



A Better Paradigm to Achieve a Better Society

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Based on joint work with Allison Demeritt and Karla Hoff



The Need for a New Paradigm

- The equilibrium framework that has been central to the development of economics over the past century is fundamentally flawed
- It was based on an attempt to create an economic science on par with the physical sciences
- Static world, underlying “forces” (supply and demand), economists strived to look beneath the surface (e.g. of the institutions, like sharecropping) to see what is *really* going on
- More complex models (DSGE) are in the same vein—but by showing what is required made clear how fanciful the whole construct is
 - HANK models, while introducing more realistic assumptions concerning individual heterogeneity, have done even more to highlight the fanciful nature of the equilibrium assumptions (though the authors of these works do not seem to recognize this)

Long Criticized

- Robert Solow (1985):

My impression is that the best and brightest in the profession proceed as if economics is the physics of society. . . . We are socialized to the belief that there is one true model [of the world, operating across all institutional arrangements] and that it can be discovered or imposed [if only economists dig deep enough below the superficial workings of economies]. (Solow AER, 1985, p. 330).

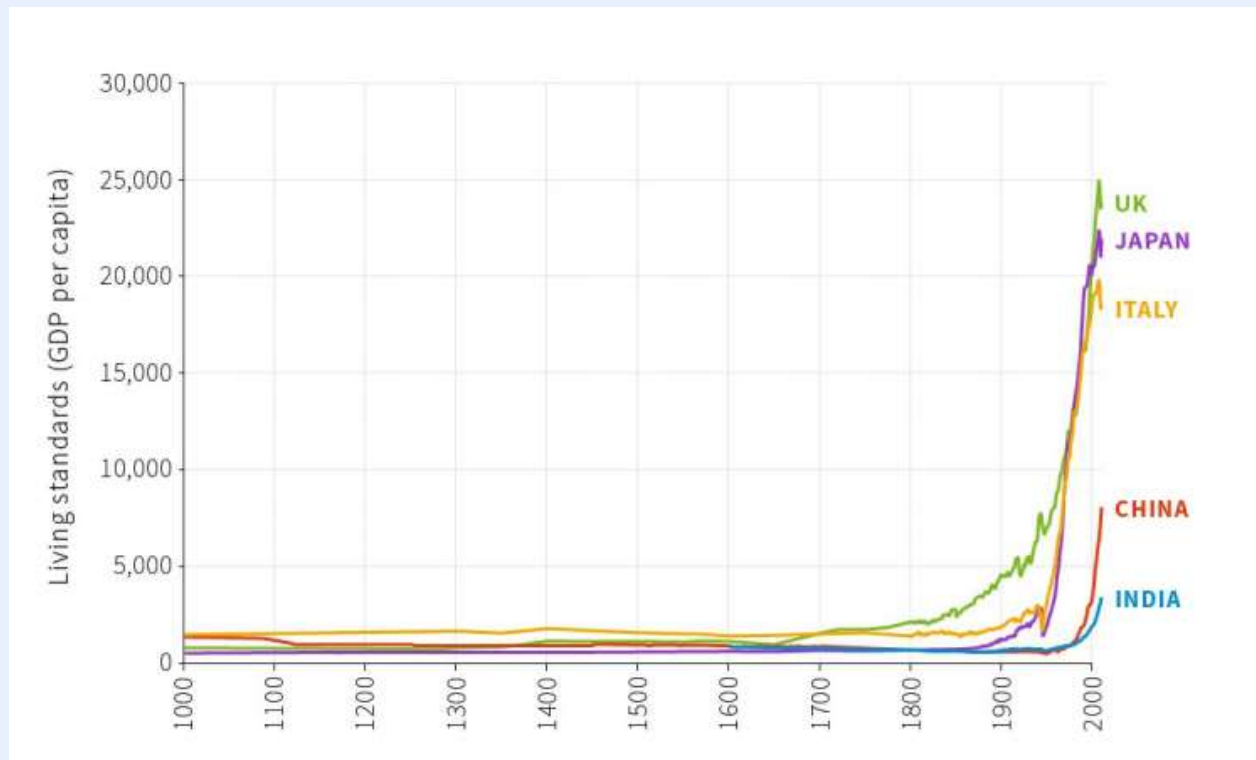
Modern Evolutionary Theory May Provide a Better Paradigm

