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The X Factor of Economics: People

By DAVID SEGAL

Economists — they certainly are a contentious bunch.

The latest evidence came last week, in the form of the minutes of the latest meeting of the Federal Open Market Committee, the brain trust that establishes monetary policy. The committee, we learned, is divided on a seemingly straightforward question: Should the Fed take action to goose the economy now, or wait, watch and perhaps goose later?

Similar debates have attended virtually every element of the government's efforts to turn the country's fortunes around — even the parts that have been unfolding for more than a year. You might assume, for instance, that there would be a broad consensus about whether the $787 billion stimulus, passed in early 2009, worked.

But generally speaking, economists who thought it was a good idea at the time think it worked, and economists who thought otherwise beg to differ. And both sides make their cases with plenty of hard numbers.

Let's leave aside the merits of these arguments and ask a question so basic it will sound naïve: Why do economists argue at all? Given that Fed members and economists are looking at the same data, and given the reams of evidence accumulated over decades — not to mention a few centuries of great minds, great theories and thick books that preceded this crisis — why isn't a right answer self-evident?

George Bernard Shaw once said, "If all economists were laid end to end they would not reach a conclusi
prevents economics from yielding answers the way that physics, chemistry and biology do?

As it happens, plenty of dismal scientists have pondered this one. After the onset of the Great Recession considerable hand-wringing about what the discipline had gotten wrong, memorably captured last year in an article by Paul Krugman in The New York Times Magazine. But the limits of economics is a subject that many in the field have been discussing for years, in print, in discussions with each other, and, in the case of Robert Solow, Nobel Prize winner and M.I.T. professor emeritus, with graduate students.

“I talk about what it is about economics and economic life that leads to differences of opinion,” Mr. Solow said. “One point I always make to my graduate students is, avoid sound bites. Never sound more certain than you are.”

To explain the case for humility in economics, Mr. Solow said, look no further than the stimulus bill: “It has run its course over the past year and a half, but it is not an isolated event. One thousand other things were happening that had an effect on employment and real G.D.P.,” a measure of a nation’s total output adjusted for changes in prices. “You want to trace the effect of one of a very large number of significant causal effects, and that’s a very hard thing to do.”

That the world doesn’t offer up clean economic experiments is a common refrain in the discipline, said Gary Becker, a Nobelist at the University of Chicago. There have been endless studies on every tax change in the modern history of the republic, Mr. Becker said, from Kennedy to George W. Bush, and arguments about the wisdom and aftereffects of each. It’s not just that there is so little clear signal amid so much noise. It’s that many economists have a unique idea of what signal to listen to and what priority it deserves.

Which gets to another great variable: personal values. In his textbook “Principles of Economics,” N. Gregory Mankiw, a Harvard professor, proposed this thought experiment: A town must maintain a well. Peter, who earns $100,000, is taxed $10,000, or 10 percent of his income, while Paula, who earns $20,000, hands over $4,000, or 20 percent of her income.

“Is this policy fair?” Mr. Mankiw asks in “Principles.” “Does it matter whether Paula’s low income is due to a medical disability or to her decision to pursue an acting career? Does it matter whether Peter’s high income is due to a large inheritance or to his willingness to work long hours at a dreary job?”

Economics, Mr. Mankiw concludes, won’t tell us, definitively, whether Peter or Paula is paying too much, because an answer inevitably leads to matters of values, which inevitably leads to different answers.

This is not to suggest that economics is a total free-for-all, lacking a broad consensus on any subject. Polls of economists have found near unanimity on topics like tariffs and import quotas (bad), centralized economies (very bad) and flexible, floating exchange rates (very good). Nor is it fair to say that economists have done little to help in the latest crisis. A depression seemed possible two years ago, and thanks to the ideas of economists, that didn't happen.

But economics will forever have to contend with the biggest X factor of all: people. As Mr. Solow notes, you feed people poison, and they die. But feed them a subsidy and there is no telling what will happen. Some will use it wisely, others perversely and some a mix of both.

As a result, a certain amount of psychological guesswork is part of an economist's job, which accounts for the rise in popularity of behavioral economics, an effort to account for the slippery, indefinite nexus of money and humans. "The entire question of how emotion will change people's behavior is pretty much outside the standard model of economics," said Dan Ariely, a professor at Duke University and author of "The Upside of Irrationality."

"Pride is not in the model. Revenge is not in the model. Fear is not in the model. Even simple things like the disenchantment of people who are fired from their jobs — the model doesn't account for how devastating that experience can be," and what that sense of devastation will mean for the economy, he said.

Professor Ariely regards the stimulus package as a $700 billion experiment that had no chance for fine-tuning. He would have tried different types of stimulus in different states. Maybe California residents would get cash, while New York residents would get pre-paid debit cards. The most effective stimulus of all, he guesses, would have been the debit card, with President Obama's face on it, along with the words: "Spend the government's money."

"We can make fun of economics, and I've made a professional habit of it," said Professor Ariely. "But there's a good reason that human irrationality isn't part of the standard economic models, and this gets to the dilemma of economics. If you have a simple problem, you can offer a simple solution. But the economy is a hugely complex problem. So we either simplify the problem and offer a solution, or embrace the complexity and do nothing."