

## The crisis and the adaptive discourse of economists \*

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2009 has been a troubled year. The signs of a sharp recession and the spectre of a terrible depression do not leave us with any doubts about the seriousness of the difficult times which, with varying degrees of pessimism, are anticipated and forecast. The crisis is not just the one that is revealed through the great disturbance felt in the economic and financial markets, the higher levels of unemployment, the loss of purchasing power, and the bankruptcy and closure of companies in all sectors of economic activity on a global scale. Besides the social and political consequences that it inevitably brings about, the crisis is also one of economics as a science that would hopefully contribute towards the understanding and solution of the problems that beset the contemporary world. As far as this naïve ambition of a prescriptive science of remedies and palliatives is concerned, it seems that people have already given up hope and that all our illusions have been shattered. But what shows that the situation is genuinely serious is the belief that, after all, economic science is not even developed enough to be able to describe and diagnose the ills that currently afflict the market. It is this dimension of the crisis that affects economics as a science and that is our main focus of attention in this paper, using as a guide the testimonies and stances adopted by contemporary economists, some of whom have been feted with the Nobel Prize, which they have either already been awarded or which they hope one day to receive. Such testimonies highlight the vulnerability of a

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\* Contribution to the 1st *Next Future* Research Workshop on “Responses to the Crisis”, Calouste Gulbenkian Foundation, 12-13 November, 2009. This presentation is an abbreviated version of the text “A Economia em tempo de crise: desafios a uma ciência com história” (Economics in a time of crisis: challenges to a science with history), in J. M. Castro Caldas, Vítor Neves and José Reis (eds.), *A Economia e o Económico*, Coimbra, CES, 2009 (in print).

science that systematically contradicts or renounces old habits of thinking. But they are also a symptom of an enormous adaptability, when the reality of events is superimposed on the abstraction of ideas.

### **Signs of alarm**

For someone who likes to don the clothes of an economic historian and a historian of economic thought, I find that the period that we are currently passing through appears almost as an opportunity for redemption, insofar as it allows us to point an accusing finger at the conventional economists who have forgotten that history offers us solutions for understanding the present, besides making it possible to demonstrate that the capacities of historians have been unfairly relegated to a secondary position. Or, in other words, economic history and the history of economic thought, two sub-disciplines that have not always been treated kindly by the mother science of economics, are now asserting themselves and enjoying a moment of glory that it is hoped will not be ephemeral.

In order to understand the depth of the current crisis in both the economy and economics, it is important to learn from the lessons that history provides. On the one hand, it is a case of learning by comparison with other times of crisis and depression that cyclically befall capitalist economies on a world scale. Economic history offers us many opportunities for discovering moments that reveal an astounding repetition of occurrences that underline the similarities between periods in which there is a rapid decline in economic activity coupled with great financial instability. The frequency with which people currently remember the Great Depression of the 1930s is perhaps the most eloquent demonstration of the fact that those who now interpret today's world wish to show that they are alert to the lessons that the past has to offer us. Yet history is also full of teachings which show us that economic science itself has, throughout its history, demonstrated the capacity to renew its doctrinal frameworks, theoretical models and economic policy programmes. This capacity is evidence of a vitality that allows us to

feel some optimism in relation to the answers that may be given for understanding and solving the problems of the present time.

This is the explanation for the recurrent and ever more insistent use that is made today of the testimonies and work of John Maynard Keynes, who has suddenly become transformed into the heroic saviour of a possible new and frightening great depression. It is therefore essential to underline the importance of knowing the history of a science whose practitioners believe it possible to find suitable solutions that have already been tried out in the past for similar problems. It is also within this particular ambit of economics as a science with history that this paper has been written.

