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

Meghnad Desai
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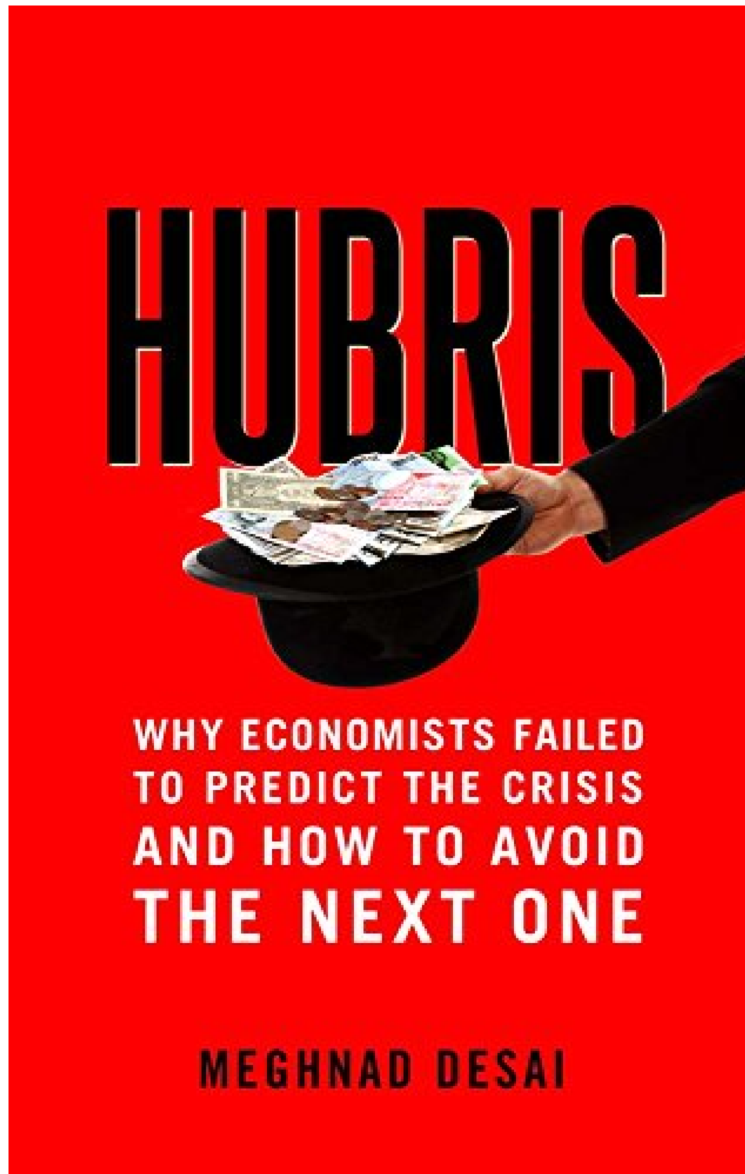

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Meghnad Desai : Hubris: Why Economists Failed to Predict the Crisis and How to Avoid the Next One before purchasing it in order to gage whether or not it would be worth my time, and all praised Hubris: Why Economists Failed to Predict the Crisis and How to Avoid the Next One:

0 of 0 people found the following review helpful. In addition to providing an excellent summary of "economic thought" since Adam SmithBy Jess StilesIn addition to providing an excellent summary of "economic thought" since

