

What Should an Economist Know?*

July 2021

Jean-Paul Carvalho
Department of Economics & New College
University of Oxford

Abstract

This note is a slightly edited version of my remarks in the panel session ‘What Should an Economist Know?’ at the IEA World Congress, 3 July 2021.

*Department of Economics, University of Oxford, jean-paul.carvalho@economics.ox.ac.uk

Even if we had a model that incorporates all markets, market behavior is still embedded in a larger social and political environment, which general equilibrium takes as given.

David M. Kreps, *A Course in Microeconomic Theory*, p. 263

Political Economy → Economics

Classical economics sprung up to analyze both the economic and social revolution that was taking place at the time, what John Hicks described as “The Rise of the Market” (Hicks, 1973), both the market economy and the market society (Polanyi, 1944). Political economy, as it was known, saw market behavior as being embedded in a social and political context, with behavioral motivations such as empathy and esteem, and history casting a shadow (e.g. Smith, 1759/2002, 1776/1976). Even Marshall, at the very start of his *Principles*, describes the study of Political Economy as follows:

[. . .] it is on the one side a study of wealth; and on the other, and more important side, a part of the study of man. For man’s character has been moulded by his every-day work, and the material resources which he thereby procures, more than by any other influence unless it be that of his religious ideals; and the two great forming agencies of the world’s history have been the religious and the economic.
(Marshall, 1890/1920)

In the late 19th century, the fruitful application of mathematics to markets led economists to focus more narrowly on “harder problems” and neglect “softer” ones. As George Akerlof (2020) has argued, these were “sins of omission”, at first perhaps venial sins, but working their way over time to being mortal. Economics’ mathematical turn and its procession down a narrow path went unchallenged not only because it was so fruitful, but also because the two sides, economic and social, were moving in lockstep. The industrial revolution caused massive social dislocation and alienation, as described by Marx and Engels (1932/2009), Durkheim (2002), (Polanyi, 1944), and many others. Nevertheless, it was not a narrow phenomenon of rising real incomes, but rather a more holistic form of economic development in which literacy, life expectancy, heights, caloric intake, and much else rose in conjunction with real GDP (Fogel, 2004a; Weil, 2014). Bob Fogel (2004b) has described this as a technophysio

revolution. Hence economics could proceed down the narrow path, in the faith that all else would be taken care of by the accumulation of wealth.

Economics → Political Economy

It is now clear that this is not true. Life expectancy began to decline in the US in 2015, driven by the deaths of despair documented by Case and Deaton (2020). In addition, there has been a mental health epidemic, especially depression and anxiety, which is concentrated among the richer, more developed countries. Can economists shed any light on what is going on?

Reductionism is a necessary part of social science. The university is organized in this way, with separate departments for biology and chemistry, for economics, political science, and sociology. As Saari (2015) has so eloquently explained, this is fine as long as the connecting information between the different components is not lost . Unfortunately, much of the connecting information between narrowly economic phenomena and other social phenomena has been lost.

What I believe economists need to understand is the interaction between economics, narrowly defined, and social structure, including norms, culturally transmitted beliefs and preferences, and social identities. In doing, we will return to a broader conception of economics as Political Economy.

Certainly, economics has expanded in scope over the last twenty years, with some measure of success. Much more serious work needs to be done. I am very fortunate to be on a panel with some of the scholars (Sam Bowles, Wendy Carlin, and Eric Maskin) who have made the greatest contributions to this program, especially through the CORE open-access platform (see also Bowles, 2004). More narrow technical work is essential and must be pursued. What a rejuvenation of political economy will provide is the connecting information for the separate fields of study in which economists are engaged.

Example: Social Polarization in the United States

Let me provide an example of how adding the missing connecting information between economic and social phenomena can improve our understanding of contemporary problems.

