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A New Soros Initiative on the Economics Profession?

Kenneth Anderson • October 30, 2009 1:49 pm

Michael Hersh describes a new $50 million George Soros initative to try and remake the economics profession so to reclaim it from "free market fundamentalists." The fund will be run by Robert Johnson, formerly a managing director of Soros Fund Management; it hopes to raise $200 million in matching funds. (H/T Instapundit; also Mark N is right in the first comment to raise Cato as a better point of comparison in the (lengthy) discussion below the fold.)

> Large swaths of economics are going to have to be rethought on the basis of what's happened." So said Larry Summers, President Obama's chief economic adviser, in an interview in the weeks after the markets crashed a year ago. Yet to a remarkable degree, economic thinking hasn't changed very much at all.
>
> Now financier George Soros is announcing a $50 million effort to speed things along. This week Soros is gathering some of the leading practitioners of the market-skeptic school, who were marginalized during the era of "free-market fundamentalism," among them Nobelists Joseph Stiglitz, George Akerlof, Michael Spence, and Sir James Mirrlees. He's also creating an "Institute for New Economic Thinking" to make research grants, convene symposiums, and establish a journal, all in an effort to take back the economics profession from the champions of free-market zealotry who have dominated it for decades, and to correct the failures of decades of market deregulation. Soros hopes matching funds will bring the total endowment up to $200 million. "Economics has failed not only to predict and explain what happened but has also failed to protect society," says Robert Johnson, a former managing director at Soros Fund Management, who will direct the new institute. "That's what the crisis revealed. The paradigm has failed. There is no guidance."

I am curious what professional and academic economists make of this kind of initiative. (Update: Here's a much better article from the FT. And I've added ... *still more* to the post below.)

> George Soros, the fund manager, has pledged $50m to back a new think-tank with the mission of reconceiving the field of economics, which he describes as "a dogma whose

> time has passed" ... The group's advisory board will be studded with economists such as Jeffrey Sachs, George Akerlof, Kenneth Rogoff and Joseph Stiglitz as well as public commentators such as Anatole Kaletsky and John Kay, a Financial Times columnist. Mr Soros is pledging $5m a year for 10 years.

II

As the FT notes, one way to see this is that Soros is simply funding a stellar academic cast in order to push his own philosophical theory of "reflexivity" — will the Nobelists go along with that? Or simply do what they were going to do anyway?:

> Mr Soros, who has long been a critic of economic "fundamentalism", blames the unwavering belief in unchecked free markets, which remains pervasive in universities, for allowing financial markets and asset prices to melt down. Through INET, he will be indirectly funding his philosophy of **"reflexivity"** – that markets tend to influence perceptions of reality, which in turn feed back into markets.

This new institute will based in Hungary, at the Central European University, by the way, which Soros created back in the 1990s, and it should certainly give some oopmh to the CEU. Overall, you can think of many ways to conceive of this kind of institute, including (thanks to commenter below) this observation from Peter Boettke:

> So to challenge the economic establishment which doesn't permit creative thought outside of free market fundamentalism, we are going to enlist 2 professors from Columbia (1 a Nobel Prize winner, and the other the closest thing the profession has to a rock star), 1 from Harvard, and another from UC-Berkeley (who also won the Nobel Prize). Because I guess the profession has been dogmatic in the treatment of their ideas, or that the US government hasn't been influenced for the past 20 years by their ideas on regulation of markets, managament of the macroeconomy, and foreign aid goals.

I think I am highly committed to free markets without thinking of myself as a dogmatist; the EMH is an empirical hypothesis that bears only as much weight as the evidence shows. I have no view that markets tend always to efficiency let alone perfection, and I am quite sympathetic to the idea that economics is entirely too much in love with elegant mathematical modeling and has turned itself into the Glass Bead Game. I am second to none in my admiration for Professor Mankiw, but I must admit that one part of his famous blog post on why study math as an economist gives me pause, even if it was no doubt tongue in cheek:

> 4. Your math courses are one long IQ test. We use math courses to figure out who is really smart.

I don't doubt for a moment the utility of much advanced math that I don't understand, particularly, as Professor Mankiw says, because there are many genuinely counterintuitive economic conclusions. The problem is, using advanced math skills as a professional filter is also a remarkably good way for ensuring that the connection between the real world and the academic world lessens. Paul Krugman took abuse from the professionals for his recent NYT Magazine essay on the state of economics. No one should be surprised to learn that I am no fan of Krugman the pundit — but much of the criticism seemed to me curiously misplaced. It was narrowly focused on talking about how little he knew about macro, and curiously unfocused, seemingly unaware, that there is a perfectly important conversation to be had about conceptions of elegance in the Glass Bead Game taking over from reality that apply, as he was speaking, to the discipline of economics as a whole. Aesthetics, in the sense Krugman meant it, is a relevant observation about the nature of the discipline, and not addressed by sniping about specialized details.

That's a point about *sensibility* that is external, as it were, to the *sense* of economics. I was both surprised that Krugman made it and admiring that he made it so well. I don't doubt — see the discussion below — that there is a role for the humanities, philosophy, and the philosophy of value — in the re-widening, as it were, of the discipline of economics. It will be incongruous with purely mathematical modeling, because it will be forms of explanation at least partly exogenous to the pure discipline. But, to be clear, I do *not* mean by this the conversation I had with an anthropologist a year ago who, sensing academic blood in the water in the economics profession, sagely nodded and told me that none of the current market meltdown surprised him, because he had carefully studied ... exchange rituals in hunter-gatherer tribal society and it wasn't that different from macro. (I exaggerate but frankly only barely.) Not *that* exogenous; the Ache can teach us many things, I suppose, monetary policy not being among them, however.

