Review of: "What Went So Wrong in Economics"

Jean Paul Chavas[1]

1 University of Wisconsin - Madison

Potential competing interests: No potential competing interests to declare.

The paper addresses a good topic: some of the historical shortcomings of economics, with a focus on the assumption of of "decreasing returns" that has been at center of economic theory over the last century. The paper properly argues that "decreasing returns" is a strong assumption that ignores some important aspects of economics. It stresses the need to relax this assumption and to explore economic behavior under more general (and more realistic) assumptions. This is a good story to tell. But it is also a challenging topic for three reasons: 1) it requires identifying situations where "decreasing returns" do not apply; 2) it indicates the need to develop a coherent theory that can handle such situations; and 3) it suggests exploring new ideas about the role of markets and of socio-economic and political institutions in the process of economic development. Of course, addressing these issues is complex, complexities that cannot be resolved in a single paper. Yet, the paper could be improved by exploring these issues in more details. See below for some suggestions.

1) Identifying situations where "decreasing returns" do not apply. I see at least three areas that could be discussed in more details. First, it is well known that fixed costs contribute to declining average cost and thus to "increasing returns". When market size is "small", this can lead to natural monopolies, in which case markets typically fail to support efficient allocations (possibly motivating policy interventions such as anti-trust regulations). Some additional discussion along these lines would be useful. Second, the presence of "externalities" can also contribute to invalidating the assumption of "decreasing returns". This can apply to firms as well as consumers. These externalities can be positive (e.g., learning from each other) or negative (e.g., pollution). When strong enough, such externalities can generate increasing returns (when avoiding negative externalities or capturing positive externalities generate large benefits). Again, some additional discussion along these lines would be useful. Third, the paper discusses the role of "bounded rationality". This discussion could be expanded. In what way would bounded rationality contribute to invalidating decreasing returns? For example, if cognitive limitations reduce the ability of individuals to assess and manage their economic environment, this may provide incentives for individuals to specialize toward specific tasks, possibly generating large benefits of specialization (benefits that would not be captured under decreasing returns)…

2) The need to develop a coherent theory that can handle situations where "decreasing returns" do not apply. The paper could expand the discussion of such issues. This would include discussing the limitations of competitive markets in handling such situations. In particular, uniform pricing may no longer support efficient allocations in the absence of "decreasing returns". This suggests the need to explore two sets of issues: the role on nonlinear pricing in market allocations; the role of non-market institutions (including government policy) in resource allocation and the process of economic development…

3) Exploring new ideas about the role of markets and of socio-economic and political institutions in the process of economic development. This is a follow-up to the previous comment. How should firms and/or industries organize to improve the process of resource allocation in the economy? How can markets help support economic efficiency? How can social networks help make human behavior “more productive”? What is the role of non-market institutions in the process of economic development? This would include the role of contracts, of “social norms”, of government policy, of NGO and of international institutions…