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# DID *ECONOMICS* AND *ECONOMISTS* FAIL US?

*During the last 50 years, unfortunately, the claims of what economics as a science considered rational, logical and manageable and the economists thought that they understood the underlying economic processes have been proven false by economic realities. Recession that has afflicted the global economy during the last five years has placed both economics and the economists amid fire. It is being said that the neoclassical economics of the post-war years failed lead to the promised sustained economic growth. The economists have misread the business cycles and are thus dumbfounded. They do not know how and when the world economies would recover. The failures on both fronts have provoked a severe lack of confidence in the validity of economic theories and the economists have been branded incompetent and useless.*

*The authors, in the following pages, intend to reflect upon some of the related issues and express their opinion.*

*Key words: crisis, DSGE models, debt-deflation, financial bubble, financial deregulation, savings glut*

The real test of the validity, accuracy and applicability of any body of knowledge/science/theory can only be proved by its sustainability to the 'fatigue test' i.e.

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its deserving respect under severe conditions. While total stock of knowledge is accumulated, every science becomes a systematised record of its evolution. In each science, theories emerge and most are based upon certain fundamental laws and pre-suppositions. Scientists develop their own logic of interpretation of outcomes based on cause and effect relationship. Over a span of time, theories die, evolve and reincarnate. *Economics* is no exception to it.

Since ancient times, philosophers have devoted attention to the economic well-being of the society. They have devoted attention to the then existing economic and social problems and devised principles and policies. *Economics*, as we know it in modern context, stems from the grafting of ideas and laws generated by the Classical economists. Since then, though the times have changed, the fundamental economic problems have not. *Economics* since Adam Smith has come a long way. It has evolved, become sophisticated, technical and professional. In its process of evolution as a modern science, it as such, in the past, has been put to test and its successes were acclaimed while failures invited serious criticisms. This is exactly what is happening now.

Since the financial crisis of 2007/08, a shadow of doubt in the efficiency of science and competence of professionals is being caste. The confidence of public, politicians and the professionals themselves has been badly shaken. It seems that *economics* and *economists* both have failed us? Let us examine the issue. Accordingly, we try to examine the:

- nature and causes of current economic crisis;
- failures of economic science; and
- the role of the professionals.

## Why Economic Crisis?

Time and again, the world has said ‘Never Again!’ But it has happened again and again! Depressions and the following crises had become a normal feature of our economic history. Let us mention that over the last 300 years serious economic depressions hit the world in 1820s, 1870s, 1880s, 1920s, 1970s, 1990s, and then in 2008[1]. Noteworthy is the fact that every time the intensity of the economic misery and pain these afflicted was different.

[1] Just to remind us, in case of the present crisis, the real panic started on 7th September 2008 and lasted for 10 days. Let us have a hurried reminder on the sequence of events. A long dwelling slump in the US housing market due to the lack of availability of funds to the prospective buyers, the market took toll of Freddie Mac and Fannie Mae (to be hurriedly salvaged by the US

It is almost six years now that major industrial economies are in deep recession, and economic growth in the developed world is dramatically slow. It is claimed that the developed world has landed into a deflationary gap and a course of recovery is failing. Fire fighting has become the order of the day. Time has come that we recognise the root causes for the crisis and then embark on a profound reform of the global economic governance system.

To be sure, the drivers of this crisis are more complex than simplistic explanations pointing alleged government failure suggests. Neither *too much liquidity* as the result of *expansionary monetary policy in the US*, nor a *global savings glut* does explain the breakdown of the financial system, so nor does the individual misbehaviour. No doubt, without greed of too many agents to squeeze double digits profit out of an economic system that grows only in single digits, the crisis would not have erupted with such a force. But good policies should have anticipated, as Allen Greenspan acknowledges that he missed that *human beings can be greedy and short sighted*. The sudden unfolding of speculative positions in practically all segments of the financial markets was triggered by the bursting of US housing price bubble, but these bubbles were unsustainable and had to burst sooner or later. For policy makers who should have known better to now assert that greed ran amok or that regulators were simply *asleep at the wheel* is simply not enough.