- The world is always changing in seemingly unpredictable ways.
- The most important events (“shocks”) are *sui generis*
 - 1929 stock market crash
 - 2008 financial market crash
 - 9/11
 - The pandemic
 - The rise of China and the East Asia Miracle
 - Trump and the end of multilateralism and the rules-based order
 - The internet, AI (and a multiplicity of other advances in technology)
- These are all consequential, and both their timing and consequences were hard to anticipate, and even ex post, not always easy to assess
- THE WORLD IS NOT IN ANY KIND OF EQUILIBRIUM
- IT IS CONSTANTLY BEING BUFFETED BY ONE SHOCK OR ANOTHER

Paradigms Specify What is an Acceptable and Interesting “Explanation”

- The equilibrium paradigm is deeply ingrained in economists’ thinking
 - Satisfying, because it *seemed* to provide subtle explanations, interpretations not available to the uninitiated
 - Has important domains of relevance
 - But has little to say about the major changes in society and the economy
- Doesn’t really have much to say about the discontinuity in standards of living after 1750—the source of the “wealth of nations”
 - In spite of “growth theory” being the major preoccupation of economics over the past seventy-five years

Historical Living Standards



Source: INET

Real Wages of London Craftsmen, 1200-2000

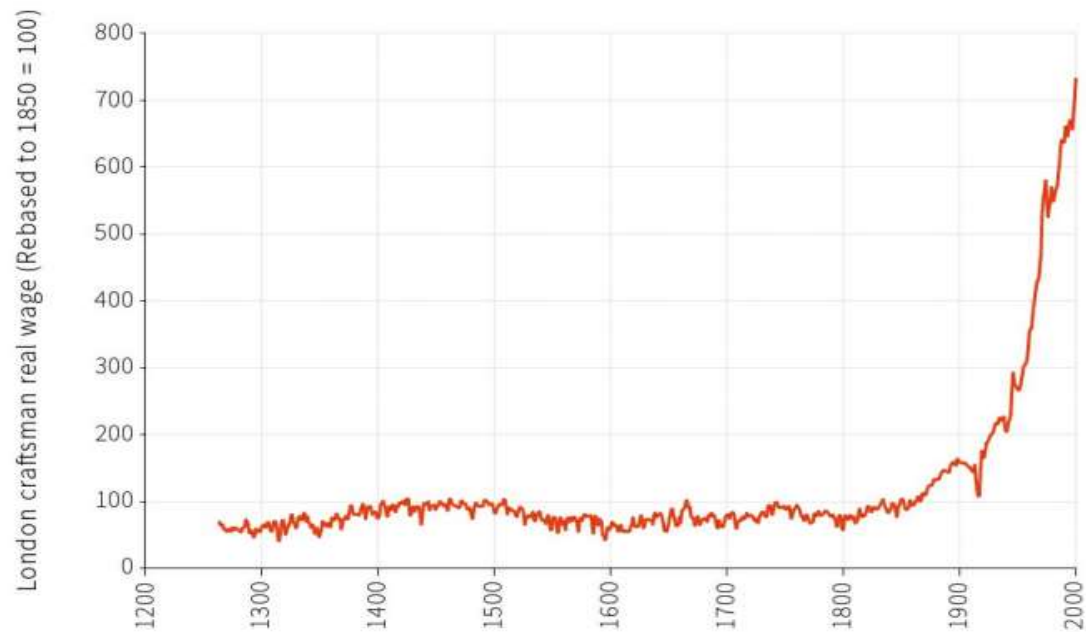


Figure 3. Real wages over seven centuries: craftsman (skilled worker) in London (1264-2001).