Does this return to Keynes mean the end of the economic doctrines and theories that in recent decades have been placed at the service of the predominant orthodoxy in academic, business and political circles? Prudence warns us against making hasty judgements on this subject. The statements of disillusion and the prophecies of doom and disaster do not help us to understand the historicity of a science that can now evoke the use of theoretical and political answers that may later be rejected as an abuse. In other words, when economists with a neoclassical education and (neo-)liberal convictions are legitimately criticised for being incapable of interpreting and solving the current crisis, attention should be drawn to the fact that the contributions that they made in the past will still be useful for constructing economic science in the present and in the future. Scientific research is not compatible with radical attitudes based on the idea of starting with a clean slate. Scientific “revolutions”, paradigm shifts and the evolution of research programmes always include elements of continuity. Thus, at a time when the dirty water is being let out of the bath-tub, we should try and avoid allowing the baby to also be drained away in the swirl of the bathwater. We do, however, know that the child that we are left holding in our hands requires very special care and treatment.

### **The conversion of the (un)believers**

The reading of occasional testimonies published regularly in the press and on the blogosphere causes the reader a great deal of perplexity, leading him to admit that the world is no longer what it once was, for economists are no longer what they used to claim to be. Respectable economists, of course, of the kind that turn the Nobel prize that they have won or hope one day to receive into more than sufficient reason for them to be consulted by the no less respectable public opinion. Let us look at a brief but suggestive example.

At the beginning of February 2009, Gary Becker (winner of the Nobel prize in 1992) and Richard Posner (who has not yet lost hope of also doing so one day), illustrious defenders of a liberal view of the world, were discussing the legitimacy of protectionist measures in a climate of depression, calling for an unequivocal policy of “Buy American!” as a means of avoiding an even greater collapse in terms of the unemployment situation existing in the American economy. And they didn’t shrink from calling for a “Keynesian anti-depression programme”, based on the financing of public projects for the building of infrastructures, especially in the sector of transport and accessibility. The rhetoric of their arguments underlined the supreme importance of the aid that the American government would, in this way, be giving to the American people, more important even than combating malaria or promoting agriculture and family planning in third world countries (Becker and Posner, 2009). Despite concealing their liberal credentials, they were not prepared to miss an opportunity for engaging in a cynical exercise in protectionist *realpolitik*.

Writing in a calmer and more prudent register, Richard Posner admits the need for a programme of government intervention as a solution for mitigating the effects of a depression that does not result from failures in terms of State intervention, but rather from the failure of a certain model of capitalist economic organisation (Posner, 2009: pp. 220-51). His testimony is particularly significant, since it comes from an ideological and political area known for its affection for the virtues and merits of the market and its capacity for self-regulation.

This doesn't mean that all economists with a liberal training (conservative, in the American acceptance of the word) have renounced their most profound ideological convictions, or that they have ceased to blame governments for the interventions and regulations that either accelerated or deepened the current financial crisis and precipitated the entry into recession (Taylor 2009)<sup>1</sup>. However, the testimonies relating their author's conversion to a new set of ideas have become more numerous and eloquent, with greater or lesser expressions of regret, ranging from Alan Greenspan's explicit confession of failure in the conducting (or non-conducting) of economic regulation policy by the American Federal Reserve to Paul Romer's candid warning that the highly rigorous and mathematically sophisticated models of real business cycles are incapable of explaining the occurrence of a new great depression (Romer, 2008). For this reason, according to Romer, the fundamentalists must give way to the realists who understand and know that pragmatism in the conducting of short-term macroeconomic policy is not compatible with a blind faith in the sacred values of markets that automatically correct themselves and return to a state of equilibrium. An identical methodical doubt is explicitly stated by Bradford DeLong about the harmful consequences of an excessive liberalisation of the capital market (DeLong, 2008: p. 63). Some disconsolate commentators cannot accept the fact that economists have renounced their principles (Hart and Zingales, 2008), even though they accept the inevitability of a government intervention necessarily based on principles. Or, in other words, despite reaffirming the markets' capacities for self-regulation, for the sake of demonstrating their intellectual coherence, they accept that the State may complement such regulation by acting in a way that is not purely discretionary. Repentance and conversion are, after all, a sign of healthy lucidity, even for those who claim to have been more sceptical from the very outset.

