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Why is economics so fragile?

Pourquoi l'économie est-elle si fragile ?

¿Porqué es tan frágil la economía ?

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Résumés

English Français Español

The association between a crisis in economics and the economic crisis, spontaneously drawn by the media and the public, is a fact which calls for explanation. We begin by identifying what the public and the media perceive as “economics”. This is not economics in its plurality but a synthesis of new-Keynesian and new classical theory which emerged in the US during the 1980s. Such a synthesis is often presented as anchored in principles which

establish the appropriate mode of economic reasoning. By reviewing what these principles state and what they conceal, we argue that this understanding of “Modern Economic Theory” leaves a number of traditions of economic thought out of economics or economic science which, although neglected and marginalized, still exist within economics departments. We then question whether the public and the media might be justified in attributing the blame for the economic crisis to the particular type of economics taken as representative of the profession and of academia. Finally we address the prospect of a (more) robust and prudent economics, which would have to be anchored in a solid understanding of institutions, institutional configurations, and their variety and dynamics.

La relation entre crise de l'économie et crise économique, telle que les médias et le public l'ont spontanément établie, appelle quelques explications. Commençons par identifier ce que le public et les médias comprennent par “économie”. Il ne s'agit pas de l'économie dans ses formes multiples, mais d'une synthèse, développée dans les années 1980, de “néo Keynesianisme” et de théorie néo-classique. Cette synthèse est souvent présentée comme étant ancrée dans des principes qui définiraient la bonne méthode d'analyse économique. En examinant ce que ces principes affirment et ce qu'ils soutiennent, on soutient l'idée selon laquelle cette conception d'une « théorie économique moderne » renvoie hors du champ de l'économie, ou de la science économique, bon nombre de traditions de la pensée économique qui, bien que négligées et marginalisées, existent toujours au sein des facultés d'économie. Nous pouvons dès lors nous interroger sur la vérité répandue par le grand public et les médias lorsqu'ils attribuent la responsabilité de la crise économique à l'économie spécifique considérée comme représentative de la profession et des universitaires. Finalement, nous considérerons la perspective d'une économie (plus) robuste et (plus) prudente, qui gagnerait à être mieux ancrée dans une bonne compréhension des institutions, des configurations institutionnelles, de leurs diversités et de leurs dynamiques.

La relación entre la crisis de la economía y la crisis económica, tal como los medios de comunicación y el público los han establecido de manera espontánea, requiere una explicación. Comencemos por identificar aquello que el público y las medias comprenden por « economía ». No se trata de la economía en sus formas múltiples, sino de una síntesis, desarrollada durante los años 1980, de neo-keynesianismo y de teoría neoclásica. Esta síntesis es a menudo presentada como con algo basado en los principios que definirían el buen método de análisis económico. Examinando lo que afirman estos principios y lo que sobre-entiende, se sostiene la idea según la cual esta concepción de una teoría económica moderna nos reenvía fuera del campo de la economía, o de la ciencia económica, que a pesar de estar dejadas de lado y marginalizadas, existen siempre en el seno de las Facultades de Economía. Nosotros podemos entonces interrogarnos sobre la verdad difundida por el gran público y los medios cuando ellos atribuyen la responsabilidad de las crisis económicas a la economía específica considerada como representativa de la profesión y de los universitarios. Finalmente nosotros consideramos la perspectiva de una economía (mas) robusta y (mas) prudente, que se beneficiaría si fuera mejor considerada haciendo una buena comprensión de las instituciones, de las configuraciones institucionales, de sus diversidades y de sus dinámicas.

Entrées d'index

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Texte intégral

Introduction

1 In November 2008 during a visit to the London School of Economics the Queen of England, who had just lost 25 million pounds in the financial turmoil, asked a terrified audience of eminent economics professors: “Why did nobody notice it?” One of the professors present was reported as replying: “At every stage, someone was relying on somebody else and everyone thought they were doing the right thing.” (*DailyTelegraph*, 5 November 2008).

