WHAT THE HARVARD PHDs WON'T TELL YOU ABOUT ECONOMICS

by Sukrit Sabhlok

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Harvard University is widely considered the world's leading institution of higher education, and is typically placed higher than other bastions of elitism such as Cambridge and Oxford in most rankings. The university is rigorous in its research output and its scholarly publications have global reach and influence.

While it's true that money and connections can often buy you a ticket into an Ivy League university, most people who get into a top ten institution are exceptionally hardworking and passionate about the area they want to study. But the mere act of studying at Harvard, or holding a research or teaching position there, doesn't necessarily guarantee that the perspectives you hold are the right ones. Harvard scholars, or people who earned their degrees there, have come up with all kinds of hair-brained or destructive ideas. For example, a Harvard team of chemists was responsible for producing napalm, the substance that led to the deaths of so many innocents during the Vietnam War. It is Harvard University's economics faculty however, that is the focus of the present article.

Keynesianism or the Free Market?

Martin Feldstein is a giant of mainstream economics who currently teaches at Harvard University and is drenched in professional honours. As a winner of the John Bates Clark Medal, former president of the American Economic Association, former Chairman of the Council of Economic Advisors and former member of the President's Foreign Intelligence Advisory Board, there's not much that Feldstein hasn't accomplished within the economics profession.

Naturally, Feldstein has published in the leading journals of economics, such as The American Economic Review and The Journal of Political Economy. He has also written for newspapers like The Wall Street Journal, where on 24 December 2008 he published an article entitled 'Defence Spending Would Be Great Stimulus'.

In his article, Feldstein argues that 'countering a deep economic recession requires an increase in government spending to offset the sharp decline in consumer outlays and business investment that is now under way. Without that rise in government spending, the economic downturn would be deeper and longer'. Feldstein makes the case for a particular type of government spending: military outlays. He writes, 'A substantial short-term rise in spending on defense and intelligence would both stimulate our economy and strengthen our nation's security'.

The belief that government spending is a stimulus to economic growth is also a standard view among many Australian economists. It is standard because the dominant school of economics taught at universities throughout the world is that of John Maynard Keynes, author of The General Theory of Employment, Interest and Money.

What Keynes and his contemporary adherents neglect to convey to their students, however, is that Keynesianism is riddled with theoretical and empirical holes. Feldstein's article will serve to illustrate the point. The argument

made by Feldstein that defence spending would stimulate the economy neglects one important reality: government spending comes at the expense of private sector spending. When governments extract taxpayer funds and spend it on projects chosen by politicians and bureaucrats, the results are unlikely to be as optimal as when ordinary citizens spend their own money. As Milton Friedman pointed out, nobody spends someone else's money as efficiently as individuals spend their own money - the incentives simply aren't there for governments to be frugal and wise.

In other words, by spending taxpayer money on defence rather than opting to return taxpayer money to them directly in the form of tax cuts, a particularly inefficient allocation of resources is brought about. If Keynesians were serious about stimulating the economy, they would immediately call for the abolition of the income tax. Does anyone seriously doubt that eliminating the income tax would unleash a burst of investment and reduce unemployment by easing the burden on sole traders, small businesses and other Australians? Ludwig von Mises, the famous economist and philosopher whose protégé F.A. Hayek won the Nobel (Memorial) Prize in Economics, once wrote that 'the issue is always the same: the government or the market. There is no third solution'. Unfortunately, as Feldstein's mistaken argument demonstrates, an affiliation with Harvard doesn't guarantee that one will choose the correct alternative for public policy problems.

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The Austrian Alternative

One school of thought that is neglected not just at Harvard but in most universities around the world is the Austrian School. This school of economic thought is said to have originated in Austria since many of its leading proponents were born in that country, however it is now taught primarily in the United States at institutions such as George Mason University and the Ludwig von Mises Institute. Although the Austrian school has become more popular since the Global Financial Crisis, mostly because its adherents such as Ron Paul and Peter Schiff are credited with foreseeing the crash, it still has a long way to go before it is placed on an equal playing field in the marketplace of ideas. One of the main ways that Austrian economics differs from the mainstream is in its methodology: Austrians prefer to talk about the economy not in the form of abstract mathematical models based on unrealistic assumptions, but using verbal logic that utilizes deduction from axioms of human nature (like the self-evident truth that 'humans act'). They also place a greater emphasis on the role of time and uncertainty in human behavior and have a well-developed theory of the business cycle that pins the blame for booms and busts on central banking and legal tender laws.

The best way to relate the differences between the two is to use a parable. The French classical liberal Frederic Bastiat once told a story about a shopkeeper who has his window broken by a passerby who threw a stone. For Keynesians and many other mainstream economists who tend to focus on the immediate effects of an action, the broken window is a great thing: it will stimulate the market for glaziers. But for Austrians, who take a long-run perspective, the short term economic stimulus is not as important as the hidden costs of the broken window – namely, the opportunity cost to the shopkeeper who could have spent the money repairing the window on something else more productive like investing in his business. Bastiat labels this distinction 'what is seen, and what is not seen'.

Guided by this approach, Austrians have developed a unique perspective on money and banking, monopolies, capital and investment. They propose doing away with agencies such as the Australian Competition and Consumer Commission, the Reserve Bank of Australia, and Consumer Affairs Victoria – preferring to rely on market competition or the courts to provide currency, discourage cartels and protect consumers. Many Austrians have gone further and studied the economics of anarchism, and have analysed stateless societies and how they could work in practice.

Until the Harvard PhD's address alternative perspectives such as the Austrian School, and try and learn from and integrate its insights wherever possible, there will be something strangely superficial about the economics they teach.