Some Nobel Prize-winning economists, widely famed for their political and ideological non-conformism (which did not have to wait for the current crisis to

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<sup>1</sup> For a similar doctrinal manifesto against solutions based on government intervention, see the petition recently signed by a few dozen American economists, promoted by the Cato Institute, against the economic recovery programme announced by President Barack Obama. ([http://www.cato.org/special/stimulus09/cato\\_stimulus.pdf](http://www.cato.org/special/stimulus09/cato_stimulus.pdf)).

establish itself – as is the case with Joseph Stiglitz and Paul Krugman), are permanently engaged in an essential civic mission that consists of explaining to the general public, in terms that they can understand, precisely why conventional (neoclassical and neo-classical) economic theory is incapable of explaining the economic problems of the real world. In his customary column of opinion-making and political persuasion, Krugman warns of the risk of entering into a limit situation liable to lead to the beginning of a second Great Depression and explains that the mistakes made in the course of the first one, at the beginning of the 1930s (Krugman, 2009), cannot afford to be repeated. To this end, he states the need for a deliberate counter-cyclical policy of budget deficit and defends the merits of Keynesian economic theory, which, if it was useful for interpreting and controlling the first Great Depression, will prove to be even more useful now in overcoming the second one. If we were all once Keynesians, as Milton Friedman stated (promptly seconded by President Nixon at the end of the 1960s) in memory of the contributions that Keynes made towards the establishment of contemporary macroeconomic language, then now there are added reasons for our once again being even more so.

With the same purpose of prevention and issuing a warning about the policies that must be followed in order to avoid more serious consequences, although perhaps expressing even greater pessimism in their diagnosis of the present situation, Barry Eichengreen and Kevin O’Rourke compare the evolution of the indicators of world economic activity (industrial production, share market, volume of trade) in the last nine months with the evolution of the same indicators in the nine months following Black Friday in October 1929. And they reach the alarming conclusion that today’s situation is far worse than the one that was noted in the first months of the Great Depression. They conclude that, in order for this new depression not to be so great, it will be essential to pursue a firm and safe policy in monetary and budgetary terms (Eichengreen and O’Rourke, June 2009)<sup>2</sup>.

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<sup>2</sup> These authors are not afraid to use the word “depression” to describe the situation of the world economy at the end of the first semester of 2009, just as Richard Posner (2009: ix) also does not hesitate in doing

The examples purposefully taken from blogs and newspaper columns<sup>3</sup> serve only to illustrate the latent anxiety and constant state of alarm in the face of a situation that challenges economists to show that not all economic theory is condemned to failure. The bankruptcy of the macroeconomic models of rational expectations and real business cycles, as well as the sacred principle of the non-interference of the State in the spontaneous equilibrium of markets, are now countered by the return to Keynes and the interventionist economic policies normally associated with his legacy.

However, in territories that tend to favour a more considered presentation of analytical arguments, the same warnings are repeatedly to be heard. The lessons provided by the first Great Depression are considered essential for understanding the new depression in its initial phase (Krugman, 2008); the heirs of the monetarist tradition are said to be incapable of understanding how situations of recession and economic depression occur (Temin, 2008); the return to Keynes is seen as essential for restoring a climate of confidence that will make it possible to reinvent the “animal spirits” that have been lost and which are seen as providing the basis for the initiatives taken to relaunch economic activity when the depression sets in (Akerloff and Shiller, 2009)<sup>4</sup>.