Tyler Cowen, by the way, remarks that as the formal discipline of economics includes fewer native English-speakers and fewer Americans:

> In percentage terms, fewer and fewer economists are Americans by birth and upbringing. Non-Americans are less likely to be fully fluent in English, which encourages mathematics. Non-Americans also tend to be less market-oriented in their thought. In any case they are less likely to stand along traditional U.S. ideological fault lines or even share ideological fault lines with each other.

If that is so, then what I am suggesting — a resurgence of humanities into economics, via such topics as the 'moral sentiments' or the deep conceptual philosophy of value (see the discussion below) — is unlikely to go anywhere. But in that case, I think much of Soros's project does not go anywhere, either, because it, too, is founded on a move away from Glass Bead Game economics as well as a move away from EMH.

III

One way to model this new institute — if, as I think many on the left do including perhaps Soros himself, you think that "conservatives" have done this kind of think tank thing better in recent decades — is on the model of Cato. As Mark N points out in the comments, it's probably the most accurate to Soros's intentions, and those of his board. If not that, then perhaps the Olin fellowship program.

Another way to see it, though, is as a sort of Hoover Institution of the left. It would be a good model for such an institute, if it had the patience to persevere after Soros has left the scene. Hoover's slogan is "ideas defining a free society." But Hoover is nowhere near as monolithic as outsiders sometimes imagine — I often have the impression that many casual observers confuse Hoover and Heritage and Hudson. Niall Ferguson is a Hoover senior fellow; so also, outside of economics, is Timothy Garton Ash or Michael McFaul, now a senior Obama official. Hoover has far more diversity of thought as an academic institution than — well, to be perfectly frank, than many of the academic institutions I've ever been associated with. It is a big tent on the idea of "defining a free society." Ironically it is not necessarily that far from Soros's own ideas about the 'open society'.

If it were modeled on Hoover, it could be a very good thing, precisely because while Hoover has a squishy tilt, it is a not a political task-master in any sense and it understands far better than most traditional academic institutions the role of free thought, particularly in academia. One virtue of a free society/free market tilt is that it leads the institution genuinely to believe in a market place of ideas. Whereas my (long and deep) experience in the nonprofit and foundation world is that, no matter what the spin, the advocacy community regards academic research and endeavors as "bought and paid for." (Which is a reason, by the way, not to bother to commission research, because — if you are looking for pre-set outcomes — it's both cheaper and more reliable to buy off the shelf.)

But if this new Soros institute actually takes seriously the Hoover model of gently mission-driven but also capacious and not partisan, a research institution in the fundamentals of ideas rather than a day-to-day policy shop cranking out stuff for Capital Hill, a believer in the market for ideas, then it could be an excellent enterprise. But also not particularly clear how this new Soros initiative is different in that respect from ... Brookings or, come to that, most universities, including their economics departments in the United States. Indeed, if I were a senior vice president at Brookings, I would be wondering why Soros isn't simply cutting Brookings a check right now.

IV

In any case, I'm not at all persuaded that the economics profession, in academia or out, has been captured by some "free market fundamentalism." It somewhat seems that the goal is much narrower than the economics profession and "market fundamentalism" — it might better be called, perhaps, the Anti-EMH Institute. But I have serious doubts that the economics profession or academy has been taken over by that, or that to the extent it has, that it will not on its own momentum shift other directions in response to ... "events, dear boy, events." The real, and real world abuse, of EMH, one might have thought, lies in the financial world itself, among people who did not sufficiently understand the models to challenge them; or who lived in a Dilbert's world of "It must be right, it has math!!"; or who might have been skeptical about the risk models, but couldn't be bothered to follow up because the monitoring incentives were wrong.

In any of those real world cases, it is easy to absolve oneself by saying, 'But Dr. Pangloss at Chicago said we lived in the best of all possible worlds' — but it is doubtful that is where the problem lies, not really. It's a convenient excuse and scapegoat. In that case, the true mission of a Soros initiative on this would be aimed not at the academy and its supposed fundamentalism, but at the really hard, grindingly hard work of the ground level structure of regulations. Policy not at the level of high, high abstraction economic theory, but the policy that deals at the ground floor of regulations and regulatory approaches to concrete problems of complexity, complacency, and conflicts of interest. Felicitously, one might think that a Soros institute run by the eminent Robert Johnson is exactly positioned to connect new intellectual movements on such things as efficient markets to the real people of Wall Street and London. But then there's a catch:

A lot of that work is *regulatory law* informed by economics, not economics as such.

I've come to believe that the lawyers have far more to contribute to fixing financial regulation than many people — read economists — understand. Or that we lawyers understand. It is principally because lawyers seem to grasp better the sticky grit of institutions and their internal workings. As a caricature, economists seem better to understand markest; lawyers seem better to understand institutions.

Why is that, if so? I think it has something to do with the fact that economists think so much of the time in models of abstract contract and freely contracting parties. I'm always surprised by what economists often think the actual rules of contract law are; they in turn are often surprised when I point how many contingencies lie within contract interpretation, default, remedies. Mitigation, for example, or oppression or adhesion. I don't mean this in any radical or skeptical sense, I just mean that contract rules and legal outcomes, as understood by lawyers and judges, are not quite as fixed as economic modeling sometimes seem to assume.

