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The Thought Leader Interview: Sylvia Nasar

The renowned author discusses how the great economists uncovered the basic truth about progress, prosperity, and productivity, and the reasons you should be careful which ideas you listen to.

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Photograph © John Blais

Many of the powerful forces that help business, hurt business, and shape our civilization today stem directly from the theories formulated by economists in the past, put into practice in the real world. That is the subject of Sylvia Nasar's new book, *Grand Pursuit: The Story of Economic Genius* (Simon & Schuster, 2011). And yet, as Nasar would be the first to acknowledge, the field of economics has suffered from a lack of respect since its formative years; Scottish essayist Thomas Carlyle dubbed it "the dismal science" in 1849. Today, when economics makes headlines, it's typically as a whipping boy ("Why Economists Failed to Predict the Financial Crisis") or as part of a sales pitch ("Prominent Economists Support Changes to Medicare"). Add the fact that economics has been delivered to undergraduates over the past 50 years in an off-putting package of mathematical equations and unintuitive charts, and it's no surprise that most people tend to see it as a difficult subject producing dubious results.

But economics has in fact made profound contributions to our understanding of how society functions. Nobody has done a better job of bringing its story to life than Sylvia Nasar. Launching into her narrative via Charles Dickens and Jane Austen rather than Adam Smith and David Ricardo, she shows how some of the most important ideas of modern times came together in London in the mid-19th century, as Britain entered an era of unprecedented economic growth — the first time in human history that the living standards of average people began to rise significantly. The key insight around which the book revolves is that business productivity drives economic and societal improvement, and the book's narrative shows us how an idea like that can be developed, debated, and accepted over the decades as empirical evidence mounts and the scholarly consensus builds.

Along the way, Nasar rights some perceptual wrongs of conventional economic history. One hero of the tale is British economist Alfred Marshall (1842–1924), who hasn't always gotten the respect he deserves. *Grand Pursuit* reveals what Karl Marx was wrong about (practically everything) and why (intellectual laziness); it paints rich portraits of neglected thinkers such as prototypical feminist Beatrice Webb (1858–1943), who formulated the idea of the social safety net in the 1890s, and American economist Irving Fisher (1867–1947), who presciently discovered portfolio theory, countercyclical monetary policy, and index numbers, as well as inventing the Rolodex and founding the company that became Remington Rand. Nasar also provides carefully reported assessments of the achievements of such better-known economists as John Maynard Keynes, Friedrich August von Hayek, and — the last in her line of profiles — Amartya Sen, whose work she sees as pointing to new directions for the field.

In Nasar's view, economics has progressed to the point where it can explain definitively how to avoid the kinds of economic catastrophes that produced the Great Depression. All the nations that have grown steadily in recent years, she believes, are following the basic economic playbook that began to take shape as Marshall visited the factories of Britain's Industrial Revolution, whereas countries that ignore those lessons are doomed to failure. But the dismal science has less to say about how to balance the roles of governments and markets or how to determine the optimal level of taxation. As examples, she cites the United States and Sweden, two countries with very different policy and fiscal profiles, but very similar — and enviable — standards of living.

Nasar, a former economist herself and a writer for *Fortune* and the *New York Times,* is the author of *A Beautiful Mind* (Simon & Schuster, 1998), the best-selling biography of mathematician and game theorist John Nash, later adapted into a hit Hollywood film. She is also the John S. and James L. Knight Professor of Business Journalism at the Columbia Graduate School of Journalism. She discussed her research and conclusions with *s+b* at Booz & Company's New York office in May 2011.

S+B: John Maynard Keynes, who plays a large role in your book, once observed that "practical men, who believe themselves to be quite exempt from any intellectual influences, are usually slaves of some defunct economist." Would you agree?

NASAR: It's true to an extent, but where people tend to go astray is when they are slaves of an economist outside the mainstream, or, worse yet, of a noneconomist. When you look at the ideas that distinguish successful economies from unsuccessful ones, it's not the difference between, for instance, Paul Samuelson and Milton Friedman, or even Keynes and Hayek. It's the difference between any of them and something or someone whose ideas are completely dysfunctional. Marx would be an example.