Financial deregulation driven by an ideological belief in the virtue of the market has allowed 'innovation'[2] of financial instruments that are completely detached from productive activities in the real sector of the economy (Davidson,

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Treasury). While the stock markets collapsed, Lehman Brothers (declared bankruptcy), Merryl Lynch, Bank of America, AIG (borrowed heavily from the government), corporation like Chrysler, General Motors took government refuge, and many became bankrupt. The bankruptcy of Iceland banks alarmed the impending financial crisis in the UK. It not only led to a collapse of some small banks and the government takeover of the Royal Bank of Scotland, but was followed by a formal acknowledgement by the government that the country is in deep recession. Soon, French, German and other EU countries started crafting anti-recessionary programmes and promising government support to banks and large corporations. Swiss banks suffered heavy losses. Rising economies Russia, China, India revised their GDP growth targets. Hurried meetings of the G-8, G-20 pledged joint support to sustain the shock. While, early November 2009, Germany, France, and US leaders declared the end of recession and mild recovery, later on 26 November 2009 Dubai Inc. declared default on payment of with 67 billion US$ sending new shock waves to the world markets. Has the global economic crisis bottomed out? We are not so sure.

[2] For the past two decades, financial innovations were promoted and protected with scant regard for the downside risks. The most serious financial crisis since the Great Depression, the *de facto* nationalization of a large fraction of the US financial system, and the deepest global recession since WW II have caused doubts on the assumptions that led former Chairman of the Fed, Alan Greenspan, to acknowledge: "Although the benefits and costs of derivatives remain the subject of spirited debate, the performance of the economy and the financial system in recent years suggests that those benefits have materially exceeded the costs", (Remark made at the Conference of Bank Structure and Competition, Chicago, 8 May 2003).

2008). Such instruments favoured speculative activities that were built on convincing information, which in reality was nothing more than an extrapolation of trends into the future. Many agents disposing of large amounts of – frequently borrowed – money bet on the same plausible outcome (such as steadily rising prices of real estate, oil, stocks or currencies).

Contrary to the mainstream view in the theoretical literature in *economics*, speculation of this kind is not stabilising. On the contrary, it destabilises prices. As the *true* prices can not possibly be known in a world characterised by objective uncertainty, the key condition for stabilising speculation is not met. Expectations about long-term price trends must sooner or later hit the wall of reality, because funds were not invested in the productive system of the economies. When the optimism of financial markets meets the reality of the slow growing real economy, an adjustment of exaggerated expectations of actors in the financial market is imminent.

In such a situation, the performance of the 'real sector' is largely determined by the size of outstanding debt: the more the economic agents have been directly involved in speculative activities with borrowed funds, greater is pain of the process of adjusting the level of borrowing to diminished returns. As debtors try to improve their financial position by selling assets and reducing expenditure, they drive asset prices down, cutting deeply in profits of companies and driving new *debt-deflation* (Fisher, 1933, Keen, 2011) elsewhere. This can lead to deflation of prices of goods and services as it constraints the ability to consume and to invest in the economy. The only way out is government intervention to stabilise the system (De Grauwe 2009).

It is instructive to recall the end of Bretton Wood's system, under which the world has enjoyed two decades of prosperity and financial stability after the WWII. Since then, the frequency and size of the imbalances and of financial crisis in the world economy have greatly increased, culminating the current one. Since current-account imbalances are mirrored by capital-account imbalances, they serve to spread quickly the financial crisis across countries. Countries with a current-account surplus have to credit the differences between their export revenue and their import expenditure to deficit countries, in one form or other. Financial losses in the deficit countries feed back to the surplus countries and imperil their financial system. In view of the lack of international financial governance, this channel has shown an enormous capacity of contagion (Folkerts-Landau et al., 2004). Another reason for growing imbalances is movements of relative prices in traded goods as a result of speculation in currency and financial markets, disturbing the exchange rates (UNCTAD, 2009).

The growing disconnection of the movements of nominal exchange rates with the 'inflation differential' between countries has been a main cause of the growing global imbalance. For increased economic welfare to be sustainable, it has to be shared without altering the relative competitive positions of the countries. This is what J. M. Keynes defined as the *transfer problem*; and it is valid to date (Keynes, 1930).

