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The quiet triumph of economics

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If an economist from 1918 could be transported to the present day, he – back then, it was always he – would be both impressed and disappointed.

He'd be impressed because economic science has long settled what in his time was the most pressing empirical issue: whether a system of production coordinated and planned from the top could yield better outcomes than the independent actions of individual people guided by the price system.

Today, there is no serious intellectual case for the planned economy. That proponents of more central planning — through, for example, industrial policy — wrap their arguments in vague language about "long-term strategy" and "mission-oriented directionality" is a testament to the lack of economic credibility such views command.

The economist from 1918 would also be disappointed, however, for the answers to other fundamental questions of economic policy remain as elusive as ever.

What causes the business cycle, and how can downturns best be combatted? What is the optimal mix of taxes and how high should they be? Does the distribution of income and wealth have consequences which economic policy should address?

More theories have been put forward to address these puzzles than were available 100 years ago. But economists remain divided as to their relative merits.

Furthermore, economic practitioners struggle, as ever, to communicate their findings to the public. So yawning is this gap that the subjects where there is the greatest consensus among economists — such as the benefits of free trade, immigration and competition — remain hotly contested among the general population. Indeed, there is no shortage of well-meaning people who blame the recent populist surge across the West on a failure of economics.

Yet, expectations that economic science will eventually deliver permanent political stability and universal contentment are destined for disappointment. But what economics can do is help to avoid the perennial instability and spiral of poverty characteristic of 1960s China and 2010s Venezuela.

Think of economics, therefore, not as a recipe for the good life, but as an insurance policy against the worst consequences of human folly.

As with any insurance plan, there is a premium that must be paid in the short term. Thus there should be no price controls on politically contentious items. Subsidies to favoured industries must also be avoided. Tight controls on the movement of goods, capital and people are a no-no, as are surprise inflations that induce artificial consumer demand.

Yet, the protection afforded by paying the premium – that is, by avoiding the short-term temptation of intervention to reward some at the expense of others – clearly justifies the cost. Free trade, competitive markets and monetary stability explain the bulk of the 60 per cent per capita GDP gap between Argentina and Sweden. It is astonishing that, as recently as 1930, there was no gap.

What about the fate of the professional economist? Much ink has lately been spilled on whether the economics discipline has anything to offer at all.

Clearly, attempts to forecast recessions have yielded rather underwhelming results. But the notion that economists are unwilling or unable to revise their theories in light of new evidence is grossly unfair. The progress of world trade and innovation, which have driven global growth and poverty reduction since 1980, is at least in part the child of a gradual and evolving consensus about the right types of economic policy.

Eric Posner of the University of Chicago and Glen Weyl recently lamented the "timidity" of modern-day economists, who unlike their historical counterparts are largely uninvolved in the political and social movements of their time.

Whereas John Stuart Mill, Karl Marx and John Maynard Keynes championed, when they didn't themselves lead, such causes as women's rights, revolution and post-war reconciliation (respectively), today's economic scribblers largely speak to their own tribe in a language increasingly bewildering to the layperson.

Yet, Mill, Marx and Keynes were much more than practicing economists. They were eminent public intellectuals of their time, so using their trajectory as a benchmark for today's average economist is like asking any small business owner to measure up to Henry Ford.

We do, on the other hand, have plenty of modern-day economists who fit the mould of earlier luminaries. Paul Krugman, Luigi Zingales and Jeffrey Sachs come to mind for their public prominence. Hernando de Soto and the late Calestous Juma are worthy of mention for their long-standing impact on emerging markets.

The bulk of the profession can only aspire to match their contribution. In the meantime, economists would certainly benefit from greater exposure to the private sector. At the moment, most PhD economists are employed either by government or universities. Yet, the natural place for those seeking to understand the behaviour of consumers and firms is not where both are conspicuously absent.

By embedding themselves within private firms, economists would not only gain access to up-to-date information about consumer sentiment, competitive conditions and the business cycle. They would also face changed incentives: rather than seeking to expand the remit of government action, or to persuade other ivory tower occupants of the validity of their model, economists would be pressed to come up with relevant answers for their employers. Their advice would be quickly tested, and accepted or rejected, by the market, making economic research an endeavour as competitive as medical and engineering research.

This is not just blue-sky thinking: Google's chief economist Hal Varian pioneered one of the most impactful innovations of our age, namely the use of ad auctions by search engines.

Economics' greatest future contributions will arguably not be made on blackboards or legislative bulletins, but on the spreadsheets, software programs and factory floors of companies.

There is ample room for improvement in the way that economic science is conducted. But those calling to tear economics textbooks apart and start over should ponder the accumulated evidence.

At a time when economic ignorance has seemingly penetrated the world's most powerful offices, it would be unwise — even negligent — to discard the rich heritage of 250 years of economic insights that have accompanied and helped to explain the most prosperous period in the history of the world.

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