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Hubris – Why Economists Failed to Predict the Crisis and How Avoid the Next One

by **Meghnad Desai**

Yale University Press, 2015.

Meghnad Desai, a scholar-lecturer at LSE, is now chairman of an independent research network. He also has an impressive list of various published works; in addition to books on Keynesian and Marxian Economics and numerous articles in academic spheres, he has also written books on Islam, the political economy of Ezra Pound, and has been involved in discussions about global security. The reviewed book is about possibilities of economic reflection. Naturally, the title indicates a certain type of *cul-de-sac* about the results of economists regarding the current crisis; the Greek word *hubris*, which is in the title, indicates an increased and hyperbolical self-confidence in the theory of economics. A new kind of *humbleness* is sought, a kind that renounces the ambition to have economic discourse that treats the world omnipotently. The question is how to achieve this, or is it just a wishful-thinking.

Therefore, it is not difficult to conclude that Desai talks about *curren*t economic theory and he is critical about the results in the science of economics, and today's economic crisis. The title emphasizes assessment with respect to the ability of forecasting, but it is clear that although the author of the book believes that the science of economics is (increasingly) self-confident in forecasting, the aforementioned problem affects the basis of economic reflection today. It is not a coincidence that Desai expresses sympathy towards those economists who represent, as Keynes put once, the "underworld of economic science". Desai creates a binary image: on the one side, there is an economic theory focused on static equilibrium and on the other side, there is a dynamic disequilibrium; his anticipation is that the current crisis has finally proved that economics cannot be understood without dynamic disequilibrium. Therefore, the current crisis is not just a financial speculation or asset bubble, but also an epoch that forces economic reflection on self-transformation. In this case, the crisis is not represented as a macroeconomic failure or structural crisis, but it is represented in the context of paths of economic theory. Desai's ambition in the book is exemplified by the following passage: "why economists failed to predict the crisis, what happened, why it happened when it did, and why economists won't admit that they were wrong. I also want to address the criticisms of the overuse of mathematics in economics and to see whether there is a new economics which can cope with future economic catastrophes better" (p. 9).

Desai's book is concise but it offers a long and extensive *tour* of economic ideas. Under the influence of Keynes (we have to say "partially" as there is criticism about the British economist further in the book), Desai believes that economists' ideas have significant influence on the flow of events: therefore, he believes it is important to devote careful attention to certain economic theoreticians. Historical formations of socio-economic structures are mentioned, but the discourse on political-economic conflict is minimized. We reveal assessments and qualifications only implicitly. Desai, who has a clear political affiliation and distinctive public appearance (a Labour politician): he was the only one with political affiliation among those economists who in 2010 wrote a public letter to the *Sunday Times* in which it was stated that "cutting the budget deficit within one Parliament" must be done; (among the signatories were Tim Besley, Christopher Pissarides, Ken Rogoff, etc.) and sometimes expresses "sympathy" towards Karl Marx, in fact does not speak about the political-economic configuration of power.

Desai simultaneously distances himself from every Keynesian fundamentalism; he cannot be classified as a representative of orthodox Keynesianism; he is not a "Structural Keynesianist" like other economists who follow Keynes's path; and he cannot be classified in "Post-Keynesianism" either. Desai has already had ventures in which he has explicitly expressed the idea that Keynes' theory does not have far-reaching consequences today, that is, the theoretical and political repertory of the British economist does affect the essence of today's crisis, one that has different characteristics in comparison to the Great Depression in the 1930s. Therefore, we will not gain orientation through the Keynesian-remedy in the manner of fiscal stimulus: the Keynes proposed his theory in a historical epoch which was defined by problems of effective demand, but in a situation of excess of saving. The situation today reminds us that we are faced with reverse phenomenon, that is, with undersaving; constant encouragement towards consumption contradicts any type of therapy in light of Keynes. The states also find it appropriate to take loans during the peak of cycle. Economic theorists, following Keynesian tradition, underestimate the level of debt and give prominence to borrowing as a stimulus to encourage growth.

