Mainstream Economics:
aims, methods, textbooks, trends, criticisms

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Overview

- What is mainstream economics?
- Samuelson and the neoclassical synthesis
- Neoclassical *micro*economics
- Mankiw and macroeconomics
- The new neo-classical synthesis
- Trends
- Criticisms

What is meant by *mainstream economics?*

Contemporary mainstream economics:

- Term used by Paul A. Samuelson (and William D. Nordhaus) who perhaps best personifies it
- A formal field mathematical modeling
- could also be called mathematical economics.
- It draws on calculus, linear algebra, statistics, game theory, and computer science.
- Professional mainstream economists must be familiar with these tools

Neoclassical synthesis

- Currently mainstream economics is dominated by the neoclassical synthesis, which combines
- neoclassical approach to microeconomics with
- Keynesian approach to macroeconomics.

- Paul Samuelson personifies the neoclassical synthesis that tried to put economics on a solid mathematical foundation.
- 1st recipient of the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel (modeled on the Nobel Prize in order to borrow the prestige)

The Economics Textbook

Economics

18th International Edition
(Paperback:McGraw-Hill/Irwin)

2006

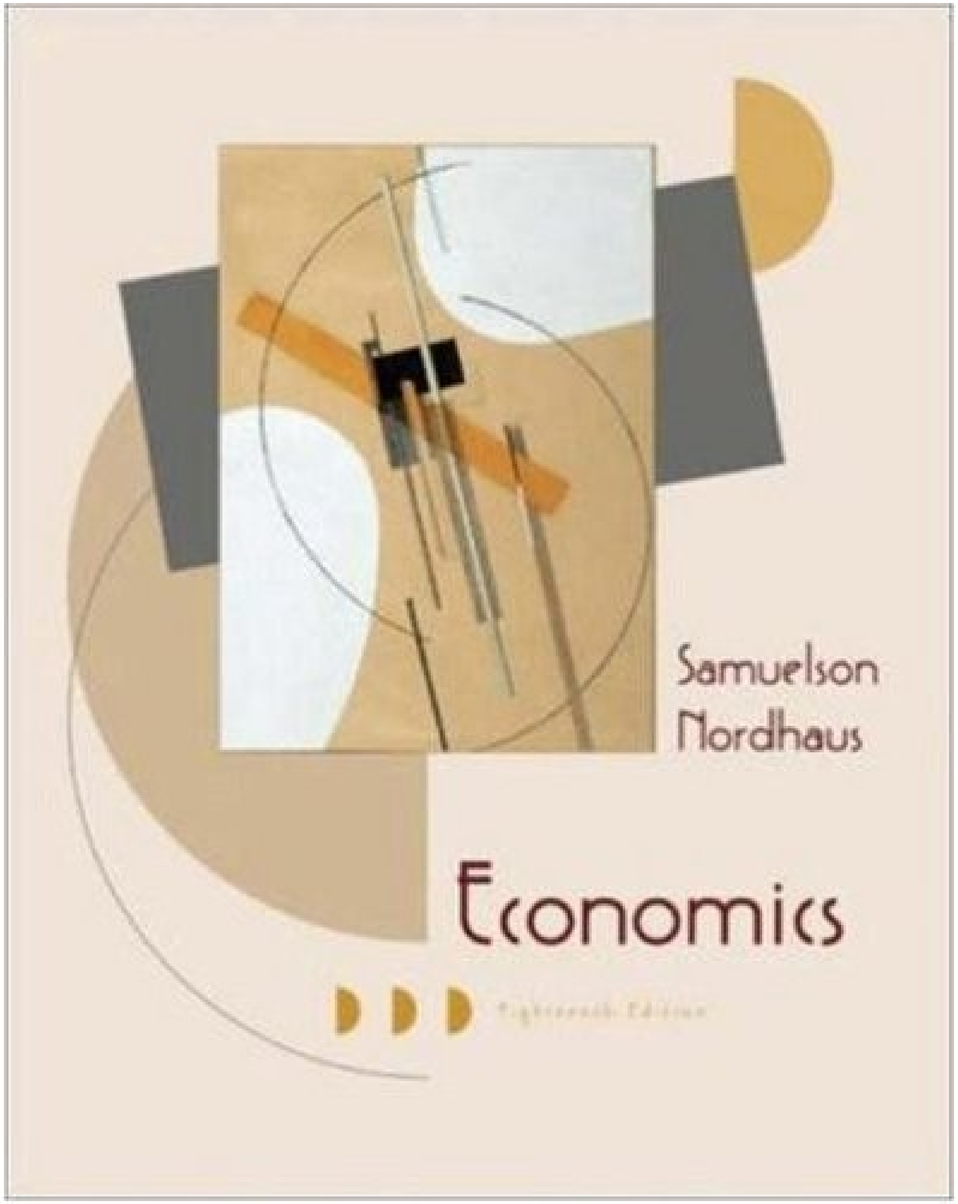
Paul A Samuelson

&

William D. Nordhaus

(since 12th edition of 1985)

1st edition 1948



Microeconomics: neoclassical

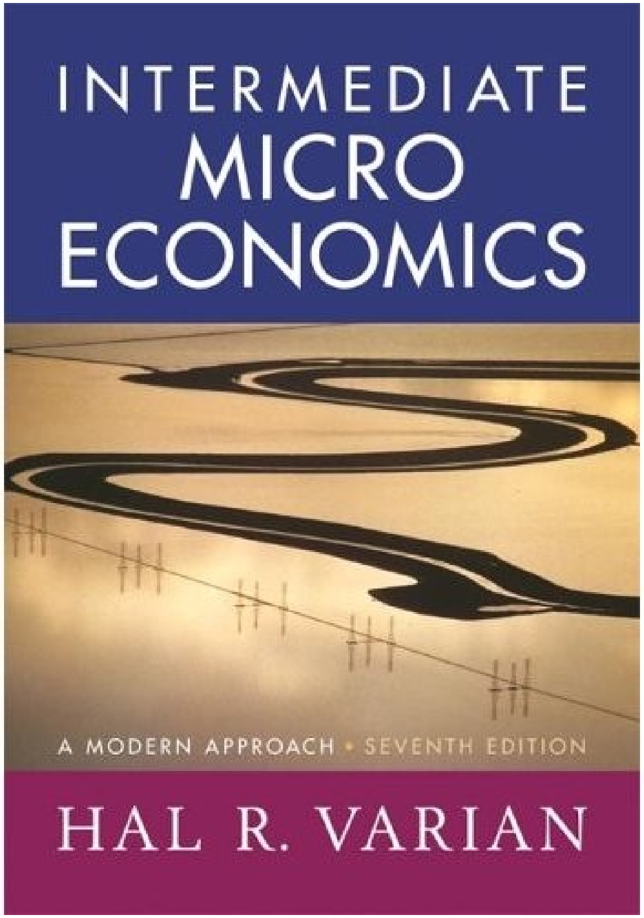
Standard neoclassical microeconomics

at undergraduate and graduate levels:

the allocation of scarce resources among alternative ends

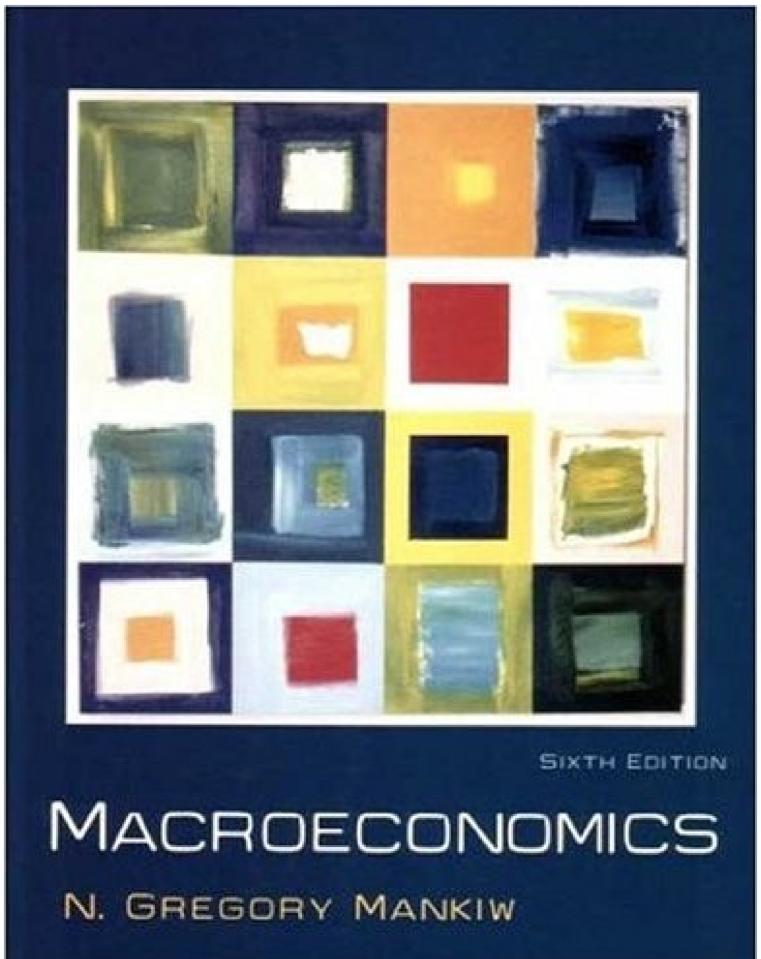
(The definition of economics to neoclassical theorists)

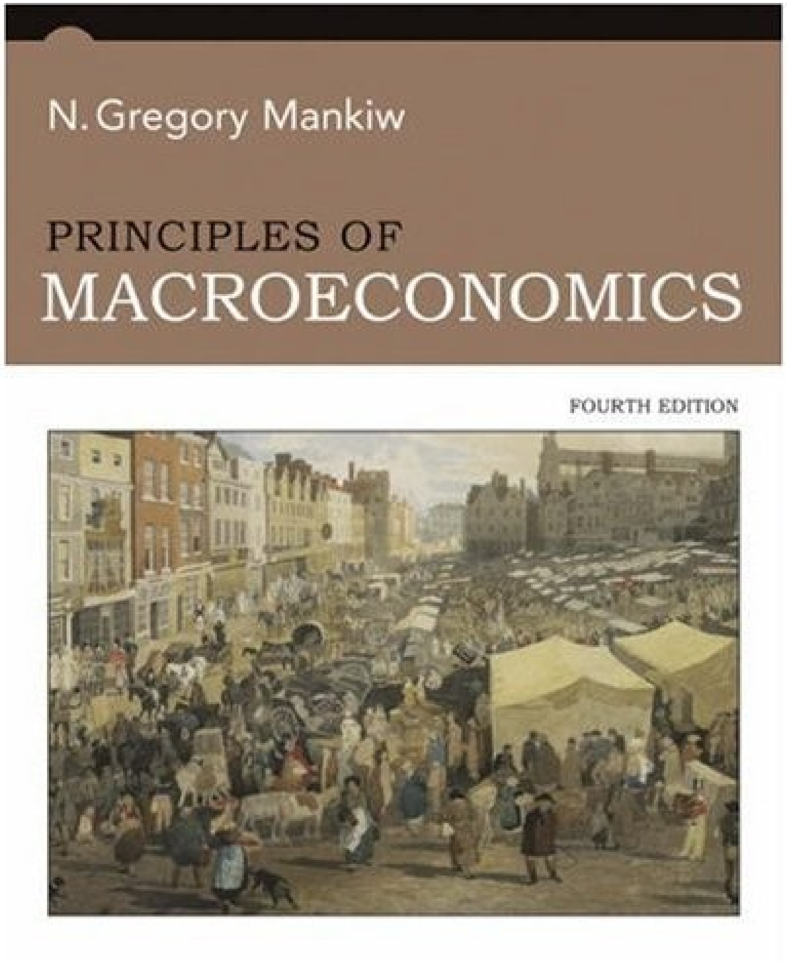
- People have rational preferences among outcomes that can be identified and associated with a value.
- Individuals maximize utility and firms maximize profits.
- People act independently on the basis of full and relevant information.



