A Theoretician's Quarrel with Theory

Economic Tales
by Ariel Rubinstein
Kineret, Zmora-Bitan, Dvir, 2009
206 pages.

By Omer Moav

Ariel Rubinstein has been promoting a rather intriguing thesis for several years now: The academic discipline of economics is of absolutely no value in trying to make sense of reality. Given that Rubinstein himself is a professor of economics, not to mention a recipient of the Israel Prize and numerous other awards for his contributions to the field, we might find his claim surprising. And yet, according to his own testimony, he customarily begins lectures by insisting that, to the best of his knowledge,

> There is nothing in economic theory that has anything at all to say about the core of the topic under discussion here. I am not certain that I know what an 'option' is. I attempt neither to predict the rate of inflation tomorrow, nor the productivity index of industry the day after. Of course, I am aware of the fact that you invited me to speak here because I am a professor of economics who is supposed to know all this; my ignorance indeed embarrasses me.

Listening to this, one might reasonably mistake his words for false modesty. But Rubinstein isn't trying to win over his audience by faking humility. Rather, he's on the attack. Indeed, after admitting his ignorance in economic matters, he goes on to explain,

> You will ask why I have come here. Because as an economic theoretician, I wish to make several points about the actual message of economic theory. Specifically, I have some reservations, to say the least, as to the manner in which economic theory is exploited in the public debate about economics.

Such is the tone of Rubinstein's *Economic Tales*, published in 2009. In many ways, the book reflects its author's winsome character: This is not a dense, humorless tome of the sort academics compose, but rather a highly readable, even amusing work that combines theoretical diagnoses with personal anecdotes. Here is a pleasant yet satisfying intellectual experience—one with the occasional glimpse into Rubinstein's life, to boot—alongside jargon-free explanations of game theory, the author's field of expertise. Indeed, it is almost *too* easy to forget that Rubinstein is in fact drafting an indictment against the science of economics, or more precisely, against the use of a highly influential academic discipline to adorn economists with a halo of professionalism—and to advance policies that are not to his liking. Substantiating this controversial argument is Rubinstein's aim—and one, it soon becomes clear, at which he fails utterly.

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Rubinstein opens *Economic Tales* with a wry description of a university meeting, the subject of which was the possibility of upgrading the degree program in accounting to a status previously reserved for major academic disciplines. Rubinstein, one of the meeting's participants, opposed the idea on the grounds that accounting is not a true academic field of research. While he does feel a certain affection for the bookkeeping profession—his father was a certified *buchhalter*—the university's goal, he insisted, is not vocational training but the provision of knowledge that will broaden students' horizons, such as that found in mathematics, biology, philosophy, or linguistics. He concluded with an appeal to his colleagues to "use your independent judgment and respond by a show of hands to the question: does our study program aspire to academic excellence, or is our rhetoric more *Pravda* than *Pravda*?"

It would seem that Rubinstein is of the latter opinion: He believes that a great deal of the academic preoccupation with economics—and not merely the bookkeeping profession—relies on rhetoric that is "more *Pravda* than *Pravda*." To prove his point, he cites examples of economic models that are, he claims, mere "legends," or myths. He explains why their assumptions are unreasonable and their results of little relevance for making sense of reality. He mocks economists—the "tellers of tall tales"—who are wracked with guilt on account of having devoted their lives to worthless theoretical sophistry while the world "is facing no lack of serious problems." True, he admits, "the obsession with formal models helps us acquire intuitions about the way things work in real life," but then adds, "I am fairly certain that if instead of dedicating my adult life to economic models, I would examine it from the perspective of a non-academic profession, I would achieve no less useful —but far less abstract —understanding."

According to Rubinstein, one of the main reasons for economic theory's detachment from reality lies in its inherent assumption that people are rational creatures. He thus attempts to show, methodically, why this assumption is invalid. Relying on studies of human behavior, he concludes that people simply do not know exactly what they want: Our ability to analyze reality is limited, we are predisposed to errors, and our self-control is fairly deficient. Despite Rubinstein's own avowed repulsion of superstitious notions such as the belief in "fate" and supernatural forces, he admits that he, too, is no paragon of rationality. In fact, he takes pride in this fact, and promises to make consciously "problematic" choices in the future, since he is "deterred by the dogmatic spirit manifested by the assumption of rationality in economics."

