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Ivory Tower Unswayed by Crashing Economy

By PATRICIA COHEN

For years economists who have challenged free market theory have been the Rodney Dangerfields of the profession. Often ignored or belittled because they questioned the orthodoxy, they say, they have been shut out of many economics departments and the most prestigious economics journals. They got no respect.

That was before last fall's crash took the economics establishment by surprise. Since then the former Federal Reserve chairman Alan Greenspan has admitted that he was shocked to discover a flaw in the free market model and has even begun talking about temporarily nationalizing some banks. A Newsweek cover last month declared, "We Are All Socialists Now." And at the latest annual meeting of the American Economic Association, Janet Yellen, president of the Federal Reserve Bank of San Francisco, said, "The new enthusiasm for fiscal stimulus, and particularly government spending, represents a huge evolution in mainstream thinking."

Yet prominent economics professors say their academic discipline isn't shifting nearly as much as some people might think. Free market theory, mathematical models and hostility to government regulation still reign in most economics departments at colleges and universities around the country. True, some new approaches have been explored in recent years, particularly by behavioral economists who argue that human psychology is a crucial element in economic decision making. But the belief that people make rational economic decisions and the market automatically adjusts to respond to them still prevails.

The financial crash happened very quickly while "things in academia change very, very slowly," said David Card, a leading labor economist at the University of California, Berkeley. During the 1960s, he recalled, nearly all economists believed in what was known as the Phillips curve, which posited that unemployment and inflation were like the two ends of a seesaw: as one went up, the other went down. Then in the 1970s stagflation — high unemployment and high inflation — hit. But it took 10 years before academia let go of the Phillips curve.

James K. Galbraith, an economist at the Lyndon B. Johnson School of Public Affairs at the University of Texas, who has frequently been at odds with free marketers, said, "I don't detect any change at all." Academic economists are "like an ostrich with its head in the sand."

"It's business as usual," he said. "I'm not conscious that there is a fundamental re-examination going on in journals."

Unquestioning loyalty to a particular idea is what Robert J. Shiller, an economist at Yale, says is the reason the profession failed to foresee the financial collapse. He blames "groupthink," the tendency to agree with

the consensus. People don't deviate from the conventional wisdom for fear they won't be taken seriously, Mr. Shiller maintains. Wander too far and you find yourself on the fringe. The pattern is self-replicating. Graduate students who stray too far from the dominant theory and methods seriously reduce their chances of getting an academic job.

"I fear that there will not be much change in basic paradigms," Mr. Shiller wrote in an e-mail message. "The rational expectations models will be tweaked to account for the current crisis. The basic curriculum will not change."

"I hope I am wrong," he added.

The political undercurrent undoubtedly makes change more difficult. There is a Crayola box full of differently named economic schools that are critical of mainstream free-market theory, but these heterodox — as opposed to orthodox — economists generally tend to fall into the liberal camp.

Given the short time span since the crisis began, no one expects large curriculum changes yet. But in addition to Berkeley and the University of Texas, professors at a number of departments including those at the University of Chicago, Harvard, Yale and Stanford, say they are unaware of any plans to reassess their curriculums and reading lists, or to rethink the way introductory courses are organized.

John B. Taylor, an economist at Stanford and one of President George W. Bush's advisers, whose forthcoming book is titled "Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis," said he was planning to update his introductory textbook, "Principles of Macroeconomics," because of the crash. But while the revision will include information about the financial crisis, he said, explanations of fundamental principles won't change.

To Philip J. Reny, chairman of the economics department at the University of Chicago — Milton Friedman's intellectual home and free market headquarters — such caution is a good thing. "Academia typically moves slowly and carefully and thoughtfully," he said. "There is a lot of speculation in the press" as to why the financial system collapsed, he added, but a lot of "work needs to be done to figure out what really happened, which dominoes are in front and caused others to fall."

Outside of the classroom, debates about the crash are taking place in several public lectures and faculty workshops on the subject. But "before we're certain of what the answer is, we're unlikely to think in terms of changing the curriculum," Mr. Reny added. "That's very serious. The responsible thing to do is wait until we have some understanding of what went on here."

There are a handful of departments that have welcomed alternative theorists, like the University of Massachusetts, Amherst; the University of Massachusetts, Boston; the University of Utah; and the University of Missouri, Kansas City (where the Heterodox Economics Newsletter is published).

To Mr. Galbraith and L. Randall Wray, an economist at Missouri, the two thinkers whose work is most relevant today are John Maynard Keynes, who argued that the government should spend its way out of the Great Depression, and Hyman Minsky, who maintained that financial institutions could prompt ruinous crashes by taking on too much risk. Neither, Mr. Galbraith said, is part of the core curriculum in most

economics graduate programs.

When asked why graduate students don't study Keynes or Minksy, Mr. Reny replied that graduate students work on subjects — like real models of business cycles — that are at the frontier of the field; by contrast Keynes and Minsky are not on the frontier anymore.

Mr. Wray prefers to call such mathematical modeling "the frontier of nonsense." For more than a decade Mr. Wray has asserted that both the theory and the models used by risk-rating agencies are wrong. He has been invited to speak at the University of Chicago, he said, but by social science graduate students, not by the economics department.

When it comes to the financial crisis Dani Rodrick, an economist at Harvard, said, "The problem wasn't with the economics but with the economists." Theories and models are tools, but "we have fixated on one of the possible hundreds of models and elevated that above the others," he said, referring to free market theory. "We form a narrative of the moment, which fits the zeitgeist."

For many the narrative that seemed to best explain the experiences of the 1970s, '80s and '90s, when the Soviet economy collapsed, and India and China became more market oriented was told by free market theorists.

A real shift among economists will come only if there is a wholesale collapse, Mr. Wray and Mr. Card agreed. If unemployment is still high three years from now, then you might start to see a paradigm shift, Mr. Card said; economists will "have to say that the market isn't supposed to work this way." But if the economy bounces back in a year, then they will be able to dismiss the financial crash as an anomaly that is unimportant to the larger theory, he added.

A field shifts, Mr. Card and Mr. Wray said, not so much because the wise elders change their minds, (they are too invested in the way things are), but rather because a new generation of scholars comes along and pushes into new areas of research.

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