Economic ideas you should forget

Bruno Frey, David Iselin 26 May 2017

It is high time to forget some economic ideas that hinder progress in the field. Some examples include the assumption that GDP is the best way to measure economic progress, or the belief that economic growth will eventually improve the welfare of the population as a whole. This column discusses some of these ideas and argues that economics is a progressive science that is enriched by the 'creative destruction' of ideas.

Economics is a well-established discipline. Nowadays, students all over the world use similar introductory textbooks and learn the same type of methodology, theory and empirical techniques. There is indeed a great amount of consensus among academic economists.

Yet, there are many puzzles and unresolved issues in economics, especially since the Global Crisis (Coyle 2012). The narrow conception of the macroeconomy as a system in equilibrium, for instance, is problematic (Kirman 2012). Many other questions remain, such as how to deal with interest rates that have dropped below zero. How to measure, and consequently integrate into GDP figures, non-priced transactions such as the ones going on in the 'gig' or sharing economy? How to sell the gains of international trade to a mainly national public? A better knowledge is required of what theories still hold, and in particular, which of them are outdated and need to be discarded because they are misleading, or at least no longer fruitful. This is exactly where the problems start. In his *General theory of employment, interest and money,* John Maynard Keynes (1936) stated, "The difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds." Old ideas are ramifying economists' minds.

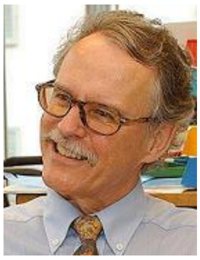
John Quiggin in his 2012 book, *Zombie economics: How dead ideas still walk among us,* labelled those old ideas as 'zombie' ideas. In particular, he mentions the 'efficient markets hypothesis' and the 'great moderation' as two ideas that economists cherished wrongly and for too long. John Brockman and his organisation and website, Edge.org, continued the funeral of old ideas in 2015 with the book, *This idea must die*, in which, for instance, Margaret Levi buried the *homo economicus*. However, this is not the only idea we should forget.

To be fair, economists are often attacked from outside their field for ideas they no longer hold. For instance, this applies to rational expectations as a behavioural assumption in financial markets, the assumptions that markets are always efficient, or the idea that individual utility depends only on absolute consumption.

There are also many examples of economic ideas held by the public that should be forgotten as well. Examples are that pay for performance raises performance, that natural resources bring wealth, that taxes are paid because of expected punishment or that artists are poor and thus unhappy.

Many government programmes are based on ideas that are no longer supported by the majority of academic economists. Examples are that home ownership is a good thing, that helicopter money helps to overcome the present problems in our economies, that public spending reduces unemployment over the long term, that innovation programmes lead to innovation and that abolishing cash can limit corruption and tax cheating.

But let us dig into some examples where economists are also slow to adapt. Much has been written about the flawed concept of GDP (Stiglitz 2009). Even the European Commission has started a 'beyond GDP' initiative where the EU is searching for indicators that are more inclusive of environmental and social aspects of progress. Even so, most economists still use GDP as a target variable that should be increased. The reasoning behind this is that per capita production and consumption of goods and services are considered to be the fundamental criterion of people's well-being. Hence, the conclusion is that growth and well-being go together. Anything that



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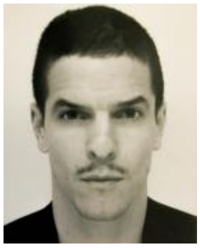

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maximises GDP is thought worthy of pursuit. This neglects the fact that well-being is a very individual experience that cannot be measured by external factors.

A counter argument would be that GDP at least allows for comparison over time and among regions, although economists are well aware of the flaws. However, if we never start with challenging GDP as our core variable, economists will be always surprised why people are dissatisfied with their situation.

The same holds true for the trickle-down or 'a rising tide raises all boats' allegory. The rising tide proposition is frequently made in relation to economic growth. Increases in GDP, so the argument runs, flow through to eventually improve the economic welfare of the population as a whole. As we just said, to put GDP and well-being at the same level is not appropriate. But why is the rising tide not lifting up all boats? First, economic growth over any given period is always unevenly distributed among sectors, with some sectors growing and others possibly shrinking. Second, economic growth is unevenly distributed among individuals. Does it matter, say, that the top 5% of the population enjoyed a 20% increase in their income if the income of the bottom 5% rose by only 2% over the same period? It does although one could say that the poor are still better off. But the gap between rich and poor will have grown wider, other things being equal, and the negative consequences of increasing inequality in the distribution of income will continue although everybody is supposed to be better off.

So, what could be the answer? One proposal is that it is the government's task to maximise the happiness of the population. Forget about that. There are many concerns about a benevolent happiness maximiser. First, governments are not per se benevolent and unconstrained. Second, which happiness measure is the right one? Third, a maximisation of reported happiness reduces citizens to 'metric variables'. Fourth, when there is an agreement on the measurement, there are incentives to manipulate the measure. Fifth, what moral values are behind achieving happiness? Should taking drugs be regarded as a happiness enhancer?

As these examples show, to have a well-balanced view on which economic ideas should be discarded is of importance far beyond the discipline of economics itself. Policymakers and the public should also educate themselves about which ideas hold and which do not. In a recently published book (Frey and Iselin 2017), we make an effort to provide such information. We collect no fewer than 71 contributions from academic scholars all over the world. Some are prominent economists – such as Daron Acemoglu, Alan S. Blinder, Richard Easterlin, David Hendry, John Kay, Margaret Levi, Andrew J. Oswald, Eric Posner, Jeffrey Sachs and Hans-Werner Sinn – and others are lesser known young scholars. The collection also includes contributions from academics outside economics, including from sociologists, psychologists and ethnologists. Younger scholars and 'outsiders' may be particularly well-endowed to see 'dead wood' in economics which is no longer useful for today's world. We aim to reveal the diversity of opinions and evaluations, to stimulate the discussion and to push forward knowledge. We see economics as a progressive science that does not lose its force when parts of its theory are empirically rejected. On the contrary, to discard unhelpful and misleading ideas shows that a discipline is vigorous as suggested by Joseph Schumpeter's idea of 'creative destruction'.

Ideas are the drivers behind innovation, may they be political, economic, in the arts or in science. "Nothing is as powerful as an idea whose time has come" is a popular remark attributed to Victor Hugo. This is certainly correct. However, the power can also lie in abandoning old ideas before moving to the new ones.

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