Source: INET

Natural log of GDP per capita from 1000 to 1750

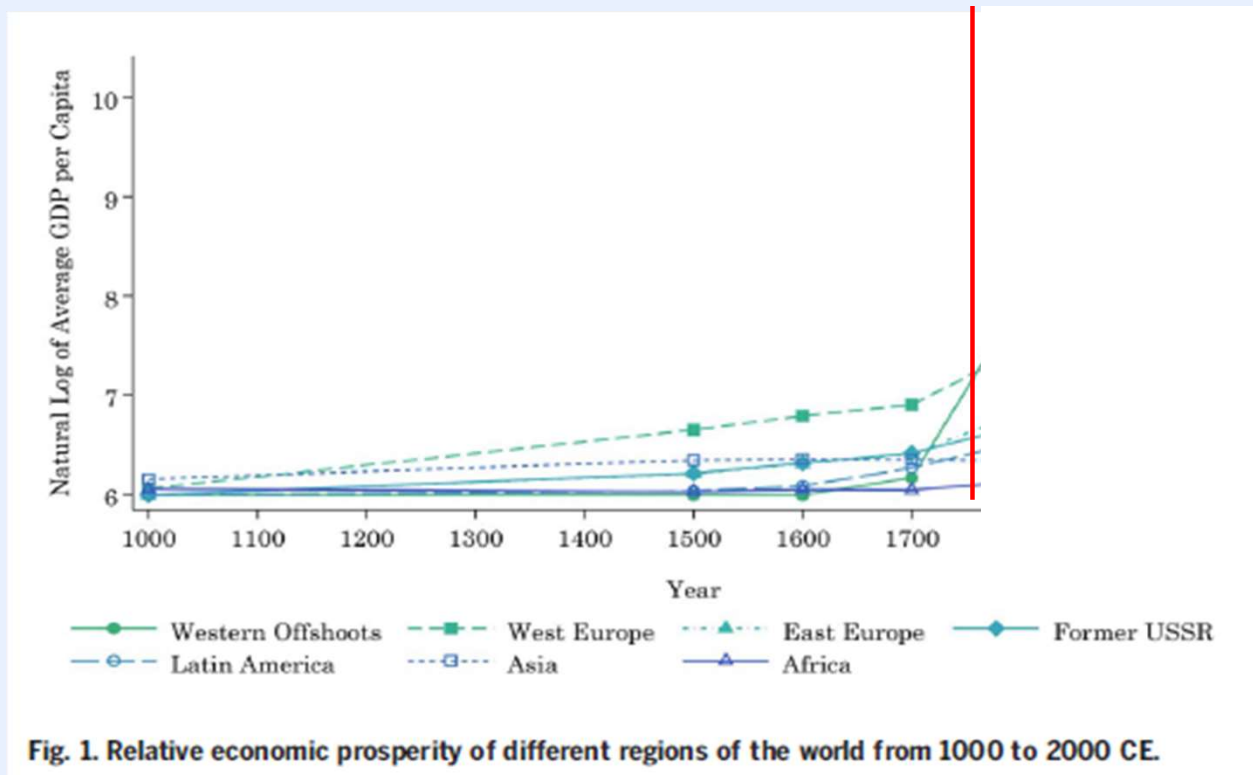


Fig. 1. Relative economic prosperity of different regions of the world from 1000 to 2000 CE.

