EconoFact Chats: Reality-based Economics and Economic Policies

John Cassidy, The New Yorker

Published on 14th November 2021

Michael Klein:

I'm Michael Klein, Executive Editor of Econofact, a non-partisan, web-based publication of the Fletcher School at Tufts University. At Econofact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us, and see our work at www.econofact.org.

Michael Klein:

Econofact was founded in 2017 to bridge the gap between the work of top research economists and the public. Our goal is to create a better informed public, by providing accessible economic frameworks and policy relevant statistics. But we are certainly not alone in these efforts. Over the past few decades, there have been a rising number of columnists, bloggers, and reporters, who also focus on economic issues. They draw from both their own background in economics, and the work of others.

Michael Klein:

One of the most prominent of these is John Cassidy, who's been a Staff Writer at The New Yorker since 1995. John writes trenchantly and clearly on a wide range of economic issues and on other topics as well. He's the author of two books: 'Dot.con: How America Lost its Mind and Money,' and 'How Markets Fail: The Rise and Fall of Free Market Economics.' The latter was a finalist for the Pulitzer Prize, and was just reissued. John, welcome to Econofact Chats.

John Cassidy:

Thanks very much for inviting me on, Michael.

Michael Klein:

It's great to have you here. I really enjoyed 'How Markets Fail.' It offers a really interesting and accessible overview of important trends in economic research, beginning with Adam Smith's 'Wealth of Nations' through recent work on understanding the role of information, the role of psychology, and the failures that can come from financial markets. Throughout, there's this theme of the tension between abstract theorizing, that shows the efficiency, but not necessarily the desirability of unfettered free market economics, and the messy reality of the real world in which unfettered markets can go awry. The first edition of this book was published in the wake of the 2008 financial and economic crisis, and I imagine that this event was a motivation for your work. Is that correct?

John Cassidy:

Yes, it was. I've been studying economics and writing about it, even at that stage, off and on for about 20 years. But the crisis itself, because it was such a repudiation of a certain type of economics, it spurred me on to actually write a book about all this stuff. One of the first things I ever wrote for The New Yorker, which was back in '96, was a piece about the state of economics, macroeconomics. When I talk about economics, I'm largely talking about macroeconomics.

Michael Klein:

As a macro-economist, I enjoy that.

John Cassidy:

Yeah. Yeah. Because that's what I write about mainly. I do do some micro pieces, but when we're talking about economic policy and the great ideological debates, et cetera, it's largely macroeconomics I was talking about. So I basically come from a Keynesian background, and I was very skeptical of the lot of the macroeconomics that had been taught from the 80's onwards anyway. And this seemed to sort of...the financial crisis spurred me on to actually write a book about it all, and where this free market economics came from, both in its original incarnation, all the way back to Adam Smith, on its more recent reincarnation in the 60's and 70's, out of Chicago and Minnesota and other schools.

John Cassidy:

And so I thought if I put that intellectual narrative together with a story about the alternative school of economics, which I call 'reality-based' economics, which is more empirical, more Keynesian. And if I added that then, within a story about how it all went wrong in the financial crisis, I could do a reasonable length book. It turned out that they are three different books, so my book is really three books in one. It's a history of free market economics, history of, I guess what you'd call in America, Keynesian economics, and a history of the financial crisis. And the trick was trying to integrate those altogether.

Michael Klein:

Well, it's very clear from How Markets Fail, that you're really well versed in economic theories, maybe to an unusual degree among journalists. How does this knowledge of ivory tower economics inform your reporting?

John Cassidy:

Well, I don't really distinguish between the two, I guess. I was on an academic track for quite a while. I did an undergraduate degree in history and economics in Oxford, which is a version of PPE. And that was largely Keynesian economics, I would say; a lot of empirical stuff. Then I spent a year, I came to America on a two-year fellowship, the first year of which I spent at Harvard. So I already did the Harvard PhD economics program. Larry Summers was there at the time, various others. And that was an introduction to American style, mathematical economics. It was a very rigorous program, obviously, the first year PhD program; managed to turn me off economics pretty quickly. I decided... I mean academic economics.

