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Book Review

Robert Skidelsky, What's Wrong with Economics?: A Primer for the Perplexed

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Robert Skidelsky yearns for an earlier time when the type of economics he advocates enjoyed respectability, if not dominance. The solutions to the question, What's Wrong with Economics? have been available to economists for generations, but present-day economists do not see them nor find need to look. Yet, it is good for any discipline to re-examine itself upon occasion to learn how it might improve. Neither economics nor plumbing are perfect, and the texts that will be written about each at some distant date will likely reflect a new and different accumulated knowledge.

Skidelsky holds the British titles of Baron and Lord. Emeritus Professor of Political Economy at the University of Warwick, he is an accomplished academic who has taught several of the social sciences and published a number of books, including an award-winning three-volume biography of John Maynard Keynes. His long and flexible political career includes stints as a member of the Labour party, the Conservative party, and a latter-day Social Democratic party, of which he was a founding member.

As with Keynes, whom he greatly admires, Skidelsky was not trained as an economist, which provides him the outsider's perspective sometimes required for intelligent criticism. It is clear from his repeated invocation of the fact that most economists and their models failed to project the 2007-2008 financial crisis that criticism and serious revaluation of the discipline are warranted.

In his view, Adam Smith and other well-rounded political economists/philosophers of the classical age set the correct tone in seeing the creation of wealth and its appropriate distribution as the proper study for economists. Although Smith's focus on individuals, free markets and laissez faire represent departures from his own approach, the author finds agreement with Smith's observation that economics may tend toward the selfish rather than toward sympathy for one's fellow man. David Ricardo took economics in the direction of the classical labor theory, the cost of production, and a concern for the distribution of wealth, all issues that subsequently led Karl Marx down a political path of social revolution.

The first of two paradigm shifts in economics, as described by Skidelsky, occurred with the marginalist revolution of the 1870s. It ushered in supply and demand, and marginal magnitudes which destroyed the notion of the "just" price, or value as different from price, and undercut Marx's exploitation of labor theory. Marginalist Stanley Jevons' work also is credited with the start of economics as a mathematically-oriented science, a methodological move antithetical to Skidelsky's interest. The second paradigm shift, the Keynesian revolution of the 1930s, was somewhat offset by British economist Lionel Robbins' 1932 redefinition of economics in terms of scarcity, which later led economics back to mathematical efficiency, the utility-maximizing individual, and the scientific approach of the marginalists.

The foundation of Skidelsky's objections to the manner in which most modern economists practice their discipline is the rational, utility-maximizing robotic man who makes independent, marginal choices in a world of scarcity. Such a simple person can be modeled mathematically and aggregated from a micro world to a macro world as the basis for quantitative predictions. However, the author observes, natural phenomena, which is unchanging, can be modeled, but real and complex humans, cannot. Thus, economists, who suffer from physics envy, cannot obtain reliable empirical results from their econometric simulations, but natural scientists, in conducting lab experiments, can hold real variables constant to obtain useful solutions. The financial crash of 2007-2008 proves economists did not model humans correctly. It also confirms, Skidelsky asserts, that no single theory about humans such as robotic man can apply at all times to all people.

Economists who hold the view of the rational robot also make the mistake of mixing risk with uncertainty, which allows them incorrectly to apply mathematical probabilities to events not subject to such probabilities. Further, although the efficient, independent robot makes his marginal choices in a world of scarcity, it is also a world of competitive free markets which naturally tend toward a state of Walrasian full-employment equilibrium. Another mistake of modern neoclassical economists is the assumption that the consumer robot is sovereign, and not subject to outside influences in decision-making. Such faulty reasoning, maintains Skidelsky, could be corrected with an understanding of John Kenneth Galbraith's notion that advertising drives consumer choices, and the unshakable view of social democrats that the individual's actions are shaped by his firm, or friends, or group, and not the other way around.

Skidelsky's litany of criticism continues by way of a grand tour through the social sciences. Misguided Nobel economists who seek to tweak or twist the neoclassical perspective often play a role on the tour as settling for the good as enemy of the great. Paul Samuelson goes so far as to praise economics as the "queen" of the social sciences because of its capacity to make quantitative predictions in contrast to the qualitative predictions of others. The author contends that economic theory is simply theory cloaked in the authority of science which leads the shortsighted to miss the fact that central banks, huge corporations and other technological institutions function through the exercise of political power, not scientific superiority.

