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## Trend Brief: Paradigm Shift Emerging in Economics

By Devin Fidler

*Long dominated by Neo-Classicism, economic thinking stands poised for fundamental reevaluation. This process will have important implications for the future of both business and government.*

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Neo-classical models have dominated economic thought over the last half century. This approach has emphasized human rationality, complex mathematical modeling, *laissez faire* policies, and long-term equilibrium. Initially embraced in response to the issues of industrialization, this approach has shown itself to be the best available alternative for predicting and dealing with the challenges of modern societies. However, there are signs that these ideas are poised for reevaluation in the light of this century's challenges.

A new cohort of economists and competition theorists are questioning many of the fundamental theoretical and empirical assumptions of this model. Simultaneously, real-world applications of strict neo-classical concepts have consistently met with ambiguous results. Finally, organizations and governments now face the emergence of global environmental and social issues that simply do not fit well into the current model. At this point, further innovations are clearly called for.

Based on the combined weight of these trends, the **Institute for Alternative Futures is now forecasting a game-changing paradigm shift in both academic and applied economic frameworks over the course of the next generation.** Such a shift will have a substantial impact on many areas including regulatory framing, business strategy and development assistance.

The Institute for Alternative Futures is a Washington DC based think-tank, founded in 1977 by Clem Bezold, Alvin Toffler and Jim Dator, which analyzes the future implications of emerging issues and trends. The Institute is actively tracking new economic ideas, innovative business models, game theory research, and trends in green business to develop a fuller picture of the potential shape of things to come.

The mid-century advent of game theory brought one of the first challenges to current economic thinking. Game theory models anticipated the sort of dynamics that have led to the meteoric rise of green business and corporate citizenship as fundamental strategic issues in a commercial context.

The film *A Beautiful Mind*, for example, dramatizes an early contribution to this paradigm shift. Mathematician John Nash helped prove that in many cases the "invisible hand" of competition can, in fact, move economic systems toward undesirable outcomes. His insights were initially seen as only marginally interesting by many economists, but have since proved to be almost prophetic.

The potential for the worsening of global climate change and the global reduction in biodiversity are two timely examples that illustrate exactly the problems with "negative externalities" that Nash helped to identify. Given the planetary nature of these issues, the Invisible Hand is unlikely to provide viable solutions to these problems.

Yet newer ideas call the whole framework of modern economics into question. For example, the field of Behavioral Economics, which is in essence an attempt to integrate microeconomics into cognitive psychology, has been growing at a remarkable rate.

Early pioneers in this area, including Gary Becker at the University of Chicago, have discovered ways that economic analysis can be applied to everyday decision making, opening the way for what might be called "design economics". The field has gone beyond its roots, though, and at this point researchers, led by pioneers like Daniel Kahneman, Amos Tversky and Vernon Smith, have shown that there are circumstances in which people consistently make *irrational* choices.

Some of these irrational choices are routinely exploited in marketing and sales efforts. IAF projects these ideas will trickle down into new ways of regulating and designing many kinds of decision making processes - from consumer lending offerings to marketing to 401K materials. Political debate following the collapse of the sub-prime mortgage market may be a bellwether of this trend. In the future, we will likely strive to manage our irrationalities as we come to understand them better.

At the most general level, next-generation economic theories now emphasize adaptive systems development. Much of this is covered by the fast growing field of Evolutionary Economics. The concept is already gaining traction in board rooms, and both Bill Gates and Steve Jobs publicly frame their companies' strategic positions in terms of a broader "business ecology." It is a trend, then, that is poised to spread, particularly in fast-changing industries where the very concept of "equilibrium" is almost dangerously misleading.

This paradigm shift is likely to have broad implications for the future of both business and government. However, there are still a number of forms that the emergence of new models could take. Within this context, the Institute for Alternative Futures is now developing comparative scenarios for this process as an initial step toward adapting organizations to the emerging realities of a next-generation economy.