

# The enduring relevance of the model Platonism critique for economics and public policy

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**Abstract:** The article briefly introduces Hans Albert and the basic elements of his critique of neoclassical economics as a form of ‘model Platonism’. The two most important elements of his general methodological critique of economics – namely the institutional vacuum inherent in much economic modelling and its unrealistic assumptions about behaviour – are introduced. It is argued that these specific critiques have been taken up with varying degrees of success in areas of economic research such as institutional economics and in behavioural and experimental research programmes. However, the fundamental methodological gist of his critique remains as pertinent to mainstream economics as it was when originally formulated. The influence of ‘model Platonic’ thinking remains pervasive in academia and also in public policy.

Hans Albert was born in Cologne, Germany in 1921. He is one of Germany’s most distinguished philosophers of science and one of the world’s leading critical rationalists, yet much of his work remains unknown to the English-speaking public. Besides his contribution to the positivist dispute in German sociology (Adorno *et al.*, 1969, 1976),<sup>1</sup> his two main works available in English translation are the *Treatise on Critical Reason* and a compilation of essays entitled *Between Social Science, Religion and Politics* (Albert, 1968, 1985, 1999). His seminal article on ‘model Platonism’ (Albert, 1963) has until now been unavailable in English. The publication of the translation of it in this issue of the *Journal of Institutional Economics* finally introduces this influential piece of particular relevance to economics (Albert, 2012). It facilitates a better understanding of Albert’s work and thought and provides a criticism of a certain type of economic

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We would like to thank Viktor Vanberg and Geoffrey Hodgson for valuable comments on an earlier version.

<sup>1</sup> The 1976 edition is the English translation of the earlier 1969 German edition.

reasoning that is still prevalent in economics and continues to influence public policy.

In this important article, Albert attacks the ‘model Platonism’ of neoclassical economic thought; that is, he attacks neoclassical theory for its construction of fundamentally non-testable, hence Platonic-like, theories. This is part of a general criticism of the institutional, motivational and cognitive vacuum within which neoclassical thinking operates.<sup>2</sup> This contribution to the methodology of economics appeared for the first time in 1963.<sup>3</sup> Since then the article has been reprinted several times with slight modifications only.<sup>4</sup> There is only one aspect of the paper, namely the discussion of consumer theory, that Albert elaborated and expanded on in a separate contribution later on.<sup>5</sup>

‘Model Platonism’ offers an incisive critique of (neoclassical) economics from the perspective of critical rationalism. This criticism is two-pronged. On the one hand, Albert faults neoclassical theory for its refusal to integrate social scientific research, especially from social psychology and sociology. Its pervasive use of the *homo oeconomicus* model for describing human behaviour is one of the most obvious examples of this. On the other hand, he opposes its attempts to insulate itself from the possibility of being falsified by immunizing its theories, for example, by the use of *ceteris paribus* clauses. In other words, it posits its theories as applicable only under rather strongly qualified conditions. Consequently, when a hypothesis seems to be refuted, one can simply claim that the theory is inapplicable to the case at hand. The validity of the hypothesis is thus purchased at the cost of its empirical content. The alternative to ‘model Platonism’ that Albert envisions for an *empirical* economic science is one that is both sensitive to the social sciences and humanities and formed in relation to facts. Specifically,

2 See Albert (1979: 20), where he criticizes Walrasian general equilibrium theory, and also Albert (1984: 57ff).

3 It should be noted that there is quite some precursory work to this seminal piece. Albert, influenced by Popper, had been working for some time on his sociological view of economics, criticizing pure neoclassical thought. His original habilitation on the subject matter, however, failed to be understood and accepted by the economic faculty of the University of Cologne, delaying Albert’s academic career as professor by several years. Besides this substantive work, Albert (1959) and Albert (1960) also contain French and English summaries. Albert (1961) and Albert (1962) can be considered important preparatory work to the 1963 piece. Albert continued to work on this topic, leading to a series of articles published over the years that are of relevance to his critique of neoclassical economics. See, for example, Albert (1978), Albert (1979), Albert (1980) and Albert (1984).

