How the Intelligent Non-Economist can Refute Every Economist Hands Down

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Abstract

Most non-economists tend to think that economists know what they are talking about when they use specific terms like income, profit, capital, market equilibrium, and so on. This is not the case. What, then, follows from the well-documented fact that the representative economist has no idea of what profit is? Quite simple: if the core concept profit is false then the *whole* economic theory/model is false. This holds for the Walrasian, the Keynesian, the Marxian, and the Austrian approach.

Most non-economists are not fully aware that economists do not understand how the market economy works. The designation economist includes here *all* economists and in particular the adherents to the Walrasian, the Keynesian, the Marxian, and the Austrian approach as well as the IIAs (Independents, In-betweens, Alternatives). This embarrassment is due to the scientific incompetence of the representative economist who stands henceforth for the personified synthesis of the familiar sects.

Most non-economists tend to think that economists know exactly what they are talking about when they use economic terms like income, profit, capital, market equilibrium, GDP and so on. This is not the case. As the Palgrave Dictionary summarizes with regard to profit "A satisfactory theory of profits is still elusive." (Desai, 2008, p. 10)

What follows from the well-documented fact that the representative economist has no idea of what profit is? Quite simple: if the core concept profit is false then the *whole* economic theory/model is false. Every non-economist can check it out for himself that neither the Walrasian, nor the Keynesian, nor the Marxian, nor the Austrian sect understands what profit is. There is no need at all to study the whole corpus of an approach in detail. If profit is ill-defined the whole theoretical superstructure falls apart. It is as simple as that. Profit is the key to all of economics.

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In more than 200 years the representative economist has achieved nothing of real scientific value. Of course, this failure has often been noticed.

> Thousands upon thousands of scholars, as well as thousands of statesmen and men of affairs, have contributed their efforts to the attempt to understand the course of events of the economic world. And today this field of investigation is being cultivated more extensively, than ever before. How is it, then, that in all these years, and with all the undoubted talent that has been lavished upon it, the subject of economics has advanced so little? (Schoeffler, 1955, p. 2)

The answer is that the representative economist does not understand the pivotal phenomenon of his subject matter. Note well that this has nothing to do with political differences. Both, the defenders of capitalism and the followers of Marx have no idea of what profit is. Thus, neither the capitalist nor the communist economic system (nor their countless variants and combinations) has a sound theoretical foundation. What economists have produced so far are elaborate social belief systems but nothing of any scientific value. Economics looks like a science but is storytelling on a level with myth or religion. Economic policy advice or institution-building never had a sound theoretical foundation.

> In order to tell the politicians and practitioners something about causes and best means, the economist needs the true theory or else he has not much more to offer than educated common sense or his personal opinion. (Stigum, 1991, p. 30)

Economists have as much opinions as non-economists but no true theory. Because of this, one always has to bear in mind the crucial distinction between political economics and theoretical economics. The main differences are:
(i) The goal of political economics is to push an agenda, the goal of theoretical economics is to explain how the actual economy works.
(ii) In political economics anything goes; in theoretical economics scientific standards are observed.

Theoretical economics has to be judged according to the criteria true/false and nothing else. The history of political economics since Adam Smith can be summarized as the perpetual violation of well-defined scientific standards. Economics as it actually presents itself to the general public is essentially political economics, which is synonymous with being scientifically worthless. This verdict applies to Walrasian, Keynesian, Marxian, and Austrian economics. Policy proposals of all these sects have no sound theoretical foundation because theoretical economics in the strict sense is virtually non-existent. Seen from the genuine sciences economics is a proto-science or what Feynman called a cargo cult science.

Has the non-economist any chance to understand what economists do not understand? Yes, of course. All that is needed is one iota of scientific instinct. As we know by now, the representative economist lacks this essential mental catalyst.

We take the simplest of all cases as point of departure. The most elementary economic configuration is the pure consumption economy. It is defined for one period by a couple of rather straightforward equations. Note well that no green cheese assumption like constrained optimization or equilibrium is put into the premises; this would be a serious methodological mistake.

