

Preface

The goal of this volume is to demonstrate the ways in which introductory economics textbooks are deceptive, insofar as they insist on singing the praises of free markets, keeping any demurrals muted. I demonstrate this stealthy quality by “deconstructing” line-by-line the well-known textbook by Paul Samuelson and William Nordhaus, *Economics* (19th edition) (hereafter S&N). Note, however, that it is by no means the worst available. It is just one example among the many similarly flawed textbooks. The inconvenient truth is that current principles textbooks in use have changed very little, if at all, after the financial crisis, although their authors should have realized that their textbooks are inadequate for the post-Meltdown world. It is amazing that competition has not created a more appropriate outcome. No less an authority than Nobel Prize-winning economist Joseph Stiglitz declared prematurely after the crisis that “neoliberalism as a doctrine; market fundamentalism is dead.”¹ Unfortunately, you would not know it by reading the textbooks in the field which influence millions of students, year in and year out.

Actually, the courses based on these textbooks are “toxic” for a number of reasons, including:

- (a) They assume that people are rational, thereby completely disregarding the work of major contributors to the field such as Herbert Simon, Daniel Kahneman and Amos Tversky; in an important sense, the standard

¹In a speech in November 2008, Stiglitz declared, “This September has been to market fundamentalism what the fall of the Berlin Wall was to communism. We all knew that those ideas were flawed, that free market ideology didn’t work; we all knew that communism didn’t work, but these were defining moments that made it clear that it didn’t work. . . . America really has a system. . . . a kind of corporatism corporate welfareism. . . . under the guise of free market economics. And it is that mixture that was fundamentally flawed, incoherent, was intellectually bankrupt from the beginning, that has been shown not to work.” Joseph Stiglitz—“Market Fundamentalism is Dead,” YouTube video, posted by ForATV, November 10, 2008. https://www.youtube.com/watch?v=x_2-Tv2GPs0, accessed, February 6, 2010.

assumptions in economics are anachronistic insofar as they are pre-Freudian and pre-Pavlovian.

- (b) They disregard the effects of incomplete and asymmetric information on choice and on allocation of resources by overlooking the path-breaking work of scholars such as George Akerlof and Joseph Stiglitz.
- (c) They assume that tastes are exogenous—that is to say that people enter the economy with tastes fully formed—which, of course, is very far from reality. This is most important, because conventional economists do not consider feedback effects from the business community to influence individual tastes. Once that assumption is made, however, it is no longer possible to discuss the extent to which consumers are manipulated through Pavlovian conditioning, through the influence of the unconscious mind, and through cognitive capture. This is probably the most pernicious of the various assumptions.
- (d) The default model in mainstream economics is the perfectly competitive model which is of negligible importance in today's world. Instead, oligopoly and monopolistic competition should be the default model. (The fact that S&N's textbook is selling currently for an exorbitant price of \$307, although the cost of production of a volume is probably in the \$15 range is a good example of oligopolistic pricing in such captive markets. After all, the students are compelled to purchase the textbook once it is assigned by the professor and the professor has no incentive to shop around for less expensive alternatives, although they do exist.²) Clinging on to the perfectly competitive model is a damaging strategy, because it enables policy makers to apply incorrect models to important issues of the day such as financial deregulation. In fact, this is the model that Alan Greenspan had in mind while he was in charge of the financial sector and why he ruled out the possibility of a destructive bubble. After all, bubbles do not occur in a perfectly competitive model with rational agents and perfect information. The damage to the world of his dogmatic insistence on mainstream orthodoxy should be obvious to everyone.
- (e) Conventional economics textbooks overlook interdependencies. Yet, there are all sorts of externalities not only in production but in consumption as well. Hence, they overlook conspicuous consumption and its corollary: "keeping up with the Joneses," the quest for social status that often drives people into a debt trap from which they are unable to escape.
- (f) Textbooks invariably provide examples of simple choice between two goods disregarding the challenges of more complex decisions in which quality and other intangible attributes are difficult—and often impossible—to ascertain. In addition, they neglect the fact that choice almost always involves a sequence of decisions which is computationally much more demanding than the no-brainers they offer as examples. In other words, the textbooks overlook the

²For example: Neva Goodwin, Jonathan M. Harris, Julie A. Nelson, Brian Roach, Mariano Torras, *Principles of Economics in Context*, (Routledge: 2014) is selling for \$82.

fact that obtaining reliable information and path-dependence are two major hindrances to optimization.

- (g) They pretend to be scientific and value free but end up being ideological through the assumptions they make. For example, the refusal to distinguish between basic needs and other goods leaves an ethical void in their teachings that enables them to take a neutral stance regarding price gauging in the pharmaceutical markets.

These examples are not exhaustive by any means. There are many other crucial concepts that are neglected in mainstream textbooks such as the important role of power, of transaction costs, and of uncertainty in determining economic outcomes. The above list merely illustrates some of the ways in which mainstream principles of economics textbooks distort our worldview with immense political, cultural, and economic consequences, as the financial crisis of 2008 demonstrated. However, students of economics deserve and need a more complete perspective and a more truthful rendering of the real-existing economy.

Thus, my goal in this volume is to critique the worldview of conventional economics and provide alternative perspectives. My version of free-market economics emphasizes that the human element should be paramount and moral judgments should override market outcomes to the extent these are not to the benefit of the common weal or distribute the benefits of economic activity disproportionately. In other words, what is important to me is not GNP as much as the quality of life; I believe that the focus should not be on inanimate objects or on abstract concepts but how people live and fare in the economy.