If you look around the world today, it's the difference between Venezuela and Chile. Venezuela is rich in resources, with some of the world's biggest oil reserves, and once was one of the region's most prosperous nations. But over the last dozen years, the average standard of living has been declining. Chile is also a big commodity producer, and certainly has lots of problems, but on the other hand, the standard of living there has been rising steadily since 1970. That's the kind of dramatic difference that really adds up over time. It's the difference between a society where living standards are rising, thanks to a growing business sector and rising productivity — as well as greater attention to law and to alleviating poverty — and a

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society that is teetering on the brink of collapse.

S+B: So what's important is whether or not the ideas influencing a leader's policies or a nation's policies are within the economic consensus?

NASAR: It's that the big insights from the best economists, over time, have become the consensus. Take the idea that the key to rising living standards is productivity gains. Today that seems elementary; it's something you learn in your first economics class. But it took many decades of intense debate by really smart people before it was accepted. That meant realizing the difference between the kind of world that existed before the Industrial Revolution and the one that became possible as a result of it. From the beginning of civilization to the 19th century, 90 percent of humanity was stuck in place, even if their country did comparatively well. Average people lived like livestock — they didn't go anywhere, read anything, or wear much; they ate bad food and didn't live a very long time. Today, in an increasing number of places in the world, the majority of people have escaped poverty and have some measure of control over their lives.

The gulf that separates successful economies from the real basket cases today is almost as big as the gulf that separates the modern standard of living from the one in Jane Austen's time. And that suggests that even in a globally integrated economy, what your country does locally still matters the most.

"Alfred Marshall's idea was that from a social point of view, the purpose of corporations is to raise the standard of living."

And what determines that? Well, it doesn't seem that it's whether you have oil or whether you have a big population or a big territory — all those things that in the early 19th century were thought to be the source of the wealth of nations. It also doesn't seem to be whether you have a large government or a smaller one. Look at two of the most successful economies today, the United States and Sweden. The U.S. has traditionally had a much smaller government than Sweden's — different institutions, a very different philosophy. And yet if you rank countries by the rate of growth of their productivity and living standards, it's really Sweden and the United States, over a long period of time, that come out on top, even though they would seem to be on opposite ends of the spectrum.

What the U.S. and Sweden have in common is a pretty good environment for business, and they always have had that. That was the basic insight of Alfred Marshall.

S+B: So Marshall was the first person to completely grasp that idea, and systematize it in his *Principles of Economics* in 1890, which became the most influential book in the field for many decades.

NASAR: Right. Marshall's idea was that it's businesses that drive increases in productivity. Obviously, that's not what stockholders or managers are thinking about, but from a social point of view, the purpose of corporations is to raise the standard of living by raising productivity. His corollary to that, which was a matter of great debate that has continued to this day, was that the productivity gains that business drove would be shared out to workers — that competition in the labor market would force businesses to share the gains — and that wages would thus rise over time. It's since been substantiated by 100-plus years of empirical data. It's still true today, as it was then, that the share of the national income that went to wages would not decline as some people, like Marx, believed, but would stay steady or rise, even as the national income grew.

S+B: What were some of the experiences that led Marshall to develop this line of thought?

NASAR: The first was his experiences with poverty. He grew up in a lower-middle-class household of very modest means, and when his father arranged for him to attend a private school, he had a long commute through some of London's worst slums. After studying mathematics at Cambridge, he made the decision to study economics one day when he was on vacation and wound up walking through the appalling slums of Manchester, which existed within a few hundred yards of luxurious neighborhoods. He began to question whether poverty was a necessity of nature, which is what had been believed by earlier economists — including many who were very liberal in a political sense, like John Stuart Mill, who was a socialist at the end of his career. Marshall felt that humanity could work its way out of what was then almost universal poverty, and he decided to understand why it existed, and how things could change.