2 In July 2009, a group of “eminent” British economists felt the need for a more formal reply to the Queen and sent her a letter in which they apologized: “[...] your majesty, the failure... was principally a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole”. (*The Huffington Post*, 26 July 2009).

3 A few days later, in an issue that displayed on its front page an image of a book entitled “Modern Economic Theory” melting under the heat waves of the financial crash, *The Economist* wrote: “Of all economic bubbles that have been pricked few have burst more spectacularly than the reputation of economics itself” (*The Economist*, 16 July 2009, “Where economics went wrong”).

4 Similar episodes took place during this period all over the world. The British case is just one of the more colourful out of many that filled the media in those days in which economics was blamed for not having anticipated, or even for having contributed, to the crisis.

5 Lately, however, as some vague signs of economic recovery have surfaced, the criticisms and the pressure for self-examination of “Modern Economic Theory” have been alleviated. Although, for many, the recovery is taken as an opportunity for a safe return to old habits of thought, there are clear signs at the top of the mainstream hierarchy of economics that some revision of the previous “consensus” is being considered¹. In spite of the ongoing backlash into *business as usual* in the economy and in economics, the clouds over “Modern Economic Theory” persist.

6 The interesting fact in anecdotal events such as the one mentioned above is that in all of them a link is spontaneously established between the reputation of the profession of economics and the state of economics, on the one hand, and the performance of the economy, on the other. How is it that an economic crisis comes to be interpreted as a crisis of “Modern Economic Theory”? How is “economic science” fragile to the point of losing its reputation in the event of an economic crisis? This is far from obvious. We would hardly expect something similar to happen with any other social science: the reputation of sociology, social psychology or political science is in no way affected by adverse social or political events.

7 In order to highlight the reasons that may account for the fragility of economics thus understood, we initially aim to clarify the meaning of “Modern Economic Theory” for *The Economist* or of economics for the public at large. We proceed in section three by identifying the underpinnings of the type of economics that is proclaimed as “economic science” and is perceived by the public as such. In section four, we address the question raised: is the linking of the reputation of economics to the performance of the economy just a public misperception? Finally, in section five, we summarize the critical areas in economics as it now stands and suggest a number of guidelines that may provide some direction in moving from the current state of crisis towards a (more) robust economics, or rather, political economy.

1. What is “Modern Economic Theory”?

8 Bearing in mind that political economy and economics has always been a field influenced to some extent by various currents, one may wonder what *The Economist* meant by “modern economic theory” (in the singular).

9 *The Economist* was, however, referring to economics as it now stands, not to the old pluralistic economics that existed in the US, for instance, during the interwar period and until more recently in Europe.

10 In fact, during and after the 2nd World War economics in the US underwent a major transformation from pluralism to neoclassic hegemony (Morgan and Rutherford, 1998; Backhouse, 2008). A quote from Samuelson, dating from 1955, may help cut a long story short:

“In recent years, 90 per cent of American economists have stopped being ‘Keynesian economists’ or ‘Anti-Keynesian economists.’ Instead, they have worked towards a synthesis of whatever is valuable in older economics and in modern

theories of income determination. The result might be called neo-classical economics and is accepted, in its broad outlines, by all but about five percent of extreme-left and write-wing writers” (quoted in Blanchard, 2008: 7).

11 Samuelson had in fact been one the main architects of the consensus he was celebrating in this passage – a juxtaposition of neoclassic microeconomics with a vaguely Keynesian macro-model – and the author of the textbook that disseminated this neoclassical synthesis over several decades. This was a consensus that left out Keynesian, Marxist, institutionalist and other traditions which were unhealthy to cultivate under McCarthyism, and economists of Austrian persuasion.

