

What Economics Courses Don't Teach – But Should

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Abstract Standard economics courses describe the economic system as though it existed in a vacuum. In fact, economic systems are only one part of the larger social/psychological systems that include human motivations, culture, politics, institutions, ethics and history. These, in turn, are embedded in the physical contexts of technology and the built environment. All of these ultimately depend on the natural world.

When we recognize the critical interactions between the economic system and the social and natural worlds, then we cannot depend on simple models that assume away most of what matters. As just one example, social and economic power affects market functioning far more than is recognized in the neoclassical economic paradigm. Markets can produce an efficient response to needs and wants only when they are backed up by purchasing power, but cannot respond to would-be consumers who lack money. The ideal of efficient markets as a social optimum ignores this important reality.

A healthy economy includes both market and non-market activities that are carried out in businesses, governments, non-profit, legal and other institutions, and in communities and households. While neoclassical economics focuses on the economic activities of production, distribution and consumption, we must add an equal emphasis on resource maintenance; that is, maintaining the human, social and physical resources that enable our economic systems to be productive and to support good and healthy lives. Our economic roles include not only those of producers and consumers, but also citizens, family members, public servants, etc..

INTRODUCTION

One of society's most important institutions is its educational system. For a long time Russia has had an educational system that has been excellent in many respects, and not so good in some others. One of its weakest aspects, during the communist era, was the teaching of economics. This was such an ideological topic that teachers were strongly motivated to avoid any risk of saying something that could be construed as against the party line. Accordingly economics teachers normally conducted their classes by simply reading aloud from their textbooks. The students who wanted to learn something tried to

copy down as much as possible; the rest chatted, or daydreamed, or found other ways to occupy their minds.

Most of this paper will be about the content of what is taught in economics courses in Russia – with an emphasis on important issues that are left out, and equally important anti-ecological or anti-social issues that are included. However, in addition to **what** is taught, I will also have a little to say about **how** it is taught.

I first became involved in efforts to reform the teaching of economics in Russia in 1989 – in the spring of that year, before anyone knew the cold war was ending, but at a transitional time when the Soviet Academy of Sciences had already decided that the economics being taught was not appropriate to the modern world. They reached out to my friend Wassily Leontief, to ask him to recommend an American textbook to be translated. With Wassily's encouragement, I collaborated with several Russian and American colleagues to eventually write the textbook we believed was needed.¹

What seemed especially important to Leontief, and to me and the others involved with this project, was that ideological Marxist texts should not simply be replaced by ideological neoclassical texts. We aimed to retain the insights in each that are valuable, and that the other lacks, while also searching the literature in out-of-the-mainstream economic writings – in ecological, feminist, institutionalist, and other kinds of economics – for elements which are needed for a theory that can describe and explain real economic systems as they exist in the modern world.

The Marxist approach depends mainly on the point of view of the worker, while the neoclassical approach is much impoverished by mostly ignoring this point of view. The neoclassical approach – which prevailed in the West throughout most of the 20th century, and continues limping on into the 21st – instead implies, and sometimes states, that the purpose of an economic system is to maximize the possibilities for consumption in a society. More precisely, the goal is to maximize what can be consumed that has been produced and distributed through market mechanisms. With that assumption about the goal of the system, then the purpose of economic theory is to teach **how to achieve maximum productive efficiency, so as to maximize output, and therefore consumption, of marketed goods.** The neoclassical paradigm fosters the belief that human experience is divided into two portions – working and consuming – and that work is virtually always undesirable. Only in the consuming mode does one achieve satisfaction and enjoyment of life. Therefore the success of an economic system is to be judged only on the basis of its success in providing a wide range of consumer choices at the lowest possible prices.

This paper will assume an alternative approach which views humans as whole persons with many roles, including citizen, family member, community member, etc., as well as consumer and worker or capitalist owner. It emphasizes **human well-being, in the present and the future**, as the appropriate goal for economic systems, and therefore for economic theory. This goal is also found in the “human development” approach of the United Nations Development Programme, following the intellectual leadership of

Amartya Sen. The emphasis on the future as well as the present builds on thinking about sustainable development, including, importantly, ecological economics; for as soon as the future is given standing it becomes imperative to consider the reciprocal influences between human behavior and the natural environment.