For that matter, I am often struck by the financial instruments that financial economics seems to treat as economically equivalent — various synthetic derivatives for example or, even easier, certain varieties of preferred stock and corporate debt. When I actually look at the law underlying the instruments –the corporate law as well as contract, the contingencies of bankruptcy, etc., I think ... these instruments are equivalent in the middle of the bell curve, in ordinary conditions trading in the market, but precisely when trouble strikes, the contingent risks that different instruments with different-reading contracts defining them will be read differently increase drastically. And I can't say I have any good reason to think that the markets have a mechanism other than fiat assumption that these contingent differences are captured in market valuations. But hey, it's tail risk, right?

V

In particular, when economists think about *agency*, they seem to think mostly in terms of failures of agency with respect to essentially contract relations. Lawyers have shifted in that direction over time, but they are still far more imbued with concepts embedded in the law about agency as a genuine form of social life itself — apart from and beyond simple bargaining between free actors. Fiduciary duty might not mean very much to an economist used to thinking solely in terms of what actors think they can get away with, but it still means something (less than it used to, granted) to lawyers.

Agency, in other words, as an affirmative body of social behavior, motivating and motivated on its own terms. That, for me, was the most important signal from this year's economics Nobels — indirectly, they signaled an acknowledgment of the importance of agency for its own sake, and as its own form of social life, with an independent impact on economic relationships. The life of a fiduciary, the social ideal of the steward, the idea of a 'shepherd'. I have written about this in passing at VC — a return to the idea of the moral psychology of finance; 'virtue economics' not in the sense of welfare and distributional justice, but instead in the idea of economics informed by the 'moral sentiments'.

This is not behavioral economics. Behavioral economics is important as an empirical correction to rationalist models — but they both suffer from the incompleteness of not taking into account the depth of human psychology, at the conceptual level. Behavioral economics is admirably superficial; in order to defend its empirical claims, it makes as few claims as possible about the deep psychology of social life. But there is a deeper, if admittedly more contestable, aspect to humans and markets: concepts such as trust, honor, fidelity, fiduciary, agent, principal, steward, are not fully captured either by rational market models or by deliberately under-theorized behavioral finance. And yet they do indeed inform human behavior and, for that matter, as Alan Greenspan noted to his sorrow, markets and even the favorite playground of the most abstract thinkers in economics, finance.

Sorry for the digression; I'd like to write a very short book-essay on the moral psychology (or the moral sentiments if you prefer) of finance. It is on my mind everytime I think of these topics; perhaps the new Soros institute would like to underwrite my work and free me from teaching for a year (well, let's say two ... or maybe a year on Soros's dime and a year out at Hoover? Wow!) In any event, if anyone related to this new institute happens on this — I hope you will consider carefully that

- an important aspect of the work worth funding is, in the intellectual foundations of finance theory, less about rationalist theory or behavioral finance than about the philosophy and intellectual history of the social virtues, the social sentiments, the socializing sentiments, the other half of Adam Smith's endeavors; and
- the biggest task of intellectual reconstruction lies, perhaps surprisingly, and in the gritty work of policy involving law informed by regulatory policy, and so you need to fund more academic and regulatory lawyer policy work than you might have thought.

VI

The other possibility for the Soros institute, however, is that the effort is seen, either as perception or reality, as being an explicit effort to politicize the economics profession. Since in one way of course economics is "politicized" in much of its work nearly by definition, in the broad sense of policy, that might be brushed off. But within the professional community, there are policy and political preferences that can be explicitly put on the table and understood as such, either as assumptions or qualifiers — and there are bridges too far, as well.

It's different if it appears that by taking funding from this think tank or that, you're bought; and it's not always easy to draw the lines, even though they are often understood informally. It's easy enough for Soros to fund the kind of research he wants to fund, and to do it in a way that absolves it of political controversy. The aim here. however, seems to be to try and create a movement. It might turn out very well, like the Olin fellows. But it might turn out that taking those funds and sticking them into an organization with an explicit mission to "re-educate" the economics profession permanently taints those funds. Is there a difference between that and Hoover or Brookings or other existing think tanks? Depends on your view of things but, yeah, I think there is.

I am not a professional or academic economist, however. I am curious to see what the professionals think and how they perceive it, now and as it plays out. The Olin fellowships, after all, were a remarkably effective catalyst for change in the academy, in economics and law. Or else they simply funded where people were headed anyway, though they were happy to take the money. Or a little bit of both.

Categories: Academia, Economy, Finance, Financial Crisis, Legal profession, Legal professor, Regulation

55 Comments

1. ***Mark N.* says:**

   I'm somewhat puzzled that in discussing (generally quite insightfully, fwiw) how this initiative/institute might fit into the current landscape of somewhat-activist or more-activist economist initiatives and institutions, you left out comparison with more of the ones that actually are activist. My first question on reading of this initiative was: "is this going to be a Cato Institute of the left?" It may or may not turn out to be, but to me at least that was the obvious initial analogy.

   Quote

   October 30, 2009, 2:11 pm

2. ***Kenneth Anderson* says:**

   Yeah, Cato might be a better comparison for what Soros actually intends, rather than Hoover or Olin. Good point.

   Quote

   October 30, 2009, 2:14 pm

3. ***Anonymous* says:**

   To international socialists, "fundamentalist" is someone who has a set of beliefs and goals that consist of something other than "power for me and people like me".

   I can see how truth of analysis of voluntary transaction would get in their way.