12 During the 1970s, however, this consensus would break down dramatically when the monetarists and the new-classicals of the Chicago school appeared on the scene. Paul Samuelson was by then no longer as happy with the prospect of a unified economics as he had been in his youth. In 1992 he even felt the need to subscribe, together with forty-four well-known economists including other Nobel laureates such as Franco Modigliani, Herbert Simon, and Jan Tinbergen, to a “Plea for a Pluralistic and Rigorous Economics” that was published as a paid advertisement in the *American Economic Review*. He may have felt that the battle then raging between the “salt water” new Keynesians and the “freshwater” new classicists might give rise to unification under a new classical hegemony. If this was the case, he had correctly anticipated the new consensus celebrated by Blanchard (2008: 5) involving “the new tools developed by the new-classicals... [and] facts emphasized by the new-Keynesians”.

13 The events in the US are of particular relevance because they came to influence and determine similar developments all over the world. From the 1980s, economics departments everywhere, which previously had been pluralistic, underwent transformations that led to the almost undisputed hegemony of a single (neoliberal) approach to economic theory and practice.

14 This new theoretical coalition that came to dominate academia in the US and elsewhere is what *The Economist* takes to be “Modern Economic Theory”. Given the broadness of such a coalition, the need has been felt by some to expound on the principles that might preside over a consensus or at least a compromise. One of the better known attempts was made by a ‘new Keynesian’ economist and former advisor to the US Bush administration – Gregory N. Mankiw – in a famous introductory economics textbook (Mankiw, 2004).

15 In Mankiw’s account, economics is understood, via a loosening of Lionel Robbins’s (1984 [1932]) definition, as “the study of how society manages its scarce resources”. This, as Mankiw immediately clarifies, is a study that, in spite of reference to the macro properties and behaviour of the system, must start at the level of individual decision-

making. Economics, thus understood by Mankiw, regardless of its “many facets” is “unified by several central ideas” (Mankiw, 2004: 4) that can be articulated as ten principles, organized into three categories: *how people make decisions*; *how people interact*; and *the workings of the economy as whole*.

16 Under the first category (individual decision-making) four principles are included: people face trade-offs (Principle #1); the cost of something is what you give up to get something (Principle #2); rational people think at the margin (Principle #3); people respond to incentives (Principle #4). Under the second heading (interaction) we find: trade can make everyone better off (Principle #5); markets are usually a good way to organize economic activity (Principle #6); governments can sometimes improve market outcomes (Principle #7). The three last principles are grouped under the macro framework: a country’s standard of living depends on its ability to produce goods and services (Principle #8); prices rise when the government prints too much money (Principle #9); society faces a short-run trade-off between inflation and unemployment (Principle #10).

17 These are supposedly broad principles that are able to accommodate specifications in every domain to which they are applied. A particularly relevant specification in relation to the “subprime crisis” is Eugene Fama’s theory (or hypothesis) of efficient capital markets. In the applied domain of financial markets, the efficient market hypothesis was in fact built up into a principle which provided the rationale for numerous financial innovations and for deregulation (Crotty, 2008).

18 However, we must note that the formulation of these principles is sensitive to some variation in political opinion. Trade “can” make everybody better off, markets are “usually” a good way, but governments “can sometimes” improve market outcomes. If the intention of the principles is to accommodate all economists that tend to disagree on the extent of “market failures” and “government intervention” as “new Keynesians” and Chicagoites, the formulation of the principles, although clearly market-friendly, should allow, as it does, for some qualification of the virtues of markets.

19 We must also note that the principles are formulated in a deliberately loose fashion that intends to appeal to the imagination of students as rules that anyone sensible would agree to. Grasping the meaning of the principles calls for more detailed scrutiny that can take into account not only what they state but what they conceal.

2. The underpinnings of “Modern Economic Theory”

20 Underlying Mankiw's principles is an *individualist conception of the economy* as "just a group of people interacting with one another as they go about their lives". No role is assigned to the institutions that govern provisioning and "through which individuals in a society coordinate their diverse wants and desires" (Colander, 1998:6). The individual is assumed as atomistic and given. In effect, nothing is said regarding the agency-structure issue, one of the most relevant problems in the social sciences, that is, the problem of how individuals and structures interact over time in a mutually determined social process. The "economic" becomes artificially fenced off from the society in which it is situated; the idea of historical specificity, so much emphasised by Hodgson (2001), is ignored, and "how people make decisions" is reduced to an abstract, universal problem of choice, independent of time and place. In Mankiw's principles "how people make decisions" becomes no more than a logical problem of optimization in a context of scarcity, depending on given individual preferences, resources, costs and incentives (all dealt with in terms of prices and monetary calculus). The problems of (un)knowledge (in the Shacklean sense), real uncertainty (to be distinguished from quantifiable, probabilistic risk) and unpredictability are absent.

