

# Macroeconomics cannot be based on microeconomics

<https://www.taxresearch.org.uk/Blog/2024/08/22/macroeconomics-cannot-be-based-on-microeconomics>

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In this morning's video, I note that macroeconomics suggests how governments work. But at present, it's almost all based on microeconomics, which is about how individuals, households and companies work. But that's absurd when micro-entities and governments are completely different in terms of purpose, goals, and the tools available to change outcomes. No wonder we're in a mess.

<https://www.youtube.com/watch?v=VSVix0vSfI0?si=LOIxReQBMPtISbv->

The audio version is here:

[https://www.podbean.com/player-v2/?i=7xjej-16ab256-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=8bbb4e&font-color=&logo\\_link=episode\\_page&btn-skin=ff6d00](https://www.podbean.com/player-v2/?i=7xjej-16ab256-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=8bbb4e&font-color=&logo_link=episode_page&btn-skin=ff6d00)

The transcript is:

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It's no surprise that the economics used by governments don't work. That type of economics is called macroeconomics, where macro means big. The alternative type of economics is microeconomics, where micro unsurprisingly means small.

Now, microeconomics is where most economists think that economic truth is to be

found, but microeconomics is an absurd study both in the way in which it's undertaken and the way in which it is taught and the way in which it describes human behavior.

It assumes that we are maximizing human beings who are totally rational and, quite absurdly, that we know everything about our futures, on which we can, therefore, make totally informed decisions.

All of this is, of course, nonsense. And I know that many economists say that as they advance through their subject. They try to relax some of these assumptions to see whether they hold true or not in particular circumstances.

But the truth is, there is almost no major study in economics that is published these days that does not assume that we are rational, that does not assume that we try to maximize our incomes and well-being, which is almost always expressed in monetary terms, and there is almost no study that assumes that we have imperfect information about both our present and our future.

In other words, microeconomics is built on completely irrational foundations. As a consequence, it prescribes things like, markets are great, people are profit maximizers, and we're indifferent to the consequence of our actions on other people, which don't matter to us because who cares what they're about? It's only our well-being that matters.

That microeconomics is then assumed by the vast majority of macroeconomists, who are those who look at the economics of nation-states and governments, to be the foundation on which that macroeconomic theory should be built. So, you take a pile of garbage and you build the whole of another subject on the basis of that pile of garbage. And that's what most of macroeconomics is. I don't believe in that macroeconomics.

I don't even believe it is possible to build macroeconomics on the basis of microeconomics, because to do so is utterly illogical, even if we could find some rationality in that microeconomics on which macroeconomics was built.

Why is that? Well, because the whole of macroeconomics looks at a totally different issue from microeconomics. Microeconomics is about the individual, the firm, or the business. Fundamentally, a tiny worldview.

Macroeconomics has to be about a whole world view, or at least that of a nation-state, and maybe how the nation-state fits into the world as a whole.

In other words, in macroeconomics, those things that microeconomics can completely ignore, like the externalities that our behaviour creates - things like pollution, things like the ill health created by many of the activities undertaken by a lot of companies producing things like alcohol, tobacco, and ultra-processed food, and so on - macroeconomics has to consider those consequences, even though microeconomics

says it's quite rational to ignore them. So, if we build macroeconomics on the basis of microeconomics, we compound the errors in microeconomics by pretending that it is somehow rational to continue to ignore all those externalities which microeconomics ignores. Those things that I've just described, the consequences of pollution, and alcohol, and tobacco, and ultra processed food, and whatever else you wish. My point is that, of course, we know that at a macro level, we can't do those things, or rather, we now know that if we do those things, the consequences are extreme.

We're seeing it with regard to the weather and climate change. The world is getting hotter because we ignored the consequences of our microeconomic behaviour in burning vast amounts of carbon. It will take decades to reverse that consequence, even if we can.

And we're seeing the same with regard to things like ultra-processed foods and the use of sugar in excess. The consequences are all around us. People are getting obese. People are getting diabetes. There is more Alzheimer's and dementia because it is believed that that is influenced by the excess consumption of sugar and on and on and on.

Government has to manage those consequences and to build economic theory about that management process on the assumption that we do not need to consider those outcomes is absurd. And yet, when we listen to government ministers talking about policy, it is as if they want to ignore those externalities.

Look at Wes Streeting when he talks about the NHS. He wants to manage healthcare, he says. He wants to manage demand for it. He wants to do that to limit costs because that's a microeconomically rational thing to do.

But he does not talk about how he is going to manage excess alcohol consumption, even though it most definitely has an impact upon depression and obesity and so many other things. He doesn't talk about tackling big sugar, even though a great deal of the demand for the services of the NHS are now driven by that, given that tobacco has, to some degree, been beaten.

He doesn't, therefore, consider the economics that he should be appraising when considering how to manage the NHS. He's still in a microeconomic framework, presuming that those things are all beyond his control. But he's a government minister. He can pass regulation to change those things and therefore change the environment, which of course somebody in the microeconomic world cannot do.

I can't change the law on sugar or alcohol or anything else. It's beyond my ability to do so. And it's beyond yours as well. But for Wes Streeting as a minister, that is not beyond his ability.

The point is, microeconomics assumes that there is a world out there we can't change.

And in macroeconomics, there's a world out there that very often can be changed by government. And ministers aren't presuming that's within their power, because macroeconomics as it is taught, does not assume that that will be the case.

We really have to rethink macroeconomics. And thankfully, there are those who are doing so. I would give a special mention to Steve Keen here, but there are most certainly others.

And the point is, that if we rethought macroeconomics we would fundamentally change our approach to the way in which we manage the whole economy and not just things like the Treasury and the Bank of England and interest rates, but everything that impacts on our well-being because economics is about well-being at the end of the day and if we want to focus on it we limit the harms as well as promoting the goods. But right now, those harms don't seem to be on the agenda, and that's a major failing in thinking.