4 The article was last republished as chapter IV ‘Modell-Platonismus. Der neoklassische Stil des ökonomischen Denkens in kritischer Beleuchtung’ in Albert (1998). While the article as such remains unchanged, Albert added an Annex entitled ‘Walter Eucken, the great contradiction and the thinking in models’ (original: ‘Walter Eucken, die große Antinomie und das Denken in Modellen’) that is not translated here since it was not part of the original version and a discussion of Walter Eucken’s methodological conceptions does not appear of general pertinence today, in particular in an English-speaking context.

5 See chapter VI ‘Bedürfnisstruktur, Konsumnachfrage und Sozialprozeß. Die neoklassische Lösung und das ökonomische Erkenntnisprogramm’, in Albert (1998).

he calls for a fundamentally more empirical approach to economics that reflects the connection of economic thinking to the historical and socio-cultural milieu out of which it arises.

Since the first appearance of the article in German, the discipline of economics has undergone substantial changes. Important institutional challenges have been taken up by burgeoning research in new institutional economics, public choice, new political economy, constitutional political economy, and law and economics. These developments are apparent in the works of Nobel laureates James Buchanan, Ronald Coase, Douglass North, Elinor Ostrom and Oliver Williamson.

The behavioural challenges have been taken up, very much in line with Albert's 'hypotheses', by a closer integration of psychology, particularly social psychology and behavioural economics on the one hand and an experimental methodological focus within economics on the other. The 2002 Nobel Prize for Daniel Kahnemann and Vernon Smith recognized these two developments in economics. Reinhard Selten, who had already received the Nobel Prize in 1994 for his game-theoretic works, is another important pioneer of such behavioural and experimental economics.

While these immense developments provide an alternative to the 'model Platonic' economic research programme, the fact that these branches of economics are now integral parts of the discipline does not imply that Albert's work in general, or more specifically the article available in an English translation in this volume of the journal, has lost its relevance to economics. On the contrary, many economists, both in academic and public policy functions, have failed to take heed of these developments.

In fact, 'model Platonic' forms of thinking continue to play a pervasive role in public policy. This is true for many policy areas, such as antitrust. Milton Friedman (1953) already considered the discussion of the proper foundations of economic models irrelevant, emphasizing that the value of models has to be measured not by the properties of their assumptions but by the empirical success of their predictions.<sup>6</sup> The repercussions of this approach are, for example, apparent in a very influential book setting out the 'Chicago' perspective on antitrust.<sup>7</sup> Robert Bork suggests that price theory is sufficiently strong so that

6 The 'as if' excuse according to which 'market forces' will inevitably lead economic actors to behave 'as if' they were maximizing profits, for example, completely detracts the focus from the relevant questions, including the question under what specific set of conditions actors may in fact *ex post* be characterized 'as if' they had maximized profits *ex ante*. Without knowledge of such conditions, any eventual predictive success of rational choice models is unreliable. Albert, at the very least, would agree with Herbert Simon's view that 'unreality of premises is not a virtue in scientific theory; it is a necessary evil' (Simon, 1963). Stiglitz (2002), similarly concerned about the assumptions regarding actors in economic models, points out that the fact that 'such models prevailed, especially in America's graduate schools, despite evidence to the contrary, bears testimony to a triumph of ideology over science'.

7 See Bork (1993) and in particular chapter 6 entitled 'The Method of Antitrust Analysis'. While Bork emphasizes that he is applying an empirically validated model, even claiming that his suggestions are

difficult empirical investigations of antitrust cases – for instance in the form of an efficiency defence – are unnecessary and can be avoided. He effectively embraces a deductive system whose axioms provide the answers; and any event not included in the axioms will either not happen or will be irrelevant.<sup>8</sup> This ‘model Platonic’ approach to antitrust set the stage not only for a series of questionable court decisions in the USA but it also continues to influence thinking about antitrust policy worldwide. The substance of Albert’s criticism is thus of considerable importance to policy makers in antitrust but also in other domains that continue to operate under the spell of the abstract beauty of ‘model Platonic’ reasoning.