   Quote

   October 30, 2009, 2:19 pm

4. ***MTB* says:**

   Peter Boettke sums it up:

   But the dogma we are told that has become entrenched in the economics profession is free market fundamentalism. And his board of advisors will consist of Jeff Sachs, George Akerloff, Ken Rogoff, and Joe Stiglitz. So to challenge the economic establishment which doesn't permit creative thought outside of free market fundamentalism, we are going to enlist 2 professors from Columbia (1 a Nobel Prize winner, and the other the closest thing the profession has to a rock star), 1 from Harvard, and another from UC-Berkeley (who also won the Nobel Prize). Because I guess the profession has been dogmatic in the treatment of their ideas, or that the US government hasn't been influenced for the past 20 years by their ideas on regulation of markets, management of the macroeconomy, and foreign aid goals.

Quote

October 30, 2009, 2:32 pm

5. ***Oren* says:**

   Soros supported out marijuana decriminalization petition here in MA. Has CATO ever actually put their money where their mouth is?

   Quote

   October 30, 2009, 2:38 pm

6. ***road2serfdom* says:**

   Lets just stipulate that no person, think tank, religion, or other institution "puts its money where its mouth is" better than Soros, and move on to relevant points.

   Quote

   October 30, 2009, 3:02 pm

7. ***bartman* says:**

   Oren:

   Cato doesn't have a lot of money.

   Sounds like Soros wants a group of people to do more non-rigorous descriptivist stuff leaning towards advocacy of central control of markets. If that's what he want, and he can afford iot, then good luck to him, but I doubt he'll have much success "changing the profession". If he wants to try to expand the frontiers in the study of non-rational economic behavior and behavioral finance, I doubt he'll do a better job than guys at places like CMU and Princeton, but once again, good luck to him.

   Michael Milken runs a similar sort of institue (in a different part of the politosphere), and I haven't seen that make much of a dent.

   Quote

October 30, 2009, 3:04 pm

8. ***Abdul Abulbul Amir* says:**

   Free market?

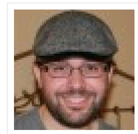
   The CRA required banks to lend to folks that did not have the creditworthiness or down payment of a conventional mortgage. Hence the proliferation of sub-prime mortgages. The government sponsored Fannie and Freddie got into the act creating a market for these mortgages by bundling them into mortgage backed securities (MBS). These MBS included no money down mortgages from states with anti-deficiency laws!! The bank regulators gave banks special incentives to hold these MBS.

   To call this regulatory induced disaster "free market" is just nuts.

   Quote

   October 30, 2009, 3:05 pm

9. ***Gabriel McCall* says:**

   Highly regulated markets fail, and this is proof that they were not regulated enough?

   What hypothetical proof would market opponents be willing to acknowledge as sufficient demonstration that the regulation is the problem? If it's not falsifiable, it's a faith, not a science.

   Quote

   October 30, 2009, 3:08 pm

10. ***NickM* says:**

    Oren — CATO's tax status doesn't allow that.

    Nick

    Quote

    October 30, 2009, 3:10 pm

11. ***CJColucci* says:**

    I am curious what professional and academic economists make of this kind of initiative.

    You mean other than "grant application enclosed"?

    Quote

    October 30, 2009, 3:10 pm

12. ***Mikey* says:**

    > To call this regulatory induced disaster "free market" is just nuts.

    It's not nuts, it's a very specifically crafted tool of intentional deception. It's a way for those responsible for the disaster to shift blame and grab more power.

    Quote

    October 30, 2009, 3:12 pm

13. ***rj* says:**

    Time to sit back and watch the crazies come out to play on this one — maybe not here, but elsewhere in the blogosphere.

    It always puzzled me how he got turned into some sort of right wing boogeyman for funding a lot of anti-Bush initiatives, as if the origin of the money is tainted because of its sheer volume. Leftish organizations, whether truthfully or not, are "attacked" as being funded by Soros, as if he had some nefarious secret agenda other than what he states very clearly any time he's asked.

    The dude is a holocaust survivor, but he even gets slandered for that!

    Quote

    October 30, 2009, 3:39 pm

14. ***Mark N.* says:**

    I'd be particularly interested in the book-essay floated in section V. I agree that the deeper structural aspects of how ideas and relations impact markets are under-theorized. Clearly a lot of commercial transactions, even at smaller scales, depend on some shared ideas like "fiduciary duty", or even informal ones like what constitutes an agency relationship, "good faith", partnership, etc.

    Somewhat unfortunately, the only people who seem to work full-time at that sort of thing are Marxists, who have huge bodies of literature on the relationship between finance, ideology, commercial relations and assumptions, etc. But, while they get some of the tools right, they clearly tend to approach the research from a conclusion-already-predetermined perspective (the conclusion will always be something about hegemony of capitalism and oppression).

It'd be interesting to see a more open-minded analysis trying to tackle the idea of: how do material elements of economies (commodities, money, markets, etc.) interact with the ideas/ideals prevalent in human societies. Is that something along the lines of what you had in mind?

Quote

October 30, 2009, 4:02 pm

15. ***Dotar Sojat* says:**

I think Soros just wants to be the biggest oligarch on the block, protected by a compliant/coopted government. With Juan and Evita in the White House, he figures this is the time.

Quote

October 30, 2009, 4:16 pm

16. ***Mario Rizzo* says:**

Where's Charles Koch in all of this? Policy studies are good but fundamental research has more long lasting effects.

Quote

October 30, 2009, 4:27 pm

17. ***roger thistle* says:**

RJ: People who disagree with you are the "crazies"? Great argument.

Quote

October 30, 2009, 4:27 pm

18. ***Anderson* says:**

If the operations of the market end up favoring anti-market economists, then who's right?

