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A critical look at the failure of mainstream economics

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A critical look at the failure of mainstream economics

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Abstract

Book Review

Foundations of real-world economics: What every economics student needs to know (2nd ed.), by John Komlos, New York, Routledge, 2019, 306 pp., \$42.95 (Paperback), ISBN 9781138296541.

Many people in the United States of America are dissatisfied with the outcomes of the economy and some are suggesting measures that seem socialistic. The time has come to recognize that mainstream economics as taught in our schools is not serving students at all. The research sharing platform of the Latin American and Caribbean Economic Association (LACEA) states that John Komlos's textbook *Foundations of Real-World Economics: What Every Economics Student Needs to Know* demonstrates how misleading it can be to oversimplify models of perfect competition relative to the real world (Vox LACEA, 2019). The math works well on college blackboards, but not so well on the main streets of America. This edition of Komlos's text explores the realities of oligopolies, the real impact of minimum wage, the double-edged sword of free trade, and other ways that powerful institutions cause distortions in main stream models. Norbert Haring wrote "there is no doubt that a student who would otherwise be left with just the textbook wisdom will benefit greatly from reading this book and seeing that" (Haring, 2014, p. 4).

Keywords

Komlos, book review, economics, students

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A Critical Look at the Failure of Mainstream Economics

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Book Review

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Introduction

Many people in the United States of America are dissatisfied with the outcomes of the economy and some are suggesting measures that seem socialistic. The time has come to recognize that mainstream economics as taught in our schools is not serving students at all. The research sharing platform of the Latin American and Caribbean Economic Association (LACEA) states that John Komlos's textbook *Foundations of Real-World Economics: What Every Economics Student Needs to Know* demonstrates how misleading it can be to oversimplify models of perfect competition relative to the real world (Vox LACEA, 2019). The math works well on college blackboards, but not so well on the main streets of America. This edition of Komlos's text explores the realities of oligopolies, the real impact of minimum wage, the double-edged sword of free trade, and other ways that powerful institutions cause distortions in main stream models. Norbert Haring wrote "there is no doubt that a student who would otherwise be left with just the textbook wisdom will benefit greatly from reading this book and seeing that" (Haring, 2014, p. 4)

Content Summary

Data from the World Factbook prior to Covid-19 Pandemic showed approximately \$20 trillion in GDP, fails to improve the lives of so many citizens. Professor Komlos's book, *Foundations of Real-World Economics*, was written to give the student a more realistic understanding of the working of the economy than the traditional theories and models that fail to explain the inequalities and excesses of the economy. In the opinion of the Professor Komlos's, the purpose of studying economics is to learn to better allocate finite resources for the benefit of all. The next generation of leaders and managers rely on what we pass on to them. Professor Komlos wrote this text prior to the COVID-19 crisis which has upended the livelihoods of millions of Americans. His argument is for a new paradigm, a humanistic economics which emphasizes people versus greed. The rollout of the vaccine and the structure of the stimulus bill are examples of the how we could be working for the benefit of marginalized citizens.

The pandemic reveals that beneath the façade of a booming economy, there were fissures and inequalities that mainstream economics somehow failed to acknowledge. Mainstream economics

failed to prevent us from falling into the biggest economic crisis since the Great Depression. 2020 was an election year and with it some expectation that a new administration will do a better job of managing the economy than the previous one.

Prior to the COVID crisis, the United States extolled a booming economy with full employment and low inflation as a model for the world. However, too many Americans could not raise \$400 in an emergency or afford to lose one paycheck and the pandemic only made that situation even more acute. Somehow, the traditional measures of prosperity did not apply. Professor Komlos wants to see an economy which sustains more people with a greater degree of dignity and one that can survive unexpected events because its fundamentals are sound and resilient.

As Professor Komlos reminds us, the mission of a teacher is to prepare the young adult for life and career; policy makers cannot do that in good conscience with ideas and theories that are not working, much as an English teacher would not teach bad grammar or a history teacher false history. Tomer (2020) wrote, “unlike most contemporary writing in economics, Komlos’s economics writings are explicitly based on his progressive, democratic and humanitarian values. His focus is on increasing people’s life satisfaction (or well-being) as opposed to the focus on growth of output and income” (p. 99). The 2008 financial crisis, the rise of Trumpism, and other populist movements which have followed in their wake have grown out of the frustrations of those hurt by economic policies advocated by conventional economists for generations.