The fact that the economics profession was caught unawares in the long build-up to the 2007 worldwide financial crisis and substantially underestimated its dimensions once it started to unfold can be attributed to two factors directly linked to ‘model Platonic’ reasoning: first, the lack of an empirical motivation in the essential modelling assumptions, combined with questionable *ceteris paribus* assumptions; and second, a blatant disregard for the complete absence of the empirical fit of macroeconomic research. Indeed, the deeper roots for this are found in what has been termed the ‘systemic failure of the economics profession’<sup>9</sup> to design models that take into account key elements that drive economic outcomes in real-world markets. Half a century of research that conveniently disregarded essential institutional and behavioural characteristics of the markets that it supposedly modelled has left its (hardly surprising) imprint on financial market regulation and ultimately on the world economy.<sup>10</sup> Instead of letting theories die,<sup>11</sup> economists preferred experimentation on a worldwide scale.

Similarly to Bork’s aprioristic approach to antitrust, by definition assumptions such as the efficient markets hypothesis of the new classical and new Keynesian approaches in macroeconomics rule out the possibility that asset prices will not fully reflect all the relevant fundamental information (Buiter, 2009; Krugman, 2009). Despite abundant evidence to the contrary, the notion continues to be

based on ‘a few empirically supported postulates’ (1993: 117) and that ‘[i]n many cases the [economic] theory is so well grounded that we can be certain, or virtually so, of its reliability’ (1993: 117), it is a nearly perfect example of the impact of model Platonic thinking on public policy questions. Bork concedes that it may make ‘some people uneasy to have to rely entirely upon theory to infer the nature of a reality that is not directly observed. Yet I am convinced both that the theory is good enough to make the task doable, and, equally important, that there is no other possible way to proceed.’ (1993: 122). Indeed, Bork not only shows faith in an aprioristic theory but also rejects the possibility of gaining insights for antitrust empirically as ‘the relevant ultimate facts for antitrust purposes cannot be perceived directly or quantified’ (1993: 130).

<sup>8</sup> See Davidson (2011) for a more detailed critique of the ‘Chicago’ impact on antitrust.

<sup>9</sup> See Colander *et al.* (2008), who also state that ‘self-reinforcing feedback effects within the profession may have led to the dominance of a paradigm that has no solid methodological basis and whose empirical performance is, to say the least, modest. Defining away the most prevalent economic problems of modern economies’, the economics profession bears responsibility for the crisis.

<sup>10</sup> Most current dynamic general equilibrium models, for example, would have to rely on some form of an *ad hoc* assumption to replicate a crisis, for instance, by assuming a substantial external shock.

<sup>11</sup> See Popper (1997: 7) ‘By criticizing our theories we can let our theories die in our stead.’

prevalent that if a model does not correspond to reality, this does not so much speak badly for the model as for reality.

A major reason why developments in the direction of ‘model Platonism’ were possible in the first place is the profound ignorance of epistemological and methodological thought, closely linked to the lack of training in this area still typical in the field of economics. Indeed, many continue to affirm the statement attributed to George Stigler that ‘it is a folly to become concerned with methodology before the age of sixty-five’ (Buchanan, 1964: 213). This may in part explain why economics still has not become an empirically oriented science or *Realwissenschaft* as Albert calls it.

In conclusion, while the behavioural and institutional vacuum in the field of economics that Albert rightly identified in the 1950s and 1960s has in the meantime been partly filled, Albert’s article remains relevant. Despite the fact that economists have begun to integrate behavioural and institutional approaches, at least in some areas, there remains an acute need for a basic epistemological understanding of what theory construction is and how economics as an *empirical* science can be developed. An orientation towards a more empirical approach is warranted.

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