

CONFLICTING PARADIGMS IN ECONOMICS AND THE DYNAMICS OF WEALTH CREATION

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1. Introduction

The world economy reveals striking contrasts. In some parts of the world many people enjoy material levels of well-being – what we can define rather imprecisely, at least for now, as wealth – far beyond what even a small minority could dream of previously. In other parts of the world many people live in abject poverty, with living conditions not very different from what their ancestors experienced. Moreover, some parts of the world are experiencing wealth creation at rates significantly higher than other parts. Finally, many observers find that those parts of the world which are less wealthy are experiencing wealth creation at lower rates than the parts which are wealthier, implying uneven wealth creation across the world economy.

Although the details of these trends are somewhat controversial – and some deny that world is experiencing inequalizing wealth creation – most would agree that ways must be found to improve living standards, especially of poor (which we can define loosely as the condition of not being wealthy) people, in countries which have low levels of wealth. This agreement, however, on what should be done to improve wealth creation in poor countries and reduce poverty. Indeed, opinions vary widely among different observers on what should be done to transform the world economy in which more countries and regions can share in the benefits of wealth creation. Some perceive that there is a difference in opinion here between informed economists and uninformed lay people, but may be argued that there are divisions among economists as well which, some believe, follow from differences between conflicting paradigms in economics.

The purpose of this paper is to examine what conflicting paradigms in economics have to say on how the goal of a broader distribution of wealth in the world economy can

be achieved, and to what extent these views are consistent with religious views on the creation of wealth. Section 2 examines some alternative approaches to economics, distinguishing between four dimensions in which one can distinguish between alternative approaches. Section 3 examines alternative paradigms and convergence and divergence among them. Section 4 concludes with some remarks on religious perspectives.

A few preliminary caveats are in order. First, given the limitations of space the examination of economic issues must be cursory and sketchy and more in the nature of general remarks than detailed analysis. Second, given my lack of expertise on religious perspectives, I will not discuss these in detail but just make some assertions about what I take these perspectives to imply. In any case, these assertions will be made in the concluding section and the rest of the analysis does not depend on it. Third, I will use the term wealth to denote something (which can be a collection of things) that is desirable and not discuss whether the term is a suitable one. One may argue that the term is too evocative of material things, property, or monetary assets, but is used here in a much broader sense to refer to how we can at least conceptually measure development and well-being (as in its older meaning, *weal*). At least one virtue of it is that, unlike the popular word capital (as in physical capital, human capital, social capital, etc.), there is the connotation that wealth refers both things that are valuable in themselves and which are resources, or means to something else.

2. Alternative approaches

The dominant approach in economics by far is the neoclassical one. Although many economists equate economics to neoclassical economics, more knowledgeable observers recognize that there are a variety of approaches in economics, including the classical,

radical and Marxian, institutional, post Keynesian, behavioral, and feminist approaches, to name just a few. Some have used Kuhnian language to describe these approaches as paradigms.

Although alternative approaches to economics exist, it is difficult to be precise about what exactly they are and how exactly they may be distinguished. Rather than trying to distinguish between paradigms, I find it more useful to distinguish alternative approaches in economics according to four dimensions: their method of analysis; their analytical views of the economy; their views on economic strategies and policy; and their conception of the desirable goals for the economy.¹

2.1 Goals

We may start with the dimension of the meaning of wealth in the sense in which is used here, that is, the meaning of economic improvement. This is a dimension which is often ignored in economics, since many mainstream economists argue that economic analysis should be value-free, ignoring normative issues. For instance, according to them, fairness may well be an important issue, but defining it involves judgments about whose well-being one is more concerned with; since reasonable people can differ on what judgments should be made about them, it is best to leave such issues out of economics. Even if they do wish to pursue fairness or other goals, economists should concentrate on the best means of achieving these goals, by which it understood the most efficient ones. Thus, these economists are more concerned with analyzing how to attain efficient outcomes. An efficient state is one in which it is not possible to make anyone better off without making anyone else worse off, that is, without a cost.

This definition is too general to have concrete implications, without making clear what makes people better off or worse off. The standard procedure in mainstream economics is to assume that individual utility depends on the consumption of individuals, and with this assumption it is easy to see that efficiency requires production efficiency, which can be achieved by maximizing the value of output. The implication is that it is desirable for the economy to produce as much as possible. Although this appears to be value free and scientific, it takes it as axiomatic that individuals prefer more, that is, that they are presumed to have the value that more is better.