Nunn, *Science*, 2020, based on Maddison, 2001

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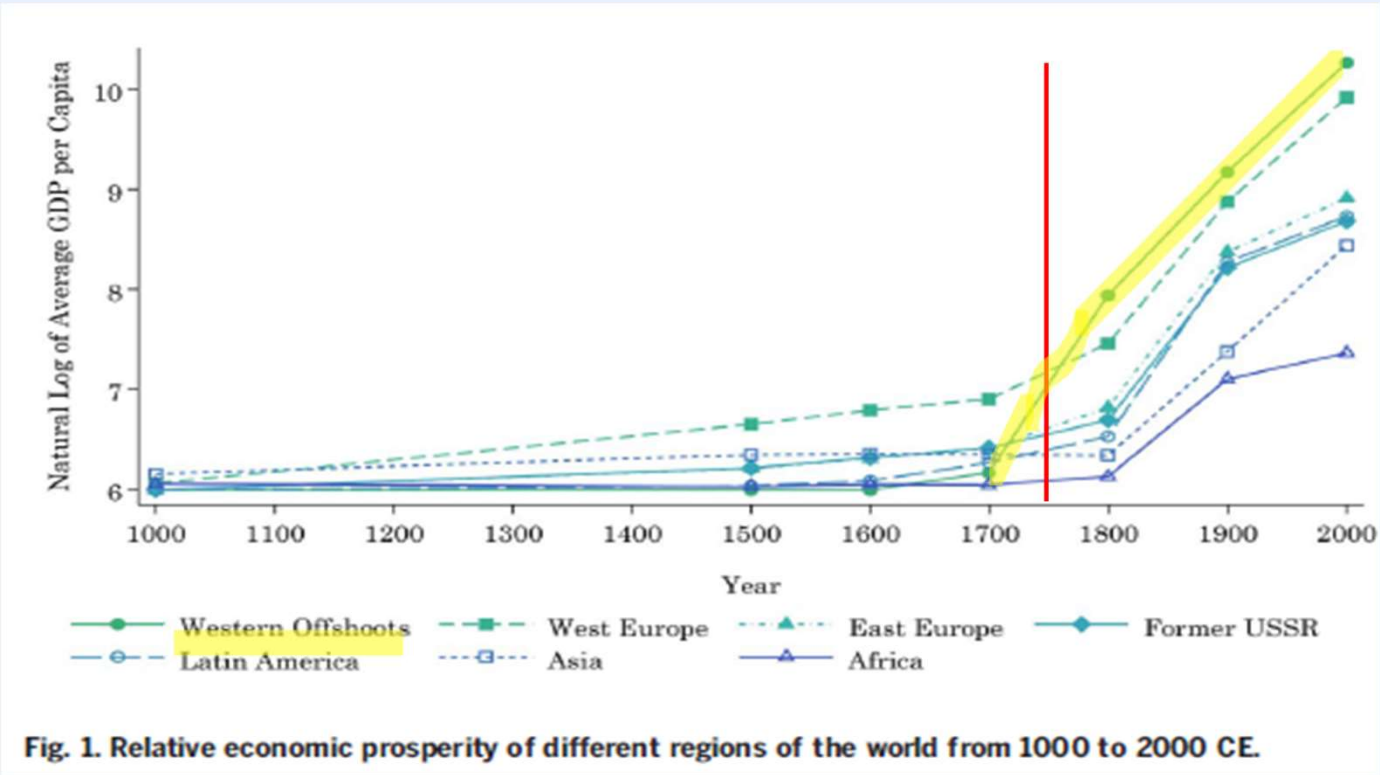
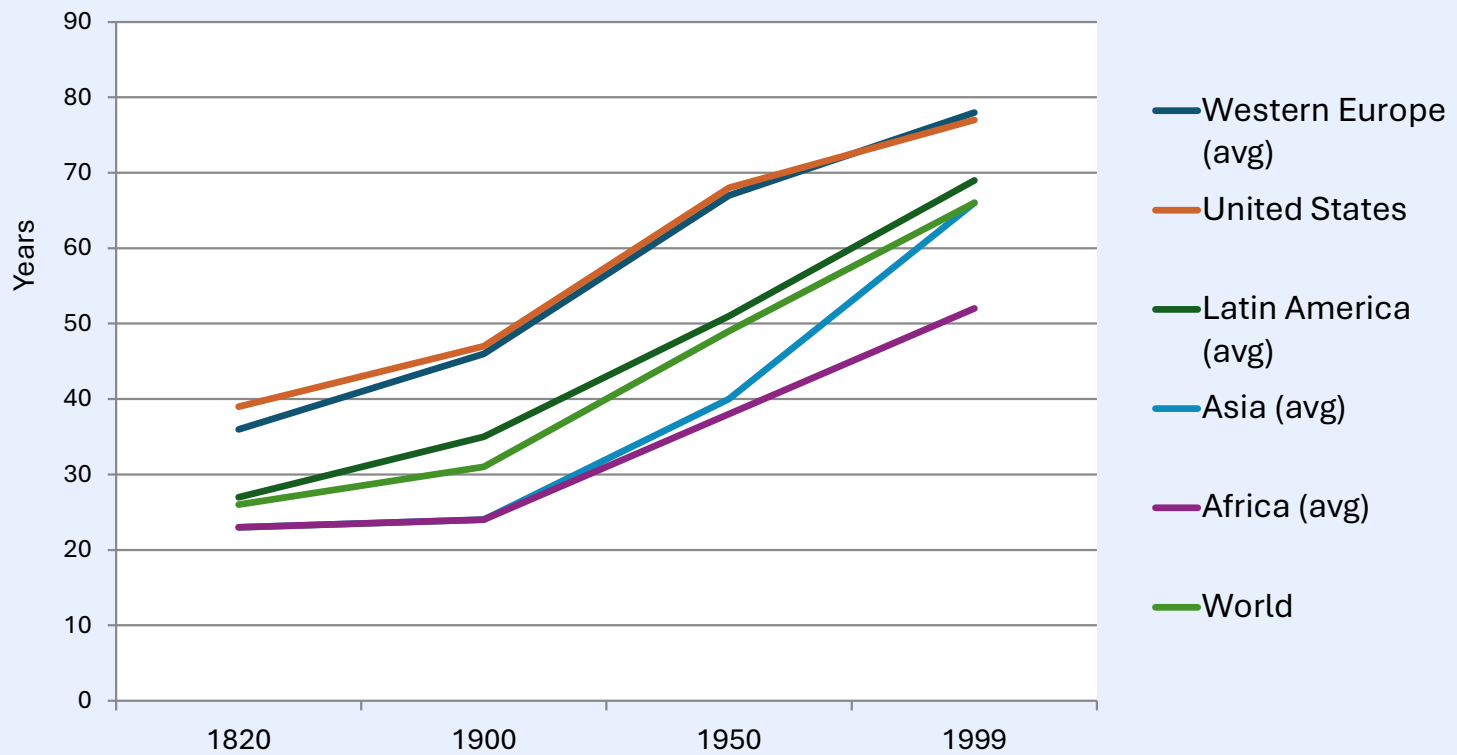