Nobelist Thomas Sargent is a good example of those neoclassical economists who employ rational expectations, treat humans as robots and incorrectly reduce uncertainty to quantifiable probabilities. Behavioral economist Richard Thaler attempts to replace eco-robot with a more realistic actor, but misses the author's point that society determines the individual's actions. Experimental economists only draw attention to irrational ways people behave rather than the faulty way economists model their behavior. Nobelist Gary Becker invokes expected monetary payouts to explain crime and love, but his approach fails because "…what was to be maximized was social honour, not money" (p. 104).

Nobelist Ronald Coase uses transactions costs to explain why firms exist, but ignores Skidelsky's claim that people bond together in a firm because of "…the fear of being alone in an uncertain world" (p. 118). Transactions costs also, incorrectly, serve Nobelist Douglass North in explaining the innovations that spurred economic growth in the 18th century. Many economic historians mistakenly employ statistics and math ("Cliometrics") rather than narrative to analyze past economic developments. Even Thomas Piketty's massive empirical undertaking to examine income and wealth inequities is not convincing because all statistical time series are just approximations of reality. Interpersonal relations are an appropriate element of game theory, but its failing is that it makes no attempt to dislodge the neoclassical rational man. Efforts to replace GDP with "happiness" measures are well-intentioned, but technically flawed in that agreement on what is good is not universal. Ironically, the author's suggestion for improvement is a public discussion that would solicit agreement on such basic goods as health, respect, and security with no recommendation as to precisely how that might be arranged.

Another deficiency of economics, according to the author, is that robot man, as a utility-maximizer, has unlimited wants in the face of scarcity, which leads to excessive, ad-driven consumption and deterioration of the environment. The selfish instincts of today's robot man exact great costs to the planet which harm tomorrow's citizens. Neoclassical economists have been diverted from the study of such important issues as inequality, automation, and climate change, an assertion that appears unsupported by, for example, the explosion of environmental economics journals. The focus of neoclassicals on individuals and markets ignores the massive power of big business, labor, advertisers, and governments. Quantitative neoclassical economists cannot model power, and the enormous funding of economic research by business and governments discourages them from the required change of approach. Moreover, journal editors are largely American, math-oriented neoclassicals who do not seek diversity of expression, contributing to the domination of all other schools of economic thought from Austrian to Swedish to Marxist.

Skidelsky advances numerous proposals detailing possible new directions for economics, but they can be reduced to two:

1) Recognize that decision-making is exercised by the group or institution, not the individual utility-maximizer; and

2) Blend economics with the other social sciences, rather than treat it as the Nobel-awarding "queen" that it professes to be.

If economists could agree with the author's notion that the individual's action is established by his social position within the group, firm, or other organization, then the neoclassical insistence that sovereign consumer's maximize anything could be undercut, thereby eliminating the application of mathematically-based quantitative predictions, opening the door to the recognition of the power of institutions, especially business and government. Teachers can pivot to observe that micro principles are based on macro principles, rather than the obverse-as is currently done - and start their business structure classes with the prevalence of oligopolistic and monopolistic forms before addressing the special case of competitive markets. Keynesian economics would be restored to the macro primacy it enjoyed before the rational economist revolution of the 1970s-80s, and would not be taught as a special case of general equilibrium explained by the lags inherent in sticky wages and prices.

With his first objective accomplished, the author could turn to his second which, in removing the quantitative element from economics, allows it to take its place beside the other social sciences as an important, but merely equal peer. Classical economists were correct in applying economic reasoning to growth and distribution issues, but they also acknowledged its limits in the need to align in varying degrees with sociology, philosophy, political science, psychology, ethics. John Stuart Mill, Walter Bagehot, Keynes and Galbraith also saw the virtue of economics as an inclusive, not exclusive discipline. Despite Keynes' background in mathematics and probability studies, he remained somewhat dubious about its application to economics. Rather than applying simple maximization principles to the consumer, he encouraged thinking about "…human behavior under varying conditions of knowledge… " (p. 185), an approach the author suggests "…points the way to a unified social science methodology" (p. 185). In fact, he contends, "…the only defensible purpose of economics is to lift humanity out of poverty. Beyond this the lessons of economics end here…" (p. 193) and those of ethics, sociology, etc. take over. The economist should become familiar with other social sciences in order to make qualitative, superior forecasts, but not attempt to intrude into the domain of peer social sciences.

