



Letters to the Editor – An Attack on Paul Krugman

May 29, 2012

The following is in response to Michael Edesess' article, [An Attack on Paul Krugman](#), which appeared on May 15:

Dear Editor:

“Equal time for Economics”

INET's [link](#) to Michael Edesess' piece is labeled “a dose of reality for economists.” I note that such dosages are inevitably prescribed for diseases that exist only in the attending physician's imagination.

As an economist for a large central bank (the one having twelve branches wherein Edesess finds so many of us wasting time and tax dollars) I must publish this rebuttal anonymously; and I am also enjoined from making the references that might most effectively refute Edesess' claims. I will however cite one publicly-available [source](#) as background for what I have to say.

This link will open an ordinary Excel workbook demonstrating economics' fundamental causality. The 'SFEcon' prototype to which I refer presents stable continuum of all the physical and monetary quanta developed as a generalized, international input/output structure finds its way, efficiently, from one Pareto optimum to another.

If Edesess expects to be taken seriously as speaking from the superior posture of Western science, then he should be open to refutation by the objectively-functioning counterexample I cite above. Otherwise he is just a red hat short of the 17th century cardinals who would not look into Galileo's telescope.

Edesess' initial point that “neoclassical economic theory is bankrupt because it is enthralled with equilibrium” obviously derives its truth from its pejorative use of the word “enthralled.” If one wishes to be merely dismissive, the same can be said of all precisely understood time-dependent phenomena. Some sort of homeostasis is key to the understanding of any dynamic system: what makes the homeostatic point desirable? How do stimuli jolt a system into sub-optimality? How does the system recover in the absence of stimuli? Remove these questions from the physical sciences and what, Dr. Edesess, remains of science in the specifically Western mode?

Contrary to Edesess' assertion that “economics is not remotely comparable to Newtonian physics,” it would seem from my citation above that economics' fundamental generalities are every bit as capable of supporting convincing demonstrata as are those of Newton.



Newton followed Galileo in generalizing that “things in motion tend to stay in motion” and economics has generalized that “quanta of economic goods must remain in flux until all economic actors have agreed as to the value of all economic goods”. In what sense are these matters not at least as comparable as are the fundamental generalities and demonstrata among those disciplines that Mr. Edesess can accept as scientific?

Edesess’ ownership of the word “mainstream” is asserted in his additional finding that ...

Schumpeter, you’ll recall, was the economist who coined the term “creative destruction” to characterize the capitalist economic process – a term beloved by nearly all economists, but of which it is difficult to find any trace in mainstream economic models.

This is merely belligerent: if our topic really is the exhaustion of one generation of economic goods in producing the next generation of goods, then the models we should be looking at are those specifically designed to portray that process. My SFEcon counterexample is an ordinary engineering-dynamic system whose state variables are the physical quanta of economic goods held among the economic actors. This system has economic actors continuously building-up and working-off their assets in search of higher returns. SFEcon originated at MIT under supervision of the then reigning Nobel Laureate and three other men who would later win gongs of their own. Might not that be sufficiently “main” in respect to Mr. Edesess’ “stream”?

Dr. Edesess also registers his difficulty as ...

a non-economist to decipher [economists’] debates, which revolve around esoteric terminology known only to the disputants – like “aggregate demand” and even “money.” Most people certainly don’t know what economists mean by “money.”

Recurring again to my SFEcon counterexample, we see the demand for any and all economic goods continuously expressed in terms of the goods’ physical units of measure. We also have continua of the commodity prices giving rise to these demands, and therefore the have demands reflected in monetary flows. Monetary flows control financial positions having definitions that are anything but exotic. “Money” exists as either 1) the amount that industries have spent, including costs of capital, but not yet earned (investment) or 2) the amount that households have earned, including passive interest income, by not yet spent (savings). If these referents are not sufficient for Mr. Edesess to compute an acceptable expression of “aggregate demand” then methinks the mathematician doth protest too much.