Rubinstein's attack on the infatuation with models extends even to game theory, a mathematical field that has draws a great deal of attention even beyond the walls of academia. Here the reader will find particularly interesting the story of Rubinstein's personal acquaintance with John Nash, the schizophrenic genius whose character was immortalized in the film *A Beautiful Mind*. But Rubinstein is not in the business of myth making; quite the opposite. He blames game theory, which aspires to develop models of rational decision-making, for encouraging "a false display of usefulness." Although it can provide considerable intellectual entertainment—"pleasant knowledge," as he calls it—its assumptions are no better than its forecasts: They do not withstand the test of reality. One cannot credit game theory with the ability to predict actual behavior, insists, Rubinstein.

Worse still, he believes this theory encourages selfish and devious conduct—although he is unable to produce evidence for this suspicion.

Having poked fun at economic theory's excessive reliance on abstract models, Rubinstein turns his critical attention to the teaching of economics, and in particular the manner in which professors present the principles of the market economy to their students. He presents two introductory lectures, one alongside the other: The first depicts the market economy, and the second, an imaginary "jungle economy." As is widely accepted, the allocation of goods in the market economy is determined in accordance with property rights and the price mechanism. The "jungle economy," on the other hand, does not respect property rights, and brute force replaces Adam Smith's "invisible hand" as a determining factor in the allocation of goods. Rubinstein shows that both models, each in its own way, achieve economic equilibrium, as well as an "efficient and stable result." He thus seeks to prove that the overwhelming popularity of the free-market model in economic circles is not grounded in serious empirical support or discernable normative advantages, but rather in its apparent elegance, which professors reinforce by manipulating theoretical concepts and rhetorical tactics—exercises that, by the same measure of success, would serve the reviled "jungle economy" just as well.

If that is not enough, Rubinstein also accuses economists of imperialism, condemning their increasing tendency to engage in interdisciplinary research and take over domains previously reserved for psychologists, sociologists, linguists, and demographers. Admitting his own compliance with this trend, he refers to a study he conducted together with Jacob Glazer in the field of pragmatics, a branch of linguistics that examines the implication of statements spoken in a conversation. The accepted theory in pragmatics, as formulated by the philosopher Paul Grace, is based on the assumption that both the speaker and the listener in a conversation share some interests in common, which the communication between them is meant to advance. Rubinstein and Glazer focused on those situations in which one individual sought to persuade another to adopt his opinion or to carry out a specific action. In such instances—and contrary to the principal established by Grace—there is, in fact, a conflict of interest between the parties; in certain circumstances it behooves the listener to refuse the request directed at him. (Rubinstein and Glazer therefore formulated an alternate model of optimal persuasion, which the book does not expound upon.) Ironically, even as their approach demonstrates the benefits of a healthy measure of economic intuition, Rubinstein cautions against the temptation to take his model too seriously, and draw from it conclusions with implications for other disciplines. "Doing 'interdisciplinary work' without a profound understanding of each of the disciplines involved borders on charlatanism," he claims.

In the book's final chapter, Rubinstein presents his social views, and repeats his assertion that economists' ability to contribute to public debate is no better than that of any other individual. He discusses an array of issues that occasionally appear on the public agenda, among them the redistribution of income, immigration policy, and the limitations of privatization. This part of the book is light on the theory and heavy on the preaching. Rubinstein sharply criticizes the economic logic that allows market forces to act without restraint, and calls for strengthening social solidarity and implementing a welfare policy in keeping with the values of the Jewish state. He lambastes the trend toward privatization, and essentially demands that we rewind the clock to the golden days of an all-powerful public sector. "It now remains for the people of this country to do but one thing: to go against the grain, or, in other words, to nationalize," he declares, adding, "the economists I know do not discuss nationalization. To those of them who seek to be ahead of their time, I would advise shutting down research programs that deal with privatization and commencing the debate over the far-more-relevant question—what to nationalize, and how."