Although there are crucial differences, Skidelsky's views echo those of Social Democrats Avner Offer and Gabriel Söderberg's ("OS") 2016 book attacking rational expectations- based economics, which is not surprising, given his connections to the Social Democratic party. All authors employ as an analytical springboard faulty macro forecasts derived from rational expectations, general equilibrium models without citing superior alternatives. They declare that economics is not a science, and observe that it is the group to which the individual belongs that matters, not the individual. They view economics as normative in terms of opinion or "should", support economists Keynes and Galbraith, and lament the timing of the turn of economics toward the neoclassical approach.

Skidelsky uses his social economic reasoning to reveal his interpretation of the discipline's deficiencies; OS portray those same deficiencies to assert the alleged superiority of social democratic policies over neoclassical economic theory. One finds in both books references to Nobelists in support of a particular point of view (for a different perspective on economics Nobelists, see Spencer and Macpherson (2020)), but while Skidelsky shuns empirical evidence, OS attempt to create it. OS attack the Swedish Central

Bank's successful efforts to lobby for an economics Nobel prize in part because of a perceived policy of the Bank to support business over labor interests; Skidelsky downplays business-labor distinctions in favor of citing a central bank as derived from neoclassical scientific authority when it should be viewed an important social institution that exercises political power.

Unlike Skidelsky who admonishes the recent development of experimental and behavioral economics as a diversion from robot man, OS applaud the new direction, which has been rewarded with frequent Nobel recognition.

In promoting the other social sciences' employment of qualitative, opinion-based reasoning, Skidelsky fails to acknowledge the growing use of mathematics in virtually all of them, which could be said to stem from Aristotle's introduction of empirical observation into the study of politics. In his denunciation of robot man as a theory of human behavior which cannot hold for all people at all times, his social democratic theory that the individual's actions are inevitably determined by the group attempts precisely that. His focus on neoclassical utility maximization leading from micro to macro ignores the importance of recent contributions by Nobelist Paul Romer and others to growth theory, the only element of economics he maintains that can be justified by the discipline. His only evidence of poor macro performance is the 2007-2008 financial crisis, which could be considered an anomaly in comparison to the preceding 20-year "Great Moderation" period and the succeeding U.S. 10-year record expansion that ended with Covid-19.

Skidelsky suggests that economic forecasting would be improved with the use of qualitative, not quantitative, inputs, perhaps drawing from the other social sciences. He refers to Tetlock (2005) who champions this sort of approach, and says very little about any other evidence for the mechanism through which improved forecasting might actually be achieved. In fact, his analysis and recommendations might carry more weight with the reader were he to explore this line of forecasting more fully rather than remain mute about DSGE forecast models in an apparent effort to separate Keynes from the new Keynesian and new classical methodology upon which such models are based.

Skidelsky's approach might be best advanced by way of the familiar left brain-right brain framework. Neoclassicals could be said to view their mathematical, analytical, scientific methodology as left brain dominant with forecasts emerging from well-defined models. Professions typically associated with left brain analysis include engineer, accountant, doctor, editor, and lawyer. Economics, as it is generally taught, is seen as fine preparation for the law (as is philosophy) based on the logical manner in which students learn to alter the assumptions that underlie standard models.

Skidelsky economists would tend to synthesize rather than analyze data, deal with ambiguity as well as with simplicity and somehow integrate inputs from all social sciences to produce, through extra rational processes, decisions, hunches, or forecasts. Professions that fit the right-brain category include artist, architect, entrepreneur, poet, detective, and high-level politician.

Skidelsky's case for the need for change in economics is derived largely from the failure of most economists to predict the 2007-2008 financial crisis. Although he provides no evidence that his approach in fact corrected that failure, it is possible that a methodology that relies on synthesis, rather than analysis, of the competing data could prove superior. When those forecasts consistently outperform those of the neoclassical models, then it becomes time to consider movement toward his framework of cures for what's wrong with economics.

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