(i) $Y_W = WL$ wage income Y_W is equal to wage rate W times working hours L, (ii) $O = RL$ output O is equal to productivity R times working hours L, (iii) $C = PX$ consumption expenditure C is equal to price P times quantity bought/sold X. For the graphical representation see Figure 1.

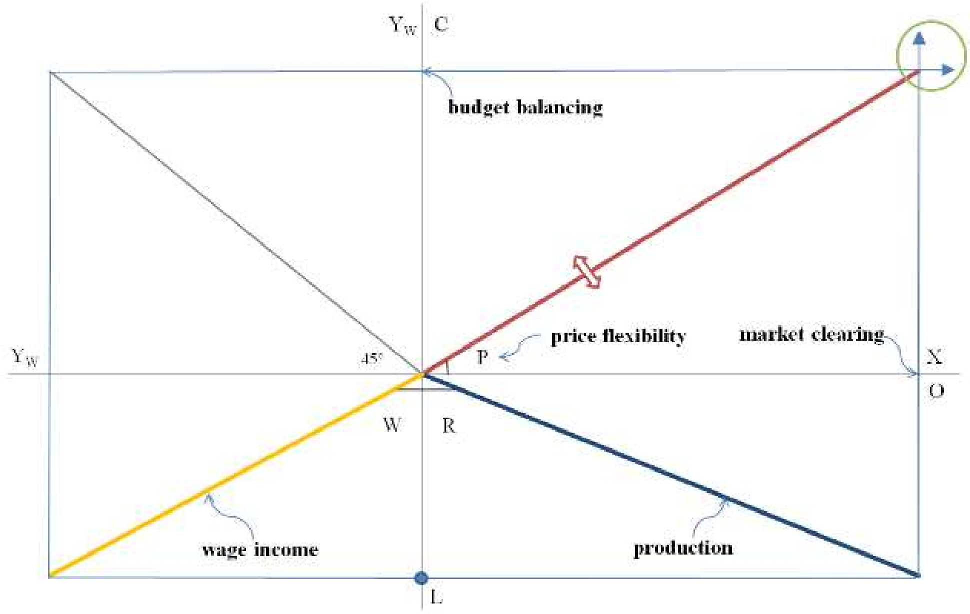

Figure 1: The price in the pure consumption economy in period $t = 1$ is objectively determined by the conditions of market clearing and budget balancing. Legend: P price, L employment, W wage rate, Y_W wage income, C consumption expenditure, R productivity, O output, X quantity bought/sold

At any given level of employment L, the wage income Y_W that is generated in the consolidated business sector follows by multiplication with the wage rate W. On the real side, output O follows by multiplication with the productivity R. Finally, the price P follows as the dependent variable under the conditions of budget balancing, i.e. $C = Y_W$ and market clearing, i.e. $X = O$. Note that the ray in the southeastern quadrant is *not* a linear production function; the ray tracks *any* underlying production function. Note also that the wage rate W is an *average* if the individual wage rates are different among the employees, which is normally the case.

Under the conditions of market clearing and budget balancing in each period the price is given by $P = W/R$, i.e. the market clearing price is always equal to unit wage costs.

If the wage rate W is lowered, the market clearing price P falls. If the number of working hours L is increased the price remains constant, provided productivity R does not change. If productivity decreases the price P rises. If productivity increases the price falls. In any case, labor gets the whole product, the real wage W/P is invariably equal to the productivity R, and profit for the business sector as a whole is zero. All changes in the system are reflected by the market clearing price.

We know, of course, that the firm sets a price which is different from the market clearing price. This case has to be treated separately on another occasion.

In the next period, the households save. The result is shown in Figure 2.