Quote

October 30, 2009, 4:31 pm

19. ***richard* says:**

To call this regulatory induced disaster “free market” is just nuts.

It’s not nuts, it’s a very specifically crafted tool of intentional deception. It’s a way for those responsible for the disaster to shift blame and grab more power.

Ah yes. 30 years of steady deregulation, started by Saint Ronnie, and when the economy collapses, its because of regulation.

It must be nice to be a true believer untethered from a relationship with facts or logic.

Quote

October 30, 2009, 4:44 pm

20. ***Connecticut Lawyer* says:**

I just find it ironic that a currency speculator (aren’t they the very worst types of capitalists, with no redeeming social value at all?) is the heart-throb of the left.

Quote

October 30, 2009, 4:48 pm

21. ***Jmaie* says:**

“Not caused by a lack of regulation” is not the same as “caused by regulation.”

Quote

October 30, 2009, 4:53 pm

22. ***Bruce Hayden* says:**

> **richard**: Ah yes. 30 years of steady deregulation, started by Saint Ronnie, and when the economy collapses, its because of regulation.

Except, of course, that the level of regulation has gone up significantly during those 30 years. All you have to do is compare the quantity of laws on the books back then to now, and the numbers of pages of the CFR, etc. then and now.

Quote

October 30, 2009, 5:02 pm

23. ***Oren* says:**

> Oren — CATO’s tax status doesn’t allow that.

Fair enough.

It just seems like he got concrete, state-wide results. That impresses me.

Quote

October 30, 2009, 5:10 pm

24. ***Mr L* says:**

 Ah yes. 30 years of steady deregulation, started by Saint Ronnie, and when the economy collapses, its because of regulation.

 You want to compare the current 'economic collapse' to Carter-era stagflation and 70s oil shocks? Oh yes, let's do that. **Please.** God, that would be great. I would be *so happy* if you did that.

 Quote

 October 30, 2009, 5:16 pm

25. ***frankcross* says:**

 The problem lies here. You write

 "the EMH is an empirical hypothesis that bears only as much weight as the evidence shows."

 Which is exactly right. But not so universally accepted. Too often it is taken as a given without any interest in empirical explanation. In its strongest form, it's been clearly refuted but it continues to have considerable credence with a significant number of economists.

 Quote

 October 30, 2009, 5:25 pm

26. ***Harry Schell* says:**

 Given the trend of thinking in other organizations Soros funds, I would expect someone will prove Das Kapital actually is a viable formula and always has been.

 It just hasn't been done by the right group of right-thinking people. Things will be different, this time.

 Quote

 October 30, 2009, 5:35 pm

27. ***richard* says:**

Except, of course, that the level of regulation has gone up significantly during those 30 years. All you have to do is compare the quantity of laws on the books back then to now, and the numbers of pages of the CFR, etc. then and now.

Stuff and nonsense. All types of industries, including the financial markets, were deregulated. Indeed, the Republican leaders — Bush, Cheney, Gingrich, etc, etc, etc — ran on their accomplishments in deregulating the economy and leading to the booming economy. But, as I said above, no use arguing with true believers. The economic collapse was caused by too much regulation because I say so — if only there had been total deregulation, everything would have been great. (Same thing on the far left– Communism didn't succeed because it wasn't every implemented in its pure form.) The same nonsense again and again and again.

Quote

October 30, 2009, 5:46 pm

28. ***richard* says:**

You want to compare the current 'economic collapse' to Carter-era stagflation and 70s oil shocks? Oh yes, let's do that. Please. God, that would be great. I would be so happy if you did that.

I just want to make the very simple point that you can't have 30 years of increasing deregulation of all sectors of the economic landscape and then make the argument that the economic collapse was because of too much regulation. (Actually you can make the argument but only if your belief in the fairy tale of the benefits of unfettered capitaliam causes you to simply ignore facts)

Quote

October 30, 2009, 5:49 pm

29. ***Adam J* says:**

Bruce Hayden– sounds highly scientific... let's do a word count to determine the amount of regulation. Or we could consider the fact that the CRA is over 30 years old and didn't even apply to mortgage brokerages and companies like Countrywide which led the subprime market.

Quote

October 30, 2009, 6:14 pm

30. ***Xmas* says:**

Richard,

You're conflating two things. The Republican and Democratic administrations were lax and random with enforcement while the the number of laws and agency rules continued to increase. Both of these are problematic, but together they are disastrous.

Quote

October 30, 2009, 7:02 pm

31. ***Mark Field* says:**

> You want to compare the current 'economic collapse' to Carter-era stagflation and 70s oil shocks? Oh yes, let's do that. Please. God, that would be great. I would be so happy if you did that.

Per capita GDP rose under Carter. It fell in the recent recession.

Quote

October 30, 2009, 7:08 pm

32. ***lucklucky* says:**

Well the regulation that matters: Price of the Money is/was identical in Washington or in Soviet Kremlin when it existed. Means State controlled.
We can well say that Mr.Friedman for all is good ideas was also a Money Statist.

Did anyone asked yet, why the U.S. Constitution has limits to Political State power but no limits to Economic State power? The State can take everything from a person.

Until there are constitutional limits to taxes and debt USA is nothing more than a Social Republic.

Quote

October 30, 2009, 7:09 pm

33. ***Ryan* says:**

Doesn't the existence of a central bank and centrally planned credit markets preclude any of this "the-free-market-causes-all-problems" talk?