Therefore, returning to the past is not recommended, and even Keynesians who call upon the writer of *The General Theory of Employment, Interest and Money* are not praised: they are not able to perceive the irreversibility of change. (It is notable that in some instances Desai makes critical remarks simultaneously about "Orthodox mainstream economists" and "Keynesian economists"; therefore, he critically addresses both orthodoxy, but also heterodox economists, following Keynes' path). In addition, if this is the case, then we can say that despite the view of the influences of economic ideas, there is a limitation regarding the power of the same ideas. It seems that this is connected with the indication that economic theory tends to be a science, but according to the "fluidity" of its subject, the respective scientific status must be re-confirmed. The subject of economics is separated from politics, but the problem is that politics shapes the "economic context" and in this case, globalization is not just a media buzzword but also an expression of formative changes with far-reaching consequences. In any case, Desai believes that globalization has "fundamentally" changed the profound context of economics; globalization is not just a mere appendage within economic theorization, it transforms the framework of economic theory. It is not a coincidence that Desai writes systematically about globalization, "governmental problems" at new levels and new power structures - not only in this book.

Desai engages in lengthy narratives; he obviously loves narrative sequences (which is also demonstrated in the description of the current crisis). The story of the book actually begins with the emergence of economy as an independent reflection by means of autonomization of economizing, and in that way, we are led straight to the fifteenth century when America was discovered and when conditions for promoting globalization were determined. However, very quickly we discovered numerous different philosophers who cleared paths for economic reflection: it began with John Locke and we discovered the classicists Adam Smith and David Ricardo who were given more attention. It has to be mentioned that in Desai's narration Ricardo played a specific role: here, his success and breakthrough in the science of economics is interpreted as "curiosity and mystery".

Let us not forget: Desai searches for the answer to the question as to how is it possible that despite their faltering during the crisis, economists do not change their orientation, that is, I would say (independently from Desai) for the purpose of paraphrasing, the processes of refutation *à la* Popper do not work. Ricardo's triumph and modification of economic reflection pave the way towards a certain understanding of economy, which is still dominant in the present. We do not want to underestimate Ricardo's merits, but he developed the comprehensive approach of economic reflection that can be applied to every situation. Regarding Adam Smith, we can think that the invisible hand is not always benevolent and this opens up many possibilities, but economic imperialism that originates in Ricardo's theories sets very firm starting points. *Hubris* (despite some pessimistic elements of Ricardo's theory about the fate of capitalism) was born, and we will follow its development in the future.

Ricardo is the archetype of today's economic reflection. In this way, possibilities are raised for mathematics of markets, as well as for the arithmetic of market operations. Later, Desai also finds it appropriate to make comments about the development of the mathematization of economics; so he prepared the draft of universal mathematization in the twentieth century, reflecting upon the different stages and "overuse of mathematics" which, for example, in the current crisis "hides a short-sighted outlook". (It is of great importance for Desai to appreciate the significance of differentiating between short and long temporal sequences; this is the only way to understand his attachment to the long-cycles). However, we have to bear in mind that Desai in fact devotes his attention to the theoreticians of dynamic disequilibrium and shows interest in cycles and crises through which capitalism is developed. Ricardo here, certainly, cannot help, but we have Marx, as a theoretician of crisis and general dynamics of capitalism, who does not appear as a theorist of value, but as a philosopher of the unstoppable dynamics of capitalism. Marx was praised because he knew how to draw conclusions about the inherently existing crises based on the immanent analyses of Smith and Ricardo. In this way, he is one of those thinkers who enable considering capitalism as a socio-economic formation which is in constant movement. Of course, this is a fact that deserves attention: Desai studies Marx, and this is certain heterodoxy. However, we still remember earlier Desai's book (*Marx's Revenge: The Resurgence of Capitalism and the Death of Statist Socialism*, London and New York: Verso, 2002) in which he used to draw inspiration from Marx's work, transforming and reducing it, *ante litteram,* into the apology about globalization. After all, it was also a book that bore characteristics that were similar to the book which I presented here; a journey into economic history but with an aim of discussing the present. The focus here is not on Marx as the forerunner of the advocates of globalization in accordance with the recognized fact that Desai was interested in the "philosophers" who were able to articulate the dynamic sequence of capitalism. Therefore, it is not at all difficult here to notice trends that strongly develop the relationship between Marx and Schumpeter: naturally, the Austrian expresses the view of cycles and innovation according to which the reflection, which is sensitive to the dynamics, may be stabilized. Finally, that is how we come to Kondratieff and his long wave which, in Desai's opinion, play a crucial role. (I will make comments later when I present Desai's program for economic theory and when I mention Kondratieff again).