I should note that, in preparing this paper for a mostly Russian audience, I am well aware that there will be a number of significant differences between your experience and mine, coming from the United States. We face a variety of very real problems, but many of these are quite different from the kinds of problems Russians encounter every day. There is some awkwardness in talking, as I will, about over-consumption and too much economic growth in a setting where a significant portion of the population lack basic requirements for survival at an acceptable level of consumption, and where there have been a number of recent years of collapse in economic growth, with great attendant hardship. Yet the same kinds of economic assumptions and teachings are promulgated in both places. The neoclassical system of theory, with its excessive emphasis on competitive markets, ignoring the social and environmental systems on which these markets depend, has some responsibility for the different kinds of problems of the two countries. With that said, I apologize in advance for a perspective that is more based on my own experience than on yours.

WELL-BEING AS THE FOCUS: CONSUMPTION VS WELL-BEING

A major problem with the neoclassical approach of using consumption as the goal and the touchstone of economic theory and policy is that **maximizing consumption is not the same thing as maximizing well-being**. To be sure, people who are in conditions of severe poverty will benefit if they can increase their consumption of healthy food, clean water, education, housing, and other things that make life possible and agreeable, and that support human development. But those are not the needs that producers are most eager to serve. The incentives faced by corporate decision-makers push them to maximize consumption, not in terms of physical quantities of goods sold, but in terms of the revenue to be derived from goods and services, with a particular emphasis on the difference between cost and revenue. This means that it is more appealing to sell expensive goods than cheap ones. Hence the system – and the theory that supports it – contains skewed incentives. It tends to maximize consumption of luxuries, at the expense of basic needs. However, 10,000 rubles worth of luxuries generally contributes less to well-being than 10,000 rubles worth of basic needs.²

What, in fact, are the elements that are most important in human well-being? Modern research on well-being³ indicates that about 40% of the variance in people's subjective sense of well-being is accounted for by a genetic predisposition to happiness, optimism – or the opposite. Poets and novelists have emphasized “the Russian Character” as a major determinant for how Russians feel about their lives, with material conditions being secondary; modern psychology suggests that the poets and novelists may have been right. Aside from genetic predisposition, the elements that researchers have found to count the most in the well-being experienced by individuals are:

security
relationships
self-respect and the respect of others
enjoyable and meaningful work, and
other activities.

It is critical for economics to ask: What portions of these elements depend on the kinds of consumption (i.e., of products produced and distributed through markets) that is emphasized in neoclassical economics?

“Security” includes assurance that one’s basic needs for food, water, shelter, etc., are being met in the present, and will continue to be met in the future. When this requirement is not met, material needs assume a great – often a primary – importance. Some people have such a happy disposition that they can maintain cheerfulness in the face of even extreme deprivation. However, well-being researchers accept what is obvious to most people, that the first requirement for well-being is to meet people’s security needs.⁴

After the basic needs that I have lumped together under “security” are met, the rest of the principal elements in modern analyses of well-being **do not necessarily depend very much on consumption of marketed products.**

The sentence above is set off because it is one of the two most radical statement in this paper. In fact, apart from security, the place on the list of important contributions to well-being where marketed products are most likely to turn up is in “self-respect and the respect of others,” but this area is highly culturally dependent. In a culture whose definition of success and social standing emphasizes acquisition of worldly goods, people who have less material wealth than others will indeed suffer from low self-respect and will feel socially demeaned. This is a form of suffering that can be found to some extent in virtually all societies, but the extent varies greatly. Robert Lane, Fred Hirsch and Robert Frank have pointed out with particular clarity how a culture that emphasizes such “positional goods” or “conspicuous consumption” as the basis for respect is engaging in a self-defeating zero-sum game: only a few can win this game, and most of the society will perpetually suffer from feelings of inferiority and dissatisfaction.⁵ Frank makes a strong argument in favor of policies to tax luxuries while stimulating the public and private provision of such “inconspicuous consumption” goods as “freedom from traffic congestion, time with family and friends, vacation time, and a variety of favorable job characteristics.” (Frank, p. 90) Such policies can encourage economic actors to provide more goods that increase well-being, over-all, within the society.