The notion that more is better is widespread in mainstream economics, as is evident from the importance attached to the focus on the rate of growth of production and income, and in the widely accepted definition of economics which states that it is the study of how scarce resources are allocated between alternative ends for the satisfaction of human wants, that is, consumption of goods and services. However, empirical analysis of the relationship between subjective well-being and income and consumption suggests that that the notion that more is better is open to question. Researchers on subjective-well being or happiness use surveys in which people are asked how happy or satisfied they are on a given scale. They find that people with higher income within a country report higher levels of well-being than those with lower income, and that happiness rises across countries with per capita income levels at low levels of income. However, these researchers also find that beyond a certain level of per capita income there appears to be no appreciable increase in subjective well-being across countries. What is more, despite significant increases in per capita income and consumption in a number of rich countries, including the USA and Japan, there has been little if any

increase in happiness. That more is better does not appear to be confirmed by available data, at least beyond a certain level.²

The emphasis on economic efficiency and growth may not be defensible on the ground that more is better in itself, but because higher levels of output and growth have other desirable consequences, such as reducing unemployment (which researchers on happiness have found to have a significant effect on happiness), and reducing poverty. Furthermore, Friedman (2005) has argued that economic growth has favorable moral effect, promoting greater openness, tolerance and democracy. Growing economies are better able to overcome social tensions, while stagnant economies and bad economic conditions result in conflicts between different groups who compete over a given pie. Some of these consequences of growth may well be valid, but it is important to recognize that whether growth reduces unemployment and removes poverty and has these other moral consequences is an empirical matter and one which depends on how the growth comes about and on the characteristics of the economy in which growth is occurring.³

For these reasons, instead of focusing on economic growth some focus directly on income inequality or on poverty measured in terms of a poverty-line level of income. But Sen (1999) has argued that focusing on income or utility (or self-reported well-being) in evaluating development is flawed, the first – what he calls opulence - because it is incomplete and confuses means and ends, and the second because subjective well-being is subject to the problem of adaptation – the poor may get used to their condition and not feel very bad. Instead of these, Sen advocates the use of what he calls functionings, that is, how well people are doing in terms of what their ability to do certain things and to achieve certain types of “beings” (such as being well nourished, being free from

avoidable morbidity, being able to move about as desired, and so on), and capabilities – that is, their ability to do achieve these functionings. One can stress among these what can be called basic needs, such as food, clothing, medicines, shelter, as stressed by the basic needs approach.

Others approaches stress other goals such as the protection of the environment, more freedom to choose what life to lead, greater participation in the life of the community, liberation from exploitation, among others. Some of these goals can be incorporated into functionings and capabilities, but others may not. For instance, one can focus on the environment not because of what it achieves for people, but for itself.

2.2 Methods of analysis

Methods of analysis refer to protocols about how explanation is organized. This refers to, among other things, what one means by explanations or what can be called organizing principles of analysis.

The neoclassical approach uses the method of couching explanation in terms the behavior of the optimizing agent which involves not only methodological individualism, but also the assumption that agents optimize. Marxist and radical economists follow the classical economics base their explanations in terms of the behavior of classes – such as workers and capitalists – as a whole, and post Keynesians have focused on the decisions of groups such as firms and financial institutions; decision-makers are usually portrayed as following rules of thumb or social norms which can be observed from the study of actual behavior. There have been endless debates about which is the better method, and orthodoxy in economics has come to require the first. The idea of the optimizing agent has been criticized on the ground that it ignores the problems of information gathering

and processing and rules of thumb have been criticized for allegedly underplaying the ability of people to choose. However, neither criticism seems to hold water, the first because optimization does not claim to be realistic, but simply an organizing principle which can incorporate any kinds of objectives and constraints, and the second because with sufficient ingenuity any behavioral rules can be given optimizing microfoundations. Thus, organizing principles may not really matter in terms of the content of economic analysis. However, the insistence on optimizing behavior may imply that, because of analytical tractability, many realistic and important features of the economy are crowded out from models. In addition, the optimization method can make successive models allow optimization microfoundations of exogenous “distortions”, which can create a tendency towards suggesting systemic efficiency from individual optimization. Despite these possible problems, the optimization methodology reigns supreme in mainstream economics. It is also being applied in ways that make the analysis increasingly divorced from reality, as in growth models in which family dynasties maximize utility intertemporally with infinite horizons.⁴ There have been some inroads into this in terms of introducing bounded rationality and examining the actual behavior of individuals – in behavioral economics – but these approaches appear to be more on the sidelines.