Thus, a new Keynesian consensus is being woven, embroidered with messages that systematically remind us that the bad news is not something that has only now reached our ears and that the dangers associated with the irrational exuberance of the markets (Shiller, 2000, recovering an expression used by Alan Greenspan when

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so. Particularly interesting, in this discursive context, is the use of the lessons of the Great Depression of the 1930s as a starting point for reflecting on the possible solutions for the present time. On this question, see the debate promoted by the Council on Foreign Relations (USA), of which a summary can be found at: [http://www.cfr.org/project/1405/symposium\\_on\\_the\\_great\\_depression.html](http://www.cfr.org/project/1405/symposium_on_the_great_depression.html)

<sup>3</sup> These occasional and circumstantial testimonies are necessarily dated and they would certainly be different, had this text been completed one or two months later. The ephemeral nature of these sundry commentaries does, however, have the merit of showing the relevance of the immediate instant as a pretext for undertaking a digression through theory and history that together enrich our understanding of the present.

<sup>4</sup> Although the notion of “animal spirits” as developed and worked upon by Akerloff and Schiller (2009) is not made clearly explicit and does not correspond to the Keynesian view of things (which points towards a kind of intuition and spontaneous urgency in the activity of economic agents), the essential point in their message is that economic life functions according to states of *anima*, depending on people’s levels of confidence and credibility, on the good faith and sense of justice of social and political actors, and on their capacity for believing in the virtues of an economic system when this shows signs of erosion.

referring to the behaviour of investors in the stock market in the mid-1990s) have long since been announced<sup>5</sup>. Indeed, the progressive dismantling of previously agreed macroeconomic policies, the excessive deregulation in financial markets, the prevailing climate of speculation and corruption in business circles (Stiglitz, 2003), are all interrelated factors that help to explain the crisis of the economic and financial system at a global level, while simultaneously underlining the continued alarms about imminent disaster.

### **In search of a lost subject**

Despite the warnings issued by dissident voices, it was difficult to either admit or predict the immense perplexity felt by those who defend mainstream economic science when faced with the successive and increasingly preoccupying signs of a crisis. Such perplexity was largely due to the disdain and lack of attention that economic theory has shown in recent decades towards the understanding of essential problems<sup>6</sup>. In fact, the fondness for supposedly more attractive or divisive themes has gradually transformed economic science into a mere methodological exercise used for analysing the problems encountered in the calculation of incentives and the maximisation of utility, in a context in which there are limitations and restrictions placed on the processes of choosing and decision-making that seek to obtain maximum levels of individual satisfaction. Economic science has changed the identity of its particular subject-matter and this has acquired a new heuristic dimension, now becoming confused with the analysis of any gesture or behavioural motivation on the part of economic agents, provided that it is served by a rigorous conceptual model and an appropriate method of approaching the question. The triumph of both instruments and method have left economics discussing the irrelevance of its subject-matter. The topics that lay at the

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<sup>5</sup> For a suggestive (even if somewhat simplistic) view of the difficulties of reconciling the idea of rationality with the workings of the financial markets, guided by the biographical paths of development followed by the authors who have most contributed to our understanding and analysis of these markets, see Fox, 2009.

<sup>6</sup> Some of the reflections and references included in this section incorporate elements resulting from my conversations and partnership with Nuno Palma (Cardoso and Palma, 2009).

origin of the formation of economics as a science have long since been abandoned. In other words, we are now far removed from studying the system of activities and relations between men in the fields of production, distribution, trade and the consumption of goods and services, as well as the dynamic interaction of such activities in time and space.

The old dream of the triumph of Beckerian economic imperialism (or, in other words, the application of traditional microeconomic reasoning to any field of human activity)<sup>7</sup> seemed finally to have gained a fresh support, founded on the community of university departments and the competitive universe of the internationally most prestigious and highly regarded academic journals: Yet such support was also based on a mass of popular texts in which economics is revealed to the general public as an effective recipe for discovering the hidden side of everything (Levitt and Dubner, 2005)<sup>8</sup>. With this expansion of its different fields into an intellectual exercise that is broad in scope but of dubious interest, undertaken on behalf of economic science and with the approval of the most serious colleges of academic authority, the subject of economics has embraced the trickery and pretence of wrestlers (Duggan and Levitt, 2002), without forgetting the mysteries of the tactics of baseball players (Bradbury and Drinen, 2007).

