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Twin peaks

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George Soros has left his mark on many economies. Can he do the same for economics?



IN 1996, David Colander of Middlebury College, in Vermont, expressed his dissatisfaction with decades of economics by invoking a lofty analogy. He felt macroeconomists had clawed their way up a mountain, only to discover, when they broke through the clouds, that a neighbouring mountain would have taken them higher. On April 8th-10th Mr Colander joined many disgruntled economists at King's College, Cambridge, for the inaugural conference of the Institute for New Economic Thinking (INET). The Institute is sponsored by the renowned investor George Soros. He has promised to spend \$50m spread over ten years to help economists climb the right mountain.

The conference rehearsed many familiar complaints, bashing the rational-expectations hypothesis (which holds that the people in an economic model all share the modeller's view of how the economy works), the efficient-markets hypothesis (which assumes that asset prices reflect all available information), and the use of representative agents (a kind of economic Everyman, whose behaviour mimics the macroeconomy in microcosm). The event was a coming-out party for misfits, mavericks and pioneers, as well as open-minded members of the mainstream.

There was gentle resistance from some well-adjusted economists. Mr Colander's analogy does not imply that economists are getting nowhere: they can make progress up their chosen peak, even if other, higher mountains beckon. Mainstream models of the macroeconomy, for example, are more sophisticated than they were, allowing for different kinds of shocks, better statistical testing and a variety of dramatis personae beyond the economic Everyman of yore. This progress is the result of hard theoretical work in response to successive rounds of criticism. The critics, who don't think the climb is worth the effort, may not always appreciate quite how far the leading economists have ascended.

The twin peaks image has a further, unsettling, implication. To get from one peak to the other, economists will have to lose a lot of altitude first. To tackle questions in a fresh way, they may have to set aside many of their favourite techniques and methods. This prospect probably explains a lot of the resistance to new economic thinking. Economists tend to cling to whatever assumptions are required to use the techniques they favour.

For example, the presumption that economic life repeats itself, eventually reverting to the mean, makes statistical work easier. Even the much-maligned figure of rational economic man, maximising his utility, is less an article of faith than an excuse to use calculus. When behavioural economists packaged emotion into equations, mainstream economists were mostly happy to entertain them. But they worry about descending into a valley of imprecision and ineloquence before they master the alternative tricks and tactics required by any new ascent.

Some attendees wondered how economists would ever get out of this valley. If the economy is governed by historical happenstance, not timeless laws, and subject to imponderable contingencies, not calculable risks, then the economist may have precious little to say. One speaker argued that economists should give up on prediction and settle for explanation, identifying where earthquakes might strike, if not when, and how they might be withstood, if not prevented. They may have to hang up their ropes and carabiners and settle for rambles in the foothills.

But the optimists think it is possible to avoid losing altitude by building a bridge between where they are and where they would like to be. Markus Brunnermeier of Princeton University, who is on INET's advisory board, is trying to incorporate a richer model of financial breakdowns into a fairly standard macroeconomic model with the help of Yuliy Sannikov of the University of California, Berkeley. For all his radical airs, Joseph Stiglitz, who is also on the board, is keen to conserve as much of the canon as possible (especially the bits he contributed). He argues that you can explain a lot of what went wrong during the crisis in a model with rational expectations, but without "common knowledge": a model, in other words, in which everyone knows how the economy works, but not everyone knows that everyone knows.

Publish or be damned

Before launching the institute, its director, Robert Johnson, studied the incentives that govern the profession. Success depends on publishing in a handful of prestigious journals, which can be too narrow in their preoccupations. One Nobel prizewinner, who sits on INET's board, told him that he ceased teaching macroeconomics to graduate students because he thought his unconventional approach would damage their job prospects.

Mr Colander thinks the imperative to publish frequently forces young economists to tackle bite-sized problems, rather than asking big questions with distant, uncertain answers. One student who wanted to work on a book was told that one book might not hurt him, but he definitely shouldn't do two. Ambitious young economists must prove that they are better climbers than their rivals. What they climb is a secondary concern.

Mr Soros hopes his pledge can change these incentives. Is the money enough to make a difference? America's National Science Foundation, which dispenses federal research grants, spends about 20 times as much on the social sciences as a whole. The University of Chicago spent \$19.6m on research in the social sciences in 2007, excluding outside bequests. In 1988 Raymond Sauer of Clemson University calculated that a publication in a leading journal adds about \$3,600 (in today's prices) to an economist's annual salary. So over a young economist's career of, say, 30 years, each article makes them \$108,000. By that standard, the Soros pledge is big enough to persuade 463 young economists to take a break from their next shot at getting a paper into a journal and spend some time rethinking economics instead. But that would assume that economists are only in it for the money.