The word “inevitable” also gets quite a work-out in Edesess’ finding that ...

this process of banks creating money, in the form of debt, would inevitably lead to frequent financial bubbles and crises.



My SFEcon counterexample features a financial intermediary who creates or destroys money in whatever quanta are needed for profit-making sectors to efficiently optimize their asset levels. This intermediary uses the leverage implicit in the resulting ratio of investment to savings in his computation of the optimal interest rate and investment term. If Edesess can make this model perform a financial bubble or crisis without introducing outright securities fraud, then I will eat a hard copy of its program in public.

Moreover, my reading of economic history finds that financial intermediation in this form has underlain capitalism from its earliest, Old Testament incarnations. Where financial intermediation has ceased, as in Europe during what we call our dark ages, so has capitalism. When capitalism came back with the Renaissance, so did the financial intermediary's ability to create capital via offsetting bookkeeping entries and based on comparatively small amounts of savings. To whom is this supposed to be controversial or newsworthy?

While the "financial bubbles and crises" that are "inevitable" in the thinking of Edesess are found here and there in history, they have until recently been comparatively rare in fact; and, as instantiated by SFEcon, capitalism's failures are anything but necessary in abstractions upon material affairs. The more productive generality would therefore have financial intermediaries creating capital wisely and honorably in the service of the productive and stable system that Edesess fails to cognize, rather than cynically misplacing of capital in the service of narrow interests. If we are to understand securities fraud the systemic norm, whence will we derive the moral authority to punish the offenders who are ruining the system?

Edesess does manage to formulate the source of his impatience with what he sees as debates on these matters:

I am particularly baffled by these debates, because my background is in pure mathematics. Economics pretends to be mathematics, but it is not mathematics. There is a major difference. No mathematician uses a term in a formula, or a statement of a theorem, unless that term has first been defined with excruciating precision. Hence, there is no question of what the term means, let alone any debate that is carried on only because two disputants have different concepts of the meaning of their terms. As a result, a very simple proof of something will invariably persuade the other side. The cost of this, however, is that mathematics is strictly limited in what it can define and prove.

The variables in SFEcon's mathematical formulae are amounts of physical things and monetary magnitudes. And, while conducting an inventory or performing double-entry bookkeeping are perhaps not sufficiently "excruciating" to be credited by Edesess, they do tend to give rather precise results – the falsifying of which is actionable at law. The variables in this mathematical system reference the processes by which inputs are turned



into outputs – which have a reality that you can see, touch, feel and measure by the commonplace technique of running your theory in reverse to infer the parameters implicit in observed behaviors.

Most importantly, Edesses fails to appreciate that 1) public intellectuals retailing scientific materialism are in the business of being credible, 2) credibility with the public is a zero-sum game, ergo 3) they will never credit systems based on terms that have “first been defined with excruciating precision” resulting in any “simple proof of something [that] will invariably persuade the other side.” Hmmm: that would put them out of business, wouldn’t it? Does Edesses want us to think that the high clergy of material causality are innocent as to where their own material interests lie?

Thank you. I feel better now.

Dear Advisor Perspectives,

Michael Edesess hits the nail squarely on the head. I remember sitting through micro and macro in college bristling every time I heard the words "holding all other factors equal." In the 20 years I have been in this business, I cannot think of any real world situation that involved numerous static constants and one variable. And while there may ultimately be a "best" way and a "right" answer, it is rare that we find or recognize it in the moment. Michael addresses three things that I have found to be at the core of analysis, trading, and investing: First, recognize the difficulty in finding absolute truths in economics. Second, there are two sides to every trade, and two sides to every market, so it follows that there will always be (at least) two sides to every decision on economic policy. Third, understand the limitations of pure math as it can be applied to economics. The psychology of "reflexivity" can wreak havoc on a model that assumes A causes B. People in general are constantly chasing performance, and planning for the past is a sure way to repeat it.

Finally, after skimming a few of the blogs Edesess cited, it really does seem like people are arguing about the best way to swim before they can define what water is.

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