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## **Edmund S. Phelps [Ideological Profiles of the Economics Laureates]**

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### **Abstract**

Edmund S. Phelps is among the 71 individuals who were awarded the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel between 1969 and 2012. This ideological profile is part of the project called “The Ideological Migration of the Economics Laureates,” which fills [the September 2013 issue of \*Econ Journal Watch\*](#).

### **Keywords**

Classical liberalism, economists, Nobel Prize in economics, ideology, ideological migration, intellectual biography.

### **JEL classification**

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### **Link to this document**

[http://econjwatch.org/file\\_download/759/PhelpsIPEL.pdf](http://econjwatch.org/file_download/759/PhelpsIPEL.pdf)

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## Edmund S. Phelps

by Daniel B. Klein and Ryan Daza

Edmund Phelps (1933–) was born during the Great Depression in Chicago. His father lost his job and moved his family to Hastings, New York. Phelps reflected on those years and how it helped him develop into an economist:

There were some clues in those formative years that I might become an economist. In the evening walks we took when I was four my father taught me to identify the automobile models we saw on the street. Later, at age seven or so, there was my admired survey of all the cats in the complex of apartments where we lived. A few years later I liked to spend the late afternoon by the main road recording the distribution by state of the license plates of the cars passing by. My kindergarten in Chicago was for gifted children, which my mother only recently mentioned (figuring, I guess, that it would now be safe to tell me). I did very well in school. My parents gathered from all this that I would be some kind of researcher, but it was not clear in what area. No economics was offered in high school (nor sociology or political

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science in those edgy post-war years). Bored, I spent increasing time with music. Nevertheless I did devour the newspapers my father brought home each night from the city that so excited my imagination. The financial and economic news was a staple of dinner-time conversation. My father had majored in economics and my mother in home economics—also clues, perhaps. (Phelps 1995, 90)

In high school, Phelps had a fancy for music. He took a course in “creative writing” that was his “first experience at inventing a fictional world, a kind of modeling” (Phelps 2007). Phelps eventually realized that a career as an artist would not be promising and explored other fields in college (*ibid.*).

Phelps entered Amherst College in 1951 thinking he would gravitate towards a money-making major, like business. He took a variety of courses including philosophy, which led him to read Plato, David Hume, Henri Bergson, and William James. He was “awestruck” and fully expected to become a philosophy major until his father cajoled him to take a course in economics (Phelps 1995, 90-91; 2007). Phelps found economics to be just as interesting and more practical (Phelps 2009a, 109). As an economics major, Phelps read and admired Paul Samuelson’s *Economics* textbook. He met and became acquainted with Samuelson and his work (Phelps 2007).

For graduate studies Phelps attended Yale. He speaks of his experience there:

At Yale, it is fair to say, the current of Keynesian economics ran very strongly even in the 1950s, when Yale was full of intellectual diversity. What I learned from the leader of the American Keynesians James Tobin, who very generously gave me an individual reading course, and, in my last year, from the young Arthur Okun became an important part of my toolkit—something I was to build on and to modify. Tobin was stunningly intelligent. . . . And he was self-deprecating to a fault—not an ideal role model for those of us who would be joining the theory wars. Yet I think those who admired Jim greatly, which I did, also could not help noticing an unreasoning conviction in some of Jim’s beliefs about the economy’s workings. (Phelps 2007)

After Yale, Phelps took a job at RAND for a year before returning to Yale as a member of the Cowles Foundation and then to the University of Pennsylvania. He joined Columbia University in 1971 where he has been, on and off, since, a professor of political economy and the director of the Center on Capitalism and Society. Phelps won the Nobel Prize in 2006 “for his analysis of intertemporal tradeoffs in macroeconomic policy,” and his work was credited for having

“deepened our understanding of the relation between short-run and long-run effects of macroeconomic policy”(Royal Swedish Academy of Sciences 2006).

A review of Phelps’s professional contributions is provided by Gylfi Zoega (2008) in the *New Palgrave Dictionary of Economics*. Perhaps the most remembered of Phelps’s works is his 1967 article on the Phillips curve, which challenged the theoretical underpinnings of the notion of a stable tradeoff between unemployment and inflation, along lines independently developed but similar to those of Milton Friedman (1968). The experience of the 1970s seemed to confirm their challenges, and professional opinion about an unemployment-inflation tradeoff moved in their direction (Hoover 2008).

