The Poverty of Neoclassical Economic Analysis (2/19/2016)

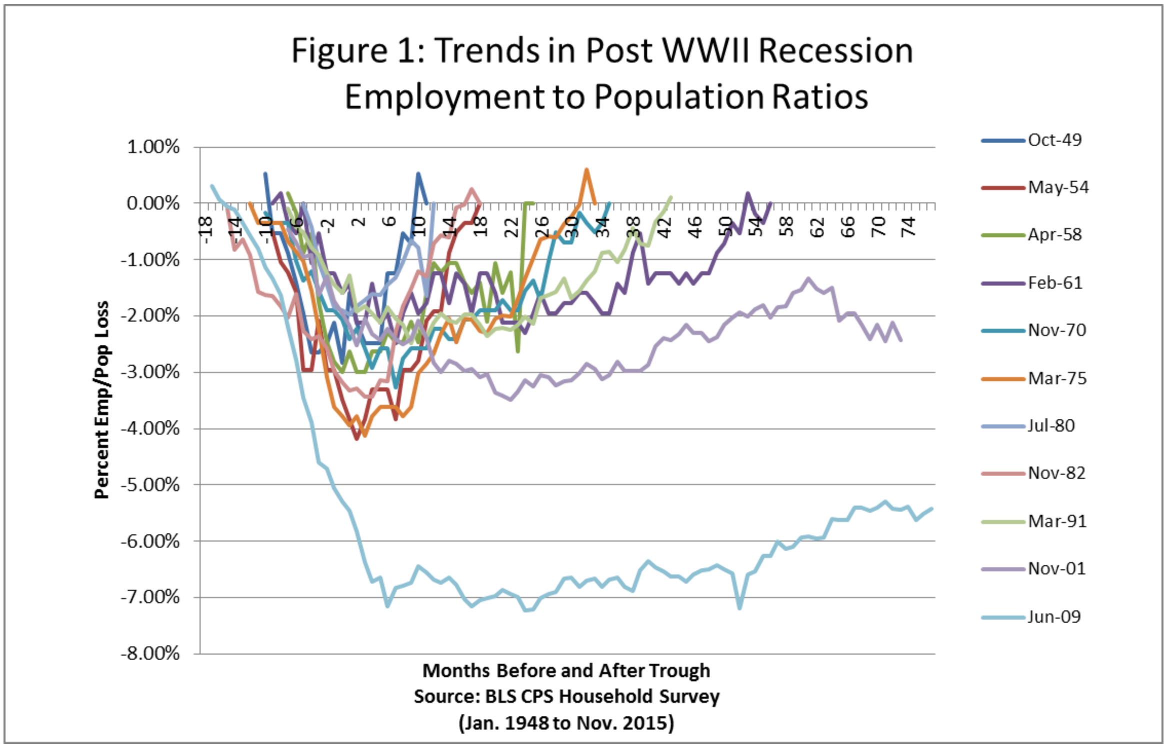
By Ron Baiman

When I first got wind of the denunciation of Prof. Gerald Friedman's Bernienomics impact estimates by prominent liberal Economists two questions came immediately to mind. Who were these "liberal economists" and what were their objections? A little googling around got me the first answer in a jiffy. The liberal economists were four former Chairs of the Council of Economic Advisors (CEA) under Democratic Presidents Clinton and Obama: Alan Kreuger, Austan Goolsbee, Christina Romer, and Laura D'Andrea Tyson. It took more time and more work to establish the second answer. According to their three paragraph letter, they: "are concerned to see the Sanders campaign citing *extreme* claims by Gerald Friedman" (Italics mine) that Bernienomics could have: "huge beneficial impacts on growth rates, income and employment" because these "exceed even the most grandiose predictions by Republicans about the impact of their tax cut proposals" and "no credible economic research supports economic impacts of these magnitudes".

