."

But distribution is only one aspect of the problem. A second issue rejoins a question that Keynes raised in a very different context: How do we know when we do not know? Like the world of finance and investment that Keynes studied, the most salient feature of the global-warming debate is, in the end, how little we know. Probabilistic models shed some light on the future, but quantification breaks down in the face of the overwhelming uncertainty about the effect of the economy on greenhouse-gas emissions; the effect of those emissions on global warming; and, finally, to complete the circle, the effect of global warming on economic activity.

Given the uncertainty, it makes little sense to rely on a sophisticated calculation of the present value of

benefits and costs. That does not mean we should take uncertainty as a reason for doing nothing. Prudence dictates that we accept the inconveniences of airport security checks for the sake of forestalling terrorist attacks even though we cannot meaningfully calculate the probabilities. By that logic, we should accept the modest costs of forestalling the dangers that might result from unchecked global warming.

Climate change is not the only example of economics' becoming part of the problem rather than part of the solution. For many years, I have been concerned with the negative impact of the market on community and with how economics has facilitated the market in that regard. The 19th-century physicist Lord Kelvin famously proclaimed the virtue of knowledge imbued with the precision of number: "When you can measure what you are speaking about, and express it in numbers, you know something about it; but when you cannot measure it, when you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind." Economics goes physics one better: Anything you can't measure — like community — simply doesn't exist. It goes without saying that economic hardship, especially the kind caused by unemployment and shortened working hours, will make community more necessary and more visible; people will have to rely on one another more and more as the market fails them.

I have observed that politics is the key to the difference between the impact of the economy on the discipline of economics in the 30s and the absence of such an impact in the 60s. The Keynesian revolution allied itself to a revitalization of politics, a broadening of the political agenda, and that broadening of politics was a necessary condition for influencing economics. By contrast, after the meteoric rise of Eugene McCarthy and his equally rapid fall in 1968 (and the reprise of the McGovern campaign in 1972), nothing much was left of the New Left. Accordingly, the new ideas of radical economists had little impact on mainstream economics. The revitalization of politics symbolized by the New Deal became progressively watered down even as Richard Nixon proclaimed in 1971 that we were all Keynesians now. Ronald Reagan's ascent and his appeal to working-class Democrats heralded the end, and Bill Clinton provided the epitaph when he announced that the era of big government was over.

Like politics, economics has become progressively narrower since the 1960s. In my undergraduate years, in the late 50s, the ghost of Joseph Schumpeter still stalked Harvard Yard, and his immediate disciples argued with the disciples of Keynes about the future of capitalism. Even if few Marxists or radicals were to be found on American campuses in those post-McCarthy years, the questions they had raised — like whether American capitalism could survive without the huge government military budgets that the cold war had legitimized — were very much on the table. Today that kind of substantive discussion has no place in most economics departments. We have gained technical sophistication, but we have lost something much more valuable.

Economics is a two-faced discipline. It claims to be a science, describing the world without preconception or value judgment. (Never mind that the heyday of positivism that enshrined the separation between fact and value is long past; economists have always lived in a time warp.) The reality is that descriptive economics has been shaped by a framework of assumptions geared more to its normative message than to its pretensions. The self-interested individual — who rationally calculates how to achieve ever more consumption, whose conception of community is limited to the nation-state — is a myth, not exactly false but a half-truth at best. That framework is essential to the normative side of an economics that proclaims the virtues of markets and is maintained even when it gets in the way of understanding how the economy really works.

At times of crisis, the emperor's sartorial lack becomes more obvious and the need for clarity more acute. We are living through such a crisis today, and we desperately need clarity on the relationship between fixes for Wall Street and fixes for Main Street; on the relationship between immediately mending the financial system and the broader economy and the longer-term problems that face the

economy, starting with global warming. A beginning would be to update Robbins's definition of economics as the allocation of scarce means among unlimited ends. That one-size-fits-all definition hides the reality of two distinct problems.

In poor countries, the economic problem is to produce an increasing amount of goods and services with limited means. Even there, distribution, and making sure people in need reap the benefits of growth, is an issue. However, the problem in the rich countries is not scarcity. Let us be clear about why recession is a calamity in the rich countries: It is not because of the output that is lost, but because the loss of a job means a corresponding loss of income and consumption for many people.

Consider this: Even if 10 percent of the labor force were to become unemployed, the loss of production would be manageable if we had mechanisms to share the losses of the unemployed among those who remain employed, in ways that did not undermine the dignity of the unemployed. Economic growth is the way out of recession not because we need the goods, but because the new jobs created by a growing economy are the only way that people laid off during the downturn can reclaim an adequate standard of living, along with their dignity as full-fledged members of society. Recessions are calamitous because the welfare state provides too little, not because it provides too much.

A renewal of economics must include an awareness of what is being sacrificed on the altar of endless growth: the environment and community. It is a reasonably good bet that the present crisis will stimulate bold thinking about both. Whether the seeds of intellectual change will find a favorable soil in which to germinate and grow into healthy plants, however, will depend in large measure on whether the questioning of economics can ally itself to a movement to broaden the political discourse: to include discussion of the purposes of growth and the virtues of restraining our appetites, of a revival of social solidarity so that we can fashion a new relationship between individual and community, between government and market.

We need to take seriously the proposition that "we are all in this together." The Obama campaign promised a revival of a broader politics. It remains to be seen whether the Obama administration will deliver on that promise. And what economists will learn from the crisis.

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