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Default Economics

A Polemic

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"[...] we are in the uncomfortable position
of having to think for ourselves."
Joan Robinson (1962) Economic Philosophy

Introduction

This paper accepts as its starting point the notion that economics is a disappointing study. But it is the intellectual heart of business studies and constitutes its basic commonsense. Sadly, as a satisfactory explanation it has badly let us down. If we persist in promoting its values through the blurred and narrow prisms of simple minded supply and demand theories that monopolise business school syllabi my contention is that the future prospects of the European economy are prejudiced. The paper proceeds to elaborate some recent critiques of economics. The prescription is not better model specification. It is not a technical problem. It is a question of philosophy made all the more important by the deepening interconnectedness of the global economy.

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Reorienting Modern Economics

Predating the 2008-9 financial crash recent developments in the philosophy of economics, in particular the work of the Cambridge UK academic Tony Lawson targeted its firepower on the inadequacy of an approach to economics that relies almost solely on deterministic approaches that are mathematically tractable. That is to say that there are unchanging relationships between entities that can be modelled using algebraic equations, e.g. if wages fall employment increases. At the heart of the model is a representative human being whose behaviour is entirely captured by rational considerations, disconnected from others. The rationality attribute enables the market to work efficiently through constant calculations of costs and benefits set by prices in perfectly competitive markets. Individualism, atomism and consumerism trumped socialism as the new anorexic citizen emerged blinking into Friedman's Chicago dawn, the last nail in Keynes' coffin having been banged in, his obituary written and his body interred in the graveyard of social democratic ideas.

Thereafter, if an aspiring economist sought professional recognition, publishing in one of the so-called top journals required adherence to the ironic monopoly of these ideas. Writing in the 2005 Post Autistic Economic Review Ed Fullbrook showed that in the 1970s the three most prestigious journals (American Economic Review, Quarterly Journal of Economics and the Journal of Political Economy) were dominated by US academics at just eight Ivy league universities (Yale, Harvard, Princeton, MIT, Chicago Stanford Columbia, and California), all departments that were financially supported by the RAND corporation, a company that worked in the service of the US military. In addition, 26 out of 29 living economists given entries in the UK Penguin Dictionary of Economics are American and all came from one of the big eight mentioned above. It should come as no surprise that progress is slowed by such academic incest as failed social doctrines have a life longer than would be tolerated in the biological world of survival of the fittest, reinforcing even Robinson's pessimistic observation that 'A professor teaches what he was taught, and his pupils, with a proper respect and reverence for teachers, set up a resistance against his critics for no other reason than that it was he whose pupils they were.' p. 79 op cit. Fullbrook entitled his paper 'The Rand Portcullis' giving symbolic power to the idea of a controlled gateway to the discipline's inner sanctum.[2]

But as Lawson argued in 'Reorienting Economics' (2003)[3] the real world is found in another ball park miles away from these arid presumptions. Mathematics is not always the sharpest tool in the box. You would not use a hammer to clean a window nor a comb to write a letter. Life is not deterministic and there are not constant conjunctions of surface events as there is evolution and unforeseeable emergent properties. Mathematics is quite incapable of explaining events at one level by shifting attention to the underlying causes at a deeper level in what Lawson refers to as the ontological depth. This step requires retroductive, not deductive reasoning. Scientific progress is not a question of going from the specific to the general, from the specific empirical observation that I see six black ravens to the generalised deduction that all ravens are black. It is rather a question of the observation that a raven is black to asking the retroductive question of why is a raven black? What are the reasons giving rise to the property of blackness? Indeed, without giving it the label of retroduction, Darwin, for example, arrived at the same conclusion and came up with evolution by natural selection which in turn has evolved into science at the deeper level of genetics. Economics has not progressed in this scientific sense.

Lawson uses autumn leaves swirling over roofs to explain countervailing powers masking the underlying reality of gravity which in the physical realm can only be isolated in a laboratory experiment with the artificial creation of a vacuum. The retroductive leap of imagination comes from asking the question 'what must the world be like for this to be the case?' Given the financial crisis, something that could not happen within mainstream economics, the deafening answer to this question is 'not at all like your theory'. Constant conjunctions of events simply do not exist in the natural world outside of controlled experiments.

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[2] http://www.paecon.net/PAEReview/issue32/Fullbrook32.htm

[3] and presented in http://ineteconomics.org/video/conference-kings/really-reorienting-modern-economics-tony-lawson

The French Students Petition

History's malcontents, Marxists, feminists, environmentalists and so on, have been here before. Their latest incarnation to make a noise and nuisance of themselves were a group of disgruntled French economics students. In 2001 they wrote a manifesto declaring themselves to be generally dissatisfied with the teaching they received. They petitioned for an end to imaginary worlds, they opposed the uncontrolled use of mathematics and they requested pluralist approaches to their studies. Perhaps the most revolutionary plea of them all was a call for teachers to wake up before it was too late. According to these students, mainstream economics is autistic, a somewhat unfortunate metaphor, to capture its inability to relate to the social world and so come up with inappropriate policy responses. The website www.paecon.net has fostered growing support for a post autistic stance, providing a convenient platform for pluralist voices on a global scale. In truth, it has not advanced much beyond their initial diagnostic challenges to a mainstream hegemony which is well entrenched.

