

Notes from the Revolution: Principles of a New Economics

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As Christians we need to bring to our scholarship and science all that we know, both from our observation of God’s handiwork in creation, and from our reading of God’s written word. Our economic science must be founded on our understanding of humankind made in God’s image, with awareness, reasoning, and moral consciousness. And as the three persons of the Godhead live together in society, so too human beings live in society, with and for each other. In the Fall, humans have become infected by sin, and so are capable of wrong actions as well as right ones. The line between good and evil runs through the heart of all human institutions, be they churches, schools, businesses, unions, markets, political parties, or governments. All are prone to fail the moral test, as all are capable of responding to God’s norms of goodness and love. So as Christians we can never fully embrace an economic science founded on individualism and hedonism, and can never accept an economic ideology based on the infallibility of some human social institution.

The heterodox approach to the integration of Christianity and economics as it developed in the 1970s and 1980s thus begins with what I have called the dual critique of neoclassical economics (Tiemstra, 1993). The ethical critique disputes the account neoclassical economists give of human nature, particularly the assertion that all relevant human motivation stems from a natural and laudable drive to maximize one’s standard of living. This forecloses consideration of how human behavior responds to the Great Commandment to love God above all and one’s neighbor as oneself. The implication that economic institutions and policies should be aimed at efficiency and growth is also brought into question, since it does not comport well with the Christian social ethics implied by the Great Commandment.

The methodological critique first denies that “positive” economics can be value-free, as is often claimed. Second, it questions the orthodox preoccupation with statistical evidence, to the exclusion of experimental

Editor’s Note: This paper was delivered to a plenary session of the Twenty-Fifth Anniversary Conference of the Association of Christian Economists, “Three Perspectives on Economics and Faith,” Baylor University, April 2009.

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evidence, survey evidence, and narrative history. This is partly a consequence of an unhealthy preoccupation with mathematical models to the exclusion of other forms of analysis.

Economists who accept the validity of the dual critique are faced with the problem of how to do economics outside the mainstream. Most fall in with one or another of the heterodox schools: post-Keynesian economics, institutionalism, or the social economics tradition. A few wind up in the Austrian camp. Others are convinced of the need for a distinctively Christian economic theory, and they have produced some interesting analyses. Many of these efforts overlap, since none of these schools offers a general canonical model in the way neoclassical economics does.

The Post-modern Methodological Revolution

While post-modernism is not a new thing, it did not have much impact in our discipline until economists began to produce serious methodological works in the middle 1980s. The post-modern message confirms what both parts of the dual critique had maintained all along: contrary to the assertions of logical positivism, all theory is value-laden. It is not possible to do science without dragging into it all of your personal baggage, including not just your personal history, but also your social position, your values, and your faith. Some founders of the approach may have wanted to explode all grand controlling meta-narratives or foundational beliefs, on the ground that none can be proven valid, but that is no more possible than shedding your own skin. Christian post-modern realists were able to carve out a place for distinctively Christian scholarship (Wolterstorff, 1984; Westphal, 2000; Hoksbergen, 1994).

The implications of this are truly startling. A science founded on a Christian worldview can be just as valid as one founded on a naturalist worldview, or a Marxian worldview, or a feminist worldview, or a libertarian worldview, or whatever (on feminist economics for example, see Hewitson, 2007). Some Christian philosophers who were early proponents of this approach became highly esteemed in their profession. New societies of Christian scholars were founded in many of the academic professions in the 1980s, including of course, the Association of Christian Economists. At the same time, many new heterodox learned societies were founded, including for example the International Society for Ecological Economics, the Society for the Advancement of Socio-Economics, and the International Association for Feminist Economics. Many traditional Christian undergraduate colleges (like Wheaton and Calvin) developed a new emphasis on faculty research and scholarship, and Christian research universities (like Baylor and Notre Dame) developed new interest in the integration of faith and learning.

