How Dead Economic Theories Persist
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How Dead Economic Theories Persist
A compelling case against the efficient-markets hypothesis, trickle-down economics

Reviewed by Glenn C. Altschuler

Kids say the darndest things, and so do economists. Mistaking beauty (expressed in elegant equations and titillating theories) for truth, some of them in recent decades have declared victory over recessions and depressions; proclaimed that unfavorable price/earnings ratios shouldn’t scare stockholders in the post–industrial digital age; and predicted that financial instruments could radically reduce—or eliminate—risks to investors.

They were wrong, of course. Nonetheless, according to John Quiggin, a professor of economics at the University of Queensland in Australia, ideas that have been discredited through facts-on-the-ground analyses of the dot-com bubble of 2000 and the global economic crisis that began in 2008 are “already reviving and clawing their way through up the soft earth.”

Zombie Economics, he tries to put a stake in the heart of several—the great moderation of the business cycle; efficient-markets hypothesis; dynamic stochastic general equilibrium; trickle-down economics and comprehensive privatization—before they do damage again.

Lucid, lively, and loaded with hard data, passionate, provocative and often persuasive, Zombie Economics provides a valuable perspective on the development and direction of macroeconomics. It should be required reading, even for those who aren’t Keynesians or Krugmanites.

Quiggin is especially dismissive of the efficient-markets hypothesis, which he labels the “central theoretical doctrine of market liberalism,” and trickle-down economics. Convinced that economic analysis should focus on assets rather than income—and that only the private sector can accurately assess assets—efficient-markets partisans were untroubled by imbalances in international trade or in savings and consumption. They demanded that markets, not governments, make decisions about investment and production. The result—financial deregulation, a massive expansion of financial institutions (which increased their share of corporate profits in the U.S. from 10% in the 1980s to 40% in 2007), and the removal of controls on the movement of global capital—brought about an economic meltdown. To those who even now say it ain’t so, Quiggin invokes philosopher Karl Popper: If a theory can’t be refuted by any conceivable evidence, it ought to forfeit its credibility.

Quiggin demonstrates that emperors of trickle-down economics have no clothes. Between 1973 and 2006, he reveals, real median income for middle-class families rose at a puny annual rate of 0.4%. For males with a high-school education or less, real wages have declined. Perhaps most strikingly, in a country that prides itself on providing equal opportunity, 42% of American men whose fathers are in the lowest quintile of income distribution remain there. Starting out poor, then, doubles the chances of staying poor. The comparable statistic in the United Kingdom is 30%. To be sure, “effects,” in the form of government subsidies, increase the resources available to the poor, but Quiggin is surely right that the stagnation reflected in the official data is not a statistical illusion.

Global economic challenges, Quiggin concludes, can best be addressed not by market liberalism but by a Keynesian system of macro-economic management. Keynesians, he suggests, now know how to solve the problem of “stagflation” that bedeviled—and discredited—them in the 1970s.

Though critics will accuse him of trying to bring the dead back to life, he makes a compelling case that Keynesian policies—government-stimulus packages during recessions, inflation-fighting measures during economic booms, regulation of financial institutions, progressive income taxes, a mixed system of public and private ownership of goods and services—are now appropriate and even necessary.

Equally important, Quiggin reminds us that the economy is not and should not be simply a “machine for aggregating consumer preferences and allocating resources accordingly.” Embedded in a complex social structure, the economy should also accommodate itself—or the collective “we” should accommodate it—to non-economic values. So let’s hope, with Quiggin, that the current crisis will produce a more realistic, responsible and socially useful body of economic thought.

Reviewed by Glenn C. Altschuler, the Thomas and Dorothy Litwin Professor of American Studies at Cornell University.

Blast From the Past
A warning about socialism

Reviewed by Gene Epstein

This short novel tells an engrossing story about a socialist paradise that swiftly degenerates into a societal dungeon. Originally published in an English translation back in 1988—which adds immeasurably to its resonance—it has been reissued recently in paperback by the Ludwig von Mises Institute (http://mises.org), a research center on free-market economics.

Utopian and dystopian fiction is often weakened by cardboard characters. Not so in this case. German author Eugene Richter (1888-1966), a libertarian politician and journalist none of us is likely to have heard of, was not only blessed with uncanny insight about the realities of socialism, he had a novelist’s ability to create engaging characters.

The story is narrated by a middle-aged bookbinder named Schmidt, who initially welcomes the “entirely new and glorious times...in store for us” as socialism takes over Germany. As events unfold, he grows increasingly troubled, providing reasoned analysis suffused with denial that borders on the comical. Vowing to “set down, in a humble way, some little account of the beginning of this new reign of brotherhood and universal philanthropy,” he never reveals his first name. But we hear about his son Franz, daughter Annie, daughter-in-law Agnes, and his “better half, Paula,” while experiencing his pain as he recounts their reversals at the hands of the new socialist order, climaxing in his own tragic end.

This is not a socialistic of Stalinist murderers, but of social engineers who unhesitatingly subordinate freedom to their egalitarian ideals, a path that leads inevitably to totalitarianism, material impoverishment and violence. When the government’s plan to confiscate all financial assets leaves the narrator’s daughter-in-law Agnes “incorruptible,” Schmidt sympathizes, explaining that “for a long time past she has been industriously saving up.”

But after the confiscation decree is issued, he reports that “it was in vain that my wife sought to comfort [Agnes] with the thought of the opulent dowry which the Government now held all newly married couples to receive.” Of course, the government goes increasingly broke and fails to deliver.

After the government asks all citizens to register their preferences for a job, with all wages set at perfect equality, Schmidt sadly reports: “Those who have manifested a desire to become cleaners of sewers are, numerically, not a strong body.”

The solution is to hold a lottery, with losers taking the more onerous jobs. When his son Franz derides these “man-raftles” as demeaning, Schmidt is forced to concede the point. But he resists the argument that plenty of people will volunteer for onerous jobs once the “spirit of Socialism” is “fully awakened.”

Then the government bans emigration and starts shooting people who try to escape across the border.

So compelling is this story of emerging socialist horror that it briefly filled me into imagining that the whole world read this novel in 1988, and was duly warned against installing such an evil system. Alas, history didn’t quite happen that way.

Gene Epstein is economics editor of Barron’s.