John Cassidy:

And I had never intended to do an economics PhD. I was thinking about doing maybe an economic history PhD or something. But I decided instead to go into journalism, and I spent about five, ten years just doing financial economics journalism there. I was back in America by that stage. I went to NYU, and did the Masters Program there, is a two years masters program, which was also a reasonably rigorous and very, very mainstream, sort of mainstream trade theory, mainstream macro, mainstream micro, et cetera; pretty mathematical as well.

John Cassidy:

So I do have a master's degree. And then since then, I would say I'm part trained economist, and part autodidact. I spent all my spare time reading economics and economic history. I was on the subway yesterday, reading a history of Indian economic history, because I'm reading about an Indian economist at the moment, J.C. Kumarappa, who was one of Gandhi's original advisors. And he's a founder of 'no-growth economics.' So I've always been ranging widely in my personal reading; and then I try and integrate that. I wouldn't say I try and integrate it, but obviously that just provides the intellectual background for my writing. I've always been interested in policy debates, et cetera. And economic theory obviously feeds into those debates indirectly and sometimes directly.

Michael Klein:

So when you're on the New York City subway, reading this obscure economics book, did you find people moving away from you and...

John Cassidy:

I keep it covered down, so people don't think I'm too much of an uber nerd.

Michael Klein:

Yeah. Well-

John Cassidy:

And I had my daughter with me too, so she was saying, "Dad, cover up that boring book. You'll embarrass us on the subway."

Michael Klein:

I guess the New York City subway is known for weirdos, and it's acceptance of them.

John Cassidy:

Yeah. Although it's actually fascinating. It's a lacuna in my knowledge, I really don't know much about India and Indian history and Indian economic history, so it was actually fascinating to read.

Michael Klein:

You published the first edition of 'How Markets Fail' in the wake of the financial crisis of 2008. And you talk about this difference between what you call utopian economics and 'reality-based' economics. It seems to me that economists were really chastened by the 2008 crisis and the subsequent downturn. And they're focusing more on market imperfections; for example, the interplay of macroeconomics and financial markets. Would you agree with that, and how macroeconomics especially has evolved?

John Cassidy:

Yes, I would. I think it's definitely been a big change since 2008, in some ways. I remember going to...one of the most just gratifying pieces I ever wrote for The New Yorker was back in 2010. I went to Chicago. Obviously I had written a lot about Chicago in the book. And I interviewed some of the high priests of Chicago economics: Richard Posner, Gary Becker, Gene Fama, and others. They were very hospitable. One thing I will give Chicago, I think they, it's a very serious, open place, they're interested in intellectual debates. Posner and Becker were very open about it. They said this is a big blow to a certain type of Chicago economics. Posner actually wrote a book about how the financial deregulation had led to the crisis. So, if even some of the people in Chicago were admitting that something had gone wrong in mainstream macro or whatever, I don't think anybody else in the profession could then stand up and say, "well, that's not true."

John Cassidy:

So I think there have been various reactions to it. You see there are...in the new introduction I wrote for the new edition, I wrote about a couple of initiatives in economics in Europe, largely there's the CORE

Project, which is a reality-based economics project, I would say. In the US also, Dani Rodrik, and some of his colleagues have set up a new economics program, which again, I would call reality-based economics.

John Cassidy:

So I think there has been a shift inside the profession. How far it's gone, I'm not sure. I still think a lot of basic undergraduate economics is still taught under the old free markets, supply and demand framework, and people don't necessarily learn about financial bubbles and externalities, et cetera, until second or third courses, in which of course, a lot of people don't take those second or third courses.

Michael Klein:

So basically, you're making a strong pitch for people who take the second and third courses in economics, which I would strongly endorse as well.