In this way, I believe that an enormously restrictive perspective has been gradually created that highlights the limited range of a science that seems to have forgotten or lost its real purpose. At first sight, it seems as if we are actually looking at a process that enriches our research, since it is considered that all the themes that the imagination touches upon are susceptible to an economic approach and explanation. However, this invasion of unexplored territories ends up transforming the subject of

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<sup>7</sup> See, in particular, Gary Becker (1976: p. 5), for whom: “The combined assumptions of maximizing behavior, market equilibrium and stable preferences, used relentlessly and unflinchingly, form the heart of the economic approach as I see it”.

<sup>8</sup> The best-seller *Freakonomics* has already sold more than 3 million copies worldwide since its publication in 2005, an unparalleled volume of sales, not even matched by any of the major and successful books of any of the great economists. A major contribution was made to this success by the masterful alliance of the techniques of communicative journalism (Stephen Dubner) with the academic merits and seriousness of an extraordinarily promising academic economist (Steve Levitt).

economics into something that almost only amounts to cost-benefit analysis and the calculation and management of incentives<sup>9</sup>.

To use the language that is so beloved of the authors criticised here, it could be said that this shift of our attention towards minor and insignificant matters has had a high opportunity cost. And the price to be paid has also had the further upshot of diminishing the attention paid to the real problems that economies are faced with, besides the enormous waste of time and talent that it has inevitably involved. On this subject, it is worth recalling the warning issued by Lionel Robbins, an author who could hardly be accused of rowing against the prevailing tides, who in his time pointed to the need for economic science not to become lost in the labyrinth of irrelevant things:

There can be little doubt that one of the greatest dangers which beset the modern economist is the preoccupation with the irrelevant – the multiplication of activities having little or no connection with the solutions of problems strictly germane to his subject (Robbins, 1935: p. 3).

Besides this irrelevance, there is another difficulty that arises in assessing the work that economic theory has been producing over the last few decades, and which, as was recently underlined by Amartya Sen (2008: p. 619), demonstrates not only the lack of knowledge about the empirical reality that this theorising is centred upon, but also the lack of interest in real and concrete problems, which are deliberately portrayed in a simplified form in the models that are constructed by economic theory. Besides the disinterest detected by Sen, I should also like to add that there is some disdain to be noted, as well as a fear of sullyng one's hands with a reality that is tremendously difficult to understand.

It is obvious that there are some excellent exceptions that stand out from this negative panorama and that have made some pertinent contributions to the understanding of the economic problems of the contemporary world. Amongst the academic publications intended for a wider public, attention should be drawn to the

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<sup>9</sup> For a critical approach to *freakonomics* and the questions that the media impact of economic science considers to be relevant and interesting for research, see DiNardo, 2007.

book edited by Stiglitz, Edlin and DeLong (2008), which reproduces small texts, initially published in an electronic format (bepress.com), written by great economists<sup>10</sup> on themes of enormous relevance, namely about climate change and global warming, globalisation and the international economy, budgetary policy and tax reform, social security and other social policies, the property market, and also about the costs of the Iraq war and the economic dimensions of the death penalty. These testimonies are proof that, regardless of ideological inclinations and political options, and beyond methodological orientations and theoretical affiliations, there still remain all kinds of opportunities for developing work of a high quality about the real and concrete economy in which we live and that we wish to understand better so that we can also intervene it in a better and more productive fashion. In this sense, the current time of crisis and the beginning of a depression represents a golden opportunity for testing the capacity that economic science has for safely reinventing its subject-matter.

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<sup>10</sup> Amongst whom, besides the actual editors of the book, I draw attention to the names of Kenneth Arrow, Gary Becker, Martin Feldstein, Paul Krugman, Richard Posner, Thomas Schelling and Robert Shiller.

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Translation by John Elliott