In our efforts to understand Phelps’s ideological character, we come to the conclusion that he is strikingly independent in resisting some influences from his academic background and surroundings, that he is comfortable in being ideologically unsettled, and that he seems to have a significant classical liberal streak, a streak that comes forward perhaps particularly with his 2013 book *Mass Flourishing*. We admire Phelps for the way he not only faces up to the fact that ideological judgments necessarily entail large philosophical, moral, and cultural issues, but he directly addresses such issues—he strives to bring them into the works undertaken to inform and instruct our judgments.

Phelps approaches the big issues with a concern for the justness of the actions of those who make or reform the rules of society. Phelps says that social justice is a “huge area of interest” of his (Phelps 2009a, 119). At one point, his office was adjacent to John Rawls’s, and Phelps has called himself a Rawlsian (Phelps 2007). He elaborated in a 2009 interview:

I came under the influence of John Rawls (1971). I was quite taken with his idea of maximin: that economic justice involves making the portion going to the person earning the least as high as it can be. I was just curious to see how that would play out in a mathematical model of taxation. At another level, I saw that Rawls was being portrayed in a distorted manner by people who wanted to use him for their causes. Some people wanted to use him as grist for their platform of egalitarianism, while I thought that what was interesting and especially distinctive about Rawls was that, yes he was in a sense an egalitarian, but he was paradoxically an egalitarian who was willing to tolerate a lot of inequality for the sake of those at the bottom of the heap. He was interested in the *absolute* rewards to the people at the bottom, not their relative rewards. I was fascinated when I stumbled on the result that the marginal tax rate on the last dollar of income of the highest earner should be zero because to leave it at some number above zero would

mean foregoing the opportunity to cut a deal with that earner to work a little more in return for a cut in the marginal tax rate on the last dollar. In a way, I was showing people: don't think that with Rawls you're getting egalitarianism. If you've read his book, he's really saying that he wants to deploy incentives to increase the amount of tax revenue in order to have the largest amount of funds possible for subsidies to lift up the contributors to the economy at the bottom of the heap. I thought I was serving to clarify things. (Phelps 2009a, 119-120)

He continued:

I always had an interest in justice and fairness, even as a high school student and certainly in college. But Rawls (1971) was almost the only piece of work that was a systematic examination of what we might mean by economic justice. It was this that got me going. Until then I was interested in the subject but my interest had been confined to providing people with social entitlements to provide for basic needs if they couldn't provide for them themselves. (Phelps 2009a, 120)

But Phelps's ideological tendencies do not conform neatly to the interventionist, social democratic outlook of most Rawlsians. Some of his responses to Karen Horn's questionnaire (Horn 2009) show other strains in his thinking:

*What is the worst economic policy error that you can remember?*

Russia's adoption of Communism after the Revolution, the rise of fascist political economy in Italy and Germany in the thirties, and China's Cultural Revolution. (Phelps 2009, 278)

*Please name a politician that you admire for his/ her good hand in economic policy.*

Ronald Reagan had some very important gifts and insights. Much earlier, Theodore Roosevelt made pioneering moves in the direction of regulation, and Franklin D. Roosevelt did important things for capitalism by means of investor and consumer protection. In Europe, Ludwig Erhard and Margaret Thatcher come to mind. (ibid.)

*In your mind, what has been the most misleading theoretical approach in economics?*

So-called Keynesian economics in the period after World War II proved to be extremely misleading and misguided. Just like supply side economics, on which the jury is still out, it swept in to influence

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without anybody having a chance to sit down and think about the merits and demerits. (ibid., 278-279)

*What was the most important theoretical breakthrough?*

Of course, Adam Smith brought about a breakthrough. It is impossible to exaggerate his importance. Also, in the 20th century, the theories of John Maynard Keynes and Friedrich Hayek. (ibid., 279)

*Who is your favorite economist today?*

My friends Amar Bhidé and Roman Frydman, here at Columbia. Beyond them, of course, my all-time favorite is Paul Samuelson. (ibid.)

*Who are you most indebted to intellectually?*

Probably my teacher at Yale, William Fellner, a Hungarian who had come over in 1939. He was a walking repository of all 20th century knowledge. He had the biggest intellectual influence on me. (ibid., 280)

*Who was your role model?*

Could be James Tobin, could be Paul Samuelson. (ibid.)