2.3 Views of the economy

Analytical views of the economy refer to understandings of how individuals or groups in the economy behave, in and with which aspects of reality they interact, and the characteristics of these aspects of reality. These views need not be absolute in the sense of applying to all times and places, but may depend on the context to which it is applied.

It may also be the case that segments of the economy may in principle be seen as being characterized in different ways.

Regarding the behavior of individuals, neoclassical economists typically assume that individuals are driven by self-interest, that is, their utility depends on what their income or consumption. Others take into account other motives, such as fairness, respect for social and ethical norms, and status seeking.

Decisions about what aspects of reality are incorporated in the analysis is often made on the basis of what is considered to be the appropriate domain of economics. But since this may well reflect past and arguably arbitrary decisions of influential economists, there is a case for incorporating important relevant factors. Mainstream economist has gone in this direction: it was standard practice in the past – a tradition which seems to be continued by some today – that matters like preferences and technology should be considered as given as exogenous in analyzing economic issues by focusing on the interaction of individual agents in well-defined markets . Now mainstream economists do routinely endogenize technology, and occasionally even preference formation. Other things often ignored in the past by mainstream economists are distributional issues (usually under the assumption of the representative agent), environmental factors, and issues such as norms and non-market interactions (because economists should deal with “economic” behavior in markets and leave these issues to sociologists). Heterodox economists have been more willing to incorporate these aspects of reality.

There are major differences between different ways of characterizing the structure of the economy and relevant parts of it, An example is the characterization of the economy as having smoothly functioning, competitive, markets which imply the clearing

of all markets through the price mechanism, and hence the full employment of all resources. This view is usually ascribed to neoclassical economists. Marxian economists, however, take the view that the economy has a reserve army of the unemployed, and that the distribution of income between workers and capitalists is determined by a complex of forces that can be summarized as the “state of class struggle”. Post-Keynesian economists follow Keynes in stressing the role of aggregate demand and how unemployment may be due to the lack of aggregate demand in a situation in which uncertainty about the future may prevent firms and households investment and consuming enough to attain full employment.

2.4 Policies and strategies

Policies and strategies refer to what kind of, government policies are recommended. One view is that the government should restrict itself to national defense and law enforcement and not interfere with operation of the free market. An opposed view is that governments should interfere with the workings of the economy by regulating markets and by even owning production enterprises. There are debates – for instance – whether the labor market should be made more flexible by reducing constraints on employers on hiring and firing, reducing the power of labor unions, and reducing welfare support to unemployment workers. Debates also abound about what the government should do about the economic relations between the country and the rest of the world. Many economists are in favor of free trade and free capital flows, while others prefer restrictions on trade and capital flows, at least in certain situations.

3. Conflicting paradigms

Although some of these different dimensions are in principle independent of each other, and therefore paradigms with uniform choice need not arise, in practice there may well be important relations between these choices because of analytical connections, sociological affinities, class and group interests or ideological proclivities. Thus, it may be true that, despite the existence of different dimensions, economists can be viewed as coalescing into different paradigms. I will discuss, in turn these different aspects of paradigm formation and examine whether they lead to convergence and divergence within paradigms, and whether such convergence or divergence is desirable.

3.1 Analytical connections

In terms of analytical connections, there is a certain coherence to the following set of choices for the different dimensions of economics: the method of starting with the optimizing behavior of agents, viewing the economy as being populated with self-interested individuals who interact with each other in smoothly functioning perfectly competitive markets with “distortions”, advocating the policy of letting free markets work without government interference beyond maintaining law and order, and having the goal of efficiency and growth. The assumptions of self-interested optimizing behavior and perfect markets imply efficiency, and government interference, which would introduce distortions, is not advocated. Since improving distribution is not an objective, there is no need for government intervention for distributional reasons either. Because this set of choices often goes together, it is common to call this configuration of views the neoclassical one.