Mankiw

intermediate-level: ***Macroeconomics***
Introductory: ***Principles of Economics***
(sold over a million copies, translated into 20 languages)





‘A generation ago, the three leading texts for [intermediate-level macroeconomics] were those by Robert Gordon, Robert Hall and John Taylor, and Rudiger Dornbusch and Stanley Fischer.

Today, the top three sellers are those written by Olivier Blanchard, Andrew Abel and Ben Bernanke, and myself.

The common thread is that each of these six books was written by at least one economist with graduate training from MIT, a prominent engineering school where the dominant macroeconomic tradition was that of Samuelson and Solow.’

-Gregory Mankiw (2006) ‘The macroeconomist as scientist and engineer’, Journal of Economic Perspectives, Vol. 20(4), p. 43.

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‘In all these books, the basic theory taught to undergraduates is some version of aggregate demand and aggregate supply, and the basic theory of aggregate demand is the IS-LM model.

The same lesson can be gleaned by perusing the most widely used textbooks for freshman-level economics:

Short-run economic fluctuations are best understood using some version of the neoclassical-Keynesian synthesis.’

‘This lack of revolution in macroeconomic pedagogy stands in stark contrast to what occurred half a century ago.

When the Samuelson text was first published in 1948 with the aim of introducing undergraduates to the Keynesian revolution, the world’s teachers rapidly and heartily embraced the new approach.

By contrast, the ideas of new classicals and new Keynesians have not fundamentally changed how undergraduate macroeconomics is taught.’

-Gregory Mankiw (2006) ‘The macroeconomist as scientist and engineer’, Journal of Economic Perspectives, Vol. 20(4), p. 44.

New neo-classical synthesis

‘Like the neoclassical-Keynesian synthesis of an earlier generation,

the new synthesis attempts to merge the strengths of the competing approaches that preceded it.

From the new classical models, it takes the tools of dynamic stochastic general equilibrium theory.

Preferences, constraints, and optimization are the starting point, and the analysis builds up from these microeconomic foundations.

From the new Keynesian models, it takes nominal rigidities and uses them to explain why monetary policy has real effects in the short run.

The most common approach is to assume monopolistically competitive firms that change prices only intermittently, resulting in price dynamics sometimes called the new Keynesian Phillips curve.

The heart of the synthesis is the view that the economy is a dynamic general equilibrium system that deviates from a Pareto optimum because of sticky prices (and perhaps a variety of other market imperfections).’

-Gregory Mankiw (2006) ‘The macroeconomist as scientist and engineer’, Journal of Economic Perspectives, Vol. 20(4), p. 39

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‘It is tempting to describe the emergence of this consensus as great progress. In some ways, it is.

But there is also a less sanguine way to view the current the current state of play.

Perhaps what has occurred is not so much a synthesis as a truce between intellectual combatants, followed by a face-saving retreat on both sides.