Consider again the deaths of despair among middle-aged whites in the US, due to suicide, and drug and alcohol abuse. Case and Deaton (2020) show that these deaths are concentrated among non-Hispanic whites without a college degree. And they attribute them to dysfunction in the US healthcare system and the shift in market and political power from labor to capital through rent-seeking. While these factors no doubt play a role, I believe there is something more fundamental going on here at the intersection of the economic and social spheres; something that is a natural consequence of the US system of meritocracy. Economic mobility—the hallmark of meritocracy—sorts people based on certain traits that are conducive to achieving ‘merit’, socially separates them into sorted groups, and thus alters peer effects and other social externalities within groups. This sorting-separation-externalities (SSE) mechanism can create a connection between economic and social outcomes that has important consequences. In the US today, elite positions are allocated on the basis of education, which requires one to sit patiently and perform well in examinations over years, sometimes the entirety of one’s youth. This has parallels to the Confucian system of meritocracy dating from the sixth century BC, which also inspired the Enlightenment conception of meritocracy. Because of this, I believe, as suggested by Hopkins (2019), that educational success and entry into the elite selects for certain non-cognitive traits, such as patience, self-control, conscientiousness, rule-following and conformity.

The key is that these traits are also associated with more healthy social behavior, including lower levels of alcohol and drug addiction. Thus, economic mobility produces polarization in social outcomes between the elite and non-elite. The college educated experience better social outcomes and the non-college educated experience worse outcomes (because of the selection effect). Moreover, if the two economic classes are socially separated, peer effects and other externalities may amplify this polarization (a treatment effect).

This is what I set out in a recent paper titled, “Markets and Communities: The Social Cost of the Meritocracy” (Carvalho, forthcoming). I present a model of the SSE mechanism and show that economic mobility not only leads to polarization in social outcomes, but can worsen aggregate social outcomes (across all classes), when social externalities are ‘convex’. This matches the contemporary US experience.

In addition, the sorting according to non-cognitive traits has dynamic, intergenerational implications. Consider a caste-based society. There is no mobility and hence no selection. Hence traits may be well-mixed in the population. When mobility is permitted, the transition

out of a caste-based society produces an initial burst of economic mobility as members of the non-elite with the ‘meritorious’ traits get educated and enter the elite. However, if these traits are passed down within economic classes through cultural transmission, then the favored traits are rare among the next generation of the non-elite. Hence fewer members of the non-elite get educated in the next generation. In this way, a dynamic meritocratic society devolves into a static class-based society. There has been a lot written about meritocracy recently, but I am not aware of anything that makes this, what I believe to be fundamental, connection between economic and social outcomes.

This is just one example of what one can purchase with a more holistic approach, considering the interaction between the economic and social spheres.

References

- AKERLOF, G. A. (2020): “Sins of Omission and the Practice of Economics,” *Journal of Economic Literature*, 58(2), 405–18.
- BOWLES, S. (2004): *Microeconomics: Behavior, Institutions and Evolution*. Princeton University Press and Russell Sage, Princeton, NJ and New York, NY.
- CARVALHO, J.-P. (forthcoming): “Markets and Communities: The Social Cost of the Meritocracy,” *Journal of Institutional Economics*.
- CASE, A., AND A. DEATON (2020): *Deaths of Despair and the Future of Capitalism*. Princeton University Press.
- DURKHEIM, E. (2002): *Suicide: A Study in Sociology*. Routledge Classics, Originally published in 1897.
- FOGEL, R. W. (2004a): *The Escape from Hunger and Premature Death, 1700-2100: Europe, America, and the Third World*, vol. 38. Cambridge University Press.
- (2004b): “Technophysio evolution and the measurement of economic growth,” *Journal of Evolutionary Economics*, 14(2), 217.
- HICKS, J. R. (1973): *A Theory of Economic History*. Oxford University Press.
- HOPKINS, E. (2019): “College as a Signal of Self-Control: Self-Control Preferences in a High Temptation Environment,” working paper, University of Edinburgh.
- MARSHALL, A. (1890/1920): *Principles of Economics*. MacMillan, London.
- MARX, K., AND F. ENGELS (1932/2009): *The Economic and Philosophic Manuscripts of 1844 and the Communist Manifesto*. Prometheus Books, Originally published in 1932.
- POLANYI, K. (1944): *The Great Transformation*. Beacon Press, Boston.
- SAARI, D. G. (2015): “Social science puzzles: A systems analysis challenge,” *Evolutionary and Institutional Economics Review*, 12(1), 123–139.
- SMITH, A. (1759/2002): *The Theory of Moral Sentiments*. Cambridge University Press, Cambridge.
- (1776/1976): *An Inquiry into the Nature and Causes of the Wealth of Nations*. Clarendon Press, Oxford, U.K.
- WEIL, D. N. (2014): “Health and economic growth,” in *Handbook of economic growth*, vol. 2, pp. 623–682. Elsevier.