Shifts in Economic Paradigms

In the pre crash phase, philosophy explained how the failed Keynesianism paradigm gave way to neo-liberalism. In short the power to choose, citing Friedman's bible of the time, bolstered by the power of rigorous mathematical logic, displaced the wooly power of governments to regulate. These ideas fitted the interests of wealth holders rather than wealth creators and were successfully taken up by Reagan and Thatcher and to a lesser extent all the hybrids of the middle way like Schroeder and Blair.

Now all that fine philosophy is over. There are no takers for the deracinated scientisms of an Efficient Market Hypothesis and Rational Choice Theory.[4] But where have we got to? What economic tricks still work on the psychology of people? A big hint is given by UK Finance Minister Osborne when he says that the UK credit

[4] For a comprehensive treatment see Skidelsky's 'Keynes:The Return of the Master' at his London School of Economics lecture (7/10/2009) http://www2.lse.ac.uk/newsAndMedia/videoAndAudio/publicEventsVideos/publicEventsVideosPrevious.aspx

card has been ‘maxed’ out. The default position appears to be nothing more than simple minded, free market, small state economics of classical liberalism in which the government is powerless to change the ‘natural’ level of economic activity. For those countries in extreme budget deficit people are left to the mercy of self help in austere times. For those countries in a more comfortable budgetary position there is a widely held sentiment that the deficit countries are the architects of their own downfall. But all they were doing was sanctioned by the system. Indeed, some of their decisions were actively encouraged by precisely those banks who believed themselves insulated from booms and busts by default insurance instruments in the form of Collateralised Debt Obligations and Credit Default Swaps. The risks of credit creation had been mathematically calculated and hedged. A problem in one trade or one bank would be diluted by the bad debts cascading throughout the system to be eventually absorbed by a variety of financial institutions. Systemic risks, threatening the whole system, according to their model, were calculated to be events so rare that the probability of their eventuality would occur with a frequency of one in 10^{140} years. On this calculation Goldman Sachs suffered a once in-every-fourteen-universes loss on several consecutive days.

The temptation to borrow was irresistible, compounded by snake oil sales practices that suckered ever more economically naive peripheral people into intoxicating draughts of the finance elixir; sweetheart first year interest deals, 125% mortgages, uncorroborated self certified income declarations etc. You are poor. Look around you. You don’t have to be poor anymore. Don’t get left out. Buy buy buy. Concomitantly, banks appeared to have enough snake oil to go around for everyone to drink at the well of wholesale money markets. Sell sell sell. Aggressive banks and ambitious bankers profited, everybody profited and despite a few temporary relapses - LTCM, Mexico, Argentina, Argentina, Russia, dot.com bubble - the regime of the freedom of capital stoked a super bubble, below the radar of the governors of the new world order like Greenspan who was forced to admit “Those of us who have looked to the self-interest of lending institutions to protect shareholders’ equity, my-self included, are in a state of shocked disbelief.” When asked “Do you feel that your ideology pushed you to make decisions that you wish you had not made?” Mr.

Greenspan conceded: “Yes, I’ve found a flaw. I don’t know how significant or permanent it is. But I’ve been very distressed by that fact.”[5]

Flawed Consequences

The tangible assets of trade surplus countries, made larger by stagnant wages, Germany included, were multiplied into fictitious amounts as credit by the banks and then absorbed by deficit countries. They had to find a home if the global economy were to avoid recession. Whether it was over production or under consumption that was the root of the problem is another story. Come the deflation the tangible assets are vulnerable. These countries want their money back. Who will pay them? Governments of deficit countries have volunteered their citizens’ future living standards. EU solidarity has melted away. An EU that was designed to bring people together is now fragmented into pushing people apart as sovereign considerations are trumps in this game of forfeits. A two speed Europe is developing. Whilst Northern Europe is benefiting from a boost to exports to the Far East Southern Europe is either grinding to a halt as in Italy and Spain or still retreating as in Greece. The prospect of rising ECB interest rates to counter inflationary tendencies and public expenditure cuts across Europe will exacerbate the problem.

Even in the North the growth of the precariat is dissolving intergenerational justice.[6] It is not only the quantity of jobs that is relevant. The quality also matters. Madeleine Bunting[7] reports that the low paid part of the workforce has been feminised and women are bearing the brunt of flexible labour markets where they are bullied into accepting, for instance, cost cutting exploitative unpaid trial periods and hectored and humiliated for the slightest lapse in standards as insecurity and work intensification have shot up. There is a ‘total absence of social affirmation in these working lives’ where people are units of labour to be bought and sold in a bleak climate where there is no conviction that life can be different. Predictably, these ‘bad’ jobs

[5] House Committee on Oversight and Government Reform 23/10/2008.

