Book Review
Fifty Major Economist 2nd Ed.
(Lessons for Economists)

Author : Steven Pressman
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If someone wants to learn the history of economic thought as well as the contribution of the economists to real world development, then he or she has to read this book. The “Fifty Major Economist” brings the reader to understand not only the thinking of the economists, but also some aspects of their daily life as well as their struggle to make economics become a respected discipline in line with other social sciences.

In addition this book can also be an important source for policy formulations. For example, an understanding of the work of Thomas Mun (1571-1641), a respected member of the so-called “the mercantilist school”, can be used to understand the economy of Japan. The success of the Japanese economy in the second half of the twentieth century was achieved with the aid of economic policies that were mercantilist in spirit, even if not in intent. The Japanese government set high productivity standards -- like those of Mun’s suggestions for benefiting from trading with other countries -- that helped Japan become a producer of high-quality consumer goods. Economic success was also achieved by using tariffs and protectionism to stem import, while encouraging domestic firms to export goods.

Another example can be drawn by reading the life of David Hume (1711-1776). According to Hume, trade helped poor nations, but it did no harm to wealthier nations. Trade enables poor countries to grow and develop their standard of living would converge with that of their wealthier neighbors and trading partners. One mechanism that Hume identified as leading to converging living standards is the transfer of technology from more advanced to less advanced economies. As the recent examples of South Korea, Singapore, Malaysia, Taiwan and
Hongkong (all the "new Tigers" in Asia) show, advanced technology allows the living standard of less developed countries to rapidly approach that of more developed nations.

As to countries with high population growth like India, Indonesia and even China, following the advice of the Amartya Sen (1933- ), the 1998 Economics Nobel laureate lecture, putting emphasis on improving life expectancy, literacy, health, and the education level of people as a goal of their economic development is a must. For Sen, the development involves "expanding the capabilities" of people. Sen distinguished economic growth from economic development. Growth means producing more things regardless of what happens to the people producing and consuming these goods. Economic growth raises per capita income and output. Economic development makes people part of their community and allow them to appear in public without shame because they are regarded as worthwhile individuals. Sen might follow the view of Gunnar Myrdal (1898-1987) who brought sociological, historical, psychological, and political insights into his economic analysis. However, Myrdal is also critical of the methodology employed in orthodox economic analysis. Myrdal goes further in criticizing the social scientists in general and economists in particular, because they could not write and speak to ordinary people. Instead, professionals generally write and speak only to each other. This reduces the importance of social science scholarship.

This kind of criticism also comes from John Kenneth Galbraith (1908-2006). Galbraith regarded his fellow economists as "idiot savants" who can do sophisticated mathematical analysis but fail to understand the real economic world. Even in his Presidential Address to the American Economic Association (AEA), Galbraith criticized economists for ignoring power relationships. Economic thinking removes power from the realm of discourse by denying its existence and by assuming that the market will mitigate the power of the firm. Nonetheless many economists would probably claim that Galbraith is not really an economist at all looking at the wide range of his ideas and writings. However, his work on economic power and on the role of government policy as a measure to control the power of large corporation is very important not just for an economic analysis, but also for a policy formulation.

The most controversial figure is Joseph Stiglitz (1943- ). Not only about his criticism to the World Bank where he had worked as its Chief Economist previously, but also about his daily life. At the young age of
26, Stiglitz had become a full professor at MIT. The position was offered only on the condition that he would sleep in an apartment rather than in his office, and that he always wears shoes around the office. This reputation for eccentricity has grown, rather than diminished, over the years. When he served on President’s Clinton’s Council of Economic Adviser, 1993-1997, Stiglitz once showed up at the Cabinet’s meeting with his ties outside his shirt collar.

By reading this book, one would appreciate the achievement of Alfred Marshall (1842-1924) who succeeded in his struggle to separate economics from other social science discipline in 1903. The teaching of economics which started at Cambridge University in that year was soon followed by other universities in Europe. And from that time on economics has become a recognized discipline throughout the world. As a result, students throughout the world were able to major in economics, and to study the many concepts introduced by Marshall and other economists up to the present time.