21 Mainstream economics has, in effect, become increasingly locked in an illusion – Hayek would say a 'pretence' – of perfect knowledge. Dazzled by the enormous potential and prestige associated with modelling, neoclassical economists were compelled to treat economic actions as perfectly knowable. Agents are modelled as (instrumentally) rational and as having rational expectations. Choice is conceived of as the selection of the best means to achieve given ends. Information may be incomplete or imperfect but any uncertainty regarding the consequences of actions or future events is reduced to situations where agents (and economists) know the probability distributions of any possible event or contingency. Fallibility of economic knowledge, limited computational capabilities and the full implications of taking action for what it is – the result of expectations regarding an unknown future or the interpretation of action situated in context – are downplayed. Economists became increasingly convinced that they had the tools required to foresee the future. Closely related to this, but not reducible to it, followed the illusion of control.

22 Having reduced the problem of making decisions to the rather crude issue of trivial choice, Mankiw's subsequent treatment of "how people interact" is a poor enunciation of basic and more or less ideologically-influenced propositions regarding the beneficial effects of trade, the "magic" of the "invisible hand" and the superiority of the market as a mode of organizing economic activity. The heterogeneity of decision rules and behaviour is forgotten in the face of a

“representative” agent, and human action floats in the air as if it was not socially and institutionally situated. In addition, nothing is said regarding the role of the state in the emergence, regulation and restructuring of markets and with regard to their institutionally-conditioned operations. The fact that markets are themselves political constructs is never acknowledged. Instead they are understood as a *natural* given and believed to be inherently stable and endowed with self-clearing properties, only disturbed by limited, temporary “external” shocks. The emphasis is on the equilibrium rather than the dynamics of cumulative processes. Everything is reduced to the logic of the markets. Moreover, prices are misleadingly assumed to “reflect both the value of goods to society and the cost to society of making the goods” and, through them, households and firms are supposed to “unknowingly take into account the social benefits and costs of their actions”. The possibility that prices do not transmit all the relevant information is kept under wraps. Although “market failures”, such as externalities, are contemplated, they are merely considered “exceptions” (even if “important”) to the usually good behaviour of markets.

23 Mankiw’s principles on “how the economy as a whole works” are even more disappointing. One is offered no more than a controversial monetarist concept of inflation and the idea of a short-run trade-off between inflation and unemployment – constructed on basic economic principles – along with a very deceptive proposition connecting the living standards of a country to its productivity. Again, nothing is said regarding the role of institutions and no mention is made of the dynamics of economic systems, coordination failures, domino effects (or systemic risk) and the intrinsic tendency of the economy towards instability and crisis.

24 Thus, in spite of their intended broadness Mankiw’s ten principles actually leave out a number of traditions that were (and to some extent still are) present and influential in academic departments and professional associations, for whom those principles are far from establishing sound building blocks of the discipline. The more representative of these schools include Post Keynesianism, Marxism, Institutionalism(s) and Evolutionary Economics.

25 These traditions are not frozen in time and have continued to develop in the last thirty years. It can be even argued that they have pushed the mainstream to consider some of its obvious shortcomings. Talk of “institutions”, “evolution” and “bounded rationality” or “animal spirits”, which was once part of the heterodox lexicon, has now become current. However, the mainstream endeavour is always to accommodate the “disturbing factors” into the ten principle framework.

26 These principles remain the criteria for discriminating against traditions of economic thought and legitimizing the exclusion of

courses and lecturers within economics departments and research projects in scientific research funding agencies. They provide authoritative criteria for determining what economics is and what it is not.