[6] For more on the precariat see http://www.guardian.co.uk/commentisfree/video/2011/feb/16/precariat-flexible-labour-market-video

[7] http://www.guardian.co.uk/commentisfree/2011/may/01/flexible-work-grinding-down-women-stress?INTCMP=SRCH

cause morbidity in the form of stress, anxiety and heart disease. With the certainty of falling living standards bad jobs will create communities that are locked into inter-generational ghettos where the sense of autonomy has atrophied to zero. The same will be true of countries.

New Economic Thinking

It is acknowledged that not everything in the economic garden is rosy and something needs to be done about the weedy state of affairs. To this end George Soros is financing 'The Institute for New Economic Thinking' (INET) found at www.ineteconomics.org where it is possible to see a star cast of global opinion formers wrestle with seemingly insoluble conundrums. How do you detoxify the economics brand and its malign influence? The conference reminds me of Arthur Koestler's 1973 novel *The Call Girls* the plot of which tells the story of a group of academic scientists struggling to understand the human tendency towards self-destruction, while the group members gradually become more suspicious and aggressive towards each other whilst locked away in an Alpine resort. Since its inception two conferences of INET have been held, the first in 2010 at the exclusive Kings College Cambridge, Keynes' Alma Mater, and the second in 2011 at Bretton Woods, the hotel retreat where the 1944 conference, attended by Keynes, pronounced on the reconstruction of Europe. Surfing the extensive coverage of both conferences, as far as I can tell the only radical voice to be heard is that of Tony Lawson, already mentioned above, who appeared to be the only one to question the whole intellectual approach of model building. Predominantly, the tenor is Keynesian and a return to reform of regulation of banks and of global governance, especially the IMF and the World Bank. The problems appear to be technical matters of policy effectiveness. Without the momentum imparting political sphere it is doubtful if this will be enough. The aftershocks of the financial crash are even now being felt in the Arab Spring and more such reactions can be anticipated in Europe where it may be impossible for certain states to pay their sovereign debts within existing Euro arrangements.

Posing the realist question of what must the world be like for this to be the case can only be answered by the obvious observation that it does not conform to the premises of Business School rhetoric. If the EU stands for anything it has to re-examine the basic values that inspired its more socially minded pioneers. The backdrop has moved on so an assessment of the new global scenery has to be undertaken. Surprisingly of interest is the presentation by Gordon Brown, the ex Prime Minister of the UK, at he INET Bretton Woods Conference April 2011 who appeared to be making an application to be the next President of the IMF on the basis that the international community recognised his pivotally instrumental role in preventing a slump developing into a depression. In this presentation[8] several factors are highlighted. He informs us that on the financial front over half the US subprime securities were bought by European banks, so it was not just a problem of the anglo-saxon way of doing things. A global growth pact failed due to an ability to resolve exchange rate issues between the US and China , the source of so much imbalance. This failure has induced a retreat into national shells and has led to a race to the bottom on bank reforms in an endeavour to retain and or attract international banks of the stature of HSBC. On the developmental front he considers the last 20 years has witnessed a revolution that will come to be seen as more important than the effects of the first 20 years of the industrial revolution. During this period there has been a fundamental restructuring of production with the US and the EU out produced, out manufactured, out exported and out invested by the rest of the world. Two continents with only 15% of world population could never maintain its hegemony indefinitely. There will be 2 billion people emerging into the world economy to enjoy a middle class life style. In absolute terms China will overtake US consumption levels some time between 2020-2025. In short, a rebalancing of the global economy away from the leaders of the industrial revolution is taking place. . The West has to wake up to the fact that it would be re-writing history if it attributes its economic successes to the invisible hand of the market. These forces appeared to work only to the extent that they were not allowed to work elsewhere. The West's ability to rig those markets to suit its own purposes is on the wane as competition for resources hots up.

[8] www.ineteconomics.org/net/video/playlist/conference/bretton-woods/F

Taking his cue from the first Bretton Woods conference, Globalisation of this order needs imaginative governance. Brown advocates a second Bretton Woods settlement that establishes an IMF global central bank, a bigger World Bank for those countries left out of the economic game and other forms of global banking governance that would ensure transparency in financial matters. Above all nationalist identification of problems has to be avoided. They are global problems, too big for individual countries to solve by themselves. Without such a visionary outlook of cooperation and inclusiveness to navigate the way, the future prospects for peace and prosperity are hazarded. Whether any of this can be realistically put in place at a global level is highly speculative in the current climate. Perhaps a limited aim of a European Monetary Fund, an EMF, is more feasible?

Conclusion

So how can we de-fault economics, if indeed that subject is the source of misperceptions? Perhaps we should look again at the sociology of the discipline and its imperialistic ambitions. Within economics departments it has squeezed out economic history and the history of economic thought, the survivors having been exiled to liberal arts departments. It has colonised business schools and invisibly, like a successful parasite, infected most substantive business subjects from accountancy to law, from management to human resources, logistics to marketing. These narrowly intellectual power houses attract research funds in a symbiotic relationship with a positive feedback loop that effectively silences all dissent to become the new religion of the age. Business studies has to be more about how to escape from conceptual jails that confine us in unconsidered narratives and less about how-to-do-it manuals; more philosophy to understand how ideas have power, an economics that explains why power has ideas and a politics to articulate power to ideas. In short, a return to critical enquiry.