In addition to all these factors, overshooting of commodity prices led to the emergence of very large current-account surpluses in commodity exporting countries during 2000-05. When the *correction* came, the situation of many commodity producers rapidly deteriorated. There is growing evidence that financialization of commodities futures markets have played an important role in the scale and degree of market volatility.

It is evident now that the global financial crisis arose amidst the failure of the international community to provide the globalized economy with credible global rules, especially with regard to international financial dealings and macroeconomic policies. Further, the crisis has made it all too clear that globalization of trade and finance calls for global cooperation, regulation and reviving multilateralism. The tendency of many governments to entrust to financial market again the role of judge or jury in the reform process would be inappropriate. The problem of excessive speculative financial activity has to be tackled in an integrated fashion.

Evidently, it follows that market and fundamental *laissez faire* policies as suggested by the *economists* over the last two decades have dramatically failed the test. Financial deregulation created the build-up of huge risky positions whose unwinding has pushed the global economy into a debt deflation that can only be countered by government debt inflation. The most important task thus is to break the spiral of falling asset prices and falling demand and to revive the financial sector's ability to provide credit for productive investment, to stimulate economic growth and avoid deflation of prices.

Due to blind faith in the efficiency of deregulated financial markets and absence of a cooperative financial and monetary system, an illusion of risk-free profits and licensed profligacy through speculative finances was created in many areas. This systematic failure can only be remedied through comprehensive reform and regulation with a vigorous role by governments. Contrary to traditional views, governments are well positioned to judge price movements in those markets that are driven by financial speculation and should not hesitate to intervene whenever major disequilibria loom.

As the growing role and weight of large-scale financial investors on commodity futures markets have affected commodity prices and their volatility, speculative bubbles have emerged for some commodities during the boom and have burst after the US sub-prime shock. Regulators need access to more comprehensive trading information to understand the moving prices and intervene if problematic. There is a need to seal the 'excessive speculation'.

Finally, the absence of a cooperative international system to manage exchange rate fluctuations has facilitated rampant currency speculation and increased the global imbalances. Thus, multilateral or even global exchange rate arrangements are urgently needed to maintain global stability, to avoid the collapse of the international trading system and to pre-empt pro-cyclical policies by crisis-stricken countries.

## Economics

It remains an undisputed fact that Professor Alfred Marshall is a legendary figure in economic literature to who goes the credit for *economics* became an independent academic discipline in university education throughout the world[3]. His unending enthusiasm in struggling for the cause – in the Cambridge University Senate and outside it – was well felt. It was his *Principles of Economics* (Marshall, 1890) that made the discipline a popular subject of study in the universities (from 1920s on) world over. Unfortunately, today just in less than a hundred years from its initiation, we are facing the crisis of economic science that is being loudly echoed in its criticisms *viz. economics failed us; it is a useless and unreliable science; economists are incompetent people and poor specialists*, etc.

Now, let us not over-react to such criticisms. To the current financial crisis, state of economic affairs and the current pessimism in *economics*, hopefully, John Maynard Keynes would have once again reacted in the same way as he did by repeating to his students in his Madrid lecture of 1930[4]. He said:

> "We are suffering just now from a bad attack of economic pessimism".
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> … "I believe that this is a wildly mistaken interpretation of what is happening to us. We are suffering, not from the rheumatics of old age, but from the growing pains of over-rapid changes, from the painfulness of readjustment between one economic period and another. The increase of technical efficiency has been taking place faster than we can deal with the problem of labour absorption; the improvement in the standard of life has been a little too quick; the banking and monetary system of the world has been preventing the rate of interest from falling as fast as equilibrium requires."
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> "The prevailing world depression the enormous anomaly of unemployment in a world full of wants, the disastrous mistakes we have made, blind us to what is

[3] P. Groenewagen (1995), *The Soaring Eagle: Alfred Marshall 1842-1924*, : Cheltenham: Edward Elgar.