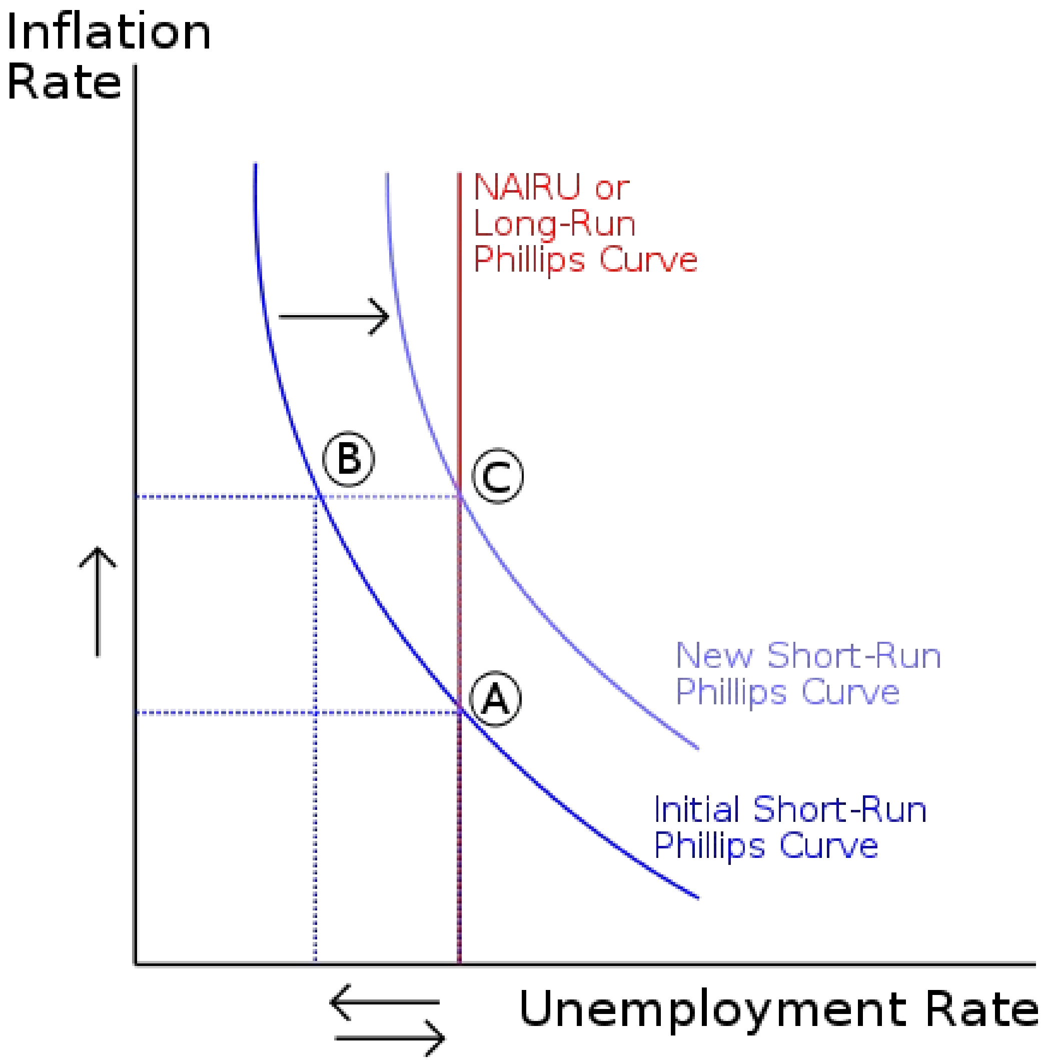
Both new classicals and new Keynesians can look to this new synthesis and claim a degree of victory, while ignoring the more profound defeat that lies beneath the surface.’

-Gregory Mankiw (2006) ‘The macroeconomist as scientist and engineer’, Journal of Economic Perspectives, Vol. 20(4), p. 39

New Keynesian Phillips Curve

Expectations adjusted Phillips curves with 'sticky' prices

NAIRU: non-accelerating inflation (or natural) rate of unemployment



New trends

Any field that embraces mathematical modelling finds a home in the new mainstream:

- (Endogenous) growth theory
- Econophysics
- Behavioural economics
- Neuroeconomics
- Evolutionary/institutional economics
- Non-linear complexity theory
- Environmental economics

Mainstream Criticisms

- Normative bias: does not explain actual economies but describes a "utopia" in which Pareto optimality applies.
- Lack of realism: overly unrealistic assumptions.
- The assumption that individuals act rationally ignores important aspects of human behaviour: Homo economicus does not resemble Homo sapiens.
- Neoclassical general equilibrium theory is not compatible with an economy that develops over time.
- Relies too heavily on complex mathematical models without enough regard to whether these actually describe the real economy.
- Copies the 19th century mechanics and the "clockwork" model of society which seems to justify elite privileges as arising "naturally" from the social order based on economic competitions. (Echoed by modern critics in the anti-globalization movement who blame neoclassical theory for inequities in global debt and trade relations.)
- Ignores the complexity of nature and of human creativity, and seeks mechanical ideas like equilibrium.
- Does not work!