These ideas are of critical importance for two reasons. Most reasonable people would agree that, if consumption conflicts with well-being, it is well-being that the economy should serve. Secondly, the results of recent studies in hedonic psychology⁶ are critical because a goal of maximizing consumption of marketed goods ignores the tremendous ecological dangers attendant on increasing throughput of energy and materials through

our economic system. Environmental realities insist that we must begin to reduce, instead of increasing, the global flow of material and energy inputs and waste products.

For thinking people the lesson from the combined environmental and social/psychological realities is clear: While we must continue to work to increase access to basic needs for all, with special attention to those who now suffer real deprivation, we must also find ways to reduce many kinds of consumption among the affluent in the world. Without the excellent research in hedonic psychology, this prescription would have seemed absolutely impossible. Given these findings, the task is only slightly less impossible: To persuade people, the world over, that the path to happiness is something other than the consumerist, materialist path on which the affluent nations – especially the United States – has led the way.

None of this is taught in standard economics courses. What students learn, instead, is that maximizing consumption is so close to being the same thing as maximizing utility (while they may, if they wish, assume that utility means “well-being”) that it is perfectly acceptable to draw graphs that show how to maximize consumption, or how much consumption will be reduced under certain circumstances, and to interpret these graphs as describing maximization or reduction of utility. And, again, “consumption” is described in money terms, so that one purchase worth 10,000 rubles is assumed identical to 100 purchases that are each worth 100 rubles. The ideology of standard neoclassical economics is thus highly compatible with the structure of economic power in capitalist economies.

This severe confusion, at the level of basic economics, makes it all the easier for producers and marketers to add more confusion at the point of purchase, through advertising, packaging, and other ways of presenting their products. The result is that even people who have very little money are often encouraged to spend it in ways that do not increase their well-being. Of course, there has always been the temptation for people whose lives are hard to seek short-term escape in, for example, alcohol or gambling, at a severe cost to their long term well-being. This does not require a consumerist society. But now, in the United States, we have new examples of confusion about how to achieve well-being. For example, there are widespread, dangerous levels of obesity, most pronounced among relatively poor people. The current cohort of American children is calculated to have shorter life-expectancies than any generation in the past century, because we live in a culture that urges parents to work long hours in order to earn more money to spend on things their own parents would have regarded as luxuries, while buying prepackaged foods or taking their children to fast-food outlets because their life-style leaves them without time to cook healthy meals.

At the other end of the socio-economic spectrum, among the very rich, we see, in both the U.S. and Russia, levels of spending on luxury goods that have ballooned out of all proportion in the last two decades. There are plenty of such people in the world whose consumption levels are more than high enough to permit a healthy, agreeable, fulfilling life, yet who do not achieve the mental or physical health or the happiness that one would imagine to be well within their reach. An inquiry into the explanation of this

phenomenon takes us back to the group in society which benefit from maximizing consumption. That is the owners and managers of major corporations. The economic system does not motivate them to maximize well-being.⁷

As a side note, this incentive structure is not written in stone; it could be given more emphasis in one direction or another. Alfred Marshall, the economist who dominated the field in the English-speaking world a hundred years ago, believed that the motive of honor should and would cause captains of industry to care about societal well-being, and to act accordingly. In Russia or the United States today such an idea is likely to provoke incredulous laughter. Nevertheless, the motive for social status is not to be underestimated. It is possible to imagine economic culture returning to norms in which social concern, honesty and generosity are the characteristics that win respect, and, hence, status.