Therefore, we come to the economist who enjoyed considerable support from Desai, that is, Knut Wicksell. Indeed, at first Wicksell appeared as a correction of Marx because the German thinker did not integrate the theory of cycles and theory of money (I am not at all convinced of Desai's assessment; the fact that Marx succeeded in harmonizing cycles and the metamorphosis of money can be argued, but there are strong outlines of such intentions). Moreover, Wicksell also refreshed the equilibrium between the theory of market and the theory of cycles; it will later be very important for the presentation, because unlike some others, Wicksell's star will continue to shine.

The only thing Wicksell does not offer are *the breaking points* when the economic boom stops and the economy goes into recession, because the theory of cycles and crises can be articulated only if there is a theoretical reflection of the mentioned breaking-node points that show the moments of transformation. Desai does not think in the same way as Hyman Minsky who projects permanent disequilibrium, and that is why he emphasizes the undeniable importance of turning points that dynamize the economy. The cycles and crises are proved to be systematic, but are not permanent. Moreover, if the mentioned phenomena are systematic, which Desai says repeatedly, then it is obvious that it is a programmatic principal.

Let us now look at the Great Depression and Keynes. Desai does not hesitate for a single moment to talk about the "Keynesian Revolution", that is, to talk about the phrase that was previously launched by Lawrence Klein. Aggregate effective demand, government spending, theory of investment and the role of interest rates have all been reformulated in a "revolutionary way". Keynes, who became aware of his theoretical position, assumed the significance of his categories based on disengagement with tradition and by searching for, as we have already stated, the "underground world of economy". Therefore, despite the fact that we indicated that we would have to deal with Keynes' criticism, Desai can in no case be put in the same category as, for example, Axel Leijonhufvud who in fact denies the revolutionary of *The General Theory*. Desai correctly interprets Keynes in terms of public debt and deficit; his sentences, which prove how wrong it is to think of Keynes as a philosopher who wants endless deficit, are concise, but useful as a necessary correction of different erroneous interpretations.

In the meantime, the domestication of Keynes, that is, theoretical-political normalization of subversive-revolutionary ideas, started. This began with American Keynesianism, but it should be noted that Keynes was pacified by mathematical articulation as well, that is, John Hicks' IS-LM diagram. (Although there is a debate about whether Keynes accepted the IS-LM diagrams, let us remember Joan Robinson, as well, who categorically said that Hicks reduced Keynes' ideas on the equilibrium; she seems to have hit the essence). Keynes no longer had to be read and economists did not have to address the subtle arguments of *The General Theory*. Instead of sophisticated text, economists recognized Keynes' categories based on the already known, old terminology. Attention is diverted from the labor market to the market of goods, attention was focused on income rather than employment, and the problem of money wage rigidity was skipped. Keynes' messages were transformed into econometric relations, into empirical uniformity, as well as a system of correlated variation for the sake of economic-political advice. As we know, despite the fact that it is robust to contradict Keynes' positions, it is not by chance that the entire issue regarding the hypertrophying of mathematics can now be attributed to Keynes. Keynes' efforts in terms of alignment between the micro and macro levels have also been neglected; the fact that his theory is inconceivable without aggregate output and employment was ignored. Desai refers to the neoclassical-Keynesian compromise elegantly as the case of schizophrenia. Of course, the emergence of "post-Keynesianism" is recorded, and it denies Hicks' ideas (Desai refers to them as the fundamentalists), but according to Desai, they are not at all able to change the constellation. In the end, monetarism demolished "official Keynesianism", identifying budget deficit as malignant and giving priority to inflation compared to unemployment.