Quote

October 30, 2009, 7:21 pm

34. ***SenatorX* says:**

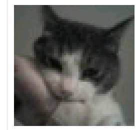
Doesn't the existence of a central bank and centrally planned credit markets preclude any of this "the-free-market-causes-all-problems" talk?

One would think so but unfortunately the meme is politicos are not responsible for anything and crises are useful for growing their power and the coffers of their benefactors. Blaming free markets is just grist for the mill among the useful idiots who somehow always think human nature unchecked is to blame for everything.

Quote

October 30, 2009, 7:29 pm

35. ***brenatevi* says:**



Blaming free markets is just grist for the mill among the useful idiots who somehow always think human nature unchecked is to blame for everything.

I'm not going to argue for or against that comment, but just wanted to point out that politics and government seems to be a part of human nature as much as any free market.

This article does make me wonder: why hasn't anyone done an in-depth study of human psychology and economics (or have they?) I mean, numbers are great and all, but people aren't exactly rational numbers, and tend to do things despite what seems to be obvious evidence to the contrary.

Quote

October 30, 2009, 8:16 pm

36. ***therut* says:**

The Brady Campaign of economics is born.

Quote

October 30, 2009, 8:26 pm

37. ***Malvolio* says:**

> **richard**: I just want to make the very simple point that you can't have 30 years of increasing deregulation of all sectors of the economic landscape and then make the argument that the economic collapse was because of too much regulation. (Actually you can make the argument but only if your belief in the fairy tale of the benefits of unfettered [capitalism] causes you to simply ignore facts)

Yes, we had 30 years of booming growth and then a correction — a correction, not a collapse — that
a. started in one of the most regulated areas of the economy
b. started with players that were *government-owned*
c. caused us to give back about two-to-five years of growth
d. caused employment to zoom up almost, but not quite, as high as European

levels during good times

so, no, I am still sort of skeptical that this is cause for condemnation of the free market. The most it suggest is that capitalism is like Churchill's description of democracy: the worst choice except for all the others.

Quote

October 30, 2009, 9:06 pm

38. ***geokstr* says:**

> roger thistle says:
> RJ: People who disagree with you are the "crazies"? Great argument.

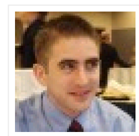
Right out of the leftist playbook comes:
Rule 5: Ridicule is man's most potent weapon.

Once you have ridiculed your opponent, you can claim that anything he says can be totally disregarded, and there is no further need to address his arguments.

Quote

October 30, 2009, 9:15 pm

39. ***Tim* says:**



> **brenatevi**: *This article does make me wonder: why hasn't anyone done an in-depth study of human psychology and economics (or have they?)I mean, numbers are great and all, but people aren't exactly rational numbers, and tend to do things despite what seems to be obvious evidence to the contrary.*

There is an entire subdiscipline of psychology dedicated to answering that criticism. It's called "Behavioral Economics."

Quote

October 30, 2009, 10:47 pm

40. ***Ricardo* says:**

> **Gabriel McCall**: What hypothetical proof would market opponents be willing to acknowledge as sufficient demonstration that the regulation is the problem? If it's not falsifiable, it's a faith, not a science.

You would have to do at least two of three things:

1. Show an actual connection between some specific regulation and the harm done — similar to a showing of proximate cause for the lawyers.

2. Show a cross-country comparison where there is a fairly strong correlation between presence of the given regulation and the outcome measure.
3. Show a time-series analysis where, again, existence of the given regulation coincides quite nicely with the outcome measure.

We don't have any of these three on the subject of financial regulation. Instead we have a lot of handwaving about the CRA (which the Fed estimates contributed to an increase of about 2% in subprime loans) and Fannie and Freddie (which, as covered extensively in previous comment sections, did not play a central role in the crisis although their own business decisions were stupid and irresponsible).

Quote

October 30, 2009, 10:52 pm

41. ***Steve* says:**

This business model has worked so well to develop contrary evidence on the issue of climate change, it seems perfectly logical that it should be adapted to other endeavors as well!

Quote

October 30, 2009, 11:45 pm

42. ***Ricardo* says:**

"Free-market fundamentalism" is a real misdiagnosis of the problem in economics. If I had to pick the tendencies or assumptions in economics that are the biggest problems in terms of understanding something like the current financial crisis, I would go with these:

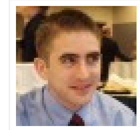
1. Obsession with static equilibrium in economic models. The nature of equilibrium is that prices tend to stay where they are: this doesn't allow for sudden swings in prices without some underlying big event triggering the price change.
2. Assuming that everything you don't understand is a random variable with a normal distribution and a well-defined variance. Taleb devotes an entire book to this extreme assumption.
3. The premium that is placed on orthodox modeling rather than realistic modeling. It must have been 30 years ago, for instance, that the "free-market fundamentalist" Milton Friedman pointed out that many Americans buy both insurance and lottery tickets. Orthodox economic models (which assume that people are naturally risk-averse and have concave utility functions) cannot account for this anomaly. Yet still, economists use exactly the same models they were using 30 years ago because these models are easily and elegantly solved.

The point here is that these problems have nothing to do with free-market fundamentalism but rather with a profession that is too used to certain methodologies and that doesn't take too kindly to "outsiders" criticizing them.

Quote

October 31, 2009, 1:03 am

43. ***Tim* says:**



> **Ricardo**: The point here is that these problems have nothing to do with free-market fundamentalism but rather with a profession that is too used to certain methodologies and that doesn't take too kindly to "outsiders" criticizing them.