This book is very good for readers who want to understand more about economics and the economists. Especially for someone who is interested in the history of economic thought. The “Fifty Major Economist” offers to the readers the development of economic thinking from the mercantilists up to the public choice school which brings economic analysis to the formulation of policies by government officials, the bureaucrats. The only disappointing part of this the book is the absence of indexes, both a name index and subject index. This makes it difficult for readers to trace certain names or subject matters.
Fifty years ago, Robert Solow published a seminal paper that until now has become one of the most important landmarks in the theory of economic growth. In the paper, he showed that while increasing investment ("capital deepening") in an economy will increase output per labor, this process will not go indefinitely. If the stock of capital per worker in the economy is low, adding an extra unit of capital will increase output by a large magnitude. But if the economy's capital stock is already large, an additional unit of capital will not yield the same rate of increase in output.

The situation is well-known as the diminishing returns to capital. Giving a worker a second machine does not make him twice more productive or double his output. Hence, according to Prof. Solow, keeping increasing investment is not the solution for long-term economic growth. The only thing that matters for the long-run is technological progress. The problem is that according to the Solow growth model, technological progress is exogenous. It's like manna falling from heaven; in other words, it is hard to define the right policy to sustain growth.

This book is about a series of studies that challenged the exogeneity of technological progress. The work culminated in a 1990 paper by Paul Romer (now at Stanford University), entitled *Endogenous Technological Change*, which was published in the *Journal of Political Economy*. Romer introduced a new kind of goods: "ideas." According to Romer, ideas are non-rivalry, which means everyone can 'consume' ideas (knowledge, invention, software, or even a cook's recipe) at the same time without taking away other people's utility. Compare it with, for example, bananas. If you eat my banana then you prevent me from consuming it.
Thus, when an idea is produced, it virtually costs nothing to reproduce it. An idea may be expensive to produce (think about how much it costs to produce a new software tool). But once it is produced, the total cost is the same no matter how many people use it. Hence, the marginal cost is declining; ideas exhibit *increasing returns*.

Under diminishing returns assumption, firms will not be too big. When a firm grows too large, the cost of producing an extra output is getting higher. There will be other firms that can sell the same product with lower cost. Hence, diminishing returns implies that the invisible hand theorem works perfectly in preserving competition.

But in the case of ideas, if other firms are free to enter the market, it is not worth investing in new ideas because the first entrance will bear all the cost of producing the new ideas. The rest will just be free riders. Unless idea manufacturers can enjoy some measure of monopoly over their ideas—by patenting them, copyrighting them, or just keeping them secret—they will not be able to cover the fixed cost of inventing them. So competition is not always good; it might end up in no one wanting to invest in new ideas. That is the message of Romer’s paper.

This book centers on Romer’s 1990 paper. It does not only explain what the paper was all about. It also tells the evolution on economic thinking prior to the paper being published, especially the riddle of increasing returns. The puzzle of increasing returns can be dated back as early as Adam Smith’s *The Wealth of Nations*. True, the book is well-known for introducing the concepts of the invisible hand, specialization and competition. But in the book, there is a story about the pin factory. According to Smith, the division of labor in a pin factory is “limited by the extent of the market” — the degree to which one can specialize depends on how much of one’s product can be sold. What does that imply? Warsh describes the implication on page 46:

*Suppose the pin maker gets into the market early, expands, and specializes in pin making by investing in new equipment and pin making R&D. He develops better steel, more attractive packaging, and more effective distribution channels. The bigger his market, the greater the specialization he can afford... the more efficient his production, the lower the price [of his pins]... the more pins he sells... the higher his profits: a greater return for the same effort, hence increasing returns to scale... Does that mean that big business is natural?*
So The Wealth of Nations is basically a tale of two stories: the pin factory which is about falling costs and increasing returns, and the invisible hand which is about rising cost and decreasing returns. The latter has been widely explored, but the former did not enjoy the same popularity.