However, regardless of the misinterpretation of Keynes and the ideological hermeneutics that flourished in the post-Keynes era, the following question should be posed: did Keynes really explain the business cycles? In that way, let us recall chapter 22 (Notes on the Trade Cycle) in *The General Theory*. However, I do think that Desai is right; no one contemplated it too deeply. Moreover, in the era after World War II interest in business cycles truly decreased; Desai reminds us that, in 1970, it was easily and declaratively said that business cycles were obsolete.

For theorists such as Desai, who highly regards globalization and corresponding changes at the international level, figures of closed economy seem like a terribly impoverished image of the economy. Keynes can be blamed for such a mistake; he uses the model that disregards international trade and the problem of payments. In this respect, Desai believes that there is no difference between Keynesianism and Monetarism; it is again a situation in which he recognizes the convergence between "orthodoxy" and "heterodoxy". Only under the assumption of closed economy can Keynes assume that an increase in saving installments reduces the level of income. However, in the situation of an open economy when a global market of capital exists, "repayment of debts" can attract foreign capital in such situations when there is a favorable credit rating compared to the economy of the country concerned.

However, this does not exhaust the critical repertoire with respect to Keynes. Desai claims that it is wrong to think that Keynes is a true hero of the Great Depression; in this way, providing him with the role of savior of this specific historical moment represents a serious mistake. Desai emphasizes (in fact in a very "orthodox way", as we shall further see) the priority of monetary policy over fiscal stimulus. What also needs to be mentioned, even when it comes to the UK, is the devaluation of the sterling fund which encouraged export. What must be taken into account is the exchange rate policies, loose monetary policy, but not Keynes, that is, not as an individual hero. In addition, Keynes' assumptions as well as his monetarist orientation do not raise possibilities for financialization, which Desai regards as an externalization in relation to the oil-shock. Financialization, without which we cannot imagine today's economy, was affected only incidentally in the form of government bonds and public finance. Finally, regardless of Desai's objections against monetarism, even he admits that there is a certain weakness in Keynesian economics in relation to inflation. Here, it is clearly presented why we emphasized earlier that Desai keeps a certain distance from Keynes (despite the acknowledgments), and from post-Keynesianism as well (without acknowledgments). As it is seen, Desai directs such criticism against the aforementioned philosophers, which could be attributed to fierce opponents of the British economist.

One thing is certain: Desai is not an apologist of Keynes. He reproaches him even for focusing on "flow equilibrium" and for eliminating issues of stock. His reasoning is that the "flow of saving" should be adjusted with the "flow of investment"; only in such a way can full employment be achieved. Here, Desai speaks about the possibility of simultaneous coexistence of full employment and "flow equilibrium" according to Keynes, and about the fact that the debt increases (what Desai suggests here with the figure of full employment in the 21st century is questionable: that is, what does he mean?). Simply, in Keynes' opinion, there is no stock disequilibrium. A public debt is legitimized because followers of Keynes believe that there is a self-liquidation of public debt which is already an intragenerational issue (unlike neoclassical and new classical economists for which debt is an intergenerational issue). Instead of the indication "we are all Keynesians now", Desai will suggest: "we are all rentiers now"; this assertion, *pace* Keynes, is saying that debt is *in fact* an intergenerational issue.

It is interesting that, while critically addressing Keynesian economics, it seems that Desai gives some recognition to Marx. Specifically, in one important moment Desai raises questions of profitability. As we already know, an opinion about profit represents a defining moment in the perception of Marx; his reasoning simply cannot be understood without taking into account his attitude towards profitability. However, Desai again reproaches Keynesians for disregarding profitability; no one cares about profit, not even late supporters of Keynes nor neoclassicists. After all, when the state of equilibrium is assumed, the profit is equal to zero.