In another interview, Phelps was asked “*Who is your favorite economist?*” Phelps responded: “I think it must be Hayek. I also admire Keynes, but I do not like his arrogant and anti-business views” (Phelps 2009c, 48).

In his 1997 book, *Rewarding Work*, Phelps makes a case for subsidizing the employing of low-wage workers, and, as stated in an interview, he offers a “free-market” solution. The interviewer then asked if he was a “devout free-market economist.” Phelps responded:

No, that wouldn’t be fair to say at all. The point of my book is that this country has a misguided tendency to be loyal at all costs to free-market principles. There are cases, however, where you have to make exceptions, where it would be wise to deviate from the free market, and low-wage employment subsidies is one of those cases. (Phelps 1997, 17)

He concludes, however, by saying: “I think there should be a presumption in favor of no intervention in most cases” (Phelps 1997, 17).

In a 2009 interview, Phelps remarked on having written a paper with John Taylor (Phelps and Taylor 1977), stating: “Later I regretted writing that paper a little bit because it seemed to put me in the camp with the Chicago school. It might have been interpreted as showing that I had gone over to the Chicago school with

its rational expectations. In fact, the rational expectations approach was not at all congenial to my way of thinking” (Phelps 2009a, 115).

In a 2013 interview, Phelps explained his critique of rational expectations, a critique developed in a book edited with Roman Frydman, *Rethinking Expectations* (Frydman and Phelps 2013):

I am far from being the only economist who has critiqued the premise of rational expectations. I’m just the main victim, since that approach drove people away from my approach—from my emphasis that expectations are a driver of what happens in modern economies. Several economists saw that the emperor has no clothes. Oskar Morgenstern explained that rational expectations would be untenable in the modern world, and Friedrich Hayek got the point. (Phelps 2013a)

At the end of the interview, Phelps had a message for policy makers:

I would tell them not to assume they have hit upon a model that captures expectations so they don’t need to think about expectations anymore. Expectations are a living thing and flighty; beliefs are flimsy, as Keynes said. The Fed is banking that expectations will behave according to the model the Fed wants people to adopt. But no central bank or anyone else should bank heavily on the correctness of its model. Expectations will almost certainly surprise the Fed and surprise Wall Street, too. Furthermore, the Fed model doesn’t allow for animal spirits in Silicon Valley or evil spirits on Wall Street. It can’t know about those things. Washington is banking on a best-case scenario to bail it out of the entitlements mess in the 2020s. The world is still in a crisis. Not a hospitable place for models based on rational expectations. (Phelps 2013a)

In a 2009 interview, Phelps responded to a question that asked if the recession validated such reservations, answering: “Yes, I think that the current crisis underlines the impracticality of rational expectation in an economy whose future is unknown. We need models which take into account future uncertainty and the potentiality of unfulfilled expectations” (Phelps 2009c, 46).

In 2010, on the government response to the recession, Phelps said:

The steps being taken by government officials to help the economy are based on a faulty premise. The diagnosis is that the economy is “constrained” by a deficiency of aggregate demand, the total demand

for American goods and services. The officials' prescription is to stimulate that demand, for as long as it takes, to facilitate the recovery of an otherwise undamaged economy—as if the task were to help an uninjured skater to get up after a bad fall.

The prescription will fail because the diagnosis is wrong. There are no symptoms of deficient demand, like inflation, and no signs of anything like a huge liquidity shortage that could cause a deficiency. Rather, our economy is damaged by deep structural faults that no stimulus package will address. (Phelps 2010a, 17)

Phelps was asked in a 2010 interview: *“The current administration has announced greater regulation and stricter game rules for the financial sector as a way to fight against the root of the problem. Do you believe there is a risk that stricter rules may deprive the financial sector of its flexibility at the expense of innovation and investment?”* He responded:

I do not care if stricter rules deprived the financial sector of some opportunities for *financial* innovation. The social value of these financial innovations is overestimated. For several years now the banks have shown little interest in lending to businesses for innovative projects. However, I am worried that a range of tough regulations on the banks might end up depriving us of a financial sector that can supply credit for *business* innovations. It is highly desirable to avoid instituting redundant and overly stringent regulations. (Phelps 2010b, 57)

In 2009 Phelps said he was making ongoing efforts to justify “capitalism”:

Since 2002, I've been trying to develop a new justification for capitalism, at least I think it's new, in which I say that if we're going to have any possibility of intellectual development we're going to have to have jobs offering stimulating and challenging opportunities for problem solving, discovery, exploration, and so on. And capitalism, like it or not, has so far been an extraordinary engine for generating creative workplaces in which that sort of personal growth and personal development is possible; perhaps not for everybody but for an appreciable number of people, so if you think that it's a human right to have that kind of a life, then you have on the face of it a justification for capitalism. There has to be something pretty powerful to overturn or override that. (Phelps 2009a, 121)

*Mass Flourishing: How Grassroots Innovation Created Jobs, Challenge, and Change* (Phelps 2013b) would seem to be part of these efforts. The book addresses “the



prosperity of nations,” arguing that it grows out of personal “flourishing” and “broad involvement of people in the processes of innovation” (ibid., vii). Phelps explores the spiritual condition of human existence, with ample allusions to major philosophers and their ideas, and he explores different systems of societal values.

From a policy viewpoint, *Mass Flourishing* comes across as the expression of a man who is deeply troubled about trends in values and in political organization, where he sees a rise of “corporatist influences” (Phelps 2013b, 165) and warns of policies that benefit “cronies” of government officials (ibid., 178, 254). The book gives extensive attention and high tribute to Hayek. Phelps does not seem to come out and say clearly that corporatism and cronyism are necessary concomitants of the increasing governmentalization of social affairs, but that idea—which could follow from ownership and knowledge problems inherent in governmentalization—certainly helps one to make sense of Phelps’s discussion. The book also gives extensive attention and high tribute to Rawls. It is reasonable to view the book as quite aligned to the efforts of John Tomasi, the author of *Free Market Fairness* (Tomasi 2012), who proposes to marry Hayek and Rawls, saying that social justice demands a largely free-market, presumption-of-liberty stance in public policy. That Phelps is not as firmly classical liberal is clear from passing remarks of interventionist flavor (e.g., at Phelps 2013b, 82, 322) and from a tepidness and scantiness of concretes in the delivery of his message. But the overall drift of the book, in regard to policy, is to object to anti-classical liberal trends in culture and politics. The following quotations are illustrative of the main drift:

With the rise of stakeholderism, anyone deciding to start up an innovative company would have to expect that its property rights would be diluted as it copes with an array of figures—its own workers, interest groups, advocates, and community representatives—who ardently believe they have a legitimate “stake” in the company’s results. (Phelps 2013b, 315-316)

It is far better to leave the directions of the economy to the competition of the market, since the state does not have the knowledge or judgment to improve efficiency of the market’s allocation of investment. ... In general, public policies and all the governmental institutions and practices of the corporatist economy must be shrunk and some of them terminated. (ibid., 320)

Labor unions and professional associations are capable of raising uncertainties for anyone contemplating an innovative venture. ... The

lawsuit of the U.S. government against Boeing for opening a plant in a right-to-work state must give pause to innovators. (ibid., 322-323)

In the final paragraph, Phelps writes:

The haze of regulation and pork barrel contracts could be curbed so that businesses across the economy would once again have the freedom and incentive to attempt innovation. Fiscal responsibility could be reestablished to allay business fears that profit from innovation would be taxed away. (ibid., 324)

Phelps has not been active in signing petitions; we know of his signing only the “Purple Health Plan” (Kotlikoff 2011).

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## Christopher A. Pissarides

by Daniel B. Klein, Ryan Daza, and Hannah Mead

Born in Cyprus, Christopher Pissarides (1948–) grew up in a relatively well-off family in a mostly rural community. Pissarides discussed his decision to study economics: “Like many well-off Cypriots, I went to London to study for a degree in economics. I wanted to study architecture, but because of my father’s business my parents persuaded me to try economics or accounting. My love at school was mathematics, but it was not considered to be a good profession for a young man, with which I agreed. When I tried economics I liked it, so I decided to pursue my studies in it” (Pissarides 2011a).

One event that changed Pissarides’s life was the student protests that erupted in the late 1960s at Essex. Pissarides reflected: “In the late 1960s, when I was an undergraduate student, Essex became active in the student uprisings that characterised the times. In 1968 student political activity became particularly intense, and although I was never very active, the liberal attitudes of the time had a lasting