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Admittedly, Rubinstein's book is quite charming, and at times quite thought provoking, too. But reading *Economic Tales,* one gets the distinct impression that the author's central premise—that the science of economics has little, if any, relevance for our attempts to comprehend the world around us—relies on a fairly narrow outlook. A theoretician of the highest caliber, Rubinstein decries theoretic tendentiousness. Yet, as he readily admits, he himself is drawn to economics, and to mathematics, precisely on account of the beauty of these disciplines' models —and not on account of any interest in economic reality. Indeed, while his own field of expertise, game theory, is undeniably elegant, and has succeeded in captivating the popular imagination, its importance to general economic discourse is limited. For contrary to the impression the book provides, the lion's share of professional economic discussion is practical in nature, and puts every model to the grueling test of facts. We should hardly be surprised that Rubinstein dismisses this discussion; By his own admission, he is entirely unversed in basic economic concepts, preferring to focus his attention instead on that small segment of academic research that grants priority to brain teasers and elegant mathematical models over the meticulous analysis of cold, hard data. Nevertheless, if he deems only abstract theories worthy of the term "economics"—an utterly misleading conception of a discipline built mainly on empirical research—why should he bemoan its detachment from reality?

Moreover, it is unclear whether Rubinstein believes that worthwhile research in the social sciences is even possible, or if the flaw he describes is specific to economics and economists. He does not bother to compare accepted standards in his own discipline with routine procedures in other fields, but it seems that in fact economics would not come out looking worse. Clearly, economists are required to utilize a methodological toolbox no less complex and rigorous in its demands than that of, say, sociologists and political scientists. We are thus forced to choose between two possible conclusions: Either *all* of the academic knowledge produced in the social sciences amounts to nothing, or Rubinstein's attack on economics is unfair.

That the latter must be true is apparent in Rubinstein's assertion that economists display an inordinate fondness for theoretical models. Now, no one doubts that reality is more complex than theory. With the exception of certain mathematicians who cultivate Platonic expectations of discovering "pure truth" through numbers, this fact is almost universally accepted—not only by economists, but also by chemists and physicists, who recognize the limits of the human mind. Indeed, for most economists, myself included, the formal model is first and foremost a useful tool for clarifying thought and improving our ability to grasp what *actually* transpires in the world around us. Until a more efficient means of utilizing science is found, we will have to rely on this tool— without turning it into a fetish, of course.

This is not to say we should dismiss Rubinstein's criticisms out of hand. His argument that economic theory erroneously perceives human beings as rational beings is a common critique, and deserves a detailed response. First, we must recognize that assumptions can be useful even if they *are* entirely baseless; physics provides us with abundant evidence of that. For instance, we can calculate the depth of a hole in a fairly accurate fashion by measuring the time it takes a stone to fall to the bottom, even if we assume, for simplicity's sake, the absence of friction. Of course, were a feather dropped instead of a stone, this unrealistic assumption would produce extremely inaccurate results. Clearly, however, under certain circumstances, it is better to keep things simple.

Second, and more important, Rubinstein's claim that the assumption of human rationality is the unchallenged dogma upon which all economic study is based is completely groundless. If such dogma does exist, it is the assertion that people react to incentives—but that is, more or less, the sum of it. The expectation of rational behavior indeed merits an important place in the science of economics, but it is certainly not its sole feature, and some theories ignore it entirely. John Maynard Keynes, one of the twentieth century's most important economists, provides us with a prime example. Keynes achieved international acclaim by identifying the error in the classic approach that held that supply creates demand, and that the economy will always gravitate toward full employment. He demonstrated, instead, that if the price mechanism does not react immediately, the *demand* would dictate supply, at least in the short term (which can last years). Consequently, by expanding the scope of its involvement in the economy, the government can increase the employment rate during a recession. Keynes' economic theories, which dominated the field for decades , are to this day considered the leading strategy for combating recession. However, his approach in no way assumes that human beings behave in a rational manner. On the contrary, an increase in government spending or a reduction in taxes in an effort to boost consumption necessarily results in a ballooning deficit and public debt—which, in the long term, require a *raise* in taxes. Indeed, if consumers were guided by purely rational considerations, they would undoubtedly realize that they will one day be forced to shoulder a heavier tax burden, and thereby attempt to reduce their expenses in the present—thus rendering massive government spending ineffective. However, Keynes believed—and to a certain extent, justly—there is no real reason to fear this prospect.