The post-modern move not only confirmed the idea that theory is value-laden, but it also reinforced the rest of the methodological critique. The preoccupation of economists with mathematical models and statistical tests was a byproduct of the positivist anointing of the naturalist worldview. If we did not have to accept naturalist foundations, economics did not have to model physics, so we could ask people what they were up to, and pay attention to the answers. The controlling meta-narrative of a canonical general theory is shown to be unnecessary to a scientific approach. This has helped convince us that values and religious commitments matter to economic behavior (Milberg, 2007).

A brief aside: Christian interest in the integration of faith and learning is no longer widely stigmatized in the larger academic world (though being a heterodox economist is still hard). Therefore, the pressure to become more secular in a drive for academic prestige is no longer as strong as it was back in modern times. Christian college and university presidents who are terrified of their institutions' going secular can relax a little. There are more and more excellent Christian research scholars, interested in the integration of faith and learning, and hiring them will not hurt the institution's academic reputation at all. At Calvin we used to have trouble finding young economists who knew what we were talking about. Now we find quite a few who have read some good stuff about the integration of Christianity and economics as grad students, and some who are already members of ACE. On the flip side, Calvin and other Christian colleges have been raided for Christian scholars by some of the best universities in the country, though this is still not as common in economics as in some other disciplines.

The Canonical Model has been Discredited

The greater openness to new forms of evidence, together with a growing embarrassment about the lack of sound psychological foundations for economics, has led to the gradual discrediting of the neoclassical canonical model, and its abandonment for research purposes (I am thinking here of Samuelson's *Foundations of Economic Analysis* or Hicks's *Value and Capital*). This was helped along by the post-modern suspicion of all controlling general theories (Davis, 2006; Colander, 2000).

I think economists were first brought up short by some evidence that came in over the transom from social psychology, at a time (in the 1970s) when economists were becoming interested in establishing a tie between utility and happiness. Yes, there was the Easterlin Paradox, with the implication that people's happiness was influenced by the consumption of others (Clark, Frijters, & Shields, 2008 reviews a lot of this literature). But beyond that, there was evidence of an adaptation-level effect, and a self-serving bias leading to upward comparisons of well-being (Scitovsky, 1976). Then too, there was all that money that businesses were spending

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on advertising and promotions that had no information value, and therefore (in utility theory) should have had no serious effects (Etzioni, 1988).

Behavioral economics has been around for a while. I remember one of my undergrad professors telling us that experiments showed then (back in the 1960s) that the only economically rational people were graduate students of economics. By the 1990s, the body of experimental evidence had grown enough to make a noticeable impact on the profession, and the behavioralists had added a lot of survey data that confirmed their conclusions. Daniel Kahneman's Nobel Prize helped a great deal. We now know that people do not always do what is in their economic interest, especially if it conflicts with their sense of fairness, or "common sense" ideas. People are notoriously bad at evaluating risks, and tend to be very short-sighted. Economists began to pay attention to puzzling little economic anomalies that they had ignored for decades. Every principles textbook these days has a box discussing why people leave tips in restaurants when they are out of town.

Macro phenomena, especially business cycles, have always presented problems for the canonical model. In the early 1970s the failure of Keynesian stabilization policies gave greater urgency to the search for micro foundations for macro theory. The failure of the "new classical" medicine to cure the economy in the early 1980s led to greater despair. Finally we have come to realize that business cycles have not disappeared, and they simply cannot be explained in a world of rational expectations and flexible prices. This also counts against the canonical model.

The revelations of widespread corruption in the American business community that came at the turn of the century I think shocked many economists more than they let on (Healy & Palepu, 2003). The redesign of executive compensation and corporate governance that had occurred over the last thirty years was supposed to align the incentives of agents with the interests of their principals, and high levels of pay were supposed to insulate executives from temptations to be dishonest. Besides, there were the banks, the analysts, the auditors, and the SEC to protect the integrity of capital markets. But it all failed. It turned out that human perversity could wreck even supposedly self-correcting markets.

