Economics Rules: The Rights and Wrongs of the Dismal Science

Dani Rodrik. 2015. New York: W.W. Norton and Co. ISBN 978-0-393-24641-4. $27.95

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There are few economists whose writing I anticipate with more eagerness than Dani Rodrik's. His academic papers are almost always novel and clear-headed, and his books are just as insightful as they are enjoyable. In his newest book, Rodrik adds to this reputation with an eye-opening examination of the fundamentals of social science's most influential academic discipline. Written amid the so-called "empirical revolution" of the economics profession, some may be surprised to find the book is primarily about the uses and misuses of theoretical economic models. In a fashion frequent readers have grown accustomed to, Rodrik writes a delightful book about a potentially arcane topic.

The first chapter of the book, entitled "What Models Do", makes Rodrik's thesis clear: A model breaks down the complexities of reality for the purpose of understanding a specific aspect of a given context. A different context requires—at least consideration of—a different model. Rodrik affirms that "when models are selected judiciously, they are a source of illumination. When used dogmatically, they lead to hubris and errors in policy" (p. 11).

Chapter two, entitled "The Science of Economic Modeling," carefully defines and classifies the discipline of economics. The use of models by economists is what makes the discipline a science. Not a *hard* science like physics or chemistry, economics is a *social* science. The unit of analysis in economics is typically the individual, the firm, or the household, which all have the agency to do what they want, when they want. This sets economics apart from other disciplines that study inanimate units such as soil, rocks, or planets. Economics, therefore, doesn't have laws or universal theories. Rodrik says that "at best, [economists] can talk in terms of tendencies, context-specific regularities, and likely consequences" (p. 45).

If one accepts the premise that economists work with context-specific models, then it may be reasonable to presume that standard training in economics involves numerous lessons about choosing models given the realities of a specific context. This presumption, as many economists will know, is largely incorrect. In the aptly titled third chapter, "Navigating among Models", Rodrik points out this sobering reality. Recent economics PhDs exit graduate school having learned an enormous collection of models for how the world works, but little to no formal training about how to choose which model works best in various contexts. This shortcoming is perhaps part of the reason why economists make mistakes, and is at the root of many criticisms of the dismal science.

In chapter four, "Models and Theories," Rodrik makes the case that "theories in economics are either so general that they have little leverage in the real world or so specific that they can account at best for a particular slice of reality" (p. 144). As the "empirical revolution" persists, with the popularity of randomized control trials and increasingly creative identification strategies, modern-day economists are more concerned with the specific rather than the general. This emphasis on causal relationships may be, on net, a positive thing, but if there is one key takeaway from Rodrik's book it is that economics is—and should continue to be—a discipline that builds models.

The first half of *Economics Rules* is full of useful reminders for aspiring and professional economists alike, but may be slightly uninteresting for non-economists. The second half of the book, however, will be fascinating for both economists and non-economists—particularly those non-economists who must work alongside economists on a regular basis. The remainder of this review will focus on chapters five ("When Economists Go Wrong") and six ("Economics and Its Critics").

One of the most popular—or at least most often repeated—critiques of economics is that economists make too many assumptions. On this topic, Rodrik is able to simultaneously scold economists for their tendency to mistake assumptions as actual facts, while responding to critics by explaining why simplifying assumptions are of value in the curious task of economics.

In one of the more illuminating passages in the book, economic models are likened to maps as illustrated through a short story by Argentine novelist Jorge Luis Borges, *On the Exactitude of Science*. The illustration tells the tale of an ancient empire that became obsessed with making perfect maps. Soon the maps they produced grew in size and complexity until one day their maps exactly mimicked the empire itself in scale and detail. At this point, the maps were considered useless and were discarded into the desert. This illustration highlights that maps are useful because of their ability to simplify reality so that specific components of the world's complexity may be understood. The same, claims Rodrik, goes for economic models.