27 In the last thirty years, principles such as Mankiw's have indeed been operational in reshaping the teaching of economics, research and professional institutions by excluding views which dissent from the principles and eradicating pluralism. A generation of economists has since learned to "think like an economist" in the terms of the rather monolithic methodological approach as understood by Mankiw. In the process, economics has moved further away from the humanities and the other social sciences. History, philosophy and sociology, once considered by the very founding fathers of neoclassical economics as essential complements to economic research and reasoning, have been discarded as irrelevant to the teaching and practice of economics.

28 Theory has become more and more synonymous with "pure" constructions based on a "core" set of "sound", usually rather fictitious, principles from which every explanation should follow. As long as these unrealistic, fictitious model assumptions lead to "elegant", "sophisticated" elaborations and "interesting" results they are not seen as a problem. Applied economics, in turn, gradually became separate from, dependent upon and less prestigious than "pure" theory. Economic tools were increasingly reduced to mathematics and econometrics and by the same token qualitative methods, history and philosophy were cast aside. Technical model-building is now the *sine qua non* of economics ("if it isn't modelled it isn't economics"). Economists turned into *experts* who provide "technical" advice to industry, the government and a wide range of national as well as international public agencies. In a related development, the previous public expectation of at least three different opinions when two economists were consulted was replaced by the perception of an economist *pensée unique*. Objectivity as *even-handedness* (as it was understood in the interwar period) increasingly gave way to objectivity, seen as *following the rules of "value-free" technical modelling* (Morgan and Rutherford, 1998).

29 At the same time, such a *pensée unique* came to pervade political discourse, becoming the justification for structural reforms along the lines of the "Washington consensus". The economy was being reshaped in terms which were perceived as being dictated by "economic science". It is no wonder that for the public the "modern economy" was increasingly perceived of as a creature of economics.

3. The economic crisis and the crisis in economics

30 Who or what was to blame for the financial meltdown? Listed by the media, it was greed, financial deregulation and regulators, bankers, economists, and finally economics itself. All things considered, economics and economists were spotlighted as the key figures. After all, economists, served by their “economic science”, were the ones who, with their theories of self-interest transmuted into the good of all, had been legitimizing greed, and they were the ones who had advocated deregulation, privatization and free capital flows. Is this just a public misperception or, on the contrary, has the public correctly spotted in “modern economics” at least one of the causes of the great mischief?

31 Three features of “modern economics” suggest that the public was indeed perceptive.

32 Firstly “positive economics”, as conceived of by Milton Friedman and other “modern economists”, claimed scientific status, since predictions could be derived from its models and these predictions stood the test of experience. Accusing a social science of being unable to predict a certain social event would be foolish. However, having in mind the concept of science of “modern economics”, the complete inability of modern economists to perceive the driving forces of the crisis and foresee their consequences would be evidence of a flagrant scientific failure.

33 Secondly, “positive economics” was conceived of as prescriptive. Being able to predict economics was a reliable guide for controlling and shaping the economy. Until quite recently some believed that economics had indeed performed incredible feats: the “central problem of depression-prevention has been solved,” declared Robert Lucas in 2003².

34 Economics (and management science), unlike the other social sciences but like engineering, claimed an active role in shaping the world.

35 As a “positive science” economics would abstain from engaging in any definition of ends to be pursued by the political authorities, but it would give clear “scientific” indications on the consistency of goals and the best means to achieve them. It might help determine what was feasible and what was not, what was efficient and what was not, and ultimately what should be chosen.

36 Under the guise of value-neutrality and scientific objectivity, economics engaged in politics and acquired an influence unrivalled by any other social science. Governments actually listen to economic advisors and (somewhat reluctantly) follow their advice. The public is not wrong in believing that economists and economics have been

politically influential over the last thirty years. Since they themselves claimed the power to control events, blaming them for a failure to control is not as unfair as it would be in the case of any other social science. To a far greater extent than other social scientists, economists have engaged in social engineering. This has become crystal clear in relation to financial markets and products. It is no wonder that the public blames the economist when the building he has designed collapses.