John Cassidy:

Yeah. Or else, teach the first course from a different perspective. I've always thought it'd be more interesting and more productive to integrate some of the market failure stuff in the first course as well, so you don't just end up with a Adam Smith, Milton Friedman view of the world, if you do economics 101. And I think maybe in some places they do that, but in other places they don't.

Michael Klein:

Well, you and I were in graduate programs in economics at roughly the same time in the early 80's, when the rational expectations revolution was really in full force. But since then, there's really been a turn towards much more empirical work in economics, and in macroeconomics as well, so it seems like, defending my profession a little bit, it seems like there has been this realization that we need to look at data. And also, it's been more possible to look at data, with the advent of...the digitalization of lots of data, and the access to it is very easy now.

John Cassidy:

No, I think you're right about that, obviously. On the micro side, the whole experimental literature, which has just been rewarded with the Economics Nobel this year, of course. That exercise is the same degree of hegemony that the rational expectations approach used to do in the 80's, I think. It's very difficult, I'm told, to get these empirical papers published these days, which don't have some sort of randomized experiment attached to them. So that is a big change.

John Cassidy:

In macro itself, I think there's been a big intellectual effort to move beyond the simple, dynamic equilibrium models, and to integrate heterogeneous agents, is obviously an active area of research, and there's been a move away from the...somewhat in more policy-oriented terms.

John Cassidy:

The Bank of England, for example, had introduced basically a dynamic general equilibrium model of the British economy, which completely missed the financial crisis, of course, because it didn't have a financial sector, because those models didn't know a financial sector. There's been a rowing away from that, I think. In policy terms, I think it's pretty difficult if you're giving a lecture to the Chairman of the Bank of England or the Chairman of the Fed these days, to say, "You'd better do X, because our real business cycle model tells you that this is what you should do." And I think you see that. You see Jerome

Powell, obviously, he's not an economist. He knows quite a lot about economics, I think. But I think he takes with a pinch of salt, a lot of the old school economic theories.

John Cassidy:

So I think that is positive. I'm not making the argument there hasn't been a big change. And the other huge change I think we've seen, is the whole emphasis on inequality, which is a data-driven thing as well. If you go back to Piketty and people, and the whole school of tracing the evolution of inequality since the 1890s to today, with Andy Atkinson in the U.K., and Zucman, and there's a whole school of them there. That's an empirically based school as well. It's not based on any real theory. There's not really a big fashionable, inequality-based macro theory. It's basically, "Look at the trends here, look at the top 1%, top 0.1% cetera, look at the Gini coefficients." So that's an empirical development as well.

Michael Klein:

Yeah. There's probably an interplay between empirics and theory where empirics informs theory and theory informs empirics, how you start to look at the data and so on, but let's talk about some particular issues. You had a recent column in The New Yorker discussing the way the pandemic has shifted power to labor after decades during which the median wage has been stagnant and inequality has risen. So this relates to the point that you were making about a greater focus on inequality now. Do you think that this represents a sea-change or is it just going to be an effect that will abate as the pandemic becomes less of a dominant factor?

John Cassidy:

That's a very good question. I don't have a definitive answer to it. My intuition is that it's going to be more than just a one off because I think there are various factors. It's not just the pandemic. If you look at globalization, for example, some of the indices of globalization started to go down in 2012 if you look world trade versus world GDP, it's actually after the financial crisis, great financial crisis when the peak was. And I think the pandemic has illustrated some of the dangers of hyper globalization, we've seen it obviously with the supply chain, et cetera. So if globalization is going to be tamed even to a slight degree, I think that has an impact on the labor share and labor's bargaining power, because I do think the threat of offshoring, even when it wasn't real, was a huge factor in the hegemony of capital in the 90's and 00's. And to the extent that gets reversed, I think that's going to have an impact on labor.