There may also be a connection between accepting some issues, such as income distribution and poverty and the environment, as goals, and considering these factors to be relevant for inclusion in analytical views of the economy. For instance, recognition of the importance of improving income distribution is very likely to imply an examination of the importance of the relation between income distribution and growth, and similar arguments apply to the environment as well. The importance given to such issues may result in a greater recognition of the role of the state. Moreover, the complexity of issues involve may induce scholars away from optimizing methods and towards the use of simpler formalizations of behavior.

However, some of the connections between the choices on these patterns are not so clear-cut. Many economists who can be called neoclassical because they start with the assumption that individuals are self-interest optimizers believe that markets are distorted, such as those due to imperfect competition, non-excludable goods, externalities and imperfect information, and some relevant markets may also be missing. As a result, the equilibrium outcome of the economy may be inefficient, so that there is room for the government to conduct policies to correct for these distortions. Thus, government policy may need to go beyond that of maintaining law and order. Moreover, in many cases efficiency and distribution are interrelated. An unequal distribution of income may result in a situation in which the poor are unable to borrow because they do not have collateral to provide lenders to overcome the problem of moral hazard, so that if diminishing returns to capital prevails, output (and even growth, under plausible assumptions) will be lower than it would be with a more equal distribution of wealth. Thus, one may favor a more equal distribution of income and wealth even if one is not interested in equity per se,

because it is instrumentally important for efficiency and growth. The policies recommended by economists such as Stiglitz, who start from neoclassical optimizing underpinnings but stress problems of imperfect information, are in many cases similar to that of neo-structuralists who understand the economy in terms of the behavior of groups and classes who follow behavioral rules such as Taylor (2004). Of course, many neoclassical economists are in favor of equity as an intrinsic objective as well, even when they accept that there are tradeoffs between efficiency and equity (in which case they seek policies which achieve some degree of equity with a minimum of loss in efficiency).

Economists who argue that the economy is not self-adjusting through the operation of market forces, and unlikely to result in genuine wealth creation however, need not approve of government intervention of many kinds. Some may oppose government intervention because it restricts individual freedom and because they believe that individuals know more about their surroundings than the state. Others may oppose it because government intervention leads to corruption and rent-seeking behavior, and because the government can become a tool in the hands of special interest groups or classes whose interests do not promote the general good, however we understand it. Some Marxists believe that unfettered capitalism should be allowed to thrive within countries and in the world economy, because only after the full development of the capitalist phase can true socialism evolve. They may even argue against ameliorative distributional changes because by reducing saving, it can slow down capitalist growth. Some Keynesians argue against potentially destabilizing government activism which can exacerbate the problem of uncertainty and become the problem rather than the solution in stabilizing the economy. Some economists who argue that free markets may well result

in patterns of specialization between countries based on static comparative advantage which are not conducive to long-run technological development and growth sometimes argue that government intervention may do worse because it creates inefficiencies and cannot pick the “right” industries to support.

The analytical connections discussed here may imply the existence of conflicting paradigms and increasing divergence between them. However, the fact that the connections are not logically tight allows room for convergence.

3.2 Sociological affinities

By sociological affinities I refer to the tendency of economists to band together because of the the nature of knowledge creation and dissemination in economics. The process of training, hiring, tenuring, promoting, funding and generally evaluating economists requires some rules, and economics has turned increasingly towards particular standards. One group has evolved standards involving rigid rules in terms of method, requiring increasing sophistication in terms of mathematics both in theory construction and econometrics and above all, the organizing principle which uses the optimizing agent. There may be different sub-groups (such as general equilibrium analysis, game theory, partial equilibrium approaches with asymmetric information, etc.), but technical sophistication and some form of the optimizing agent is a common denominator. Groups that do not follow these standards are increasingly left behind, possibly for no other reason than having fewer adherents. This truce within the mainstream may well be due to the arguably least important (in the sense of determining the nature of other differences), but its logic in causing the domination of the mainstream method over economics – just like the QWERTY phenomenon – is inexorable. But because of analytical connections

between alternative methods and alternative views and policies, the increasing domination of economics by one approach is likely to lead to a distorted understanding of the problems of wealth creation and the emergence of appropriate solutions. .