The growth of price discrimination as an acceptable business practice has also helped to undermine the neoclassical paradigm (Tiemstra, 2006). Many economists have become comfortable with price discrimination as a second-best solution to allocation problems in monopolies, especially natural monopolies. But it remains *prima facie* evidence that monopoly power exists in these markets. And we are talking about some of the more important, technologically progressive, growing markets, like internet access and pharmaceuticals. The notion that all or most markets are perfectly competitive, or even workably competitive, is more and more difficult to maintain.

Then there is the issue of distribution. The mythology of economics has always been that a growing, industrialized economy will tend to become more equal over time. This is the generalization embodied in the Kuznets Curve, but apparently it goes back as far as Adam Smith (Van Til, 2007, p. 20). The canonical model is not well-suited to handle the issue. But the increased inequality of incomes in our growing U.S. economy over the last thirty-five years is one of the great public concerns of our time. The reality is inconsistent with the Kuznets rule. We look for answers, but without considering the role of power in the economy there are none.

As a result of all this, the neoclassical research program has basically been abandoned. Cutting-edge work these days is behavioral economics or specially conceived bits of game theory. Some of it is not economics but freakonomics, the application of clever econometric devices to questions that are of such narrow scope that they are not particularly interesting. Okay, that is a little unfair. Sometimes the questions are interesting. But often the questions are outside the traditional subject matter of economics, and they certainly are not informed by insights from the canonical model. The theorizing is strictly small scale and *ad hoc*. Not that this is bad. It is possible to make progress this way, as I argued at the ACE tenth anniversary conference (Tiemstra, 1994). Research questions need to be asked about important and centrally economic issues, even if they are narrowly framed. The recent move is a big change from (as Shackle called it) “the Years of High Theory.”

Research is one thing; teaching is something else. We still pay our bills by teaching the canonical model to our students, much to their frustration. Part of this is the natural conservatism of economists, or if you will, inertia. Part of it is the revenge of the teacher for having been made to jump through these hoops as a student. Part of it is our lack of imagination about how to organize an economics course around anything but the canonical model. But this is my plea for open-mindedness. We need to decide what the great ideas and great questions of our discipline are. We need to decide what we really know about the economy. Then we must organize our courses around that. The publishers will resist, but you can publish anything yourself on the Web. Go for it (Tiemstra, 1999, 2000).

Economists have not yet learned to be circumspect in basing their policy advice on the old model. Behavioral economics has made some inroads in practical finance, especially issues like the design of retirement savings programs. But many economists still base their mechanism designs on the assumption of pure economic rationality. For example, they resist the Corporate Average Fuel Economy standards, preferring increases in fuel taxes to induce consumers to buy more fuel-efficient cars, indirectly driving the automakers to provide them. Thirty years of short-sighted, irrational decisions by drivers and the Detroit Three should convince us that fuel taxes alone are unlikely to work. There is still controversy over Sarbanes-Oxley and other new regulations to control abuses in financial markets. The

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claim is that all the wonderful information available to investors now will cause them to discipline management, and obviate the need for regulation. One would think that Enron had never happened. I could go on, but the point is made. We have to stop making policy recommendations based on a model that we all know is wrong.

Principles of a New Economics

A new economics for Christians should not be vulnerable to the dual critique, but rather should draw on the best of the new research that has taken place outside the neoclassical paradigm.

First, there needs to be a fuller and more thoughtful understanding of human nature. People are inescapably religious, as John Calvin and Bob Dylan (“You’ve got to serve somebody”) both have noted. People work out their understanding of ultimate values and the spiritual world not just in thought and art and scholarship, but also in their daily economic behavior. This means that although behavior is certainly influenced by economic incentives, it is driven by meaning and purpose, by people’s sense of what is good and right, helpful and fair. It is not always strictly self-interested, but is informed by duty, moral obligation, and by love and care for others. Much of what is done by specialists in marketing and advertising is based on appeals to these deep-seated motives.