37 Thirdly, modern economics formulated models according to which optimal and stable growth paths would be obtained as long as monetary policy was targeted towards low and stable inflation and governments abstained from interfering with markets. These models involved some heroic assumptions. However, instead of questioning the realism of the assumptions, the “modern economist” advocated the reshaping of reality in order to actualize the models’ assumptions. If prices, namely wages, were sticky they should be made flexible, if trade barriers existed they should be removed, if property rights were ill-defined they should be specified, if some markets were missing they should be created.

38 Economists were actively engaged, not only in the analysis of the economy, but in the design of institutions, property rights, markets and financial products. Their role in the conception of financial products, the setting up of a new financial architecture and of new markets came clearly to the fore. To a large extent economists have been reshaping the economy. That the public sees the economy as a creature of the economists is only in part a misperception.

39 “Modern economists” may still claim that their prescriptions were incorrectly or insufficiently implemented and that “imperfections” were not eradicated as they should have been. They may have a point. Reality resists attempts to update the dystopia of limitless markets, and backfires. However, they will have difficulty in persuading the public to venture further down a road which they designed and which has led us all to the verge of collapse.

4. A (more) robust and prudent economics: how is it possible?

40 Is the association of the reputation of economics with the performance of the economy just a public misperception, or a consequence of the development within the discipline of a perspective on actors and their behaviour which, in spite of claims to the contrary, is normative, context independent and asocial? Is it not true that this peculiar normative view of agency and behaviour has projected itself

on a perspective of social systems that has deprived them of history, thickness and contingency?

41 Questions like these substantiate the diffuse feeling (felt both by the public and by many engaged in the plural debate within the social sciences) that mainstream economics has evolved to a point where its fragility can no longer be hidden.

42 The hypothesis advanced here is that the fragility of economics is most clearly perceived in its relation to secular life, that is, in its manifest incapacity to provide a robust understanding of the historical formation of social provision systems. Its reductionist theoretical principles for rationality and action and their extension to the prominent assumption of the convergence of social systems of production, together with an inability to face the reality of the diverse mechanisms of economic coordination (Hollingsworth and Boyer: 1997) has blinded economics to institutions and the political mediation that configures the economy. Instead, social systems are represented by a set of stylized facts as arenas of interaction for imaginary actors.

43 A critique of “Modern Economic Theory” thus invites a dual reconsideration: the critical reconsideration of theory and careful observation of the multidimensionality of life. As stressed by an “old institutionalist” – Veblen – the object of economics is “the life process”.

44 At stake are the basic assumptions of rationality and action, that is, the neoclassic presupposition that “the actors possess cognitive systems that provide *true* models of the world about which they make choices or, at least, that the actors receive information that leads to convergence of divergent initial models” (North, 1990: 17). This normative representation of action, which precludes more accurate understandings of intentionality, conscience and identity, has a macro correspondent in a similarly normative perspective on social systems of provision.

45 Take for instance the *obsession with convergence* and the *phobia with variety* typical of mainstream economics. More than the result of the current growing inter-dependence in the world economy, the prominence of the “hypothesis of convergence” is a shortcut to the consolidation of a paradigmatic view of the homogenization of economic structures and performances (Boyer, 1996: 29-30). The inability to face diversity and the presence, in each social formation, of multiple distinctive features, once consolidated, has reduced these distinctive features to accidental or transient facts.

46 Mainstream economics has thus lost the conceptual instruments needed to identify the role played by the concrete trajectories of each social system in explaining the present economic configurations and in unveiling future potential. It has also become unable to understand the institutional configurations within each socio-economic system:

the relationship between the financial and productive systems, the forms of accumulation of productive capital, governance systems, cultural features conditioning individual, family and group behaviour, the judicial system, and forms of state and political systems.