[4] 'Economic Possibilities for our Grandchildren', (1930) included later in his (1931), *Essays in Persuasion*, New York: Norton, 1963 pp. 358-373.

going on under the surface to the true interpretation...of the trend of things. For I predict that both of the two opposed errors of pessimism which now make so much noise in the world will be proved wrong in our own time – the pessimism of the revolutionaries who think that things are so bad that nothing can save us but violent change, and the pessimism of the reactionaries who consider the balance of our economic and social life so precarious that we must risk no experiments."

"...do not let us overestimate the importance of the economic problem, or sacrifice to its supposed necessities other matters of greater and more permanent significance. It should be a matter for specialists like dentistry." (J. M. Keynes, 1931)

Today, we can well endorse the above statement of Keynes with a minor change in his vision of specialists i.e. "*economists might one day be thought as humble competent people, on a level with dentists*". Note, since then, fluoridation, better oral health, and sealants have contributed to reductions in the demand for, and the supply of dentists. Can we hope for such preventive breakthroughs in *economics*? Probably, Yes!

Pessimism in our science has a history. In last quarter century, on one hand, to no ones surprise, the classical teaching of *economics* slowly started withering away even in the most prestigious universities and on the other in the US, Europe and Asia in 1990s and 2000s there was a strong surge in admissions to the Business Schools at the cost of *economics*.

Sadly enough, economic science is ailing today. As the doubts in the forecasting accuracy of *economics* grew, the interest of researchers in general *economics* gradually declined. Inside company research became popular. Moreover, the scepticism of 1980s grew and engulfed the entire economic forecasting activity. Many companies disbanded their forecasting units and independent forecasting economic consultancies vanished. *Economics*, as a science, was branded *unreliable* and the *economists* as *poor*. Naturally, after twenty or so years we are asking ourselves as to what has happened to *economics*.

Since 1990s, the confidence of American, Japanese and West European corporations in the economic forecasts has been badly shaken, because even with the help of computerised models, the *economists* had failed to foresee the stagflation of the 1970s and the cyclical trends of the 1980s. The confidence further depleted in the usefulness of *economics* as a science for the experts did not accurately predict the consumption pattern of the households or the firms. In the mid 1990s some big multinationals in the US started firing their *crystal bowl watchers*[5]. The

[5] General Electric, a giant corporation that earned revenue of some 70 billion in 1996 did not employ even a single economist. IBM fired its 'team of economists' in favour of good 'portfolio and risk managers', because as one spokesperson said, 'it is much cheaper for us'. Soon company experts

Swedish Academy of Sciences too recognised this shifting course in *economics* by awarding the 1990 Nobel Prize to Harvey Markovitz, Merton Miller, and William Sharpe. But, this was of little help as later, the failure of their financial model contributed to huge losses at the stock market, damaging not only the shareholders but also the reputation of the Prize. Somebody must have regretted in Swedish Academy!

Note that the macroeconomic models of the 1930s were based on consumption and saving/investment equations. The year following the WWII, were the 'golden years' for such models. For two decades the world recorded high economic growth rates, but in the 1970s the high hopes were watered down when these models could not foresee the repercussions of the explosive hikes in oil prices. The mainframe computers were fed with 'known' and 'unknown' parameters to produce equations that could be used in justification of proposed growth policies. One worthy author of such models Lawrence Klein won a Nobel Prize for his model in 1980. These models were designed to simulate faster sustained economic growth of the developed western economies[6], which never came through.

In the wake of the current crisis ***economics*** **has definitely failed us**. In past ten years it has provoked a lack of confidence in validity of its theories. It is being said that *few economic bubbles have burst more spectacularly than the reputation of economics as a science*. In the wake of biggest economic shake-up in 80 years its reputation has taken the beating. While Paul Krugman argued that much of the macroeconomics of the past 30 years was *spectacularly useless at best and positively harmful at worst* ; Barry Eichengreen went on to say that current economic turmoil has *cast in doubt much of what we thought we knew about economics*. Lately, some enthusiasts (Keen, 2011 and others) are trying to uproot post-war neoclassical economics by arguing that it is '*profoundly wrong*' and if the '*real world were accurately described by economic text books, there would not now be a financial crisis*'.