Armed with the above-mentioned arguments, Rubinstein advises against giving any weight to the opinion of economists in the formulation of policy. I must admit that I, too, am alarmed when a colleague proposes a plan of action that relies heavily on one theoretical model or another; likewise, I cringe at economists who support their recommendations by wielding professional authority, without providing anything resembling a convincing explanation. Nonetheless, it is obvious that having a particular political outlook or ethical stance is insufficient to make well-informed decisions concerning the intelligent allocation of limited resources. One also needs objective knowledge—and this knowledge, as incomplete as it may be, is more readily available to economists than to any other group of experts or laypersons, given that they have amassed it over years of methodical research and a consistent effort to make sense of their findings. To ignore their contribution—to dismiss them, as does Rubinstein, as "tellers of tall tales—is a privilege reserved for those who have given up not only on economics, but on the search for the truth altogether.

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Rubinstein's critique of the value of economic research is rife with generalizations and sweeping conclusions, but at least it is presented in an original manner. Unfortunately, the same cannot be said of his attack on the market economy and the professionals who allegedly serve, as its simpleton aficionados. Here Rubinstein's arguments veer into the realm of the banal and the demagogic. He declares, for instance, that he is "repulsed by economics as an academic branch that leans toward conservatism and assists society's stronger segment in [its efforts] to preserve its hegemony, thus serving people with whom I do not sympathize." Rubinstein is, of course, at liberty to think that the businessmen and employers are no better than gangsters who deal in exploitation and abuse. In fact, similar opinions are frequently voiced by politicians and academics. Yet it is difficult to understand why Rubinstein fails to see that it is precisely the distrust of the wealthy elite that motivates Adam Smith's intellectual heirs to support a system that encourages competitiveness. Were economists truly interested in preserving *any* hegemony, as Rubinstein is convinced they are, it is far more likely that they would argue in favor of monopolies instead of calling for their dismantling at every turn.

In addition, Rubinstein's use of the "jungle model" as a tool for criticizing the teaching of economics—and more precisely, as a tool for criticizing the teaching of market economy—is, quite simply, throwing dust in the reader's eyes. Rubinstein juxtaposes the market model and the jungle model, in which the strong takes for himself whatever his heart desires, and shows how both cases result in an allocation of goods that meets the requirement of which economists are so enamored: efficiency. From this, he concludes that proponents of the market economy may as well subscribe to the jungle economy. Shrewd argument, yes, but marred by trio of crucial and misleading errors.

First, Rubinstein paints a very distorted picture of the way economics is taught in the classroom. He certainly never attended the introductory course that I teach, and I doubt whether other members of the economics department really conduct themselves as Rubinstein describes. I can attest that the majority of the lectures I give are not at all devoted to heaping praise on the exalted efficiency of the market model. In fact, considerable time is dedicated to the discussion of market failures and the role of government in handling them, as well as its contribution to the redistribution of income. An important message, which I—like my instructors before me—frequently impress upon students of economics is that "efficient" and "good" are not the same thing. Indeed, efficient allocations can be deplorable from a moral standpoint.

Second, Rubinstein ignores a fundamental difference between the market economy and the jungle economy: the process of production. Since such a process does not exist in the jungle economy, which makes do with the distribution of existing goods, it is unaffected by the lack of incentives for investing effort and resources in the manufacture of products. In addition, in an economy that does not respect ownership rights, many resources—too many, in fact—will be allocated to the *protection* of property; the market economy, by contrast, provides an abundance of incentives for production, all of which motivate economic growth and lead to a rise in living standards. Because he does not consider this crucial point, Rubinstein's argument is fundamentally flawed. Were the matter of production taken into account in his presentation of both models, the apparent similarities between them would immediately vanish.