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Improvements in Life Expectancy Since 1820



Data are estimates from A. Maddison, 2001, "The World Economy: A Millennial Perspective," OECD.

What Caused this Seemingly Sudden Change?

- **The enlightenment—A CHANGE IN MINDSET**
 - Questioning authority
 - Recognizing that our understanding of the world could increase and change was possible
 - Requiring reassessment of how we know “truth” **and of how we organize society**
- The **scientific method** provided systemic way of figuring out how to improve productivity
 - Getting more outputs from given input
- **Advances in social organization** (rule of law, new institutions) allowed cooperation among larger numbers of people—increasing the extent of the market and the ability to solve complex problems

These Explanations are *Outside* the Standard Paradigm

- Yet they illustrate that there are interesting and meaningful “explanations” that can be brought to bear outside of the equilibrium paradigm

More generally:

- We can say a great deal about evolutionary processes
- We can take actions which affect the pace and direction of evolution.
- There is human agency.

Elements of a New Paradigm

- (a) We can't separate economics from politics or society. As Polanyi emphasized, economies are embedded in culture and society.
- (b) We are each shaped by our environment, and an important part of our environment are the individuals surrounding us, our culture.
- (c) But our culture is endogenous, determined by "us." There is an ever-evolving world, with what we might call a momentary equilibrium followed by another.

Reflexivity

- Our collective *beliefs* –including our economic paradigms—*affect the evolution our society*
- This is a fundamental difference between social and natural sciences—beliefs about atoms don't affect how atoms behave; beliefs about a virus don't affect how viruses behave (though in both cases, our beliefs can have real consequences, e.g. the development of nuclear energy or bombs or the control of pandemics)

Example 1: The Industrial Revolution

- How we are shaped *together*—our culture—is the central determinant of the wealth and well being of nations and individuals.
- Enlightenment beliefs led to the creation of science and rule of law
- Now, a different set of beliefs is leading to the undermining of science and the rule of law—society seems to be once again evolving, but in a different direction

Example 2: Neoliberal Capitalism and Its Consequences

Neoliberal capitalism is not a sustainable economic/political/social system

- Beliefs that markets are naturally competitive—so antitrust was weakening, leading to the growth of monopolies
- Emphasis on selfish behavior and individualism led to selfish, greedy, materialistic individuals
 - Market economies can only flourish when individuals are trustworthy and when there is trust
 - But neoliberalism undermined trust
- Argued that regulation and more broadly collective action was neither necessary nor desirable
 - Just at a time when societal and economic changes made both more important—urbanization, climate change, growth of importance of innovation based on basic science

Much Naivete in Primitive Economic Evolutionary Analysis (Hayek)

- Belief that it provides the basis for progress
- “Natural selection” (Social Darwinism)
- But there is no teleology in evolution, no presumption of efficiency, no matter how defined

No Teleology

- “Survival of the fittest” is a statement of performance (in some dimension) relative to others *at this moment*
 - Determined by *today’s environment*
 - Not necessarily tomorrow’s
 - Which can change simply by today’s evolutionary process
 - Thus it’s *short term*
 - *Without necessarily giving appropriate weight to adaptability, flexibility*
- Our intervening in evolutionary process thus may be desirable

An Alternative World is Possible

- Recognizing that our economic, social, and political system shapes us—we and our culture (our beliefs) are *endogenous*
- This is a major paradigm shift, which has the potential to change our society in a different direction

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