# The End of the History of Economic Thought and its Future[1]

**by**

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## I

This honorary membership brings me great pleasure. Some of my colleagues think of me as a monetary economist who has sought refuge in the history of economic thought (HET hereafter) as his ideas have become unfashionable, and perhaps they have a point, but that isn't the way that I think of myself. HET constituted a large and compulsory segment of my undergraduate education at the LSE, and along with monetary economics it was one of my two fields of specialization as a Ph.D student at Chicago. Moreover, my first paper in the field, on Thomas Tooke, though not published until 1972, was actually written in 1965-66, within 18 months of the completion of my degree, and I had no qualms about including it in my (1975) collection of essays on then current issues involving money and inflation. In short, I learned long ago that its own history is an integral part of monetary economics, and I have never drawn a sharp distinction between the two areas.

But my pleasure tonight is tempered by the apprehension that many of us feel about HET's future. Though matters are not so far gone in Europe as in North America, its serious study as a branch of economics seems to be in decline everywhere. So tonight I want to sketch out a monetary economist's suggestions about why the academic mainstream - please forgive this label, but I don't have a better one - has recently wandered so far off course in its treatment of HET, but also about why the inevitability of the end of history within economics might just be an intellectual illusion created by a certain way of doing the subject that is itself perhaps on its way to becoming part of that history..

This topic is well suited to a long and boring lecture, but our President, Harald Hagemann, has warned me that, if I talk for longer than fifteen minutes, my honorary membership will be revoked. Since I really do value it, I shall take full advantage of the conventions of a brief after-dinner talk to be assertive and to avoid all intellectual nuances.

## II

It is not news that today's mainstream believes economics to be a science which makes orderly progress, that old ideas which are still useful are in the current body of knowledge, and that those which are not there have disappeared because they are not

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[1] After-dinner speech, delivered in mid-Bosphorus on May 21st 2011, in acceptance of honorary membership in the European Society for the History of Economic Thought at the Society's annual conference in Istanbul. Helpful discussions with Harald Hagemann and Hans-Michael Trautwein are gratefully acknowledged, but I am entirely responsible for any boredom or other adverse reactions generated by what follows.

useful. Paul Romer's rather condescending view, expressed to Snowden and Vane in 1999, that "ancestor worship as a research strategy [is] probably. . .unproductive. But as a consumption activity it…can be fun" is widely held, and though it might leave HET an honourable place in general undergraduate education, or even in the graduate history of science curriculum - which has probably been just as well for the area's survival in recent years - it excludes it quite firmly from any serious economics program.

This view has always been around, of course, but it has taken hold with increasing strength over the last four decades. It should not have done so, because over this same period its falsity was quite evident. Now as ever, it is closer to the very complicated truth to describe economics as a subject in which new ideas do sometimes turn up, but in which old ones also regularly reappear in various disguises and for various reasons, seldom if ever disappear entirely or achieve complete dominance, and usually, though not always, are sharpened up a little along the way.

Consider a few examples: the quantity theory of money seems to have begun its modern journey in 16th century Salamanca, and after much coming and going to have arrived in Chicago in the 1950s and 60s on its way to a prominent position in monetary policy in the 1970s and 80s, before sinking into today's (probably temporary) obscurity; the two interest rate approach to discretionary monetary policy, with which the quantity theory sometimes crossed paths, began its wanderings in 18th century Stockholm and Regency London, passed through Stockholm again in the 1890s, only to vanish in the 1930s and then re-emerge at the turn of the millennium in the research departments of all those inflation targeting central banks; and, more broadly, the reputation of the "market" as a way of organizing economic life has regularly risen and fallen over two and a half centuries, and has continued to do so since the early 1970s.

Economics makes much use of arguments whose logic is either sound or not, and it sometimes develops potentially refutable empirical predictions as well. These attributes surely give it some claim to be classified as a science; but a science which makes, and always has made, orderly and unidirectional progress? In which almost forgotten ideas from the past never have nor ever will take on renewed relevance? And in which there never was nor ever will be anything to be gained from some familiarity with its own history? Please! As the old English saying puts it: "Pull the other one, it's got bells on"

But over the last thirty or forty years, this is what more and more economists have come to believe, and with growing confidence too, making HET's position within the discipline increasingly precarious. Surely, the rise and prevalence of these beliefs in the face of so much contrary empirical evidence needs explanation, and because this is a historical phenomenon within economics, those of us who still take HET seriously had better try to find one. Here, I confess that I am getting a bit out of my depth – when I first inserted this phrase into my notes, I had no idea that I would be speaking in mid-Bosphorus! - but since I have a sympathetic audience, at least for about another ten minutes, let me offer a few conjectures.

## III

I suggest that the very approach to economic theory which has been increasingly widely taught, particularly in the monetary area, since the early 1970s – rational expectations modeling and all that, itself one of those successful new sets of ideas that do indeed turn up from time to time - presents a serious barrier to observing, let alone, comprehending, the facts presented by the subject's own history, and that this is because it has turned that particular view of the discipline's scientific nature already mentioned into an axiom upon which economics itself is founded.