Two central parts of the discipline – macroeconomics and financial economics – are now being put to serious re-examination. The attack is directed on three major fronts: that macro and financial macroeconomics helped cause the banking crisis, that it failed to foresee and stop it, and that *economists* have no idea how to fix it.

While the *economists*, especially in the central banks, were too fixated on taming inflation and too brave about asset bubbles; financial economists formal-

became more concerned with risk management, watching financial derivates, hedging against price and interest rate fluctuations, inventory management, etc.

[6] Note that using such models in 1974 the Economic Council of the President of the United States enthusiastically overestimated the economic growth for 3 per cent and underestimated inflation by the same percentage.

ised theories of the efficiency of the markets, fuelling the notion that markets would regulate themselves and financial innovation are always good. Macroeconomists also had their blind spot. Their standard models assumed that capital markets work perfectly. By assuming that it is so, they were largely able to ignore the economy's financial plumbing. The models that ignored finance had little chance of spotting a calamity that stemmed from it.

The Keynesian task of *demand management* (Keynes, 1936) outlived the Great Depression, becoming a routine duty of governments. They were aided by economic advisers who built economic models and were guided by apparent trade-offs between inflation and unemployment. But their credibility did not survive the oil price shock of the 1970s and western economies were deposed to stagflation – a situation which the Keynesian consensus grasped poorly and failed to prevent.

The mainstream macroeconomics embodied in DSGE – *dynamic state general equilibrium* – models was a poor guide to the origins of financial collapse. The conventional instruments of monetary policy proved insufficient. Today, some *economists* advocate a bold fiscal expansion. Evidently, economics requires a revolution in techniques. Macroeconomists should turn to patient empirical spadework, documenting crises – past and present – in the hope that a fresh theory might later make sense of it all.

On the other end, in financial economics, the EMH – *efficient market hypothesis* – strategists claimed that their approach made the financial system healthier and safe. This is why many people view the financial crises that began in 2007-8 as a devastating blow to the credibility of banks but also of the academic discipline of financial economics. The banks assumed that they can always rollover their short-term debts or sell back mortgage backed securities. The financial failures made a mockery of both these assumptions. Funds dried up and the markets thinned out. What followed was a serious rush for cash, and the growing financial bubble had finally burst.

Macroeconomists split – into purists and pragmatists – drawing opposite messages from the episode. The purists blamed the stagflation on restless central banks trying too hard and the pragmatists that markets malfunction, wages fail to adjust and prices are sticky. For two decades after 1982 the two schools converged into the *new synthesis* that flowed from universities to central banks. It underlay the doctrine of inflation targeting.

However, the fragile consensus of monetary/fiscal policies was blown apart. With their compromise tools useless, both sides have retreated to their roots. Keynesians have become uncritical of fiscal stimulus; and even with zero short term interest rates and banking troubles on hand, monetary policy works less well. Naturally, there is a clear case for reinvention. Just as the Great Depression spawned Keynesianism; stagflation of 1970s fuelled Monetarism; now the Schumpeterian 'creative destruction' is underway. May be we come up with a *new economics*. Further, it is true that current economic crisis has exposed bitter divisions among the *economists*; many people in the profession still believe that it could be good for *economics*.

However, we must remind that the troubles of *economics* are purely methodological issues and it is in this context that these should be addressed. The general technique to study the works of *economists* and philosophers which develop, apply, and discuss the theory is to rely on the tentative results of contemporary economics and on initial judgments concerning the nature and worth of theories and *economics* as a discipline. We should acknowledge that the discussions of economic issues are often biased and distorted because of their importance to interests of individuals and social groups. *Economists* can, however, address a broader audience and a wider spectrum of issues if they do not start by taking them as the paradigm for what economics should be. *Economics* must thus struggle to avoid becoming apologetics for any *school of economics*.

History is a witness that, usually, the business cycles have been followed by the reassessments of the economic science. Deep recessions have been followed by negation of the existing orthodoxies giving way to the new. As more than over a century ago, as now, many of us feel that the glaring lack of consensus on fundamental principles compromised the scientific status of *economics*, and there are strong professional and public pressures to establish a new orthodoxy that could speak authoritatively on economic matters.