META-EXTERNALITIES AND MACRO-ECONOMICS

This brings me to a related topic, with a possibly unfamiliar name: meta-externalities. Meta-externalities are externalities in which the economic culture fouls its own nest, if the "nest" is understood broadly as all the contexts in which we humans live. In a positive development, the discipline of economics is wrestling with efforts to "internalize" the costs of economic activity that have been "externalized" to the natural world. However, other "meta-externalities" – *unwanted side-effects of the whole economic system upon its physical and social contexts* – continue to be invisible to the theory.

Critical meta-externalities show up in the impact of the economic system on the social context. The example just given was the way a production system geared to sell luxuries creates cultures in which materialism is carried to an extreme by those who have the means to do so, and where people seeking to "satisfy immaterial needs with material goods" (as Dana Meadows used to say) are often running away from, rather than toward, their own well-being. To give some other examples, still in the realm of cultural meta-externalities: Productive enterprises need a workforce that has been socialized to be able to defer gratification, to think independently and sometimes creatively, and to be honest and responsible. Citizens and politicians need to care about the long run, and to be able and willing to address intelligently the myriad highly complex issues that face modern societies. But the sales efforts within modern enterprises are focused on a different set of requirements. From the sales point of view, the self-interest of business is served by a consumer-oriented culture of instant gratification and simplified thinking that urges material purchase as the answer to any discomfort. The strongest influence from the economy to the culture is motivated by corporations' desire to increase short-term profits and sales, achieved through advertising, ownership of news media, and purchase of political influence. Selfishness, short-term thinking, cynicism, and impatience with complexity are cultivated in the populace at large – even though these are not the characteristics that will best contribute to a healthy society or a healthy economy.

Rich nations in the world today have enough material goods and productive capacity to provide a high level of security, health, education, self-actualization, comfort, and stimulation to all of its people. They do not need to create a culture that makes people believe – against the evidence of their senses as well as the results of good research – that happiness is usually or best achieved by “more stuff.” The great challenge before us is how to glide off of our present path, in which whole societies are organized around the need of business to sell more things, onto a different path where business success is tied to achieving the social goal of sustainable well-being for all.

Such an idea raises a core issue, as radical as the notion that economic systems may have more important contributions to make to well-being than consumption through markets. This is the idea which Herman Daly has insisted on for more than forty years: **There must be some end to economic growth as we know it.**

Modern economies are predicated on growth; an economy falls into recession or depression, with the traumas of unemployment and bankruptcy, when it stops growing. Yet we know that the planet cannot accommodate an indefinitely growing population or infinitely increasing consumption. And it seems likely that, after a certain, fairly modest level of comfort has been achieved, we can actually be happier, healthier, and better protect our environment by producing and consuming less stuff. There appears an inherent conflict between the requirements for economic health as we know it and an emerging vision of a better world, where people enjoy life and preserve and heal our natural environment.

Perhaps in that last sentence lies a temporary solution to the conundrum. There is much work to do in cleaning up and healing our physical environment; perhaps that could be the growth industry that would allow us to go on raising GDP through healthy activities. At least, this could help us through a transition period of a few decades, before we are forced to take an even more radical look at the future of growth.

THREE ECONOMIC SPHERES; FOUR BASIC ECONOMIC FUNCTIONS; THE FAIRNESS AND EFFICIENCY OF MARKETS

The preceding section mentioned rather briefly some realities about the physical world, taking for granted that it is not necessary, for this audience, to spell out the details about the overload that human activities are placing on our environment. I have dwelt at more length on psychological realities that are only recently coming to be well understood. These two themes together create a strong argument for reconsidering several basic assumptions of neoclassical economics.

In this section I will briefly consider three sets of assumptions that need to be reconsidered. This requirement stems not only from a wish to present as accurate as possible a picture of the world. Another motive, perhaps even stronger, is that bad choices are encouraged by ongoing failures to present these facts. Worse yet, such failures are often fortified with falsifications, where the world that is described is

significantly different from the world we actually live in. The result is that the teaching of economics fails to convey much of what we need to know in order to make individual, firm, government, and other decisions that will promote sustainable human well-being; and some of what it does convey actually encourages acts and decisions that work against sustainable human well-being.