Adam Smith, Lord Desai outlines some of the problems that brought about the GFC (Global Financial Crisis). For me the summary of "economic thought" is the most interesting portion.23 of 23 people found the following review helpful. Not quite enough questionsBy BreakingviewsThe response of the dismal scientists to their collective failure to anticipate the global financial crisis has been dispiriting. Economists have refused to set aside their abstruse models, even though these models failed to predict the economic catastrophe. During the boom years, almost all economists applauded Alan Greenspanrsquo;s easy money policy. After the bust, the same people continue to deny ndash; in the face of common sense - that the low interest rates of Greenspanrsquo;s Federal Reserve were largely responsible for the debt bubble. In short, economics has failed to address its intellectual weaknesses.In ldquo;Hubris: Why Economists Failed to Predict the Crisis and How to Avoid the Next One,rdquo; Meghnad Desai, a retired professor at the London School of Economics, relishes exposing the flaws of his field. Unfortunately Desairsquo;s attempt to point the way forward is vitiated by his own weaknesses as an economist.Back in the 18th century Adam Smith established economics, according to Desai, as a ldquo;combination of philosophy, history, economic theory and some practical policy advice.rdquo; Yet modern economists, while adept at mathematics, lack Smithrsquo;s intellectual breadth. In particular, they are largely ignorant about economic history and know even less about the intellectual development of their own discipline.As a result, economists fail to learn the lessons of history. Herersquo;s an example. In the 1920s the Austrian economist Friedrich Hayek criticised an interest-rate policy that was focused exclusively on maintaining price stability ndash; a policy stance recommended at the time by leading economists, including John Maynard Keynes and Irving Fisher. Hayek suggested that, under certain circumstances, such a policy could result in rates being set too low, fostering a credit boom, which would inevitably burst. The Great Crash of 1929 supported Hayekrsquo;s view.A little more than a half-century later, central bankers made exactly the same mistake, concentrating on price stability and ignoring the rapid growth of credit. Had economists been aware of Hayekrsquo;s analysis, they might have been less sanguine during the balmy years of the so-called Great Moderation.Desai suggests that many of the flaws of economics derive from the attempt to turn the subject into a science; a development he traces back to the father of classical economics, David Ricardo, who theorised that the economy tends naturally towards equilibrium. Such a balanced state can be modelled mathematically with ease, allowing economists to satisfy their ldquo;physics envy.rdquo; As Desai points out, modern economists are wedded to mathematical models, despite the modelsrsquo; reliance on highly unrealistic assumptions about the real world.While Ricardo was postulating equilibrium in the early 19th century, other commentators noticed a regular ebb and flow to economic life, including occasional but recurring financial crises. Yet the economics profession has tended to ignore the credit cycle, instead ascribing all oscillations in economic activity to random, or in economist-speak ldquo;exogenous,rdquo; shocks. According to this view, economic catastrophes such as the Great Depression and Japanrsquo;s lost decade only came about due to policy mistakes by central bankers.Certain economists noticed that production rises and falls with some regularity. Desai provides a brief introduction to various theories of the economic cycle, including that of Karl Marx. The author of ldquo;Das Kapitalrdquo; was so persuaded of the fragility of capitalism in the 1850s that he feared the economic system would implode before he had completed his magnum opus.Marxrsquo;s cycle, according to Desai, resulted from the competition between workers and capital for the economic surplus. This has some contemporary resonance since in the years prior to the financial crisis, the profit share of GDP in the United States was extremely elevated and household consumption was buoyed by credit rather than wage growth. When capital vanquishes labour, in Marxrsquo;s analysis, a crisis beckons.Yet for all his bluster about the inevitable collapse of capitalism, Marxrsquo;s approach shares a common fault with mainstream economics. They all overlook the key role played by credit in driving economic activity. Economists often describe money as a ldquo;veilrdquo; which must be lifted to observe what really matters, the workings of the ldquo;realrdquo; economy.Yet, as the events of 2008 revealed, the real economy can turn out to be something of an illusion. Homebuilding and consumer spending depend on mortgages; imports and exports require trade finance; the governmentrsquo;s ability to sustain economic activity is determined by access to the capital markets. When the failure of Lehman Brothers broke Wall Streetrsquo;s credit machine, the global economy ground to a halt.While ldquo;Hubrisrdquo; provides a readable account of the various failings of economics, Desairsquo;s understanding of modern finance is not quite up to the job. For instance, his definition of a derivative ndash; which he describes as a financial instrument ldquo;based on equitiesrdquo; ndash; is inaccurate and his description of so-called ldquo;shadow bankingrdquo; is confused.Desairsquo;s attempt to direct the attention of economists back to the economic cycle is welcome. Yet he espouses the nebulous cycle theory of the Soviet economist Nikolai Kondratieff which is derived from a confection of miscellaneous factors.Desai stresses the importance of money and credit, opposes the notion of equilibrium and champions unorthodox economists. Yet not once does he mention the contributions of the late U.S. economist Hyman Minsky, who saw economics as a study of dynamic disequilibrium, placed finance at the centre of his analysis, and developed a coherent cycle theory of boom and bust. The Lehman bust has been justly described as a ldquo;Minsky moment.rdquo; Desairsquo;s oversight of Minsky leaves a gaping hole in an otherwise admirable book.Minsky was unpopular among his fellow economists for two reasons. First, his analysis was difficult to model mathematically. Second, his views were unorthodox. By the turn of this century the economics profession had become extremely intolerant of dissent ndash; intellectual heresy

wasnrsquo;t persecuted, it was simply ignored.If economics is to regain its status as a serious intellectual discipline, economists must be prepared to relinquish their mathematical models and rekindle the intellectual breadth that the subject has lost since Adam Smithrsquo;s day. Since the Lehman bust, they have made distressingly little progress.-Edward Chancellor8 of 8 people found the following review helpful. Not stunning, not bad.By DarrenIngram_dot_comHave economists been collectively asleep at the wheel and failed to see the wood for the trees, allowing society to walk into a sudden global financial crisis and recession? Or is this excusable. Is there the potential to forecast the next ldquo;big onerdquo; and try and mitigate its effects?This book tried to argue a partial disconnection, suggesting that economists need to reengage with the history of economic thought and be receptive to insights that might give clues towards a future meltdown, yet at the same time it feels that some feather cushions are being laid out to soothe criticism. One problem is that the book just doesnrsquo;t get out of second gear. It gives the impression as if it pootles along, juddering from side to side, yet failing to zoom along to ldquo;Pointsvillerdquo; when it gets the chance.At times it feels as if a punch is thrown, such as the author noting that the last big economic meltdown was not a problem with the economy per se, but with economics and economists who will not admit that they were wrong. Can all the criticism be justified without it appearing one-sided, granting far too much power to the few? Determining this is beyond this reviewerrsquo;s pay grade, yet it didnrsquo;t feel entirely right.Yet it was an interesting read, giving various points and counterpoints. It did not feel revolutionary. Maybe it was the culinary equivalent of a fast food restaurant: there was nothing wrong with the food as it filled a gap, but it didnrsquo;t win you over either. It wasnrsquo;t an expensive meal, nor a gourmet delight, yet it was food for the mindhellip;Several opinions are always better than one, after all.

The failure of economists to anticipate the global financial crisis and mitigate the impact of the ensuing recession has spurred a public outcry. Economists are under fire, but questions concerning exactly how to redeem the discipline remain unanswered. In this provocative book, renowned economist Meghnad Desai investigates the evolution of economics and maps its trajectory against the occurrence of major political events to provide a definitive answer. nbsp; Desai underscores the contribution of hubris to economistsrsquo; calamitous lack of foresight, and he makes a persuasive case for the profession to re-engage with the history of economic thought. He dismisses the notion that one over-arching paradigm can resolve all economic eventualities while urging that an array of already-available theories and approaches be considered anew for the insights they may provide toward preventing future economic catastrophes. With an accessible style and keen common sense, Desai offers a fresh perspective on some of the most important economic issues of our time.

'Here is something completely different: a really rather delightful and useful little survey of economic history... that deserves to be widely read.rsquo;mdash;Diana Hunter, Financial World.