A New Economics for the Twenty-first Century

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The critical role for economic theory is no longer simply to explain how the existing system works, but also to explore how the economic system can be changed to become more adaptive and resilient in the face of the challenges of the 21st century, and how it can be more directly designed to support human well-being, in the present and the future. Simultaneous changes are needed, in both the actual economy (how it functions, by what rules, how it can be made responsive to constraints) and also in economic theory.

The economic theory that was accepted as standard in the non-communist world during the second half of the twentieth century erects serious impediments to meeting the challenges of the twenty-first century. These impediments include:

1. **Inappropriate goals**: standard economic theory prizes wealth creation above all, and most often defines this goal in terms of steadily growing GDP – instead of focusing on what economies should really produce, which is human well-being, in the present and the future.

2. **A bias toward monetary values**: application of cost/benefit analysis or a focus on narrow measures of economic success often lead to an effort to apply monetary measures to human values, such as dignity, health, or fairness. The focus on what can be submitted to the measure of money leads to an overemphasis on formal markets, and pays insufficient attention to essential unpaid economic activities.

3. **Difficulty in dealing with the future**: the standard use of discounting often leads to conclusions that make future concerns appear less significant than they are.

4. **A de-contextualized view of the economy**: economic systems are viewed as operating in a vacuum, without regard for the critical ways in which the economy affects, and is affected by, its ecological and social contexts.

5. **Bias toward the status quo**: a number of tools and concepts used in economic analysis accept the existing distribution of resources as "given" – not really up for discussion. These include the concepts of Pareto optimality, aspects of the Coase theorem, and a focus on aggregate growth indices at the expense of disaggregated inequality indicators. The strong assumptions of rationality at the root of the theory often are used to assert that the existing system is the best possible; if it could have been made better, it would have. (This is the basis for the joke about the economist who walks past a ten dollar bill lying on the sidewalk. When asked why, he says "it couldn't have been real; if it were, someone would have already picked it up.")

6. **Bias against the public sector and in favor of markets**: economists, business people and politicians have joined in a chorus of disparagement against government, buttressed by an increasingly blind, but fervent, belief that markets can solve all problems. In fact, while markets can be a part of the solution to many human needs, they rarely can be the whole solution. Markets need boundaries, rules, and safeguards against their internal tendency toward concentration of power and their lack of internal motivation to work for the wider good. In many situations markets are, in fact, the problem. Some attention to environmental concerns has led to the idea that, if there are

market failures, they can be corrected by internalizing externalities. It needs to be emphasized that market actors have no inherent incentive to do this: that incentive has to come from outside the market system.

7. **Methods of analysis that exclude non-economists**: Students, policy makers, and other citizens frequently complain about economists' increasing reliance on highly mathematized modeling techniques. These require extreme simplifying assumptions – such as perfect competition, perfect information, and complete markets – and create a mindset reluctant to grapple with issues that are not amenable to such modeling. Meanwhile, the very sophistication of the mathematics used in these models means that fewer and fewer people can participate in an ever more obscure – and less relevant – discourse.

In order to redirect economics to be more useful, and more truly reflect the world we now face, a good starting point is to go back to the goals that are embedded in economic thinking. Here it is useful to make the distinction between intermediate and final goals. Final goals are ends that are worth achieving in themselves, while intermediate goals are pursued because they are expected to contribute to the final goals.

As final goals for any economy I would propose two overarching concepts. The first is **well-being and equity in the present.** A successful economy will maintain or increase human well-being especially among those who now lack the essentials for a healthy life. The second is **productive capital for the future**. The economic system must maintain and, where necessary, rehabilitate, the productive resources required to preserve or increase human well-being in the future. These must include not only the obvious things, like factories and roads and other infrastructure. Productive capital needed to maintain well-being also necessarily includes natural resources, as well as human health and education, and cohesive social systems.

Increasing production and consumption are important intermediate goals for humankind in some times and places. They are often important means to the ends of well-being, but are positive if, and only if, they do actually enhance well-being. But in cases where we find that the pursuit of increased production and consumption – that is, of growing GDP – creates negative externalities that reduce over-all well-being in the long run, then these goals should be recognized as subsidiary to end goal of general well-being.

With that said, it is critically true that at least two-fifths of the world's people suffer from nutritional, health and educational deficits that severely depress their well-being, and that could be overcome with some of the things that money can buy. With respect to these individuals, increased production and consumption obviously remain very important intermediate goals.

Another critically important intermediate goal is the reduction of inequality. Some even argue that this should be placed in the category of final goals. Other obviously critical intermediate goals include climate mitigation, and promoting resilience and adaptation within both human society and ecological systems. Responding to global inequity as well as global climate change requires coordinated public policy to fundamentally redirect existing economic systems. Standard economics, with its various principles that create a status-quo bias, is often used as a justification for not addressing this task.

In addition to a much greater emphasis on equity, economic theory that is appropriate to the needs of the twenty-first century will need to be more concerned with the meta-externalities of the economic system. Meta-externalities are unwanted side-effects of the whole system affecting its physical and social contexts. In the cultural context, examples of negative meta-externalities emanating from the economic system we now have would include the way values like thrift have been replaced by conspicuous consumption, and concern for integrity has been replaced by obsession with winning. Climate change is perhaps the greatest negative meta-externality ever imposed by human economic systems on the natural world.

Positive meta-externalities should be looked for in the common assets upon which society at large depends. A sustainable system works, for example, to ensure an ethically and intellectually educated populace and a supportive physical environment.

