Article from

Innovators & Entrepreneurs

August 2019

Issue 68

The Case for Learning Economics History

Carlos Fuentes

"*I don't think most of Congress understands how economics works.*"

—Alexandria Ocasio-Cortez

Economics plays an essential role in politics, public policy, private opinion and the actuarial profession. Considered a science by many, economics is remarkable in that it is frequently invoked to justify almost any opinion, including those that contradict each other. Its forecasting track record, poor as it is, does not seem to raise basic questions about assumptions or methodology, and neither does the lack of explanatory power of many of its theories. Almost any other science considered respectable that reliably fails to explain or predict would be discarded. Yet, economics, like the phoenix, comes back to life after burning itself in an endless cycle. How can this be?

The answer has to do with perceptions about the complexity of economic theories and, more importantly, the prevalence of vested interests. The former is rooted in the impression that economic theories are the exclusive realm of the trained professional. The public, incapable of delving into the intricacies of this "science," the argument goes, should rely on the advice of experts. Are the key aspects of economic theories beyond the reach of non-economists? No. Most of the fundamental ideas that shape the economic discourse can be expressed in clear English, even if the minimally coherent maintains otherwise. The rest requires additional effort, but nothing beyond the abilities of a serious, non-specialist reader.

The latter—vested interests—explains the adulteration of cause-and-effect, a phenomenon worthy of sociological and psychological study, whereby theories are developed first and "facts" are coerced to fit conclusions that align with certain views. The role of vested interests in public policy and economics1 (or in what used to be called political economics) has been so prevalent that economists and non-economists alike have uncovered its modus operandi. Consider the following paragraph written by Sir Dudley North in 1691:2

For whenever Men consult for the Publick Good … they usually esteem the immediate Interest of their own to be the common Measure of Good and Evil. And there are many, who to gain a little in their own Trades, care not how much others suffer; and each Man strives that all others may be forc'd in their dealings to act subserviently for his Profit, but under the cover of the Publick.

An important consideration when embarking in a serious study of economics is how to approach the subject. When the goal is to understand the lay of the land, that is, to

develop a strategic view, there is no substitute for a solid grasp of key aspects of economic history. History shows how ideas originated in specific places at particular times and how they evolved. Learning about the lives of economists sheds light on the environment in which they lived, their interests, political views and even the level of honesty of their professed commitment to the truth.

We must be guarded against the natural condescension toward ideas advanced in the past, avoid the spurious belief that our modern world is the pinnacle of centuries of analytical thinking. Scorn for what we don't know but believe we understand explains to a great extent our ignorance on basic economic principles.

One area of economics closely related to actuarial theory, specifically to predictive models, is econometrics. Some may be surprised to find that techniques many consider innovative in actuarial sciences have been known to economists for decades. This means that by understanding the track record of econometrics, we are better able to assess the usefulness of predictive models. We can do more. We can find answers to the following questions: What are the most common econometric techniques? What are the areas where they have been applied successfully? What are their pitfalls? Where have they failed? If they failed, how can they be improved? Are actuaries developing new tools, improving over tools already understood by economists or "reinventing the wheel"? What other techniques can actuaries borrow from econometricians? Are there modeling tools, so far unknown to actuaries, that can be adapted to tackle existing problems and even problems that currently lie outside the actuarial realm? The answer to the latter question is a resounding yes.

Carlos Fuentes, FSA, FCA, MAAA, MBA, MS, is president of Axiom Actuarial Consulting. He can be reached at carlos-fuentes@axiom-actuarial.com.

1. One would think that a science is not affected by public interests. Maybe the economics is not as scientific as most people believe.
2. North, Sir Dudley. *Discourses Upon Trade*; *Principally Directed to the Cases of Interest, Coynage, Clipping, Increase of Money*. A Reprint of Economics Tracts . Edited by Jacob H. Hollander. (1691; repr. Baltimore: John's Hopkins University Press, 1907).