Learning from Business

S+B: And one of the ways he did that was by actually spending time visiting factories and learning about business.

NASAR: Marshall spent his summers traveling to factory towns and interviewing businessmen, along with his wife and partner [Mary Paley Marshall], who was one of the first women to be educated in economics at Cambridge. He spent hours observing, recording manufacturing techniques, pay scales, and workplace layouts. He questioned everyone, from the company owners to the workers on the shop floor. He knew many businessmen and trade union leaders. He knew a lot about technology. Marshall felt that he needed this knowledge to inform his scholarly work. In fact, he could have written his theoretical insights 20 years before he produced his great work, *Principles of Economics,* but he felt an obligation to assure himself that his ideas and assumptions were grounded in reality. He also understood that to persuade others that economics had something to say about the real world, he, the economist, had to understand it.

S+B: Which is in real contrast to Marx, who did none of those things.

NASAR: I don't know that I'm the very first person to discover that Marx had never been in a factory at the time that he published *Das Kapital,* but it blew me away. In fact, he only ever visited one factory: a porcelain factory when he was at a spa in Czechoslovakia.

The thing about Marx is that he was a brilliant journalist in many ways, but he was a terrible reporter. Despite his reputation for being the great chronicler of the Industrial

Revolution and its evils, he was more like a Web news aggregator.

The worst thing about Marx was that he began with an answer, and then set out to find the facts that would support it. He was actually quite isolated. He lived in London, which was the center of the economic and intellectual world, within a mile of the greatest geniuses who were living at the time — George Eliot, John Stuart Mill, Charles Dickens — all of whom were obsessed with economic issues and were talking about them and debating them. Yet he never engaged with them. The reason he didn't was that he already knew capitalism was rotten, that it was doomed.

S+B: Where did that conclusion come from?

NASAR: It came straight out of the Book of Revelation, which was a bit of a revelation for me, and came to me because I spent some time at a research institute with [Princeton professor of religion and author] Elaine Pagels, who was writing a book about the Book of Revelation. I found that Marx really got all his economics, and the bones of his narrative, from Friedrich Engels, who was his coauthor, financial benefactor, and all-around guardian angel. Engels, in fact, ran a cotton factory in Manchester to support his slacker friend — who spent 20 years not writing his book — and had been reared as a sort of fundamentalist Lutheran. Engels knew the Bible inside and out, and the Book of Revelation was his favorite book. And there it all is: the world splitting into two great armies; the fundamental conflict that ends history, that brings justice; and finally the downtrodden will prevail. I was able to trace that link in their correspondence and their writing.

That to me answers the question of why people embrace bad ideas or ideas that don't work. It's because we're human beings, and we find narratives that are very powerful and appeal to our emotions.

S+B: So Alfred Marshall was spectacularly right, and Karl Marx was spectacularly wrong, yet Marx is much better known.

NASAR: This is the weird thing. If you look at the first edition of Robert Heilbroner's *The Worldly Philosophers: The Lives, Times, and Ideas of the Great Economic Thinkers* [Simon & Schuster], which was published in 1953, Marx is the hero and Alfred Marshall is this little Victorian prune who was totally out of touch with what was really going on. So it was really amazing to find out that the opposite was true.

Marshall was very well regarded in his own time. One of the striking things about him that I found was that he was so clearly focused on poverty. He was supportive of labor unions, so he was very different from some of the earlier economists, and he really differentiated himself in the policies that he supported. He favored antipoverty measures and public schooling, which in England was controversial much longer than in the United States. He also was certain that antipoverty measures would not fatally undermine the competitive mechanism that was driving business to pursue greater productivity, which was something many people believed then. Some people believe it even today.

S+B: Another thinker whom you rescue somewhat from the past — and who built on Marshall's work — is Beatrice Webb. She doesn't feature much in most conventional accounts of the history of economics, and few people are likely to recognize her name, or realize that she was the inventor of the concept of the social safety net.

