Reserve Bank of India Occasional Papers
Vol. 45, No. 1 : 2024

My Journeys in Economic Theory by Edmund Phelps, 230 pp, Columbia University Press (2023), ₹2164

"My Journeys in Economic Theory," written by the Nobel Laureate Edmund Phelps offers a captivating memoir that delves not only into the intellectual evolution of the author, but also into the broader debates that have shaped contemporary economic thought. Phelps' engaging narrative and personal anecdotes, together with insights from his interactions with prominent economists of the century, such as John Rawls, Arthur Okun, Amartya Sen and Paul Samuelson, provide a valuable perspective. Influenced by the philosophers Plato, David Hume, and Henri Bergson, Phelps was convinced to major in Philosophy. However, engrossing textbooks and witty lectures nudged him towards economics. Dividing this journey in economics into eight chapters, Phelps provides an account of his ground-breaking works along with the recount of his academic life. Phelps' discussion extends beyond technical details, providing insights into the learned exchanges and lively debates that surrounded his novel ideas of unemployment theory, dynamism and indigenous innovation, among others.

In the initial chapter, Phelps explores his early career at RAND (Research and Development) Corporation, California where talented economists and mathematicians used to work on problems of national defence. The desire to join academia bought him back to Yale University where he started his career as an economic theorist. During this time, Phelps addressed the question of golden rule of saving and public debt. He published his widely read article "The Golden Rule of Accumulation" which showed that there could be too much savings, thereby challenging the contemporary notions. Phelps came up with his idea of *Fiscal Neutrality* wherein he addressed the contrasting Keynesian and Neoclassical views on public debt. The former says that public debt serves to pull up employment whereas the latter believes that public debt sets the capital stock onto a lower growth, ultimately decreasing employment. Phelps concluded that public debt adds to wealth but contracts investment, thus reducing the growth of wage rates and lifting up interest rates.

In the subsequent chapter, Phelps explicates his long endeavour to address the lacunae in contemporary economic theory. He discusses his theory of wage rate determination, the first such effort in macroeconomics founded on microeconomic principles, to examine the theoretical gap left unaddressed by Keynesian economics with regard to sticky wages. This is when Phelps realised that expectation of the changes in wage rates are important for determining the actual change. If these expectations are slow to adjust, wage rates will also adjust slowly. This notion not just underlined the role of uncertainty but also provided the missing link in Keynes' theory of depression. A further implication of this idea helped Phelps to build a model expounding how the rate of inflation depends upon the rate of unemployment and the expected rate of inflation. The model predicted that a loose fiscal policy pulls unemployment below its "warranted" or "equilibrium" level. However, high utilisation of the labour force today comes at the cost of high inflation in future, as inflation rate exceeds its expected level, introducing the concept of "equilibrium," or "natural" rate of unemployment.

Phelps argued persuasively for the role of imperfect information and costly communication with his theory of money wages, popularly known as the "Augmented Phillips Curve". It differed from Keynes' theory of constant money wage level and Phillip's postulate whereby money wages moved mechanically in accordance with the rate of unemployment. The model implied that an equal change in the actual as well as expected rates of inflation would have "neutral" effect on unemployment. This insight also gave rise to "inflation corrected Phillips Curve". This view contradicted the neoclassical view of the firm as a price and wage taker. The proponents of rational expectations critiqued this theory, arguing that economic agents are not fooled by short-run policy changes.

In the book, Phelps goes on to discuss his time at Centre for Advanced Study in Behavioural Sciences (CASBS) where he developed his *Unemployment Theory*. Here, Phelps presented various models of the economy to investigate the optimal fiscal and monetary policy. Phelps describes optimal policy as the one which pushes the expected inflation towards the level giving maximum sustainable benefit. As the desired rate of expected inflation is approached, the natural unemployment rate also converges towards its requisite level. Phelps believed that though his models could not deliver a workable monetary policy manual, his works came closer to it as compared to Milton Friedman (who advocated passive monetary policy) and Robert Lucas (who advocated leaving unemployment to rational expectations of the market). Phelps' novelty also lies in going beyond the analysis of standard neoclassical variables (labour, capital and land) and giving importance to the question of unemployment as well.