## The Economist

*Economists* talk about their own work in many ways. They write, for example, about *principles*, *models*, *theories*, *assumptions*, and *definitions* and make use of previous work by epistemologists and philosophers of science. An economic scientist studying economic theory is in the same philosophical position as any empirical philosopher of science seeking knowledge of sciences. *Economists* need to trim, revise, and even invent philosophical categories in trying to make sense of economic theory.

Now let us now redeem who is an *economist* in practice? What he does? Is he someone a social philosopher like Adam Smith or an analyst and teacher like Alfred Marshall or a dentist of Keynes's dream? To us, it seems that modern *economist* is none of the said sort. It appears that he is someone – with a little bit of everything – a theoretician, observer/researcher, analyst, diagnostician, policy designer and sometimes one who gets involved into policy implementation. Evidently, such a person would have to be an intellectual giant and could exist only in our minds.

Keynes in his remark on the role of the future of *economists* was rather sceptic as he thought that *economists* could manage to get themselves thought of a humble, complete people, on a level with dentists. If so, he said, *that would be splendid!* Alas, even after eighty years of this remark that has not happened. Today, *economists* have either been reduced to pure theorists – academics caged in prestigious university campuses, some receiving the Nobel Prize for their theoretical contributions, or the massive number holding graduate degrees in *economics* and business working for state or private employers doing routine work for which no higher education in *economics* is necessary.

***Economists*** **too have failed us** because except a few, to our regret, the vast majority is neither well averse with real *economics* nor is able to use the acquired knowledge in appropriate manner. Professional *economists* have been to their desks doing some routine statistical analyses or designing models of little use. Evidently, we have reached nowhere close to Keynes's dream.

Personally, we would like to see our fellow *economists* of the future in the role of a mechanics – knowledgeable, well-equipped with plenty of analytical tools in their tool-boxes, capable of fixing the defects in the economic system[7]. We see him well aware of economic doctrine, finance, economic history, mathematics and philosophy. We see them talented in understanding the socio-psychological reactions of the people in face of the economic trends and capable of using appropriate analytical tools. Since, the economic system by nature, like an old car, is prone to frequent breakdowns and cyclical fluctuations, their role as constructor and repairer is of utmost priority. For such a role, we visualise an apprenticeship in places where economic policy is evolved.

Since, the 1970s, unfortunately, in the academia, the pressure for jobs, promotion, tenure and publications has grown so such that the *economists* had to cultivate ever narrower fields. The slogan became *publish or perish*. The result was that the economics students were trained to become narrow specialists even without understanding the institutions, the economic thought, the economic literature, the handling and evaluation of quantitative and qualitative data, learning to weigh evidence, and without wider visions.

We are confident that we do not require an army of *economists* to run the economy well. A massive enrolment of students is not required in the universities, because educating an *economist*[8] of the needed type is not going to be an

7 Economic system should be understood as a compound of institutional framework including economic legislation, economic structure of the society and economic policy of the state.

8 I mean here graduate (master) and postgraduate (doctoral) education of 'economists' only.

easy task. While the students will have to be gifted, the teachers would have to be highly qualified and competent and curriculum tough. For a moment, let us not be misled by Keynes's remark that *the study of economics does not seem to require any specialised gift of an unusually high order*[9], instead we would like to cite and agree with him when he writes in his essay on Marshall that … *the master economist must possess a rare combination of gifts*[10].