NASAR: Yes, the idea of the minimum wage, the notion that government policy could actually prevent poverty, starts with her. Many people today would call her a sociologist, but in her lifetime, she was regarded as an authority on economics. She took from Marshall the idea that one cause of poverty was poverty, and she worked out policy solutions.

She was a great empiricist. She wrote a book about poverty [*The Prevention of Destitution,* coauthored with her husband, Sidney Webb] that should be read today. What's brilliant about it is that it recognized that poverty was not a homogenous condition — that there are different kinds of poor people, who are poor for different reasons.

Webb showed that while some poverty would be eliminated through economic growth, other kinds of acute, short-term poverty are simply due to unemployment and could be cushioned by having either public works jobs or unemployment insurance. She saw that other kinds of poverty wouldn't be at all affected by the state of the economy — in particular, the kind of poverty that was passed on from one generation to another. She understood that this kind of self-reinforced poverty required a different kind of intervention.

The politics are rather surprising, because the first person who picked her brain and applied her ideas was the young Winston Churchill. The welfare state did not emerge after World War II; it emerged before World War I. And it was not a coup by the left, nor was it a product of bad times or a reaction to crisis. It was a product of Britain's boom in living standards, which enabled people to see that there was a process for eliminating poverty through growth, and that we could afford to speed it up.

Keynes and the Great Depression

S+B: The Great Depression is the other major drama in your narrative, with John Maynard Keynes and Irving Fisher playing large roles. What struck you most as you studied Keynes?

NASAR: I came to really admire his willingness to change his mind. Once one has said something publicly, such as "There's not going to be a recession," there's a human tendency to stick to your guns and keep defending your point of view. Keynes was different. He had a very acute sense of circumstances.

When you look at the world as it went into the Great Depression, you have to remember it was hap-

> "The welfare state was not a product of bad times; it was a product of Britain's boom in living standards."

pening in a different time frame in England than in the United States. At the beginning of the Depression, Keynes believed it was caused by monetary mismanagement, and that monetary intervention could cure it. His thinking about this, I discovered, had been heavily influenced by the work of the American economist Irving Fisher in the 1920s. So initially, Keynes was confident that if Britain and the United States went off the gold standard and reversed the deflation, that would end the Great Depression — which, of course, at first looked like just a really bad recession. Well, that didn't happen.

So Keynes came up with a theory explaining why it was possible for the economy to settle into an equilibrium in which it wouldn't repair itself. And in those circumstances, he showed why monetary policy might not work, and why government would need to supply the demand that the private sector couldn't generate. When you look at the chronology of events, you see that Keynes got there in a step-by-step fashion. He was in many ways very conservative; he wasn't a big government guy.

With the benefit of hindsight, and the subsequent research of Milton Friedman and Anna Schwartz, we can see that perhaps what Keynes thought was general was in fact more special and more particular to the circumstances of the 1930s. Again, the chronology is instructive, and it reinforced my sense that ideas really were important. People talk about the Great Depression as if it were a uniform malaise across the world, but it was not. The United States had a Great Depression, but it wasn't typical. The Scandinavians, the Japanese, the British — all the countries that went off the gold standard early — didn't suffer the same kind of extreme collapse. So that suggests, again, they were doing something different, and what they were doing was pursuing different monetary policies, and that experience supports Fisher's point of view in the 1920s.

S+B: Most people, if they've heard of him at all, probably know Fisher only for his famously incorrect forecast in October 1929, that stock prices had reached "a permanently high plateau."

NASAR: Irving Fisher was the quintessential American entrepreneur. You have to remember that the 1920s was a fabulous decade. Contrary to what people said after the stock market crash — that the 1920s were an economic mirage — it was in fact a fantastic decade for technological innovation, for the growth of important businesses and industries, and for productivity and wages. There was no inflation; the price/earnings multiple of the market in 1929 did not seem to be that high. So being upbeat about stock prices wasn't unusual.

But Fisher had so identified himself with the "can-do" school of

The global macroeconomic environment is not the main determinant of the success of companies, or even of countries.

American thought that it was difficult for him to realize what was happening.