47 Instead, “one best way” has been postulated. Technology, adjustments to factor combinations together with an openness to trade and capital flows, parallel with the expansion of markets and homogenization of ways of life were deemed sufficient to promote the convergence of economic structures. The possibility of multiple equilibria was disregarded. The necessary result would be a kind of general equilibrium.

48 The outlook resulting from the absence of any consideration of variety and uncertainty was one of “a singular world of market unification and institutional convergence” (Peck and Theodore, 2007: 731). Alternatively, the idea that “ends can be achieved in a large number of different ways” (Rodrik, 2008: 1), which is far more suggestive, was disregarded.

49 “Modern Economic Theory” is locked into its inability to understand institutional configurations. The statement “institutions matter” has now become trivial. However, history and diversity still are a challenge to the analytical tools of mainstream economics. “Modern Economic Theory” is fragile because, in spite of claims to the contrary, it disregards institutions.

50 An awareness of the meaning and role of institutions therefore seems crucial to the reconstruction of economics as a prudent and more robust social science. This must extend far beyond the isomorphic mainstream perspective which is unable to articulate more than a postulation of “good” versus “bad” institutions, in which the good ones are the focus for the desired convergence once deviant paths have been corrected.

51 The articulation of a useful concept of institutions that may overcome this interpretation of them as restrictions, defining the context needed for the enforcement of property rights and the “liberation” of markets, is therefore important. Understanding institutions as a result of the “efforts of human beings to deal with and confront uncertainty in a non-ergodic world” North (2005: 5) represents a good proposal which neatly accommodates both the intentionality of actors and the non-ergodicity of development processes.

52 A proper understanding of institutions will help establish a conceptual hierarchy of levels and processes of regulation, help distinguish between the proper role of markets in society and a market society, and will contribute towards highlighting the interplay between individual strategies and sustainable forms of organization.

53 The diversity and complexity of economic life can only be captured by researching the interdependence of institutions that connect the

economic with the political, the organizational and the social (Aoki, 2005). The diversity of institutions is what may account for the fact that economies with similar technologies and market configurations may perform differently. Understanding the institutional configurations of different economies calls for reintroducing into the debate and analysis of economics what has been expelled by “positive economics”, namely the political, social and organizational dimensions.

54 “A first-best mindset which presumes the primary role of institutional arrangements is to minimize transactions costs” (Rodrik, 2008: 2-3). A “second best mindset”, however, may be preferable. There is a consensus in contemporary discussions that institutions contribute towards economic performance. But this discussion has “paid little attention to how institutions themselves are created and change” (Jackson and Deeg, 2006: 7).

55 A dynamic theory of institutional change has to be incremental and take on board path dependency. The notion of institutional complementarities shows that “institutional practices of various types should not be distributed randomly across nations. Instead, “we should see some clustering” (Hall and Soskice, 2001: 18). In other words, “adjustments would be largely path-dependent ones”. For this reason the transformation of “overall institutional configurations from one type of capitalism to another” is unlikely (Jackson and Deeg, 2006: 36). Furthermore, advances in evolutionary economics following Nelson and Winter (1982), seminal work combined with research aimed at integrating technology and institutions more closely, are relevant in this connection.

56 The exposure of the fragility of “Modern Economic Theory” favours a reconsideration of the role of economic governance. Rather than unavoidable interferences with the market mechanism resulting from market failures, public policies have to be addressed as forms of collective action aimed at reshaping institutions and institutional configurations. Economics in its present shape can scarcely provide guidance in this respect.

57 A more robust institutional political economy is no less normative than the current mainstream. However, rather than being disguised, its normativity is brought out into the open. Values, the ends of public policies, are not taken as given, nor is their determination disregarded as politics. Values are instead seen as an appropriate object of reflection within the sphere of the discipline and of deliberation within society. Political economy involves participating with other types of knowledge in the process of determining the ends worth pursuing.