John Cassidy:

Also, another huge change I think is in the Fed policy and the commitment to real full employment. I think the other factor which undermined labor as well as globalization was the Milton Friedman natural rate of unemployment model. The Fed see the natural rate of unemployment at 5.5%. 5.5% is a high rate of unemployment. You've got a large reserve army, to go back to the old Marxian terminology. Labor just didn't have much bargaining leverage. It's got a hell of a lot more bargaining leverage when the unemployment rate's 3% or 3.5% than it does when it's 3.5, 5.5 or 6. So you see from 2015 onwards, when the unemployment rate gets down to very low, you immediately see the wages starting to rise, especially at the bottom of the income distribution, the wage [inaudible] starting to rise.

John Cassidy:

We're talking about maybe getting back to levels of unemployment we last saw in the 60's, when wages were still rising, and we basically had 30, 40 years of monetary policy aimed at stamping out inflation at all costs. If that approach to monetary policy has gone for good, and I'm not saying it has, the test case is going to be in the next couple of years -- I think that will also have a big impact on labor share and wages.

Michael Klein:

Yeah. We have a number of Econofact Chats podcasts where we address these issues. We have one with Jeff Fuhrer who spent decades in the Federal Reserve system talking about the Fed's new framework. We have a podcast with Paul Krugman in which he talks about the way in which globalization may have affected the median wage, but he also points out that it was other things as well, for example, the collapse of unionization in the United States, and technological change. So we're all multifaceted issues in many ways, right?

John Cassidy:

Definitely. But economists for 20 years basically just said, this is technical progress. I remember back in the early 90's, when you would ask about all this stuff, it was basically capital bias, technical progress was the explanation for everything. It's only in recent years, I think that people, mainstream economists have started to look again at the impact of globalization. And as you say, the impact of institutional changes, like attacks on the labor laws and attacks on the unions, et cetera. We've had a huge shift in the distribution of income over the last 40 years. It would be very unusual if it was a unimodal explanation. We basically had a completely different political economy imposed after 1979. Globalization, different monetary policy, different domestic policies, plus the technology shock of computerization and subsequently the internet. So we basically had a whole new economy and I think it is over simplistic to just emphasize one of those factors to the omission of the rest.

Michael Klein:

Another issue that you've been writing about recently is the infrastructure. And we've just seen some infrastructure bills pass Congress. Rather than focusing on the politics of this, let me go back to your reading of Adam Smith and others about the appropriate role for the government. How is your knowledge of these economists influence your views, especially in the context of the provision of public goods and a social safety net.

John Cassidy:

That's a good question. Adam Smith himself, of course, even though he is seen as the great free market economist, which he was a great free market economist, made an exception for public goods...was the original economist to make the argument that there are certain types of goods -- he didn't use the phrases that we use today; non-excludability, non-rivalness -- in the language of his day, he said there are certain goods which benefit the community, which it doesn't pay any private individuals to make for various reasons. And the government, that's a rationale for government to provide those. He pointed to defense. I think you may have also mentioned lighthouses, or I'm not sure about that, but basically he provided [crosstalk 00:20:03],

Michael Klein:

He didn't mention the internet. Did he?

John Cassidy:

He didn't mention the internet. No, but defense and the internet are obviously very closely linked, because the Department of Defense originally developed the ARPANET, and the internet.

John Cassidy:

So to answer your question. I think my view of public goods is a market based one that. When private markets can provide goods, we should let them do it. And when the markets can't provide them, for various reasons, we should have public provision. The other economist, I would point to along those lines are old economists on this is Arthur Pigou. He now known in the US for the Pigouvian tax, tax on carbon.

And Pigou in his own time was much more famous for his arguments with Keynes about macroeconomics. He was Keynes' predecessor as the most eminent Cambridge economist in the start of the 20th century. But I think in historical terms, his big contribution was that he wrote the first book about market failures in which he emphasized spillovers -- negative externalities, as we call them these days.