In fact, the idea of increasing returns has been explored in separate discussions. In the late 19th century Alfred Marshall touched the idea of falling cost as being derived from the industry’s spillover effects (neighborhood effects or externality). Marshall’s successor at Cambridge, A.C. Pigou, argued that falling cost in an industry provides a justification for the government subsidy. Then in the 1940s, Edward Chamberlin, then at Harvard, was puzzled by the fact that products in the market are not necessarily homogenous, as predicted by the theory of perfect competition. They have brands attached to them: Chevrolet, RCA, Kelvinator, Quaker Oats, Gillette, and so on. He became convinced that “some such element of monopoly was virtually always present,” which he refer to as ‘monopolistic competition.’

The idea of falling cost enters the domain of international economics in the 1970s. This time it was Paul Krugman who raised the issue. He argued that, as Warsh wrote it in page 186:

If one country got a head start in mass production of some sophisticated good for which there were no near substitutes – cars, say, or airplanes or silicon chips – it may keep it. Specialization would lower unit costs. Others could find it impossible to break in.

The implication was that markets couldn’t necessarily be counted upon to “get things right.” ... there might be multiple equilibria ...

It takes fourteen chapters and 194 pages before Warsh’s story finally turns into the life of Paul Romer. His encounter with the idea of increasing returns started when he was a graduate student at MIT in the late 1970s – but he finished his graduate school at the University of Chicago. In the mid eighties he began modeling increasing returns in the growth theory context, based on the idea of monopolistic competition and spillover effects.

But in 1985, Romer’s teacher Robert Lucas a Nobel laureate) delivered the Marshall Lecture in which he mentioned about human capital spillovers as the source of increasing returns. Lucas’ speech on the one hand helped Romer’s idea enter the academic discussion. On the other hand, the lecture put pressure on Romer because he needed to differentiate his work from his mentor’s. Romer managed to publish an
article titled *Increasing Returns and Long-Run Growth* in 1986, which paved the way for his seminal 1990 article.

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The book is not a technical reading. It tells a story (and history) on how one single academic paper was published. As in many other great works or inventions, the output is not isolated from the other works. The book neatly tells the interconnections between the 'Romer 90' paper with the works of Adam Smith to Chamberlin to Krugman to Lucas to Barro, and even to the previous Romer's works. Not only with other academic works, the book also relates the paper with how the QWERTY typewriter layout was found, how Microsoft pioneered the software industry, and even the Microsoft court in the case of monopoly.

The author, David Warsh, is an economic journalist. *The Economist* described himself as a "veteran observer of dismal scientists (yes, it means economists) at work." Warsh was a regular columnist of the *Boston Globe*. Now he maintains an online column *Economic Principals* (www.economicprincipals.com).

As a journalist, his book contains a lot of interesting details. For example, in addition to writing about Romer's thoughts, he also writes the ups and downs of his career as an academic. At one point on his career he was so frustrated that he planned to quit academic world and join his father in politics.

In the preface, Warsh mentions that the secondary aim of his book is to "convey something about how economics is done today in universities "That is, the story about great ideas and great people in modern economics. Many inside story behind some great papers and important academic seminars are told in the book. In addition to that, Warsh also takes the readers to review changing approaches and methodologies of economics as a science from the philosophical-literary approach of the classical era, to the marginal revolution of neoclassical theory, to Keynes' macroeconomics invention, to the more mathematical-scientific approach of the modern days. There are also interesting stories on the rivalry between the 'saltwater' (Harvard, MIT, NYU, Princeton and others) and 'freshwater' (Chicago, Rochester, Pittsburgh and others) economists.

In short, this is a very interesting book to understand how the economist profession works. It is a "story of economic discovery," as the subtitle illustrates it.

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