58 The issue is not only whether and when the present crisis will be overcome, but which social alternatives will prevail in the resolution of the crisis. From an economic, social and political point of view the

alternatives presented are clearly contrasting. They also differ with regard to sustainability. The stance upheld here is clear. It rejects the idea of universal mechanisms which, in the name of economic science, should be imposed upon diverse social dynamics. Instead, a robust understanding of the importance of immaterial resources – political, institutional and symbolic – that supports collective objectives and action is called for.

59 An ontology of the individual based on self-interest is not helpful in conceiving of sustainable alternatives to the present state of affairs. Space must be provided for the search for institutional compromises, social inclusion and collective action. This amounts to emphasising the political dimension of the economy and acknowledging the crucial role of the state and supra-national institutions. The transnational arenas of integration and cooperation may play a decisive role which extends far beyond the abstract notion of the global market, commercial openness and technological convergence. At transnational level there is clearly an increasingly relevant need for governance.

60 To sum up, what we have in mind is an interpretation of the social system of production which is not held hostage to the stylised facts of modern economic theory. In opposition to this theory we propose the complex dimensions – political, social and economic – embedded in the concept of institution. Moreover, by emphasising collective action and collective intentionality the aim is to restore the political dimension to economics.

61 Moving from the present state towards a robust and prudent economics calls for the revival of an institutionalist political economy. A future generation of scholars educated in the discipline of analyzing concrete phenomena taking place in particular contexts, at particular points in historical trajectories, political cultures and geographical locations is needed. The object of economics, if it is to survive, must be “the life process”.

Conclusion

62 The origins of this paper lie in the perception that the association between the economic crisis and a crisis in economics, spontaneously drawn by the media and the public in the heat of the financial meltdown, calls for explanation.

63 We began by identifying what precisely “economics” or “Modern Economic Theory” is perceived to be by the public and the media. This is not economics in its plurality but a synthesis between new-Keynesian and new classical theory that emerged in the US during the 1980s and subsequently expanded all over the world.

64 Such a synthesis is often presented as being anchored in principles which establish the appropriate mode of economic reasoning. By

reviewing what these principles state, but more importantly what they conceal, we concluded that this understanding of “Modern Economic Theory” leaves a number of traditions of economic thought – Post Keynesianism, Marxism, Institutionalism(s) and Evolutionary Economics – out of economics or economic science which, although neglected and marginalized, do exist within economics departments.

65 We then questioned whether the public and the media might be justified in attributing the blame for the economic crisis to the particular type of economics that is taken to be representative of the profession and of academia. The answer was positive. A number of features of this genre of economics may indeed explain and vindicate this popular view. “Modern Economic Theory” promised prediction, it boasted of being able to control economic events and trends, it engaged in politics and social engineering. “Modern Economic Theory” was arrogant, imprudent, and it failed. This failure has exposed its fragility.

66 We finally addressed the prospect of a (more) robust and prudent economics.

67 We do not intend to replace Mankiw’s ten principles with another set to serve as commandments that all economists should obey. The desirability of constructing a discipline on immutable principles is itself at stake. Plurality is an inherent feature of the knowledge of society and the economy and the renewal of economics stems from different sources, theoretical traditions and even other social sciences.

68 From these different sources a number of common concerns and perspectives are emerging.

69 The critical spots identified in “Modern Economic Theory” are its peculiar normative view of agency and behaviour and its projection of a perspective on social systems that is deprived of history, thickness and contingency. “Modern Economic Theory”, in spite of claims to the contrary, has become blind to the reality of institutions.

70 A (more) robust economics would instead have to be anchored in a solid understanding of institutions, institutional configurations, and their variety and dynamics. Only such an understanding can provide guidance for economic governance and public policies.

71 However, the shift towards a (more) robust economics depends on the transformation of the institutional context for economics research and teaching. This can only happen if the current public distrust in “Modern Economic Theory” gives way to the perception that the present sorry state of economics teaching and research is a public issue calling for urgent public action.

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Notes

1 See, for instance, Blanchard *et al.* (2010).

2 Quoted by Paul Krugman in “How Did Economists Get It So Wrong?”, *The New York Times*, September 2, 2009

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