The first of the set of economic beliefs that will be challenged in this section has to do with **the nature of economic activities**. Many standard textbooks state that the three significant categories of economic activity are production, consumption and distribution. This leaves out a fourth category that is equally essential: We call it resource maintenance.

It is well known that firms are obliged to maintain their physical capital – plant, equipment and inventory. If roads, communications systems, etc., are allowed to deteriorate, future resources will have to be diverted to rebuild what could have been maintained. The uneconomic results of degradation of the natural world (pollution, etc.) are becoming equally obvious. The maintenance of personal, communal and environmental, spaces for human life-support and well-being has received far less economic attention. Critical resources-maintenance activities are carried out in homes and communities, including the work that develops and maintains what may be dryly called human capital – that is, for children, nurturing, nutrition, basic education and socializing; and for those already in the work force, the refreshment of mind and body that result in enhanced health and vigor.

Ecological economists have noted the meta-externality in which the whole eco-system is endangered by the consumerist way of life, most glaringly in the fact of global warming. Socio-economists observe that critical functions of maintaining human capital may be eroded by repetitive pronouncements from the business sphere that “you deserve it all,” and “you’ve got to be the best.” Feminist economists emphasize the importance of “caring labor” for maintaining human resources. However the overall requirement for resource maintenance has not been recognized and codified in standard economic theory as one of the basic and essential economic activities.

The second broad challenge raised by contextual economics has to do with **where economic activities takes place**. Much of what is economically important is not, in fact, produced, maintained, distributed, or consumed through markets. One of the critical elements missing from standard economics teachings is the importance of economic activities that take place in homes and communities. In contextual economics this is called the “core sphere” of the economy, and it is calculated to account for a minimum of 30% of economic activity in even such a highly marketized economy as the United States.⁸

Unpaid but economically essential activities in the core economy include creating and maintaining home and other environments that support human well-being (including, e.g., the transformation of food commodities into nutrition); nurturing civic institutions; socializing children; fostering constructive norms and values; and caring for people who

are not able to supply all of their own needs. This is the system that maintains the health and sanity of workers through their productive years, and gives basic care to the infirm and the old.⁹ If the core sphere fails in its tasks of human support, there is no viable alternative. To the extent that it fails in upholding norms of honesty, responsibility, etc., then the rest of the economy must fall back on the far less efficient alternative of policing. If governments and police are corrupt (as they are likely to be, if the people are corrupt), then efficiency very rapidly leaks out of the enforcement-dependent economy.

Mainstream textbooks focus almost solely on the business sphere of the economy, paying relatively little attention to either the core sphere or what we call the public purpose sphere. The latter comprises both government and non-profit, or NGO, activities. In the U.S. it is estimated that 59% of economic activity occurs within the business sphere, and 11% within the public purpose sphere.¹⁰ In a welfare state such as Sweden the public purpose sphere is at least twice as large as this, in percentage terms, and the business sphere is proportionately smaller.

Even where the business sphere is very large, as in the U.S., much of the activity in this sphere does not go through markets. Large firms routinely include significant economic transactions within their own boundaries, even when these transactions cross national boundaries. For example, when the Hong Kong arm of IBM sells parts to the US company, the transaction can be priced by mutual agreement, or by a company manager, with reference to such things as tax rates, and where they want profits to show up, rather than based on competitive market forces.

The point here is that production and consumption of marketed goods is a much smaller part of economic activity than you would think from the attention it receives in standard economics courses. If we want to understand the full scope of the economy we need to go well beyond the business sphere, to understand the core and public purpose spheres as well. Indeed, economic life could continue, in a very different form, without the business sphere, but it would be much more difficult without government of some kind, and absolutely impossible without the core sphere. And all of this considers only the strictly human aspect of the economy. It is also essential to remember at all times that all three economic spheres are embedded within, and absolutely dependent upon, the natural world.

Neoclassical economics texts thus deal with a small subset of the world they should describe and explain, focusing almost exclusively on the business sphere, and there over-emphasizing the business activities that are subject to competitive market forces – a small part of the totality with which economics should be concerned.