In his recent book, *The Age of Fracture* Daniel T. Rodgers (2011) discusses the development of American social, political and economic ideas since the early 1970s, and notes that this has been marked by the widespread and persistent creation of *wrinkles in time* into which matters of history as well as intellectual and institutional evolution tend to disappear. I have no qualifications that would allow me to judge the overall validity of Rodgers' analysis, but it certainly seems to fit recent developments in American economics even better than he thinks.

That theories based on the idea that agents form and act upon rational expectations derived from their knowledge of a true model of the economy fold the economy's future into its present is a phenomenon that has already attracted a good deal of critical attention. We've all long known that the assumption of perfect foresight totally eliminates the distinction between present and future, and that the rational expectations hypothesis gets as close as one can to the same outcome while still permitting the construction of explicitly dynamic models that have the potential to mimic what happens in the real world as real time passes there. We've also known for some time that this hypothesis, and the clearing markets assumption that goes with it, excuses its exponents of any need to pay attention to what Keynes called the "dark forces of time and ignorance". Whether this should be regarded as a boon or not is a matter of considerable and still ongoing controversy, though let me remark in passing that I for one have felt increasing qualms about it lately.

But mainstream economics does strange things to the relationship of the present to the past as well, and these are less widely noted. At first sight, the past seems to matter quite a lot to the forward looking agents who inhabit today's models. It has left behind endowments of productive resources to which they can apply inherited technology, as well bequeathing an institutional framework defining property rights and the terms on which they can be exchanged, not to mention knowledge of the "as if" true model that is the basis of the expectations that inform their choices. Had these starting conditions come by way of a big bang at the instant we encountered these agents, however, everything would be the same, because the processes by which they came to exist in the past are irrelevant to the way in which agents deploy them in the present, which is, as I have noted already, completely forward looking.

Furthermore, and crucially, mainstream economic theory became explicitly self-referential with the rise of the rational expectations hypothesis. Today's archetypical model teaches that the economy behaves the way it does because, among other things, the agents inhabiting it use that very same model to devise their strategies. But this incorporation of the true model of the economy into its own structure has transformed the hypothesis that economics is a science that makes unidirectional progress from just one among several ideas about how the subject develops into the only one tenable by exponents of modern theory, and hence has ensured the simultaneous spread among them of the view that HET cannot be integral to the discipline.

The past may be the only source of data against which economic hypotheses can be tested or calibrated, but data never speak entirely for themselves. They need to be interpreted though a theory. When the only theory deemed suitable for this purpose embodies itself as part of its own structure, even on an "as if" basis, then that structure is inevitably projected onto the past, and other perspectives on the historical record are obscured  The "as if" element here does perhaps leave a little room for HET, but only for an ultra-Whig version of it that focuses on the increasing mathematical sophistication with which economists have analyzed the same old questions and answers about economic life that their theory insists have always informed agents' behaviour. To adapt Bob Lucas's deservedly well known (1980) remark - "to ask why the monetary theorists of the 1940s did not make use of the contingent claim view of equilibrium is. . .like asking why Hannibal did not use tanks against the Romans instead of elephants"  - it is as if the history of warfare has to be confined to tracing the slow but steady technical evolution of the battle-tank from the war-elephant. This might be an interesting story, but whether it is enough to occupy the whole history syllabus even of a military academy is another matter.

## IV

I persist in thinking that the key to getting mainstream economics to begin paying attention again to the intellectual diversity and ambiguity that is at the heart of HET lies, first of all, in embracing wholeheartedly its insights that economic ideas are self referential and that they do indeed affect economic behaviour, but, second, in insisting that when the actual outcome of the application of some particular set of ideas deviates from what they have led their exponents to expect, this dissonance be taken seriously and followed up.

As I have often argued before, the real world is inhabited not by representative agents but by diverse ones who practice the division of labour, and those who create the economic ideas that inform economic activity are called economists. HET is the history of their activities, and it teaches us that there never has been a single economic theory which has also been the undisputed common property of all agents, let alone a theory that was also agreed to be clearly true - let's not get diverted so late in the evening into discussing what this last phrase might mean! HET tells stories about the continuous interaction and evolution of competing and often contradictory theories that have not only influenced behavior, but have also been influenced by its consequences, as events have forced agents to rethink old ideas and conjecture new ones.

Today's mainstream monetary economics, with its reliance on clearing markets and rational expectations, has surely earned a permanent place in the subject's history, but as an important part of the story of its ongoing evolution, not as an end-point whose achievement has rendered what went before it irrelevant to understanding what is now happening. The idea that political history came to an end at some time during the Reagan administration – another example that Rodgers cites of time-wrinkling, by the way – did not last long in the face of the evidence generated in the years that followed. Perhaps the economic crisis that began in asset markets in the summer of 2007, and whose consequences continue to reverberate, is now forcing a similar reconsideration of the ideas that blinded so many to its approach, and perhaps also helped to create its preconditions.

If such reconsideration does take hold, then HET's decline over the last three or four decades will itself turn out to have been yet another example, albeit on a large scale, of the way in which economic ideas almost disappear from time to time, only to resurface again as people begin to find a new use for them. Let us at least hope so, and, given tonight's occasion, demonstrate our optimism by raising another glass of wine to the prospect as well.

## References

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