Unlike Keynes, who had suffered some business reversals in his life, Fisher, bless his heart, had only seen things go up, both in the economy and in his personal affairs. His achievements were impressive. He was a pioneer in discovering the role that money played in the economy's stability or volatility, and in establishing the link between prices and unemployment. He created the idea of inflation indexing. As early as 1911, he had argued that a diversified portfolio of stocks was a better long-term investment than bonds. He invented the Rolodex to help himself keep track of his contacts and started a company to manufacture and promote it, which later became Remington Rand. He was also the leading wellness guru of the early 20th century.

S+B: So what should we learn about the usefulness of economics from the fact that one of the smartest and most creative economists of his time could be so spectacularly wrong?

NASAR: Well, you have to be careful about what you listen to. If what you listen to is that business managers should focus on making their businesses better, because that's what drives productivity and growth, then I think you're golden. I think one thing we've learned — and the lesson has been repeated recently — is that we can't predict the macro economy very well.

Another thing to keep in mind is that the global macroeconomic environment is not the main determinant of the success of individual companies, or even of countries. Because if it were — if that's what made the difference — then we wouldn't have the huge disparities in performance that we see, because everyone's sharing the same global environment. Why was Britain such a success? It's an island with no resources. Shouldn't it have been Russia? No, Russia was a basket case. You can compare countries that have been split apart: East Germany and West Germany, North Korea and South Korea. It seems to come down to the local environment, and the decisions that countries and companies make. What is important is whether or not you have an environment that encourages productivity growth, in which managers can focus on running their businesses.

Lessons of the Great Recession

S+B: What lessons can we learn from the policy experience of the Great Depression, compared with the recent Great Recession?

NASAR: Policymakers made a total mess out of the Great Depression. In both 1929 and 1936–37, the Federal Reserve made some disastrous decisions. We have learned quite a bit in the interim. True, the fiscal stimulus this time may have been poorly designed and too small. But on the other hand, the Federal Reserve kept the financial system from collapsing. Today's policymakers acted with a kind of conviction that was not possible in the 1930s, when the ideas of economists like Fisher and Keynes were very new. That conviction about what to do made action possible. You also had international cooperation instead of each government trying to solve its problems at the expense of its neighbors.

Nobody is going to be happy with the explanation that things could have been much worse if we hadn't learned these lessons from the past, or even with the fact that the U.S. actually did not have a worse recession than the rest of the world this time, and in fact is having a better recovery. But if you want to ask, Have we learned anything from economics, the answer is: Oh yeah.

Look at George W. Bush and Barack Obama. We think of them as being on different planets politically. But guess what? They did pretty much the same things in response to this crisis. They saw a situation in which the whole financial sector was shutting down, and concluded that the government had better do what it could on every front. And sure, it would be nice if it had worked faster or been cheaper, but economic policy worked. What we had was a recession that was in the same league as the recessions of the mid-1970s and especially the early 1980s, albeit somewhat nastier. But it was nothing in comparison to the Great Depression.

S+B: How do you view the political–economic debate in the U.S. today, where one party is urging a return to the pre-Keynesian, pre-Fisherian economic policies of the early 20th century?

NASAR: It's a lot of noise. It's like the people who, in the middle of the recession, were saying that this is the end of capitalism and we now have to do everything different. No, excuse me, let's not. People tend to talk about economic policy as though there is a blank slate. It's more like we are climbing a mountain, and the question is where do you take the next step. We are always going from where we are, even though the language of the debates suggests that it's all or nothing.

S+B: Here's another Keynes quote: "If economists could manage to get themselves thought of as humble, competent people on a level with dentists, that would be splendid." Do you agree?

NASAR: Yes. That's a great quote. Keynes had a very modest view of what economics could and couldn't do. He once offered a toast to "economists, who are the trustees, not of civilization, but of the possibility of civilization." He felt that the real trustees of civilization were the artists and philosophers of the world, and that economists could best help civilization by minimizing crises and setbacks, and ensuring that there was a continual rise in the standard of living. +

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