To summarize the argument thus far, the major problems with mainstream economic theory begin with its assumption of final ends – most notably, maximizing GDP – that are not appropriate to a resource-constrained world. It views the economy as separate from its social and ecological contexts, understanding neither its dependence on these contexts nor the impacts of meta-externalities from the economic system upon them. It only counts things that go through the market, and it has a bias against the public sector and in favor of the status quo.

So what is the alternative? There are, of course, many: ecological, radical, feminist, social, humanistic, old and new Institutionalist, old and new Keynesian, and many other kinds of economics. Each of these emphasizes one part – sometimes a critically important part – of what is missing in the standard approach. But it doesn't work just to plug in something new: there's too much wrong with the whole approach. It is necessary, I believe, to start afresh, using as building blocks the best pieces from each of the various alternatives, as well as from standard theory, but fitting them all into a new design. This is what I set out to do nearly 20 years ago, when I began collecting what I judged to be the most useful alternatives within a system that I have called Contextual Economics.

There is no better way to force yourself to think through an entire theory than to write a textbook. I have now been the lead author on two textbooks for the college level: **Microeconomics in Context** and **Macroeconomics in Context.** In addition to the U.S. editions there are Italian, Russian and Vietnamese editions of these books. Roughly 40% of their content is similar to what can be found in a standard, neoclassical textbook. Much of the new material came from existing alternative schools of economics.

The starting premise for Contextual Economics is that an economic system is embedded within a **social context** that includes ethics, norms and human motivations, and the culture that expresses them. It also includes politics – that is, the deployment of economic and other kinds of power – as well as institutions, and history. Equally important is the recognition that an economic system is embedded within a **physical context** that includes the built environment, as well as the natural world from which all the materials we use ultimately derive. The health of any economic system is absolutely dependent on the health of these embracing contexts.

Next, contextual economics understands that the economy itself contains at least three spheres. In addition to the **for-profit business sphere** – the focus of mainstream economics – there is also the **core sphere**, consisting of families and communities; this is the focus of a good deal of work in feminist and social economics. Third is the **public purpose sphere**, which includes governments as well as institutions that are both non-governmental and not-for-profit, such as not-for-profit hospitals and universities, environmental advocacy groups, foundations, etc..

The business sphere is currently creating meta-externalities of culture and politics that place great burdens on the core sphere, and that tie the hands of governments. This does not necessarily imply that the for-profit sphere is "bad" and the others "good" – rather that institutional changes must be made to bring the purposes and functions of all three spheres into better harmony.

Another foundational question addressed by contextual economics is: What, in fact, constitutes economic activity? The list found in all standard textbooks is "production, exchange, and consumption." Beyond these it is critical to include **activities of resource maintenance** such as work directed toward maintaining environmental sustainability, infrastructure maintenance, and caring activities. Theoretical economics, which has been praised for its ability to improve efficiency in production, will gain in relevance if it also teaches how to sustain and build human, social, natural and built capital.

The preceding is a bird's eye overview of the content of what I believe needs to be included in an alternative system of economic theory – which is, of course, what is included in contextual economics. As noted, contextual economics has been woven together with strands of everything I and my colleagues could lay our hands on that appeared useful. .

There is not perfect harmony among the various schools of heterodox, or alternative, economics. Ecological economists emphasize environmental sustainability. Socio-economists and others emphasize individual well-being, often within a communitarian context. Radical economists emphasize social justice, and often align with Keynesians in assuming that the only way to achieve that is by growing the economy – as Paul Krugman keeps urging.

There are real conflicts among these visions of what constitutes a good society, and how to get there. As I look at these, I am struck by the realization that we may not actually have the choice as to which value should be uppermost. The natural world imposes absolute resource constraints – e.g., on water, fish, wood, and land – that, if used in one way, are not available for another use. Not to mention the limits on the atmosphere's ability to absorb climate changing pollutants.

If we start with nature as the binding constraint, the resource limits of a finite world mean that economic growth, as we currently understand the term, cannot continue indefinitely.

If we must accept the end of economic growth as we know it, this means that social justice cannot be achieved through the Keynes's or Krugman's prescriptions. In a non-growing global economy there is only one way for the poor to have more: that is for the rich to have less. Please note: this means less stuff, not necessarily less well-being.

There has recently been much good work directed to better understanding what really does contribute to well-being. Hedonic psychology and related studies suggest that there may be a reasonably good resolution to the dilemma of how to achieve environmental sustainability **and** equity **and** well-being: it lies in cultural and value change, to better understand what truly makes us feel happy and fulfilled.

Some of the unsustainable material pleasures and conveniences of the rich world may need to be given up: casual use of transportation; very large houses; water-skiing; the convenience of massive throw-away packaging, including in medical applications – and so on. But better urban design can offer compensating benefits, such as vastly reduced commuting time and more pleasant living environments.

If labor productivity continues to increase, as it has for the last two hundred years, in a post-growth world one result could be ever greater unemployment. But the obviously preferable alternative would be policies to promote an ever shorter work-week – hence more free time.

Keynes himself imagined this, in his paper on "Economic Possibilities for our Grandchildren." He projected economic progress forward a hundred years – to the year 2030 – when there would be very little reason for anyone to scramble for life's necessities, and we could mostly devote our lives to the arts of leisure. I would look for those arts of leisure to include active participation in arts, crafts, and other makings, such as gardening, as well as athletics, time with family and friends, and more time available to give every child a superb education.

2030 is only two decades away. We may not have achieved Keynes' vision by then, but the barriers to doing so lie not so much in the physical constraints posed by nature and technology as in human culture, politics, and values. To change these we need to change much more than economic theory – but changing economic theory is a good start.

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