*Economics* requires broader knowledge. Does this broadening not mean that we have to sacrifice some education in *economics* that is all the time becoming more and more technical, specialised, fragmented and professional? We are sceptic that unless we lengthen the time of study, evidently, some sacrifices in curriculum will have to be made. Scholars are saying world-wide that the *specialist knows more and more about less and less until he knows everything about nothing*. The real question is should a well-trained business economist deal with few areas or spread his investigation widely? Currently, a widely held criticism of modern American and European education of economics is that it has, unfortunately, become too narrow and too far from reality[11]. The Economics Departments in universities are awarding degrees to generations of *fach idiots - brilliant at esoteric mathematics yet innocent of actual economic life*[12]. We would rather agree with Streeten and favour *being a broad-gauged economist and vaguely right to being precisely wrong.*[13]

Since J. M. Keynes published his *General Theory of Employment, Interest and Money* (1936), *economics* education in the Western world, particularly in the US, has moved far away from the tradition. Many distinguished *economists* in the 1990s accepted that in the US Graduate (Master) education the tools and theory

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[9] Keynes, J. M., 'Alfred Marshall' in his *Essays in Biography*, London: Macmillan (1972). This remark should be taken in context to the then prevailing widespread feeling among the university students and the public that the study of *economics*, compared to other sciences or law, does not require any pre-requirements and is easy to complete.

[10] "Is it not intellectually regarded a very easy subject compared with the higher branches of philosophy and pure science? Yet good or even competent, economists are the rarest of the birds". He further adds, He must reach a high standard in several different directions and must combine talents not often found together. …. He must be mathematician, historian, statesman, philosopher – in some degree. He must understand symbols and speak in words. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must study the present in the light of the past for the purpose of the future. No part of human nature or their institutions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, yet sometimes as near the earth as a politician." Ibid.

[11] Klamer, Arjo and David Colander, (1990), *The Making of an Economist*, Boulder: West View Press.

[12] Kuttner, R (1986), 'The Poverty of Economics', *Atlantic Monthly*, February Issue, pp 74-84.

[13] Paul Streeten, *American Economics Education*, Mimeo.

are preferred at the cost of creativity and problem solving. It is also noted that graduate students who come from other fields can get Ph.Ds easily with little or no knowledge of economic problems and institutions of the system[14].

We feel that time has come to reverse the trend. We further believe that it would perhaps be right to sacrifice some technical aspects of *economics* (including some of mathematics) in favour of disciplines like political science, logic, sociology, philosophy and history. Our argument in support of this is that philosophy consists of logic, epistemology, moral and political philosophy. A sound knowledge of logic and theory of knowledge will make an *economist* not only good theorist but also teach him to distinguish between, on one hand, tautology and deductions from them, and on the other, empirical facts and their relation. *Economics* suffers from mistaken validity for truth and the easy transition to falsehood that lies at the alleged rigour and precision of mathematical economics. Conclusions may be valid but untrue. Similarly, a good education in moral and political philosophy would avoid or at least reduce the numerous hidden biases in economic reasoning. The knowledge of political institutions and processes makes the *economist* aware of the constraints and opportunities for getting policies right. *Economists* need to take their investigation into the political variables in economic policy, and supplement positive with normative political economy, because such knowledge is deeply neglected in modern *economics* education. It hardly needs any argument of defence.

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## JESU LI NAS *EKONOMIJA* I *EKONOMISTI* IZNEVJERILI?

### Sažetak

Tijekom proteklih 50 godina, ekonomska je stvarnost pokazala da su bile pogrešne tvrdnje koje je ekonomska znanost smatrala racionalnim, logičnim i razumljivim, a ekonomisti su, pak, mislili da razumiju ekonomske procese na kojima se one zasnivaju. Recesija, koja je proteklih pet godina pogodila svjetsko gospodarstvo, bacila je ekonomiju i ekonomiste usred vatre. Govori se kako neoklasična ekonomija, u poslijeratnom razdoblju, nije uspjela dovesti do obećanog stalnog gospodarskog rasta. Ekonomisti su pogrešno protumačili poslovne cikluse pa su tako ostali zatečeni. Ne znaju kako ni kada bi se gospodarstvo moglo oporaviti. Neuspjesi, na jednom i drugom planu, su izazvali ozbiljno nepovjerenje u valjanost ekonomskih teorija, a ekonomiste se proglasilo nestručnima i beskorisnima.

Autori se u svom radu žele osvrnuti na neke probleme s tim u vezi i izraziti svoje mišljenje.

Ključne riječi: kriza, DSGE modeli, deflacija duga, financijski mjehuri, financijska deregulacija, prekomjerna štednja.