Third, although Rubinstein attempts to persuade his readers that the majority of economists are acting as an organized lobby in the service of the market model, the truth is far more prosaic. The primary function of the model is not to promote an ideology, but rather to assist in understanding reality. Adam Smith did not *invent* the "invisible hand." He *discovered* it, by observing what was happening around him. Smith and numerous scholars after him sought first and foremost to explain existing phenomena. The truth is, a good portion of those who live in societies where a market economy is the norm simply do not pay attention to the plenitude available to them (yes, even the low-income earners among them. The poor of today's generation enjoy luxuries of which the affluent of bygone eras could only dream). They seem barely to notice, let alone appreciate, the fact that the grocery store is open most hours of the day; that the line at the cash register moves rapidly (most of the time); that the shelves are packed with products—and that all of this transpires even though there is no supervising body that provides for their needs. Economists, however, do not take these things for granted. Rather, they take an interest in the price mechanism and in the way incentives function. To date, the market model is the best explanation they have found. Is it elegant? Is it moral? I am not convinced that these questions are relevant in the context of an empirical economic discussion. What I do know is that the theory of the invisible hand, with all the modifications and fine-tuning it has undergone over the course of years, enables us to understand a very valuable thing about the world.

But, as can be expected, economists are not satisfied with simply describing the state of affairs. They offer prescriptions, recommend certain channels of action, and rule out others. In this, economists are no different from other scientists. If a physicist were presented with a flight plan to outer space that is based on Ptolemaic cosmology, which places the Earth at the center of the universe, he would have no choice but to reject it. Likewise, were a biochemist asked to express his opinion on a medicine based on Hippocratic theory of the human body, it would be incumbent upon him to advise against it. The physicist and biochemist would be forced to denounce certain ideas simply because they contradict what we know about nature. The same is true for economists. They reject the model of a command economy not out of some deep-seated hatred of socialism, but because they understand that, given what is already known about human behavior, and what we have learned from past experience, an attempt to manage the market by means of massive government intervention will not succeed. Had these same economists chosen to praise lofty ideals, instead of sticking to the hard facts, they might have merited Rubinstein's approbation—but they would also have lost their right to be called scientists.

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Rubenstein, interstingly, is no socialist. He does support welfare policy, but his approach is much more conservative than it initially appears. Simply put, he believes that society should assist those citizens who are less fortunate—a point, he believes, on which he differs from market-economy fundamentalists—but not spread its grace all over the place. He is unmoved by populist social righteousness: Indeed, he has reservations about new immigrants to Israel whose ties to the Jewish people are tenuous, and whose economic contribution to the state is minuscule; he opposes importing a foreign workforce that wrests employment away from low-income earners; he criticizes the government's active encouragement of a higher birth rate; and he cautions against the proliferation of the needy. According to Rubinstein, it is an individual's right to make decisions that affect his own fate, but this right must not burden society with the obligation to compensate that person for poor choices made. Anyone can choose not to work, for example, and to live in poverty, or not to save for old age and suffer pangs of hunger after retirement. People can even bring children into the world for whom they are unable to provide—but they must bear the price of their decisions. It is not the duty of the state to serve as a safety net.

This is all well and good, but Rubinstein seems content simply to present a general outline of his social views, without bothering to examine their applicability. Unfortunately, economists cannot allow themselves this privilege. It is too easy to wave the banner of justice from on high; what are needed are concrete solutions to practical problems. Thus does Rubinstein avoid proving his own thesis that common sense is preferable to the theories of an economist.

I do not take issue with Rubinstein's claim that a considerable part of economic research (and particularly his own field of expertise) has gone off on a tangent. However, when the brilliant theoretician elects to challenge the entire discipline of economics; to draft sweeping indictments against it, and deny it even a shred of legitimacy—then one cannot help but form the impression that he is not waging war for the *sake* of logic, but rather, in opposition to it.

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