3.3 Class and group interests

Class and group interests are stressed by Marxist economists and by those who focus on interest group politics. One can think of different classes or groups acting in ways which promotes their own interests, and to promote views of the economy and strategies and policies, and even meanings of development to further these interests. There are obvious collective-action and free-rider problems that can prevent these groups and classes acting in a concerted way to further their interests, but these problems can be overcome in many cases, for instance, by small memberships, inequality within groups, and organizational structures. The classic Marxist conception of the capture of the state by the capitalist class, but other classes or groups on interest are financial classes, labor unions, educated elites, upper castes, ethnic groups, and the coalition of rich countries (against poor countries). The connection between these class or group interests and economic ideas and policies may be based on the membership of economists and other policymakers in these groups, or financial relationships between them either through direct or by the funding of particular kinds of scholarship, or in the way economics is taught (for example, in rich country institutions to poor country students). This is not to say that the approach of all or even many economists and policy makers are driven by class or group interests, but it would be naïve to ignore the role of such interests.

It can be argued that economics at many levels, including policy, is dominated by more dominant groups and classes, such as corporate interests, financial interests, and the

interests of economically advanced countries. If class and group interests are in conflict, it may be expected that there will be a divergence in views of different approaches based on such interests. Debates in economics in different dimensions may be affected by such different views. The interests of elites may result in a focus on the goal of efficiency rather than on improving income distribution, removing poverty and improving primary education. Business interests may see the economy as generally being self-adjusting and as not having significant levels of unemployment while labor interests may prefer approaches which imply that unemployment may persist. Debates on whether the labor market should be made more flexible, may be driven by class divisions. Finally, debates on the benefits of free trade and the protection of intellectual property rights may be stoked by the differing interests of rich and poor countries. As Friedrich List pointed out a long time ago, it is in the interest of rich country to kick away the ladders by which they have increased their wealth, preventing poorer countries from climbing up.

Differences in terms of class and group interests are not likely to be desirable in cases – which arguably are common – in which the interests of dominant groups and the goals of development do not coincide. A convergence of views in directions favorable to promoting appropriate goals is, by definition, desirable. While it would be naïve to expect a great deal of convergence, the possibility of convergence among paradigms can occur if links between interest groups and economists is reduced and if alternative analytical approaches can coexist. Moreover, convergence, given the role of class and group interests is likely if economic analysis suggests that the economy is such that the interests of dominant groups and the goals of development are in harmony. Recent research in economics showing that improvements in income distribution may be

efficiency-enhancing for a variety of reasons, and that reductions in international inequality may be in the interests of rich countries (because of the existence of global public goods like health, international security and the global environment, not to speak of other standard economic factors such as finding markets and opportunities of investment in growing “emerging” countries) may encourage such convergence.

3.4 Ideological factors

Finally, ideological factors may be responsible for the existence of conflicting paradigms, and to the extent that such factors are important in affecting economic understanding, divergence can be expected to persist. Since we have already discussed other sources of divergence, by ideology in this context we mean points of view which are different for exogenous reasons: for instance, some economics are just wedded to free markets and others believe that markets always create problems and must be supplanted by government activity.

Such dogmatic differences, to the extent that they are based on reasons that cannot be reduced to other things, may persist, but it can be expected that reason will prevail as we accumulate more evidence about how the economies are and increase our analytical understanding of how economies behave. The accumulation of such evidence and theoretical understanding has already informed us about why markets may not achieve our social goals not just because of traditional market failures and distributional problems, but also because of the inadequate social and political embeddedness of markets, and because the goals that many think markets achieve may be problematic (such as the single-minded pursuit of efficiency and growth). It has also informed us that governments cannot always improve on the market, and can possibly make things much worse because

of state capture by interest groups and classes, political stalemates, information problems, incompetence, or corruption. We have also made some progress in understanding how the state, market, and other institutions can, in synergy with each other and in certain circumstances, improve the likelihood of achieving appropriate goals. If such trends continue, it could be expected that divergences in economic approaches will narrow.

4. Religious perspectives and the possibility of genuine wealth creation

I conclude with a brief discussion of how religious perspectives can inform debates concerning alternative approaches in economics.