At the same time, the human race has fallen into total depravity, and people respond to temptations as much as to values, emotions, and incentives. Our self-serving biases and distorted perceptions of our own intelligence, strength, and immunity from harm lead us into decisions that are not rational (in the fullest sense) or wise. There is no salvation apart from divine intervention in the person of Christ Jesus. Therefore, no system of rules, institutions, or policies will guarantee that individuals will always do the right thing, or that the right outcome will always be achieved. A humane economics will always seek to understand before it prescribes or instructs.

Economic efficiency and growth are not the only values people serve in their economic lives, and are not the only proper objectives of private or public economic policies (Finn, 1989). Equally important is justice and fairness, both commutative and distributive. Sustainability, both economic and ecological, is essential for the survival of the planet, and human beings with it. In more biblical terms, we call this the stewardship of God’s creation, which God declared to be good, though it has become fallen at our hands. As Christians we also give much attention to the dignity and value of human individuals as bearers of the image of God, however tainted they may be by sin. This leads to a basic concern with the quality of human relationships within economic institutions. As economists, we are interested in how people organize and manage the use of resources to achieve all of these values.

The institutions of an economy give different degrees of power and discretion to people in different positions in society, even as the economy develops with the division of labor. This is liberating, because it means that people have the freedom to make real choices and achieve the ends they believe in. It also means there is scope for people to behave irresponsibly, in particular, to exploit others who have less power. Economists should be able to analyze the distribution and use of economic power.

Because we have real power and real choices, the goodness and rightness of economic outcomes cannot be guaranteed by any particular set of economic institutions, rules, or policies. Good and right choices by economic actors are also required. Economics is not about achieving a world in which outcomes reflect human desires. It is about moving toward a world in which economic outcomes reflect God's will, as much as we can discern it in our imperfect state.

The Neoclassical Counterrevolution

As I remarked earlier, economists tend to be a conservative bunch, and many within the profession want to save the old paradigm. Part of this is a generational thing. Many who became economists in the prior epoch are loath to see their knowledge go out of date. Many were attracted to economics by the values that inform the old paradigm, and still believe in them.

The counterrevolution begins by reasserting the fundamental assumption about human nature: people are rational, and pursue their self-interest. Apparently irrational behavior can be explained as resulting from lack of correct information, mistaken reasoning, or misplaced incentives. Such irrational behavior can lead to inefficient economic outcomes. Fortunately, it is within the ability of economists to fix these problems, when they have the opportunity to do so. Information costs can be reduced, and accuracy improved. People can be educated to calculate costs and benefits properly, and to ignore emotion and incorrect "common sense." Incentive systems can be designed so that rational, well-informed actors will always do the efficient thing, which is the right thing, and efficient outcomes can be achieved. The methodology of this view is discussed at length in Caplin and Schotter (2008). Fullerton and Stavins (1998) applies it to environmental economics, and Burtless, Lawrence, Litan, and Shapiro (1998) to international trade.

The counterrevolution also maintains that efficiency is the ultimate value, out of which all others can be bought. You can protect the environment if you want, or treat people well, or redistribute income, but you will pay a price. In principle, market values are supposed to reflect non-pecuniary preferences, but in practice most economists opt for GDP growth over all other goals. The research reflects these priorities.

The counterrevolution holds that market competition (or at least “workable” competition, or “potential” competition) is enough to keep private accumulation of power in check, and prevent exploitation from occurring. This means that for all our talk about “the science of choice,” in the end economic outcomes are determinate. It is also this assumption of competition that stands behind the proposition that right incentives mean right conduct and right outcomes.

This approach uses the results of the new behavioral economics to avoid the circularity of the neoclassical system, breaking the identity of preference and choice. It also is consistent with the way most economists do analysis. However, it is very hard to reconcile with the empirical evidence, because it is trying so hard to rescue the neoclassical paradigm. In addition, it brings out the worst in economics: its paternalism, and its tendency to function like a religion itself, by claiming to save us from our sins, and create a heaven here on earth (Nelson, 1991).