In 1971, Phelps started another phase in his academic career and took up a job at the Columbia University. He started exploring beyond growth theory and macroeconomics and found himself fascinated by the concepts of altruism and Rawlsian justice. Phelps organised a conference on the effects of altruism and morality in the economy with speakers like Kenneth Arrow, Paul Samuelson and James Buchanan wherein an intriguing finding emerged that altruism reduces inefficiency in resource allocation. In 1973, Phelps published "Taxation of Wage Income for Economic Justice," whereby he laid Rawlsian foundations for a theory of economic justice. In the spirit of Rawlsian justice, it argued for the maximisation of the rewards of the most disadvantaged worker. His model, like a profit maximising model of the firm, implied that the marginal tax rate on wage income of highest earners must be zero so that a small cut would not increase both, the government's tax revenue as well as the after-tax income of the highest earner. Here, optimal tax policy's aim was to collect maximum revenue.

In the 1980s, Phelps recounted his dissatisfaction with the theories prevalent at that time. He highlighted problems with Mundell optimal policy mix. To boost demand in the economy, the monetary authority is required to bring the actual as well as expected inflation rates to a desirable level. Similarly, to boost supply, the fiscal authority reduces tax rates on profits to increase investment demand or contract public expenditure to boost the supply of saving. In either case, the capital stock gets pushed onto a higher growth path, but it comes at the cost of increasing the public debt. This also creates a wedge between wealth and capital. If public debt continues to rise, it squeezes national saving relative to national income and ultimately decreases the capital stock relative to the national output. Phelps also critiqued the limitations of rational expectation hypothesis perpetuated by New Classical Economics.

In the decade of 1990, Phelps, analysing the reasons behind the economic slump in Europe in 1980s, developed a structuralist view, in contrast to

Keynesian view, in his *Structural Slumps: The Modern Equilibrium Theory of Unemployment, Interests and Assets.* In this work, he analysed the structural (non-monetary) forces affecting unemployment. The results received mixed reception. In 1997, Phelps' *Rewarding Work: How to Restore Participation and Self-Support to Free Enterprise* was published. In this work, he discussed the ideas of self-support and value of participation in work and how these were difficult to be attained by the disadvantaged workers. The book also called for employment subsidy.

The 2000s proved to be a fruitful decade for Phelps. In his 70th year, traditional *Festschrift* was organised in his honour which saw participation by eminent economists, such as James Tobin, Robert Lucas, Robert Solow, Bob Mundell and Gregory Mankiw. Paul Samuelson openly credited Phelps for taking the lead in introducing imperfect information and imperfect knowledge into macroeconomics. In an endeavour to develop a new theory, Phelps advocated "Dynamism Theory" which talks about innovation stemming from within a nation and the role of nation's institutions in imparting dynamism. The concept of dynamism implies that some countries acquire an ability to boost the performance of their workers which improves total factor productivity. However, Phelps failed to clearly and concisely distinguish his theory from that of Schumpeter's neoclassical approach to innovation. In 2006, after a long wait, Phelps' rich body of work finally culminated into a Nobel Prize.

In the ensuing decade, Phelps published *Mass Flourishing* which introduced the concept of indigenous innovation which drew on people's observations and experiences. The book talked about possibilities of life beyond working and savings which provided a spark to modern economies. Vitalism and adventurousness of people impart dynamism which leads to indigenous innovation and lifts countries out of poverty. In order to test the theory statistically, Phelps constructed an Index of Modernism and examined its relationship with Mean Job Satisfaction which came out to be positive in line with the thesis advocated in *Mass Flourishing*. Similarly, Index of Traditionalism showcased negative relationship with Mean Job Satisfaction. This lent credence to the notion that modern values impart dynamism to a country which ultimately leads to its economic growth.

This book offers a unique opportunity to its readers of being a witness not just to the long enriching journey of Edmund Phelps' life but also the intellectual underpinnings of various well-known concepts in economics. What sets Phelps apart from other theorists is the emphasis he lays on grounding his analysis in real-world scenarios while considering the complexities of human behaviour. His insights underscore the importance of fostering innovations and human capital development. His emphasis on wage-setter expectations and the "natural rate" of unemployment highlights the limitations of solely relying on monetary policy to address unemployment issues. Having said that, there are many more of Phelps' ideas which have still not been fully integrated into mainstream economic theory pending further development, indicating the vast potential and promise of his work.

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