To be sure, many professors argue that introductory textbooks have to present a watered-down version of reality, because one has to lay the foundations before students can learn more sophisticated aspects of the discipline. In other words, principles textbooks should convey a very simple overview without getting bogged down in the details of more advanced ideas. Such justification for half-truths is, in my opinion, selling the readers way too short, is counterproductive, and is hardly warranted because the simplification distorts to such an extent that the students leave the course with a distorting caricature of the economy.

I think that a more realistic version is compulsory from the very beginning for at least four crucial reasons: (1) Half-truths do not belong in a scholarly publication, and especially not pretending to be the whole Truth and nothing but the Truth; (2) it is much easier to learn a discipline correctly the first time around than learn the watered-down version and have to unlearn it subsequently, as it is extremely difficult to unlearn something. The human mind is not that flexible once the neural networks are connected, they are hard to rewire; (3) the more sophisticated ideas are actually not so complicated and can be presented at the introductory level; (4) most of the more than a million annual readers of principles textbooks do not continue learning economics so they never do get the more sophisticated version of the discipline anyway and are therefore misled for the rest of their lives. Thereafter, these students, however, go on to become voters responsible for choosing among policies and newspaper editors or small-town mayors—in other words, their careers

take them to responsible positions within the society—mistakenly thinking that they have understood the basics of markets and continue to believe that they work efficiently as a matter of course. Hence, it is most important to approach the first course in economics with a fuller perspective before one is socialized into thinking that competitive markets can always and everywhere provide efficient solutions automatically. Paraphrasing Frank Sinatra, half a Truth does not appeal to me.

While agreeing that markets are important and useful institutions I believe that we should control markets and not the other way around. Markets should be regulated so as to provide for the common good. I advocate Capitalism with a Human Face in the tradition of economists such as Joseph Stiglitz, John Kenneth Galbraith, and Robert Reich. I believe that creating a just economy should be on our agenda and that the fruits of such an economy would benefit all and not only a handful. In my just economy people would not be excluded from the labor market.

In contrast, in mainstream classrooms free markets become God's gift to humanity, government is the boogeyman, and taxation is a burden on society's well-being. But such claims are bogus! Taxes are used to finance schools, basic research, and infrastructure and markets go haywire without adequate government backstop as the recent "mother of all financial crises" so amply demonstrated. But most teachers of Econ 101 are immune to such evidence. After all, the models work perfectly well on the blackboard!

But the models are so simplistic that they present a caricature of the real existing economy. Charles Ferguson in his Oscar-winning documentary "*Inside Job*" demonstrated most vividly the culpability of academic economists. Stiglitz has also repeatedly warned that the invisible hand metaphor ought not be taken seriously: "the reason the invisible hand often seemed invisible was that it was not there. . . . Markets by themselves do not lead to economic efficiency. If we look at examples of market successes and failures around the world, we see that many are understandable in terms of economic theories based on imperfect markets in which governments must play an important role. . . ." ³ The Federal Reserve in Washington, DC had no less than 300 PhD economists working for it, yet were incapable of seeing the crisis brewing for years. Presumably those who dared to disagree with Greenspan's ideology that bubbles were nothing to worry about and that markets worked perfectly well without government supervision became outcasts.

So it should not be surprising that students around the world demand a more colorful palate of perspectives. After all, markets are man-made institutions. So the human element with its emotions and complex psychology should be an integral part of the discipline. These students do not want economics to become a branch of mathematics. There is a growing global resistance to the fantasy world created in mainstream courses. The walkout of students from their Principles of Economics class at Harvard in solidarity with the "Occupy" movement is just one example of

³"Joseph Stiglitz: Smith's 'invisible Hand' a Myth?" YouTube video, posted by ForaTV, March 8, 2010. <https://www.youtube.com/watch?v=9qjvwQrZmpk> accessed June 1, 2014.

this realization.⁴ They realized that the economics they were being taught was doctrinaire, failed to provide a balanced perspective on the real existing economy, and did not show sufficient empathy for the 45 million people living in poverty. No wonder, the economics being taught on blackboards in most classrooms makes it appear as though markets descended straight from heaven while maintaining a conspiracy of silence on the Achilles heels of free markets such as not paying sufficient attention to safety, not caring enough about the environment, accepting an obscene distribution of income and wealth, and being indifferent to the welfare of future generations.

A group of students in 16 countries are also pushing back on the arrogance of mainstream economists and are demanding that a more realistic economics be taught with fewer abstractions, less emphasis on mathematical methods of problem solving, and more attention devoted to the plight of the real-world economies.⁵ They are resisting the mainstream's view that super rationality reigns in the market inhabited by consumers with sufficient brain power to know every detail of the economy and therefore are not satisfied with anything less than achieving an optimum outcome. They do not believe that most people possess perfect understanding of all the nuances in small print and perfect foresight from the beginning to the end of their lives and are not inhibited by the challenges of information overload insofar as information is not free, not available instantaneously, and not a cinch to understand.

To be sure, markets do work perfectly well on the blackboard. However, what the students are demanding is that they work as well in real life and not only in Fairfax County, VA—one of the higher income counties in the USA—but also in the South Bronx, NY, a low-income slum. In other words, they are demanding a paradigm switch in the curriculum of Econ 101. This volume is a step in that direction. It should make it possible for students to understand the weaknesses of the mainstream approach and for professors to offer alternative perspectives.

⁴Jose A. Delreal, "Students Walk Out of Ec10 in Solidarity with 'Occupy'," *The Harvard Crimson*, November 2, 2011, <http://www.thecrimson.com/article/2011/11/2/mankiw-walkout-economics-10/>, accessed July 22, 2014.

⁵John Cassidy, "Rebellious Economics Students Have a Point," *The New Yorker*, May 13, 2014. <http://www.newyorker.com/online/blogs/johncassidy/2014/05/rebellious-economics-students-have-a-point.html>, accessed November 21, 2014.

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