I don't think that's a correct assessment of the problem. Economists are married to their models because they do have an excellent explanatory power–they work. But, as you point out, there are observations that no model explains well.

The problem, as I see it, is that critics aren't interested in coming up with a new paradigm that gives testable predictions based on the empirical evidence. The "anti-market fundamentalists" aren't interested in finding the truth–they simply focus on the conclusions with which they don't agree and thus try to trivialize the work of the people making the observations that lead to those conclusions.

Problem 1 is wrong. If that were true, there wouldn't be so many critics of DSGE models. Paul Krugman's recent rant in the *NYT* spent a lot of time attacking DGSE models and the efficient market hypothesis. His solution? Let's return to 1935 Keynes and ignore the last 70 years of research. I think this criticism would have made more sense 50 years ago than today.

Problem 2 is definitely legitimate. Hopefully more observations will help. Simplifying assumptions are always necessary, but they must be as robust as possible. This one isn't.

Although I love math (even though I'm terrible at it), I do think that academic economics would be well-served to get away from its reliance on complex mathematical models. It seems to me that the only think every department wants its new Ph.D students to be capable of is to use econometrics to build a model that is as difficult as possible to criticize. Professor Mankiw's statement about 'take a lot of math' if you want to be an economist is testimony to this. It's very seldom that I ever use my skills of integration from my Calculus courses, and I have never seen trigonometry in any economics paper. I do find myself lacking in other types of mathematics *that are not required for the degree*. Additionally, this religious-like faith that math makes someone a good candidate for an Econ Ph.D program disfavors American students, who by world standards, have a very hard time competing with students from other education systems. Perhaps others' experiences may vary.

I've enjoyed studying economics for the last four years, but it is shocking and awful to me that most people–even college educated people–lack even a principles level understanding of economic theory. Many of the people who control the debate in newspapers and such are blatantly ignorant which issues are actually contested in the discipline and which are settled. This post, based on this paper from the American Institute for Economic Research, explains this better.

Quote

October 31, 2009, 3:47 am

44. ***nunya* says:**

sounds a lot like olin, which funds a lot of reactionary wingnuts who purport to study "law and economics" but who really don't know jack abt empirical research but do know a lot about right-wing jingoism.

Quote

October 31, 2009, 4:13 am

45. ***Ricardo* says:**

> **Tim**: I don't think that's a correct assessment of the problem. Economists are married to their models because they do have an excellent explanatory power–they work. But, as you point out, there are observations that no model explains well.

This is a glass half-full v. half-empty debate. It would be awfully pathetic if economic models had absolutely no explanatory power. Instead, economists develop their models in such a way that you get certain results that reflect the real world. These models inevitably miss out on pretty important features of the real world at the same time. What economic models miss — for instance, asset bubbles cannot exist within the neoclassical framework — can lead to pretty serious consequences when people take them seriously. Too often economists start with theory and then furrow their brows in puzzlement when the theory doesn't match up with reality ("How can there possibly be asset bubbles? Why doesn't someone just step in, short the market, drive prices back down and make piles of money?"). Instead, the starting point ought to be that both economic history and experimental economics have documented the existence of asset bubbles beyond any doubt. It's up to the theorists to then account for this fact in the models they develop.

> Problem 1 is wrong. If that were true, there wouldn't be so many critics of DSGE models. Paul Krugman's recent rant in the NYT spent a lot of time attacking DGSE models and the efficient market hypothesis. His solution? Let's return to 1935 Keynes and ignore the last 70 years of research. I think this criticism would have made more sense 50 years ago than today.

I don't follow. First, note that Krugman published his "rant" in the New York Times, not in, say, American Economic Review or Quarterly Journal of Economics. When I was in grad school, DSGE was sold to us not because its assumptions are particularly realistic but rather because you need to know it in order to get a macro theory paper published in a top journal. This kind of cynicism is really at the heart of my point — a lot of economists don't really believe a lot of the theoretical assumptions they make in their academic work yet they do it anyway because that's the way things are done in the profession. You are right that lots and lots of people criticize DGSE (although many of the harshest critics are not macro people) but that's not inconsistent with the fact that it is the default methodology you need to use to publish macro research.

True story: one development economist I know submitted a paper focusing on a field experiment done in a developing country to a prominent journal. The referee report basically said "What you say here is all true but how does it apply to the United States?" This same kind of narrow-minded provincialism applies to theoretical assumptions and frameworks.

Quote

October 31, 2009, 5:58 am

46. ***Mikey*** **says:**

> Ah yes. 30 years of steady deregulation, started by Saint Ronnie, and when the economy collapses, its because of regulation.

As has already been pointed out, the level of overall regulation has steadily increased over the last 30 years. Even if some sectors were de-regulated (generally in very minor ways). And the specific level and type of regulation in the financial sector, especially in housing, were almost completely responsible for the collapse of the housing market and subsequent recession.

What you and your ilk are trying to do is like blaming de-regulation in airline prices for the collapse of the housing market.

Quote

October 31, 2009, 10:33 am

47. ***LarryA*** **says:**

> **richard**: All types of industries, including the financial markets, were deregulated.

Rule of Thumb: A 500-page "deregulation bill" doesn't actually reduce regulation, despite what the label says.