Rodrik argues that making simplifying assumptions allows economists to study specific and interesting aspects of the world's complexity. Abstractions from reality allow economists to predict the outcomes and consequences of policies, such as setting a ceiling on the price of oil, increasing the federal minimum wage, or reducing global migration restrictions. Without simplifying assumptions, economists would have little—if anything—to contribute to public policy or business administration. Economists must, however, be careful not to forget that these contributions often—and perhaps always—rest critically on assumptions that may not hold in all places or at all times. As one of my mathematics textbooks much less colorfully, but no less instructively, states:

> Assuming something is not the same as asserting it. To assert a statement is to claim that it is true, and such a claim is never acceptable in a proof unless it can be justified. However, the purpose of making an assumption in a proof is not to make a claim about what is true, but rather to enable you to find out what would be true if the assumption were correct. You must always keep in mind that any conclusion you reach that is based on an assumption might turn out to be false if the assumption is incorrect. (Velleman 2009, p. 87)

Economists make mistakes when they become overconfident in one popular paradigm or when they disregard important characteristics of the specific context in which a model is being applied. The financial crisis represents a huge mistake on the record of many economists. It would be misleading, however, to state that all economists made this mistake or that the discipline itself didn't possess the tools to predict such a calamity. In fact, Robert Shiller had long foreseen a housing market collapse prior to the 2008 bubble (Shiller 2005). The core mistake of the financial crisis was assuming that financial markets always behave rationally and, by extension, that phenomena like a housing bubble could not exist.

Similarly, the so-called "Washington Consensus" is another giant mistake that was initially advocated heavily by economists. It may seem plausible—and perhaps even obvious—that the relative economic success of many developed nations stems primarily from trade liberalization and broad privatization within the economy. Several decades later, it is not especially controversial to make the claim that many of the policies introduced in lesser-developed nations by way of the Washington Consensus didn't spur growth and perhaps made things worse. Again, this particular mistake doesn't rest on the fundamental tools of the discipline, but rather on the fact that many economists failed to verify the critical assumptions underlying the Washington Consensus model. In years prior to that time, many institutional economists—Ronald Coase (1992) and Douglas North (1971, 1973) in particular—were researching the deeper institutional underpinnings of market-oriented economics.

This book left me with two broad thoughts about the nature of the intersection of Christian faith and modern economics. The first thought is about the tension between Christian values (e.g. loving neighbor as self) and the strong desire among economists to institute incentive-based (i.e. self-interested) policies and practices in almost all aspects of life. Day One of most Principles of Microeconomics courses often begins with the lesson that demand curves slope downward. In applying this model to the real world, if one wants less of something then all one has to do is make that something more expensive.

This incentive-based model lies behind the argument many environmental economists make when they advocate for a carbon tax or some sort of cap-and-trade policy. The goal, generally speaking, is to make carbon expensive, and therefore make polluting less profitable for businesses.

The different approach might rest on a model of human behavior that emphasizes the power of moral responsibility. All humans possess some sort of culturally defined compass of moral responsibility. Consider the case of an Israeli daycare center that, in order to reduce the tardiness of parents when picking up their children, instituted a "late penalty." The daycare wanted to reduce the number of times parents were late picking up their children, so they made being tardy expensive. To almost everyone's surprise, the tardiness of parents actually increased after the penalty was introduced. It turned out that, since being late now carried a fee, parents felt it was morally okay to show up late (Gneezy and Rustichini, 2000).

Perhaps an overreliance on incentives fosters values that are corrosive to a morally rich society (Sandel 2012). This is striking in the context of Rodrik's book. For many economists, the solution to climate change is simple: just make carbon more expensive. But what if caring for creation is more like daycare pick-up than the demand for, say, widgets? What if many economists have chosen the wrong model?

My second thought is about the characteristics of a Christian economist. What, if anything, makes a Christian economist distinctive? Certainly we all have different gifts (Wydick 2015), but what are the characteristics that cut across our tribe? Perhaps being hard working, caring, and having integrity are all fitting and—when we are at our best—characteristics found in most of us. In light of this book, I'd like to suggest that Christian economists should be known as humble economists. A humble economist would never confuse *a model* with *the model*. A humble economist is comfortable saying "I don't know" when asked about the economy or some policy. A humble economist is able to rethink their outcomes when the critical assumptions of their model fail to align with the reality of the context they are studying.

Economics Rules is an enjoyable and insightful read for economists both young and old. It would make a fantastic companion to an Economics 101 syllabus for a professor interested in teaching a bit of empirical reasoning when introducing basic theoretical economic models. The book succeeds in striking the difficult balance between being critical of the mistakes economists have made in the past while being firmly rooted in the core foundations of the discipline.

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