It seems that Desai tends to accept a certain form of the "profit-squeeze" theory, which assesses the divergence between wage and profit share based on the struggle between workers and capitalists. These are actually those moments which allow some insight into the political-economic configuration for which we claimed that it was neglected. However, according to Desai, it is essential to include Richard Goodwin and his theory of cycle, by mentioning the relationship between "rabbit and foxes". Nevertheless, the assessment is that the dominant economic discourse has not noticed the significance of the reduction in wage-share. This would mean that, despite criticisms of Keynes, Desai accepts the assessments of fatal effects of the reduction in wage share made by many Keynesians today.

We have to mention a few aspects of the description of the crisis phenomena by Desai. Wicksell, who enjoys a special place in the pantheon of Desai's characters, is not only an actor on the stage of economic history, but also a philosopher who sheds light on the present. In this way, regarding the situation in 2007, Desai said that it was a "classic Wicksellian situation". *Firstly*, there is a series of good performances: low inflation, low interest rates and "plenty of credit". *Then*, there is a tendency, which has not been seen even by economists who would like to follow Keynes, but also not by those who repeat various patterns of monetarism. Namely, the accelerated growth of China presents strong pressure on raw material prices; from the perspective of the Fed in the USA, this is the sign of emerging inflation and increases in interest rates. This is a "classical Wicksellian situation": "The market rate of interest had been so low that investments with even a modest rate of return - a low natural rate - had become profitable to invest in. But what was profitable at 1 percent could not be so at 5 percent. The boom collapsed" (p. 153). The cycle from 1970 to 1990 contained Wicksellian moments for developing countries: oil-exporting countries were not able to take advantage of income in domestic economy and they were left as deposits with foreign banks, which began to lend aggressively.

To sum up, new Classicists could not predict the crisis due to inherent limitations. Keynesianism was able but did not do so. Is there an "alternative narrative" (Desai)?

Yes, it exists in one consilience-based and syncretic variant. Desai wants a harmonization of discourse that is sensitive towards globalization, and is open towards the play between the real and financial factors. It is even stressed that demographic factors could be taken into consideration; they have a different role in the cycle of 1992-2007 with respect to the cycle of 1945-1970. *Firstly*, there is Kondratieff paired with Schumpeter. *Then*, there is the pair of Marx and Goodwin, with sensitivity towards the cycles and crisis based on wage and profit shares. *Finally*, the Wicksell-Hayek pair with hints of short cycles based on the gap between the natural and market rate of interest. The conclusion is drawn without any mathematics, but it is recommended as a synthesis.

Although Kondratieff was not able to use the developed and sophisticated statistical methods, he developed a theory which is still useful today; there is evidence for long cycles. There are, of course, difficulties regarding the exact articulation. It is possible to map out the situation. This is how Desai speaks about the 1970-1990 cycle, when there was a duality between a Wicksellian boom in developing countries and stagflation in developed countries. Developing countries influenced the tightening of monetarist policies in developed countries; this was the moment not known to Keynesians. The next cycle was the fall of the Soviet Union; this is the example of a Wickesellian cycle intertwining with Kondretieff cycle. This is a combination of the short and long cycles. However, if we look at the situation in the present, Desai is biased to the figure of secular stagnation. Alvin Hansen, slavishly following Keynes, made a mistake when after World War II he anticipated secular stagnation for the USA. Nevertheless, if we look at present trends, the figure of secular stagnation that sheds light on the "long downsaving" can be re-evoked.

Desai poetically finishes his argument by referring to the "fascination and horror of capitalism". Moreover, in the last sentence, Marx, who is deemed as the "eternal optimist" in the context of projections of capitalism which (for now) persists despite gloomy forecasts, appears again.