As Friedman's comprehensive and detailed analysis (56 pages with four Appendices, 22 Tables, and 12 Figures) uses public data and standard techniques to estimate the economic impact of 9 major policy, 11 Revenue Enhancement, and 6 regulatory, Acts or proposals raised by the Sanders' campaign, I tried to find out what techniques, data, or estimation errors, the CEA's objected to? I was not able to find anything. As Jamie Galbraith has pointed out in his excellent retort there are no specifics. The CEA's three paragraph letter presumes that Friedman's report does not even warrant careful study as growth rates, income, and employment, have not reached these levels in recent years. Adding insult to injury, the former CEA chairs imply that Bernienomics , and Friedman's estimates of its impacts, is equivalent to Republican "Laffer Curve" assertions that have never passed muster in any standard impact analysis of the kind that Friedman has subjected the Sanders proposals to.

As Galbraith, citing Mathew Iglesias notes, the CEA's appear to believe that their status entitles them to a blanket dismissal, without a shred of argument or analysis, of a standard economic analysis of a raft of economic proposals the scale and scope of which have not been seen since the New Deal. Far from being an "extreme" analysis, the Friedman study conservatively uses standard techniques such as those employed by the CBO, OMB and CEA to estimate economic impacts. In another excellent retort Matthew Klein shows that real GDP growth rate projections of 5.3% by the end of a Sanders second term (one of the Friedman estimates that the CEAs believe is not credible) is in line with pre-2007 estimates of long-term U.S. trend growth. Klein points out that short-falls in government spending and residential construction can explain much of the gap. But under Bernienomics government spending would undergo a massive increase so that it is not hard to imagine infrastructure and direct green energy job creation programs including housing and energy retro-fitting providing a more productive economic boost than pre 2007 residential housing construction - see for example CPEG jobs program.

Klein and Iglesias also both discuss the extra-ordinarily low post-2007 Emp/Pop ratio in the U.S. , see Figure 1 below:

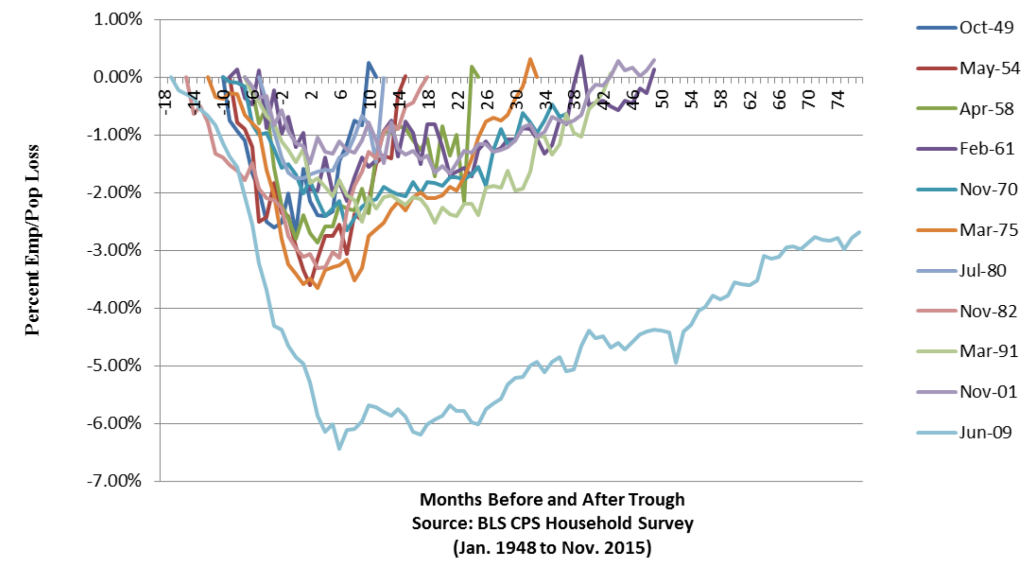


The U.S. Emp/Pop ratio is more than 5% below its pre Lesser-Depression 2007 level. This is a lot of labor market slack that could be drawn upon by large scale job creation programs that should be able to at increase employment above its pre-2008 level. To the argument that changing demographics have made prior Emp/Pop ratios unobtainable, see Figure 2 below shows that the current ratio is roughly r3% below its *demographically adjusted* pre-2008 Emp/Pop ratio. Paid Family leave, child care, equal pay, youth job programs, should significantly drive up the Emp/Pop ratio, whether this is measured after adjusting for demographics or not. As Klein points out, is it really that unrealistic to hope that we can achieve things are a reality in Canada?