The third set of neoclassical assumptions to be challenged concerns **the fairness and efficiency of markets**. To examine these issues we need, first, to think about the meaning of efficiency, as that word is used in economics.

One of the first lessons learned in standard economics courses is that competition is a good thing. It's good because it increases efficiency. Efficiency is normally just

considered good in itself, but if you insist on knowing what it's good for, you will be told that it increases consumption opportunities by making it possible to obtain more output from a given level of inputs. Other things being equal, that sounds like an excellent idea. From an environmental point of view, less materials and energy are used for a given output. From the workers' point of view, efficiency gains usually result in increased output per worker, which could result in higher wages, or shorter working hours, or both. Of course, that doesn't always happen; in the boom years of the '90s in the U.S. labor productivity increased dramatically, but almost all of the benefits went to shareholders, in the form of profits, or to managers, in the form of soaring salaries at the top, and to consumers, enjoying lower prices. From the consumers' point of view this is what is good about efficiency – that it lowers prices.

Economists often say that efficiency is about using society's resources to maximize production of the **most valued outputs**, while using less of the more valued inputs, and more of those on which society places a lower value.

This raises the question: how are we to decide what society values most highly? Some people might think society's most valuable products include good nutrition, good education, good health, and good neighborhoods. But the market values for these things doesn't equate very well with what we might call human value. A piece of jewelry or an elaborate dacha can cost a lot more than a year's food, care, education, and housing for a child, or for many children. You can explain this by the basic lesson from Economics 101 – that prices are determined at the intersection of what suppliers can supply, under existing market circumstances, and what consumers want that they are willing and able to pay for. Beneath this story there is, in fact, a lot of circularity; the market circumstances that affect supply are a result of prices, as well as being a partial determinant of prices. The most independent variable in this picture is on the demand side: what consumers want that they are willing **and able** to pay for. Thus the price system is ultimately a system of "one-ruble, one-vote."

So, in fact, efficiency is about producing more of the outputs that people want and can afford to buy; rich consumers get many more votes than poor people do. An efficient system, to put this in the crudest terms, is one that is highly responsive to the desires of the rich. If, along the way, a process uses a great deal of an input that is highly valued by many people who have few money-votes – for example, if it spoils the quality of water in a stream where poor people used to catch fish for free – that doesn't make the process inefficient, in economic terms. Standard economic theory in the past has paid little attention to needs and wants that cannot achieve market expression through purchasing power. This oversight is beginning to be corrected with increased emphasis on externalities. The attention given to that topic may be one of the most hopeful signs that economic theory is beginning to adapt to reality.

To return to the concept of efficiency, it is curious that this approach is so rarely applied to either consumption or distribution. Might there not be important ways that well-being could be enhanced by consuming things that actually make us happy, rather than things that are designed only to make us want more? As indicated earlier, there are dramatically

different classes of consumption goods: more status goods in a society do not make the whole society better off, while an increase of certain other types do contribute consistently to happiness.

The effects of competition are not always benign; and the reality of competition is less than the neoclassicals believe. Social and economic power affects actual market functioning far more than is recognized in the neoclassical paradigm. Political power determines much of the risk/reward environment that makes it profitable, for example, for the sugar beets of Western Europe and the U.S. to compete against the much lower-cost production of Caribbean cane sugar. Political power determines the nature and the duration of copyright and patent protection, determining which firms can compete successfully, for example, in production of medicines.

Individual economic power is an essential feature of markets, which can produce an efficient response only to those needs and wants that are backed up by purchasing power; they ignore would-be consumers who lack money. The vaunted "efficiency" and "impersonal fairness" of markets ignores this important reality. Markets create winners and losers in a process that has some, but not very much, intrinsic fairness; and by themselves they do nothing to help out the losers.

This section has briefly reviewed the critical importance of resource maintenance; the essential contributions of the core and public purposes spheres to economic life; and the ways in which market outcomes are determined by purchasing power, as well as by the economic power that translates into political power. All of these are issues that receive virtually no attention in mainstream economics teachings.

