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Book Review

Seven Bad Ideas:

How Mainstream Economists Have Damaged America and the World

Reviewed by Tiziano Distefano, IMT Institute for Advanced Studies, Lucca, Italy

Seven Bad Ideas: How Mainstream Economists Have Damaged America and the World
Jeff Madrick
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Seven Bad Ideas argues that mainstream economic ideas are responsible for the recent financial and economic crisis, burst in 2008 in the USA and then spread out in Europe and in the rest of the world. In an overwhelming landscape of economic publications concerned with laissez-faire think tank and Keynesianism, this book offers a clear overview of historical facts showing the harmful consequences of an uncritical application of oversimplified, and ideological-laden, economic ideas. I recommend this book mostly to young students and people outside academia who are interested in the never-ending struggle between free-market advocates and opponents.

Century Foundation fellow Jeff Madrick, whose previous books include the best-selling *Age of Greed*, is a contributing editor at Harper's Magazine, a columnist and, first of all, an economist by training. He has devoted his career in understanding the causes of economic growth, emphasizing the need for active public investment. The book focuses on the deleterious consequences of the core orthodox economic ideas that contributed and justified much of the financial behaviour that caused the recent global crisis, exacerbated by the policies of Austerity. The theme is of course highly relevant for contemporary concerns in the recovery of GDP growth, mass unemployment, globalisation as well as a rethinking of professional attitudes, and responsibilities, of the economists. Madrick forces the readers to take *cum grano salis* the mainstream prescriptions because, behind the alleged scientific approach, it is hidden an ideological attitude. If it is true the author's contention that economists seem unable to agree on a response to the current recession, Madrick limits his analysis within a narrow and old-fashioned perspective, leaving outside many other important economic contributions.

So what are the seven bad ideas? Actually, they aren't all that distinct, as I'll clarify later. No. 1 is the well-known Invisible Hand, that is the belief that individual self-interest and free-markets necessarily maximize common welfare through a self-correcting mechanism. No. 2 recalls the assumption that supply creates its own demand (Say's Law), while No. 3 summarizes the Friedman's contention that any Government intervention is doomed to fail. No. 4 reviews the mainstream obsession for low and stable inflation; No. 5 describes the alleged belief that major speculative bubbles can't happen and No. 6 refers to the presumed win-win effects of (global) free trade. Finally, No. 7 critics the illusion of scientific objective knowledge, dressed up in fancy math that gave to the economic models a false appearance of rigor.

The first beautiful idea actually subsumes most of the other ideas that seem derivatives, rather than different first principles of the orthodox economic thinking. The Invisible Hand appeared just once in *The Wealth of Nations*, but suddenly became the fundamental justification that free-markets work in some ideal way without more than marginal government intervention. Why is it so appealing? As Madrick makes clear, "The possibility that a *single [economic] mechanism* could explain economic advance was exciting. [….] Supply and demand *automatically* adjust to a 'general equilibrium' that satisfies as many people as possible" (pag. 19-22, emphasis added). Government should be simply set aside because it would "distort" the market functioning that would ensure national prosperity.

Why is this belief still in vogue even though it is not grounded on empirical and historical evidence? The author explains it in the last chapter, "Economic theory is a mathematical analysis [and economists] feel secure when speaking with the authority of numbers. [It led them to an] uncritical trust in economics as a science" (pag. 126-127). Here, and throughout the book, Madrick underlines the ideological thrust behind any economic model. More than that, he reports several quotations in which the defence of free markets is underpinned on moral grounds. Even the most fundamentalist market devotee, Milton Friedman, dedicated the book *Capitalism and Freedom* to explain how this mechanism should lead to ideal and fair distribution and, most important, personal freedom.

Say's Law is the last brick, cited in the book, that completes the mainstream edifice. If savings are automatically invested, so that there cannot be an overall shortfall in demand, then any Government stimulus will crowd out an equal amount of private spending. Markets are self-sufficient. Bad ideas No. 2 is strictly tied with No. 1-3-4-5 for its focus on the sacred cow of "rationality". Madrick underlines the Lucas belief in consumer rationality, and even prescience, that would nullify any Government intervention. Fama, from the University of Chicago, moved from similar stands to justify the Efficient Market Theory. Free markets will fix the 'natural' price, therefore the financial bubbles cannot even exist (No. 5).

The book offers several convincing historical real case examples and empirical studies to justify an inclusive approach in which (big) Governments would play a crucial role. The oversimplified models behind the policy of Austerity (Bad Idea No. 2-3-4) and in favour of Globalization (No. 6) are the main responsible of the economic failure. Finally, the author recommends a multidisciplinary approach in which social, cultural, historical and psychological stances should be integrated in the economic analysis.

Fair enough, but how to do it? Madrick does not provide any epistemological suggestions on how economic model should be built or how they should be tested. Secondly, as I have argued, sometimes he confused original ideas (No. 1-2-7) with their implications (No. 3-4-5-6), leading him to a flurry of redundant examples aimed to attack Friedman and his followers. Still, he overestimates the political influence of economists, in other words, media and politicians have their burden of guilt in having promoted such bad ideas. There are important non-mainstream Nobelists unheard.

I'd make a couple of further observation here: first, I would expect a greater effort in the explanation of the historical, moral and philosophical foundations of mainstream ideas. Second, I question whether those bad ideas are really "mainstream." He seems to ignore that many free-market economists, e.g. Hayek and Shumpeter belonging to the Austrian school, dissent in important respects from the mainstream.

All in all, after a century of economic investigations is there something more than laissez-faire and Keynesianism? Is GDP growth a "good" idea? The massive research on the limits to growth and the related environmental problems are utterly neglected. The author seems to be stuck in the faith of growth as many other mainstream economists.

This quibbles do not diminish the main message of the author, economic ideas are powerful and a thoughtless application of them might be detrimental.