The Revolution is not Finished

The new mainstream research is attractive to heterodox economists, Christian and otherwise, who have long felt that the neoclassical approach was unsatisfactory. Economists in general no longer seem troubled by the value-laden nature of any social analysis. The profession has a new openness to different types of empirical evidence, and to methods and results from other social science disciplines. Thanks to burgeoning research in behavioral economics, many economists are no longer committed to the proposition that all human behavior is driven by the self-interested pursuit of material gain, or that all markets are at least workably competitive. (For elaboration of this perspective, see the work in Altman, 2006). All of this goes a long way towards addressing the concerns that were expressed in the dual critique.

The biggest problem that remains is the continued preoccupation with economic efficiency as the standard for what is good, right, and even normal. It is true that economic analysis enables us to make statements about the efficiency of certain outcomes or arrangements that are more specific than we could make about their distributive justice, human solidarity, or ecological sustainability. Deadweight burdens can be estimated in monetary terms. This gives economists a franchise in public policy debates. Furthermore, once multiple goals or values are admitted into the picture, the issue of tradeoffs and synergies among the goals arises, and with it additional complications. This undoubtedly accounts for the continued popularity of the efficiency standard.

But this preoccupation comes with a price. In the first place, mainstream work continues to be subject to the criticism that it is disconnected from concerns that are central to Christian social ethics. The neglect of

justice, stewardship, sustainability, and respect because standard theory does not have way to measure or make concrete statements about them sparks conflicts between economists and theologians that lead to much misunderstanding and ill-feeling.

The focus on efficiency also distances economists from the public discussion of economic issues, and from the everyday concerns of ordinary people, including our students. Most people do not understand what economic efficiency means, or the connection between the structure of incentives and efficient outcomes. Our refusal to say much about distributional or environmental issues convinces many of our students that we are out of touch with reality and useless, if they have not already concluded that from studying a difficult theory that even the professor thinks is wrong.

There is also a continuing reluctance to incorporate issues of power into economic analysis. This applies mostly to market power, but also to political power, and to the power of deep pockets to determine the direction of investments in new technologies, different communities, and through philanthropy to different social goals. Without concepts related to power, how can we understand price discrimination, or increased inequality of wages, or the effects of capital mobility in a globalized economy? The resurgence of game theory in the recent era gives economists some tools to deal with power issues. With the new methodological openness, we could also raid the political scientists' toolbox, since power has always figured big in their analyses. But yet economists tend to talk as if all markets are perfectly competitive, all decisions driven by profits, and all outcomes determinate. This is obviously untrue, and the profession risks irrelevance by continuing to base its policy recommendations on these outmoded ideas.

Conclusion

There has been a lot of progress over the last twenty-five years in the mainstream of the economics profession, but there is still work for Christian heterodox economists to do. The decline of the canonical neoclassical model and the rise of behavioral economics and game theory have made economics more scientific, not less. How scientific we are has nothing to do with how mathematically sophisticated or general or complete our theoretical models are. It has to do with how much we know about how the real world works, and we are way ahead of where we used to be. The science of economics is also more open to the concerns of Christians than it was in the old days, and we have to take advantage of that to bring the discipline closer to those concerns.

What remains to be done is first, to transform how economics is taught at the undergraduate level. What is done now is a crime against learning,

and the sooner we overhaul it the better. Economists working in teaching-oriented Christian colleges are in an excellent position to do something about this.

Second, we need to remedy our neglect of power as an important dimension to understanding how the economy works. This is an area in which heterodox economists have specialized, and the new economics can learn much from this body of work. The tools of game theory offer the possibility of bringing new rigor to this aspect of economics.

Perhaps most important, we also need to learn how to relate our new knowledge to both sophisticated policy discussions and to the everyday concerns of ordinary people. Over the last six decades or so economists have developed a lot of bad habits that we need to shed. Economists still pretend to be doing value-neutral analysis, when we all know there is no such thing. Economists pretend that the only issue is prosperity, and ignore equality, sustainability, and charity. There is no time like now to begin the process of attuning economics to the great questions that today's world raises for Christians, and for everyone.

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