Quote

October 31, 2009, 12:23 pm

48. ***SenatorX*** **says:**

I think my problem with Soros's reflexivity isn't that the subject isn't interesting and could be studied more but more that everything learned will be handed over to the nearest State of his choice to manipulate free citizens into doing what the politicians of the time want (with Soro's money one step ahead of course). I don't really see his view as ground breaking as he seems to think it is as there have been many interested in the subjects of feedback loops, cognitive dissonance, the subjective and really all the social psychologies. He seems to want to create a new demarcation between social sciences and natural sciences because humans have subjective views and can influence their environment with these flawed views. Because of this he wants to break the whole social "science" into a new science classification. It seems like kind of a gimmick though as I don't see any actual new methods. Just a kind of "up till now" economic theory has used natural science methods which fail because humans aren't perfect and can influence things.

But it seems like a strawman to me where he puts people at believing non-falsifiable economic models as perfection, then knocks them down. The same old leftist attack on free markets basically. It ignores the moral aspects of a free market for example where you accept flawed actors because a) it leaves them free and b) it assumes an outsider(like the state) doesn't have perfect knowledge either. Outside of efficient pricing and distribution there are moral arguments for free market systems.

I just think Soros will be all too comfortable devising "superior" models which allow the state 1984 style to backdoor manipulate citizens into doing what they want. Philosophically/morally I'm opposed to "improving" social science in such a way. If he was looking for ways to replace State control with mechanisms that improved transparency and citizen freedom (like replacing central banks with feedback loops that control interest rates) I would be more pleased with where he is going. I'm just highly skeptical that is where he will end up.

Quote

October 31, 2009, 12:24 pm

49. ***Mike Rappeport* says:**

Two points
1. As anyone associated with politics will surely confirm, the reason the quantity of "regulations" has increased is that the people being regulated figured out that the way to limit the impact of regulations was to keep adding details and exceptions.

2. Even if that weren't true, both quantity and quality matter. All the new financial regulations combined were less important to the regulated) and less effective in any sense than breaking down the wall between trading and banking.

3. On another topic,
This article does make me wonder: why hasn't anyone done an in-depth study of human psychology and economics (or have they?) I mean, numbers are great and all, but people aren't exactly rational numbers, and tend to do things despite what seems to be obvious

There are such studies. They are however outside the realm economists are familair with, since they are concentrated in religion departments. Virtually all economics (notably including behavioral economics) is founded on the idea that people only try to maximize their returns in this life. But all experience says this is simply not true. Some (not all) of the things economists see as non-rational are a desire to go to heaven, which accounts for (or at least says a lot about) a large part of everything from anonymous giving to all kinds of do-good organizations, to not cheating on your income tax.

Quote

October 31, 2009, 12:38 pm

50. ***Whitehall*** **says:**

To paraphrase Woody Allen, economics is a social science, but as social sciences go, it's one of the best.

As a case of "deregulation" increasing regulation, let me offer the California electric grid. Following the disaster of 2001, state control of the electric grid, generation construction, even customer demand has increased greatly. The largest utility in the state, PG&E, is now a servant of the Democratic majority in the legislature. The state wants to set your room thermostat, prohibit large screen TVs, and select your light bulbs.

My view of the economics profession is also that equilibrium is over emphasized. Every active economy has millions of players who STRIVE to upset equilibrium since that is the only way to make a profit! The academic infrastructure is increasingly a corrupt priesthood. Killing the tenure system would be my first recommendation.

As to asset bubbles, how the heck do you short residential real estate?

Quote

November 1, 2009, 1:12 am

51. ***Sammy Finkelman*** **says:**

. Through INET, he will be indirectly funding his philosophy of "reflexivity" – that markets tend to influence perceptions of reality, which in turn feed back into markets....

Reflexivity doesn't sopund like much of a theory — basically it is a statement that bubbles exist, except that it assigns no blme and no cause to any individuals.

That probably has nothing much to do with what's going on here.

One point worth making is let's say theer is some dogma and it's wrong — there are multiple alternatives some of thejm a lot worse.

You could come up with a theory that says — markets are not efficient — except when the government is the only buyer...well nobody would actually say anything so absurd, but sort of imply it and avoid contradicting it — to articulate it is to refute it.

Quote

November 1, 2009, 2:37 am

52. ***Allan Walstad* says:**

From the FT article:

> [Soros]hopes, however, to inspire a groundswell of support from students that will "shift demand" at universities to include economic ideas that are more reality based and less focused on rigid mathematical models.

In the grand tradition of monkeys typing at typewriters, Soros gets one thing right. The math fetish of modern mainstream economics subordinates active reasoning to the needs of differential equations. There's an econ school that did anticipate the meltdown, that eschews mathematicization in favor of actual thought, that unlike the neoclassical mainstream actually does consistently favor free markets: namely, the Austrians. Among other things, the Austrians notice and talk about the elephant in the room, the Fed and its bubble-and-bust manipulation of the money supply. The neoclassical mainstream may well collapse. What a shame if Soros and his band of blithering collectivists get to pick up the pieces.

Quote

November 1, 2009, 10:27 am

53. ***davod* says:**

This may be pertinent. During the scream about the budget I recall hearing that the Administration was being advised by a number of French economists.

Quote

November 2, 2009, 12:02 am

54. ***davod* says:**

PS:

The problem with advocates of a command economy is to get their way you have to destroy the economy.

For all those who keep saying the country has a way of correcting itself every four years. How quickly do you recover from a tripling of the deficit and the institution of a command economy?

Quote

November 2, 2009, 12:06 am

55. ***Ricardo* says:**

> **davod**: For all those who keep saying the country has a way of correcting itself every four years. How quickly do you recover from a tripling of the deficit and the institution of a command economy?

You could research the post-World War II years in the U.S. for your answer.

Quote

November 2, 2009, 4:11 am