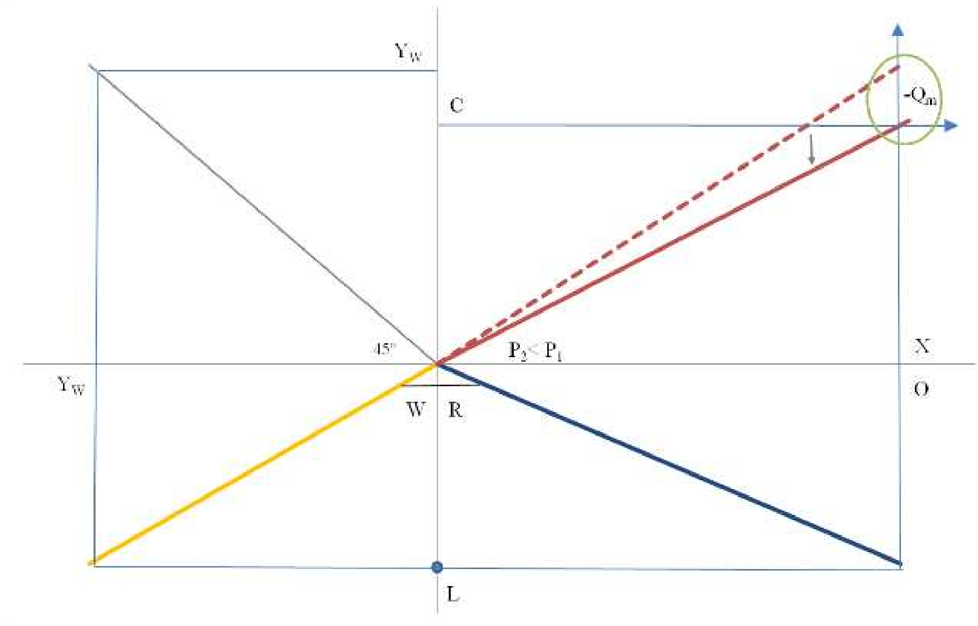

Figure 2: The monetary loss in period $t = 2$ is objectively determined by the difference between wage income Y_W and consumption expenditure C under the condition of market clearing

Consumption expenditure C falls below Y_W and with it the market clearing price P. With perfect price flexibility there are *no* unsold quantities and *no* change of inventory. The product market is always cleared and there is no such thing as an inventory investment. So we have household sector saving S_m but no business sector investment, that is, monetary saving which is given by $S_m = Y_W - C$ is *not* equal to investment.*

The crucial conclusion is that the business sector makes a monetary loss which is exactly equal to the household sector's monetary saving, i.e. $Q_m = -S_m$. Therefore, loss is the exact counterpart of saving; by consequence, profit is the exact counterpart of dissaving, that is, of the growth of household sector's debt. This is the most elementary form of the Profit Law. It follows directly from the profit definition $Q_m = C - Y_m$ and the definition of household sector saving $S_m = Y_W - C$. As always, the sector balances add up to zero, i.e. $Q_m + S_m = 0$.

Note well that profit for the economy *as a whole* has nothing at all to do with productivity or the wage rate. And this is why all stories that economists tell about the functioning of the market system and the price mechanism are false (2014; 2015). For an individual firm there is indeed a relationship between productivity or wage rate and profit. But this relationship cannot be generalized for the economy as a whole. This logical mistake is known since antiquity as fallacy of composition. This methodological blunder is the defining characteristic of microeconomics, so much so that the representative economist could well be characterized as a fallacy of composition on two legs.

The Profit Law for the investment economy reads $Q_m = Y_D + I - S_m$ (2014, eq. (18)). Legend: Q_m monetary profit, Y_D distributed profit, S_m monetary saving, I investment expenditure.

The Profit Law gets a bit more complex when foreign trade and government is included. Regardless of complexity, the Profit Law contains nothing but measurable variables, which means that its empirical fit can be established with the accuracy of two decimal places. This ultimately leads from the worthless political economics and the silly model bricolage of the representative economist to economics as a science.

The most valuable contribution to science the non-economist can actually make is to bring in his realm of influence an end to the incompetent waffling of Walrasians, Keynesians, Marxians, and Austrians. Peer-reviewed journal articles, standard textbooks, and the debates between the sects are wasteful in all material and intellectual dimensions. To expect New Economic Thinking from people who have demonstrated over two centuries that they cannot think is futile.**

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* For details of the I=S blunder see cross-references Refutation of I=S

http://axecorg.blogspot.de/2015/01/is-cross-references.html

** For details of the bigger picture see cross-references Incompetence

http://axecorg.blogspot.de/2015/07/incompetence-cross-references.html