Income transfers alone do not build prosperity, job creation does - and that depends on educational opportunities and adequate health care. Our economy is facing some headwinds as a result of the Pandemic. The measures that the government has had to use are going to add to federal debt and do not address the need for business investment. Anemic GDP growth may be the new normal in the 21st century with an actual GDP lagging behind potential growth. This has been the new normal with the U.S. economy for the past thirty years. A two-tiered economy distributes income via wages to the bottom and capital gains and dividends to the top. Education as the elevator of opportunity is expensive and out of reach for too many.

The new normal means that the COVID pandemic and global warming are significant events that have impacted an already off balance and vulnerable economy. The two political parties have opposite philosophies when it comes to spending money. The Republican Party sees big government as problematic while the Democratic Party sees a huge spending as necessary to rescuing the needy. The national debt, which is already a drag on the economic future, will soon exceed GDP in the United States. Unfortunately, the lifeline keeping citizens afloat who are struggling paycheck to paycheck is borrowed dollars of debt, again with its crowding out effect that slows economic growth.

Despite a huge amount of spending on health care, factors such as the Opioid crises the pandemic and a persistent level of poverty have eroded gains in life expectancy. The democracy that we strive to protect cannot thrive in a nation with a permanent underclass.

There are four elements to GDP: consumer spending, business investment, government spending, and new exports. Government spending is the only one that can be controlled to help the other three. The peace dividend that was expected from the collapse of communism never materialized and instead war has continued since 2001. The government has spent trillions on conflicts in Iraq

and Afghanistan. The new budget proposed by the Trump administration calls for cuts in health and human services, education, agriculture, and energy and increased spending on defense and homeland security; all clearly designed not to change the American status quo. The U.S. system of democracy and free markets has produced an economy that was the envy of the world. Is it perfect? Obviously the distribution of income and access to health care say otherwise, And this is where Professor Komlos tells students to work to make it better. Given the factors of production, American citizens should enjoy a good quality of life provided they play by the rules. The first question in Economics 101 is: *Why do we study economics?* The answer (I hope for) is to make better use of our finite (scarce) resources. We talk about the supply and demand curve and the invisible hand in an economy where competition is compromised witness the explosive growth of giants such as Walmart and Amazon.

GDP is a useful indicator of productivity but when used as a measure of welfare, it can be misleading. GDP fails to measure the negative externalities such as pollution, temperature rise, drug and gun violence, and the relentless inequality in income distribution. Averages are made up of extremes; the income of a homeless man and that of a Jeff Bezos are averaged but is it indicative of either man's consumption of goods and services?

Similarly, international monetary fund head, Christine Lagarde, Nobel Prize-Winning Economist, Joseph Stiglitz, and MIT Professor, Erik Brynjolfsson all noted at the recently concluded World Economic Forum in Davos-Klosters, Switzerland that GDP is a poor way of assessing the health of our economics and we urgently need to find a new measure. GDP doesn't adjust for distribution of goods. Imagine two economies but this time one has a ruler who get 90% of what is produced and everyone else subsists barely on what is left over. In the second case the distribution is considerably more equitable in both cases GDP per capita will be the same but its clear which economy we would prefer to live in.

The United States spends 18% of GDP on health care unfortunately due to third party payers and the steep cost of research and capital investment people with no health insurance are priced out of the equation (Kamal, et al., 2020). Medical school enrollment keeps the number of new doctors at a low level resulting in a higher price for their services and, therefore, more people who cannot afford to pay for them. One only need look at the neighborhoods with the worse Covid infection rates to see the consequences.