In terms of the different dimensions in which alternatives exist in economics, religious perspectives have immediate consequences regarding the goals. They do not attach much importance to material goods and consumption, and instead emphasize goals such as equality, reduction of poverty and environmental protection. Catholic Social Thought, as expounded in the papal encyclicals and pastoral letters, states that excessive consumption by some individuals and nations, while others suffer from want, is morally unacceptable since income spent on luxuries by the rich could have been available to others for necessities, and excessive consumption, by threatening the earth's environment, is morally unjustifiable (see Wilber, 1998). In Judaism there are Biblical directives and rabbinic glosses which deal with limiting consumption because of concerns for environmental sustainability and the efficient use of resources. God's commandment is "not to destroy that which generates progeny or produces fruit"; "[t]he Torah's intention is ... to encourage Creation to exist as fully as possible" (cited in Diamond, 1998, 397). Islam also emphasizes the importance of charity to help the poor

and protection of the natural environment. The *Quran* proclaims: “Eat and drink, but waste not by indulging in excesses for Allah does not love the wasters” (VII, 31).

The effect of religious perspectives on goals may, because of the analytical connections discussed above, have the effect of changing views about the economy to take into account issues connected with these goals. More emphasis may be given to distributional, poverty and environmental issues. This analysis may provide instrumental reasons why these issues are important, for instance, because of their relevance for efficiency and growth, but religious perspectives primarily stress their intrinsic importance.

In addition to the influence on goals, religious perspectives can influence views about characteristics of the economy by affecting how economists view behavior and by affecting behavior itself. Economists are likely to see that individuals are driven by motives other than self-interest, such as, for instance ethical considerations. Thus, they have multiple identities, not just the identity of the homo economicus (see Sen, 2006). But awareness of these issues can also change behavior as people begin to appreciate their own multiple identities. Thus decision makers in corporation and in government may not just see themselves as profit or income maximizers, but also as religious and ethical people, and bring it upon themselves to help the poor and protect the environment. The unintended consequence of some of these actions may be to increase their profits as well, by increasing productivity and by expanding markets. Religious perspectives can thus potentially overcome problems of the Prisoners Dilemma type in which self-interested behavior can make everyone worse off. A simple example of this is that consumers, who derive satisfaction from their consumption relative to that of others

because they perceive themselves to be competing with others and hence overconsume at the expense of other things they value (such as time spent with friends or family), may be influenced by religion to become more interested in competing “with themselves” to become better human beings, and thus be happier as a result (see Dutt, 2001).

Last, and not least, religious perspectives may make economists appreciate, appreciate the multiple nature of their own identities beyond that of the homo economicus interested in his or her own career, develop a fuller understanding of the real goals of development and get down to the difficult business of understanding economies as they really are and of devising suitable policies and strategies.

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NOTES

¹ This list of dimensions is not meant to be exhaustive, but will be sufficient for the present discussion. Another dimension that economic methodologists emphasize is the relation between analytic views and the real world. This dimension refers to how – if at all – analytical constructs are constructed from information about the real world and how they are validated in terms of how they correspond to that world; an example of this relation is that the constructs are developed from some theory-driven axioms and only the implications of the theory are tested against real-world data using econometric methods.

² The research along these lines was pioneered by Easterlin (1973). See Easterlin (2001), Frey and Stutzer (2002) and Layard (2005) for recent reviews of the evidence. This research suggests that subjective well-being depends more on the income and consumption of people relative to others, rather than their absolute levels of income and consumption after basic consumption requirements have been met. This could explain why in a particular economy the rich report higher levels of happiness than the poor, but there seem to be no increases in happiness as income increases over time in rich countries, and across countries beyond a certain income level.

³ It is, for instance, possible to have “jobless” growth (as occurred in India in the 1980s when the growth rate accelerated) which can even increase unemployment if growth is accompanied by a high rate of labor productivity growth and concentrated in sectors which have low labor intensity. It is also possible to have economic growth without reductions in the poverty rate, as seems to have happened in the United States since the 1970s. Economic growth can also be associated with increases in inequality and in environmental problems for long periods of time, despite the faith of optimists in various types of inverted-U-shaped Kuznets curves.

⁴ For a critical discussion of these models from within the neoclassical approach, see Banerjee and Duflo (2006).