Desai's syncretism may be "challenging", but it involves problems and risks. Desai wants an "alternative", but in the end, he overly embraces orthodox views. The goal and the method are in a strained relationship. In this way, calling upon Wicksell and a natural rate of interest is not a "neutral" move because Wicksell and his loanable funds theory holds a special place precisely in the conceptual system of the new macroeconomic consensus which addresses the destructive criticism of Keynes; it is not a coincidence that it is precisely due to today's orthodoxy that "neo-Wicksellian" - orientation can be discussed. Milton Friedman's natural rate of unemployment certainly must be understood in Wicksell's perspective. In addition, it is not a coincidence that Keynes rejected the natural rate of interest that mediated between saving and investment in order to achieve equilibrium. How can Wicksell then be integrated (as well as the gap between natural and market interest rate[1]) into discourse that tends to achieve dynamic disequilibrium? Finally, Desai mentions The Cambridge Capital Controversy regarding the issue of valuation of capital. Now the question is: should we not say that it was precisely the respective "capital debate" which brought into question Wicksell's theory of capital? Here, we follow the convincing analyses of Colin Rogers[2]: the natural rate of interest in Wicksell's terms can only be imagined in a stationary equilibrium system in a *one-commodity* world. How can this not too realistic starting point fit in Desai's "alternative narration"? We know that even Hayek adopted figures of "natural rate" from Wicksell, just as he found the loanable fund theory from the same source. At one moment, Desai evokes Paul Sweezy, who despite a well-known affiliation, said that "Hayek had the key to capitalism", but, was it enough to justify the Hayek-Wicksell relationship regarding "alternative narration"?

Further, Desai underestimates the achievements of fiscal policy. As in the case of Wicksell, he continues to repeat the patterns of the existing orthodoxy; it is especially expressed in the unpleasant, but noticeable interpretation of the economic policy of the Great Depression. It seems to me that it is not just an economic and historical analysis because it penetrates into the dilemmas of the present. By emphasizing monetary policy with respect to the fiscal policy, Desai is simply acting within the

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[1] Here, the aforementioned Leijonhufvud operates against *The General Theory...* with Wicksell, even accepting his loanable fund theory.

Leijonhufvud, Axel. 1979. "The Wicksell Connection: Variations on a Theme". University of California, Los Angeles (UCLA) Department of Economics Working Paper 165.

[2] **Rogers, Colin.** 2006. *Money, Interest and Capital: A Study in the Foundations of Monetary Theory*. Cambridge: Cambridge University Press.

framework of orthodoxy, which is, of course, legitimate. The problem can arise if a step forward is to be realized based on "alternative narration". It must be mentioned that there are studies that put the problem of economic policy during the Great Depression in a different light compared to Desai. The same orientations show that the fiscal multiplier (it is usually presented as evidence in relation to the irrelevance of fiscal policy) can be measured in different ways, and that the unconventional operationalization of the fiscal multiplier proves the extraordinary relevance of fiscal policy in light of the New Deal. Thereby, the same unconventional methods can be used to demonstrate the extensiveness of today's fiscal policy as well.[3]

The manner in which Desai appoints Marx as the "eternal optimist" should be discussed. However, it could not be understood without Desai's book on Marx which was mentioned earlier: I am afraid that this is in fact a depreciation of Marx. Desai has to take too much from Marx in order to convert him into a formatted theoretician who assists the unobstructed circulation of globalization.

Finally, the problem that Desai is presented with remains an open question. Where does the immunity of economic discourse supported by the disproportionate use of mathematics in relation to "refutation" come from? The whole problem is not just a "psychological" issue regarding the "surplus of mathematics"; it cannot be deduced from the individual choices of economists, nor is it based on reductive abstraction of "interest". The posed question can be answered if we follow the axis of knowledge/power and mathematics in this context: cognition and epistemological work in economics is the problem which must be articulated in the *political-economic context*. Conceptuality of economic science and production of knowledge is historically determined and embedded in the knowledge/power configuration.

[3] **Perry, Nathan, and Matías Vernengo.** 2013. "What Ended the Great Depression? Re-Evaluating the Role of Fiscal Policy." *Cambridge Journal of Economics*, 38(2): 349-367.

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