John Cassidy:

The example he focused on was railway tracks and how they, in those days there were steam engines and how they used to give off sparks, which would set the neighboring fields on fire. But the principles are all the same. The prices, in that case, the contracts which the railway companies were given, didn't internalized all the costs and benefits of the transactions. So I see climate change -- a stable climate -- as basically the ultimate public good. And the climate change to use the words of Nicholas Stern, and the Stern Report [sic], is the greatest market failure we've ever seen.

Michael Klein:

Yeah. We have a number of memos and podcasts on the carbon tax, which is a Pigouvian tax. And I found those chapters in your book, I didn't know that much about Pigou as a person. And it's actually kind of sad the way he seemed to be eclipsed, and his ideas fell out of favor; and yet now those ideas are very, very important, and really part of the public debate.

John Cassidy:

Yeah. Keynes was very cruel to him actually. Keynes was very arrogant, and used him as a piñata board for attacking what he called classical economics. So Pigou basically gave up the public intellectual role and just retreated into his rooms in Cambridge and was very rarely seen in his later years.

Michael Klein:

Yeah, it was a sad story. In our last few minutes, John, I'd like to turn to what you and we at Econofact are trying to do. Both of us have a mission and goals that are quite similar -- to make economic ideas accessible to a broad public, and to show the relevance of those ideas for issues of the day. So we have a view of our audience as we curate our memos, our podcasts and our videos. People want to understand these issues from a reliable source, without political slant. People who might not have much background in economics, but can follow a logical argument. What's your view of your audience, and how do you think about them when you're writing a column?

John Cassidy:

Yeah, it's a very good question. I try to keep the audience in my mind is sort of a general interest reader who is interested in economics, but hasn't necessarily received anything beyond the economics 101, if he's even received that. A lot of the readers of The New Yorker, certainly the old days before the internet tended to be English graduates and arts graduates, who didn't actually know much economics at all. But even on the internet of course, it's different because you know that professional economists are going to be reading the pieces as well. So I do do occasionally a more dense piece, which is more aimed at the economist among the audience. I did a piece a few years ago about John Nash, which was pretty dense in the explanation..Nash Equilibrium and modern game theory. But I don't do that very often.

John Cassidy:

Most of my columns, which are policy based, I aim just at the general reader, and try and... I obviously have my own views, but...when I'm writing a policy column, I'm paid to give my own views. But even when I do give a certain view, I try to back it up with this is the sort of economic argument underlying view rather than just being a straightforward political argument.

Michael Klein:

Well, I think you succeeded admirably in How Markets Fail. I could see how it'd be very accessible to a general reader and as a PhD level economist, I also enjoyed it quite a bit.

John Cassidy:

Oh, thanks. Well, I guess that one worked. I'm sure you'll find the same thing on your podcast. It is very hard to know where to pitch things. And I think on the internet, you can maybe be more flexible because the long tail people...will find it if they're interested in it. I basically come from a mass market journalism. I was in newspapers before The New Yorker. So I still remember what they used to tell me on fleet street, which was think of a guy on the underground subway in New York, with sort of with a newspaper in one hand and his hand holding on with the other. And you are trying to keep his attention while he reads a paper and the trains rattling around and people are bumping into him. So I always trying can keep that image in my head too, which also teaches you to not write a too great a length, although, I am guilty of that in some of my New Yorker pieces.

Michael Klein:

Well, the problem now is that my image of somebody on a subway is you reading about this obscure Indian economist. So it might mean that we pitch things very differently now, but I'll try to remember that original fleet street one as well.

John Cassidy:

As I was saying, that's right for a mass marketing newspaper, but I'm thinking of it more in terms of a general, an educated person, but who isn't an economist sitting down on an evening saying, "this infrastructure bill, what the heck's it all about? Is it really a good idea to pass it? What the arguments for and against?" And I try and provide a thousand words on that.

Michael Klein:

That's what we're trying to do as well. So good luck to both of us in informing the public. And thank you very much for joining me today, John.

John Cassidy:

Thanks very much, Michael. It was fun.

Michael Klein:

I enjoyed it too.

Michael Klein:

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