Bernie's economic program is exposing the long politically dormant deep fissure within economics between generally "progressive" economists who still broadly adhere to mainstream Neoclassical (NC) economic theory and "radical" economists who have long rejected core NC theory. I don't know Prof. Friedman personally but he teaches at one of the five "heterodox," or "radical" in U.S. economics parlance, Ph.D. granting economics departments in the U.S. The "radical" moniker stems from the name of the major professional organization of left leaning heterodox economists in the U.S. – the "Union for Radical Political Economics" (URPE). Jamie Gailbraith is a prominent Post-Keynesian heterodox economist. In contrast, the four former CEA Chairs all teach in mainstream NC economics departments that reject heterodox economics as unscientific value-laden deviance. To be fair the CEA foursome are known as political liberals who, like Paul Krugman, another generally progressive NC economist, have often been stalwart supporters of politically progressive economic policies and principles, using data analysis that is indistinguishable for all practical purposes from that employed by radical economists.

But this time apparently, the structural economic changes that Sanders is proposing have simply gone too far for them.

Figure 2: Trends in Post WWII Recession Employment to Population Ratios Assuming that Population Age Cohorts (16-24, 25-54, 55 and over) Fixed at November 2015 Shares



The CEA's blanket argument is that economic outcomes that have not occurred in the recent past are not possible. This reminds one of the, similar, refusal of the vast majority of NC economists to contemplate the 2008 crash because this had never happened in recent history, and the optimistic estimates of the CEA, based on the average of post-war recessions, of the impact of the woefully inadequate Obama stimulus. I believe that the former CEA chairs are, like 99% of economists in the U.S., a victim of the NC economic school that they have been trained in. They think of economics as an objective "science" and cannot accept the possibility that a fundamental change in the *basic structure* of the economy can lead to impacts that have not been seen in recent years, because they cannot accept the possibility of fundamental structural economic changes. The New Deal raised U.S. real GDP growth rates by over 10% in years of government spending expansion. Is 5.2% late in a second Sanders term unrealistic assuming these programs are passed?

And this brings me to my final point. No one assumes that Bernie's economic program will be passed as currently conceived. The fate of these proposals depends on the *power* of the "political revolution" that the Sander's campaign is leading. Like the Clinton campaign, the, NC economics trained, former CEA Chairs exhibit abundant "pessimism of the intellect" but little "optimism of the will". This is not a technocratic economic debate. It's a political and ideological debate that reflects the deep division in fundamental theoretical outlook between NC progressive and radical democratic socialist economists. For more background on this see my upcoming book: *The Morality of Radical Economics: Ghost Curve Ideology and the Value Neutral Aspect of Neoclassical Economics* (Palgrave, 2016).

Postscript (2/21/2016)

Unfortunately, even politically liberal, mainstream or "Neoclassical", economists do not believe that massive increases in effective demand, or other large scale public spending and policy measures, can produce lasting major and fundamental structural changes in the economy (in spite of the examples of the New Deal, WWII, etc.). They also don't accept Verdoorn's law (which Friedman employs) in spite of numerous empirical studies and common sense validation: long-term growth in demand leads to increased investment and thus increases in productivity and by implication structural changes in the economy. NC "Keynesians" believe only in short-term Keynesianism, not in a long term principle of effective demand. To the extent that Friedman (rightly) employs a long-term "Post Keynesian" principle like Verdoorn's law (in addition to all of the other standard techniques that he uses) he crosses a line that NC economists will not cross. I belatedly remembered after writing and posting this piece that Friedman had employed Verdoorn's Law in his study of the long-term economic impact of Bernienomics.