CONCLUSION: "HOW" AS WELL AS "WHAT"

At the outset I suggested that this paper would include some comments on how economics is taught, as well as on what is taught. The "how" suggestion I would make can be summarized in two words: **with humility**. We would like to think of economics as a science; indeed, it is important that it be developed and practiced in as scientific a manner as possible. However, given that economics is a **social** science – its subject matter is human kind – the desire to be scientific must include a recognition of what this can mean, and what the limits are.

All scientific theory exists in a tension between complexity and simplicity. Theory must abstract from specific cases, finding the generalizations that will fit a large number of individual cases. This process necessarily depends upon a process of simplification, in which the complexity of the world is presented systematically, through a small enough number of terms and ideas so that they can be grasped, after a reasonable period of study. That process must begin with selection. A useful, relatively "true" theory is one in which:

- The necessary *selection and simplification* of facts and concepts is done appropriately, emphasizing the issues that are most important to human experience as well as those that are most useful for achieving an understanding of economic realities.
- The most critical *logical relations* (such as causality, temporal sequence, exclusivity, etc.) among the selected elements are appropriately identified.
- There are *contextual guidelines* to indicate the circumstances under which the selection of critical elements and the identification of their logical interrelations will be more – and less – relevant.

A social science theory may succeed quite well on the first two of these requirements but still fail on the third. When there is failure to recognize that every simplification has its appropriate range of application, then there is no guard against the tendency to misuse concepts outside of their range. An adequate economic theory must understand the multiple economic spheres within their physical contexts (ecology and technology) as well as their full social/ psychological contexts (human motivations, culture, politics, institutions, ethics and history). While certain broad statements about economic theory may apply widely, they must always be reexamined within time and location-specific contexts.

In neoclassical economics, the mix of real-world complexity with scientific simplicity has become seriously overbalanced, as the impressive mathematical development of the most sophisticated economic models has been overlaid upon a highly reductionist view of reality. Much everyday knowledge and understanding about human nature, and about interactions between the economic system and the social and ecological systems in which it is embedded, has been lost as the field has been driven by the internal logic of ever more complicated and difficult methods, tools and models. One motivation behind the growth in sophistication of neoclassical techniques has been the hope that more complex tools could handle a richer, more complex view of reality. Fifty years of intensive experimentation with this hypothesis have failed to confirm it; the evidence suggests, indeed, that this is a dead-end road. "More of the same" will not be the solution; **greater realism may require the use of simpler, rather than more complex tools.** (That is the third most radical statement in this paper.)

The neoclassical approach begins by disabling one of its greatest assets: the social scientist herself, who is, after all, a member of the group – humanity – that is the subject of the social sciences. A determination to ignore all knowledge, experience, judgment, or values that are not spelled out within the deductive system is a very bad start. Such a plan cannot succeed; but in the trying it encourages economists to hide their beliefs and values, which, driven underground, will inevitably reemerge as ideologies. However, if we decide that we will not ignore the experience, values, etc., of the individual social scientist, we must then confront the question of how best to use these assets, while still aspiring to achieve the best aspects of objectivity.¹¹

The humility required of a social scientist offers, perhaps, some psychic relief; if you had been worried that you did not know all the answers, you can stop worrying: you are not expected to – and you are not alone. The true complexity of our subject is such that no

one has a complete understanding of it all. Humility is also a desirable quality in a teacher, as it may encourage a recognition of the value of other people's experience, aside from one's own, and thus makes the teacher more likely to welcome class discussions with the attitude that the teacher, too may have something to learn.

This paper has offered a brief introduction to what it means for economics to be taught, learned and understood in relation to the physical and psychological/social contexts in which real economies are embedded. There is a price to be paid for such contextualization: a loss in certain types of simplicity. However, what the neoclassicals have gained by simplifying their subject matter, they have lost by mystifying their methods and, except for the very best of them, their exposition. In contrast, the emphasis of contextual economics is on clarity of expression, reduction of jargon, and reference to a real world which, by its familiarity, is intrinsically easier to understand than a counterfactual world of perfect markets and simplified human psychology. In this way "more complex" and "easier to understand" can come together to be (in a social science context) "more scientific."

