

Letter from America

Shutting up shop, at least for now?

Arguing against recent criticisms that economics cannot answer major questions, Angus Deaton's latest Letter from America shows that economists understand a great deal about how the world works.

According to a recent *Financial Times* column by Samuel Brittan, at the end of his life Keynes came to believe that economics was in a period of turmoil that, at least until things were sorted out, had destroyed its applicability to policy. Some feel that economists today should listen to Keynes, though I suspect that many find it more tempting to follow his example, not his advice. Non-economists have been admonishing economists, from the Queen's pointed questions about why economists did not see the crisis coming, to a speech a year ago by Robert Zoellick, President of the World Bank. Zoellick, who employs a large number of economists, argued for 'democratizing development economics', that knowledge needed to flow *to* the North and West not just *from* the North and West, and jibed that 'in physics, Nobel prizes are awarded for being correct while in economics they are often awarded for being brilliant'.

(It is an interesting exercise to list economics laureates, and allocate them to one or other of Zoellick's boxes.) The barb brings to mind Niels Bohr's visit

to Kings', during which he

asked Keynes for a nice economic problem for a physics rest day. Keynes suggested he think about the stock market, and Bohr came back to high table the next evening with something very close to the efficient markets hypothesis. Once Keynes had recovered from his merriment, he suggested that Bohr stick to his atoms, and so delayed the birth of modern finance for 50 years. Many would argue that the switch from trying to predict the market to understanding that it cannot be predicted was one of the great successes of modern economics — something that was not just 'brilliant' but 'correct' — so that it is ironic that the profession should now be so heavily criticized for failing to do something the impossibility of which, at least in part, is one of its signal achievements.

Facing the critics...

Another influential economics skeptic is a one-time family doctor from Oklahoma, US Senator Tom Coburn, who has set himself up as a scourge of wasteful government expenditure and who targeted the National Science Foundation in an April 2011 report. The NSF spends about \$7 billion a year, mostly on the physical sciences,

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biology, engineering, and mathematics, and has a relatively small SBE directorate (4 percent of the budget) standing for 'social, behavioral, and economic' sciences. SBE has been for many years a major funder of basic research in economics in the US, including data collection such as the Panel Study of Income Dynamics. Coburn's report is of a quality that would have shamed the late *News of the World*. Like that lamented publication, much of it is about sex, about NSF employees 'pervasive' viewing of pornography on the web, and about NSF researchers at the South Pole who exhibited 'moral failure' by indulging in spare time activities that in some cases involved nudity ('Guilty, m'Lud!') The report mistakenly identified \$1.7 billion that should have returned to the Treasury (the sum turned out to be previously committed but undisbursed funds), and produces a long list of 'silly' projects, that 'most Americans will consider fraud,

waste, and abuse'. Only a few of these are in economics, including Charlie Brown's calculation that a husband generates seven hours of additional housework for his wife (a classroom exercise on

using the PSID that was not funded by NSF), which is taken as evidence that the \$60 million that the NSF has spent on the PSID over the years was wasted. Out of all of this, Coburn draws the 'obvious' implication, that the NSF should stop funding social, behavioral, and economic science. Physics, biology, and engineering presumably do not lead to the moral failure that the report documents in such meticulous (and even photographic) detail.

...with the evidence

Meanwhile, the social, behavioral, and economic sciences directorate of the NSF had been active on its own behalf and, in the end, the Coburn proposal was defeated. (The NSF offered work on kidney matching and spectrum auctions as examples of economics funding that had benefited the nation.) In 2010, the Director issued an open invitation to economists to write brief white papers identifying 'grand challenges' in economics that might help shape NSF funding in the future, and 53 economists responded.¹ Collectively, they are an excellent antidote to grumpy old men who are prone to over-critical views of their profession, or to those who spend too much time reading the

shrill debates in the media. They are honest about problems and important things we do not know but they are also full of ideas for the future that build on the successes of the past. There is an impressive amount of agreement. Macroeconomists, while claiming some recent success in monetary policy, are uniformly concerned about their inability to incorporate financial frictions and systemic risk into macroeconomic models and about the lack of recent work on fiscal policy. More broadly, these papers remind us that we know a lot even when our understanding is incomplete. Oliver Hart (writing about contract theory) notes that ‘theory is enormously useful in clarifying the trade-offs and helping us to avoid the adoption of policies that may actually be counterproductive’. Helping stop nonsense is important, and we are good at it. Life-cycle theory is another example. It is incomplete and in many respects incorrect, yet it is hard to see how without it we could even begin to think about pensions, aging, or the funding of healthcare. Dani Rodrik argues that our fault has been forgetting that good economics avoids the commitment to *one* model, but rather consists in knowing how to choose one from *many* according to circumstance.

Many of the white papers call for more data, including internationally comparable micro data, the easier use of administrative data, and the ability to ‘drill down’ from macro aggregates to various levels of disaggregation. The last was one of the more important recommendations of the Stiglitz Commission and is currently being pursued within the American statistical system. What is perhaps most surprising is the almost universal call for greater collaboration with other disciplines, particularly but not exclusively with other social sciences. Behavioral economics and psychology are everywhere, and it is much harder than once was the case to see any real distinctions between what economists do and what is done by sociologists, psychologists, and political scientists. This is not the imperialist economic enterprise of 20 years ago, where economists set out to conquer their poor sisters — armed with rational choice and a self-proclaimed monopoly on the tools of causal inference. Nor is it the funder-enforced tokenism of which Michael Boskin rightly warns. Instead, economists now believe that it is impossible to think about economic development, or about macroeconomic policy, without incorporating politics, and that sociology and psychology have serious things to tell us about human behavior. Of course, we have hardly started the most difficult tasks, including, as Peter Diamond notes, discovering what the insights of behavioral economics tell us about the working of markets.

While it is hard to rejoice in the quality of economic policy making today, it will not be done any better in the absence of the knowledge that economists bring to the table. Economists have indeed learned a lot since Keynes.

Note:

The grand challenges white papers can be found at
<http://www.aeaweb.org/econwhitepapers/>

The Rybczynski Prize for Business Economics

The Society of Business Economists has, since 2000, awarded an annual prize for the year’s best piece of writing on an issue of importance to business economists. The Rybczynski Prize — worth £3000, thanks to the generous sponsorship of KPMG — is awarded in memory of the late Tad Rybczynski, an eminent economist and long-serving former Chairman of the Society.

Essays can be written especially for the competition, or may be work published in the course of 2011. The judges will be looking for around 3000 — but not more than 4000 — well-written and thought-provoking words. Previous winners have been Roger Bootle, Simon Briscoe, Joanne Collins, Fergus Hicks, Thomas Mayer, Pam Woodall, Kevin Daly, Ian Bright, a research team of four Italian economists and, last year, George Buckley. To have the chance of adding your own name to this list, please contact the SBE secretariat at admin@sbe.co.uk, or visit the SBE website, for an entry form. The closing date for entries is **5 December 2011**.

The Certificate and Prize will be presented by the SBE President and Chairman at the Society’s Annual Dinner early in 2012, and the winning entry will be published in the Society’s journal *The Business Economist*.