During the Great Depression, classical economic policy prevented the government from reacting to a recession before it turned into a depression. Fortunately, John Maynard Keynes proposed a school of thought which bears his name today. Governments could use deficit spending during times of recession to stimulate the economy and repay the debt during economic upswings Komlos in his text reminds us, the steering wheel should be against the wind and not with it; Keynesian monetary policy should be counter-cyclical, expansionary in downturns but contracting in any upswings. Ideally, governmental budgets would be balanced over the business cycle. Keynes did not intend for debts to accumulate.

Keynes most significant policy proposal for economic stabilization was that deficits from stimulating a weak economy would be repaid with growing government revenues. The problem now is that the needs of the population for government help is mortgaging future economic growth at the expense and the costs of global warming do not allow for any reduction of the debt. The

continuing deficit spending ties the hands of policy makers in the future (Keynes, 1935). Unfortunately, the counter-cyclical fiscal policy became impractical in practice and U.S. debt continues to grow at an alarming rate, leaving future generations financially responsible for the debt of generations past.

Mainstream economics has always advocated open trade and it has clearly raised the standard of living in the increasingly global economy. Operating in a global economy means treating the entire globe as one market place, because of higher wages in the US manufacturing jobs were sent offshore. The service sector that cannot be so easily shipped out remained. The so called blue collar segment that supported a middle class was decimated. The problem here is that one economy and one company became so powerful that it actually was capable of making losers in trade of many American and instrumental in helping eradicate the well-paying jobs that provided middle class through better wages and benefits was eradicated. The documentary, *The High Cost of Low Prices*, chronicles the predatory practices Walmart has used to force industry overseas and how a Walmart store has the power to shut down local businesses in the very community that had welcomed them and paved the way for its construction.

The low wages and paucity of vital benefits demonstrated by Walmart policies, especially the lack of medical care, have shifted much of this burden to state and federal governments to make up the shortfall. Public opinion has brought pressure to bear on the company but clearly, the Walmart effect has further damaged the economy. Typical of our capitalism; the Walton family holds about 40% of all the worth in America and sees income increases in the billions of dollars while their employees struggle with food and medical insecurity (Greenwald, 2005).

The future of American democracy depends on its ability to maintain a citizenry capable of participating in the economy on equal footing. The wide gap between rich and poor is not conducive to societal cohesiveness and equality. It makes little sense to allow 45% of single mothers to be poor while the top 50 hedge fund managers have a combined income of \$29 billion dollars. The inequality we see is part of the problem. The conventional view presented in conventional economics is that the immutable law of supply and demand implies that equilibrium exists in all markets at all times. Yet, markets sometimes do not reach equilibrium, and it has never been specified just how long it would take to reach equilibrium given our current pandemic clouded market.

Price depends on two crucial variables often absent from conventional supply and demand models: location and time do not always have the patience to wait for the market to find equilibrium. As Keynes mentioned that supply and demand curves do not help people to afford what they need That is, hungry people do not have time to wait for the price of bread to decline until they can afford it (Keynes, 1935).

Professor Komlos has challenged the teachers of future managers and leaders to take a hard look at what they are passing on. The modern world is complex, changing, unpredictable, and requires that current students and the next generation are grounded in a fluid mindset. Political and economic forces are anything but textbook in their outcomes, and there remains much to be done if the system is to guarantee citizens life, liberty, and the pursuit of a satisfying life experience.

Conclusion

Where does this discussion of Professor Komlos leave informed citizens? Professor Komlos's economic philosophy amplifies a belief that the system works for the few at the expense of the many. Prior to COVID 19 our economy appeared robust but failed to deliver improving comfort and dignity to so many. The COVID 19 pandemic and lockdown magnified obvious weaknesses in the system that a massive financial *band aid* could not cover. Political gridlock and a looming election further delayed a stimulus package that is deemed necessary to rescue a sputtering economy. 50 percent of Americans surveyed said recently that they need or rely on a stimulus bill. Policymakers are faced with the difficult choice of adding to an already huge debt or seeing the economy mired in recession well into 2021.

Even with another stimulus package, the same underlying problems will still exist unfortunately in a world of uncertainty and conflict. The challenge facing policymakers is how to create a world in which employment and educational opportunities permanently raise incomes and ultimately the standard of living. This will require a transfer of wealth and a new economic model where GDP per capita has a more realistic meaning.

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