ENDNOTES

¹ Goodwin, Neva, Thomas Weisskopf, Frank Ackerman and Oleg Ananyin, 2002, *Mikroekonomika v kontekste*. This book may be acquired from RGGU (Russian State University for the Humanities) in Moscow, main building (entrance on Miuskaya Sq), rm. 21. (The marketing department telephone number is (7 095) 973-4200 and they are open Monday-Friday, 11-4.)

This edition has also been translated into Vietnamese. A later edition, revised for use in the U.S. as *Microeconomics in Context*, has recently been published by Houghton Mifflin.

² This is an idea that can be extracted from marginal theory, applied to the marginal utility of money. A hundred years ago economists accepted as obvious the conclusion that an additional expenditure by a rich person contributes less well-being than the same expenditure by a poor person; however, this position did not fit in the evolving neoclassical ideology, and was gradually dropped out.

³ An excellent reference is Kahneman, Daniel, Ed Diener and Norbert Schwarz (Eds.), 2001, *Well-Being: the Foundations of Hedonic Psychology*, New York: Russell Sage Foundation.

⁴ We should note that one of the critical security needs is not a "material" need as such; it is the need for security against violence.

⁵ See Lane, Robert E. 2000, *The Loss of Happiness in Market Democracies*, New Haven: Yale University Press; Hirsch, Fred, 1976, *Social Limits to Growth*, Cambridge, MA: Harvard University Press; and Frank, Robert H., 1999, New York, NY: Free Press

⁶ The simplest definition of hedonic psychology is that it is the study of happiness, or well-being. In this field a distinction is made between subjective well-being and something that can be objectively observed. Most of the research is on the former, depending on self-reported states of satisfaction with life. However, these subjective reports have been exhaustively checked against observations by friends and family and by professional psychologists, as well as by longitudinal studies which show that, without major life changes, there is a tendency for people to estimate their own life satisfaction consistently over years or decades. The issue of human development. Hedonic psychology has achieved a high degree of scientific rigor – this author, for one, was initially skeptical of this ambition, and has been agreeably surprised at how credible the field now

is. It will be much more difficult, but no less important, to achieve the same for the concept of human development, which has not yet been much integrated into hedonic psychology, since human development involves intuitions of what is possible for people that they have not yet attained.

⁷ The maximands that are to be found in the objective function of corporate decision-makers include, importantly, profits – as is stressed in neoclassical theory. They also include also such things as market share, total revenues, political power, and social status, which receive little or no attention in standard texts.

⁸ Estimates of the core sphere proportion of economic activity are considerably higher for some other countries where there is a large amount of subsistence farming and high levels of home production for home use.

⁹ “When an economist undertook to quantify the replacement value of just one function of this Core Economy, he found that the unpaid work done by family, friends, neighbors and kinfolk to keep seniors out of nursing homes totaled \$196 billion in 1997. By 2000, when he updated his computation, it had risen to \$257 billion. The value of just the informal caregiving portion of the labor produced by the Core Economy was six times greater than the money spent in the market economy to purchase formal home health care services for the elderly; it is over twice what the federal government spends on nursing home care.”

(Edgar Cahn, private communication – further reference needed.)

¹⁰ These estimates are based on the U.S. Bureau of Economic Analysis, table 1.7, “Gross Domestic Product by Sector, 2000,” with some changes; e.g., services of existing owner-occupied housing have been moved from “business” to “core,” and unpaid household labor has been valued (conservatively) at one-third the value of GDP. See also Robert Eisner, “Extended Accounts for National Income and Product,” *Journal of Economic Literature* 26 (December 1988), 1611-1684.

11. For a more detailed discussion of this, and some other methodological issues, see Neva Goodwin (1991) *Social Economics: An Alternative Theory Volume 1: Building Anew on Marshall's Principles*; Macmillan, London and St. Martin's Press, New York. This book is now out of print, but can be found in libraries, or acquired through the Global Development and Environment Institute at Tufts University.