Cambridge Journal of Economics 2005, **29,** 827–835
doi:10.1093/cje/bei092

Economics for the future

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Many of us decided to study economics because we were interested in issues such as economic growth, unemployment, poverty, discrimination and social exclusion. And for much of the history of the discipline, economists grappled with explaining such phenomena and, hopefully, helped to improve the development of economic policy. But now the discipline is increasingly dominated by other concerns, such as mathematical rigour and econometric modelling. The *New York Times* columnist, Michael Weinstein, recalled how his passion to learn economics, which was driven by a desire to understand the causes of poverty and the impact of technical change, was immediately quelled when on his first day as a graduate student at the Massachusetts Institute of Technology the professor announced that 'all of economics is a subset of the theory of separating hyperplans' (Weinstein, 2000). The subject has become so obscure that even orthodox economists are bemoaning its intellectual poverty. According to Milton Friedman, 'economics has become increasingly an arcane branch of mathematics rather than dealing with real economic problems' (Friedman, 1999, p.137). And Robert Solow has observed: 'Today if you ask a mainstream economist a question about almost any aspect of economic life, the response will be: suppose we model that situation and see what happens. . .modern mainstream economics consists of little else but examples of this process' (quoted in Lawson, 2005).

So many economists are now increasingly engaged in research and teaching that is disconnected from the issues that influence people's lives, as Long (2005) observed: 'academic economists remain hidden in their ivory towers. They are neither household names nor a significant presence in newspaper commentary pages. How strange for a country that produced the most famous economists of all time: Adam Smith, David Ricardo and John Maynard Keynes'. But not all remain hidden in their ivory towers: there are a few who do influence the policy domain, but they come from the intellectually narrow sect of neoclassical economics. And there are those from the neoclassical sect who have managed to infiltrate popular culture by throwing away the maths, packaging their prose in airport-style books and entertaining their readers with stories about why sumo wrestlers cheat and why drug pushers live with their mums (see Levitt and Dubner, 2005).

As modern orthodox economics moves away from reality, there is both the opportunity and the need for heterodox economics to orientate economics towards

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relevance to the real world and to become more fully engaged with the policy community. There are valid complaints that the hegemony of neoclassical economics makes it increasingly difficult to get an academic appointment or promotion in an economics department unless one complies with the orthodoxy. But as the *Cambridge Journal of Economics* (*CJE*) has shown, there are opportunities and means to highlight and promote the important insights of heterodox economics. It is a testament to the influence of the *CJE* that many academics and policy-makers believe that the Economics Faculty at Cambridge remains a heterodox school that is building on the 'Keynesian revolution'. In reality, the Cambridge Faculty is dominated by neoclassical economics and has been since the mid-1980s. There are, of course, members of the Faculty of Economics on the Editorial Board of the *CJE* – but most of them were appointed in a different era – and although they are internationally respected, they are in a dwindling minority in their own Faculty.

But there is an important distinction to be made between Cambridge Economics and the Economics Faculty at Cambridge. The former is a much broader church, encompassing heterodox economics and interdisciplinearity, with a presence in many Cambridge Faculties and Colleges. Thus the *CJE* Editorial Board includes members drawn from the Judge Business School and the Faculties of Geography, Law and Social and Political Sciences, as well as other universities in the UK.[1] Sharing knowledge and learning from other disciplines is an important aspect of the *CJE*'s work. And its importance is growing as, increasingly, orthodox economics operates in a narrow academic silo - with periodic forays to snatch elements of other disciplines in order to reconfigure them according to neoclassical axioms and strictures (take, for example, the new economic geography and the use of psychology in behavioural finance).

Where are the future heterodox economists to come from? The narrowing of focus of economics courses increasingly limits the access of students to alternative paradigms. Despite this, there are reasons for optimism. Other disciplines are demanding teaching in economics that is both relevant and useful – requirements that modern economics is ill-equipped to meet. And students themselves are reacting to the irrelevance of orthodox economics. The perhaps unfortunately named Post-Autistic Economics Movement is student-inspired and is calling for economics to engage with economic realities, and for the adoption of a range of approaches to understanding economic phenomena (see www.paecon.net). Thus pressure is coming from within, as students use what consumer sovereignty they have to call for change. The process of learning neoclassical economics itself impresses on students its limitations and restrictions. For instance, undergraduate economists at Cambridge are now required to write a dissertation in their final year. Many of them would prefer to research topics in such areas as methodology, philosophical aspects of economics or economic history but they perceive the riskiness of such a course of action and instead opt to test some model using the latest econometric technique. They soon realise that getting the 'right' result is merely a matter of the time and effort required to run numerous specifications – adding variables, deleting variables, using lags (the econometrician's notion of 'history') and so on. Results, therefore, are a product of patience and programming, not of understanding and evidence.

[1] The number of members of the Editorial Board drawn from outside Cambridge is constrained, as members must be able to attend the weekly meeting of the Board in Cambridge.

One of the important activities of the Cambridge Political Economy Society (CPES: the cooperative which publishes the *CJE*) is to support the studies of graduate students. Since the early 1980s, the CPES has provided grants and scholarships totaling more than a quarter of million pounds to graduate students studying economics or related disciplines. The CPES has also supported a range of conferences and workshops to help highlight and disseminate the work of heterodox economists. For this purpose, the Society decided to organise a conference in Cambridge in 2003 to celebrate the centenary of the Cambridge Economics Degree (called the Economics Tripos). Cambridge Economics was originally grounded in moral philosophy, its *raison d'être* was traditionally to understand why societies malfunction, and the devising of policies to offset the impact of malfunctioning and, especially, to protect those most vulnerable to their impact. The purpose of the conference was to build on this tradition by encouraging open dialogue amongst social scientists concerned about the future prospects for economics. The contributions to this volume are a selection of the papers presented at the conference

The need for a new paradigm?

One of the most powerful criticisms of heterodox economics is that although it provides effective critiques of neoclassical economics it does not provide a coherent alternative paradigm. So it ends up winning battles but not wars. The plenary lecture at the conference, written by Luigi Pasinetti, identifies eight building blocks for a viable alternative to the neoclassical school. These include a focus on reality rather than on abstract rationality; economic logic with a 'vigilant eye on reality'; the importance of classical roots; a stress on non-ergodic rather than timeless systems; macroeconomics to come first; instability and not equilibrium is the normal state of affairs; the importance of economic growth and of social concern. Pasinetti also highlights the need for a two-stage approach encompassing firstly 'pure theory' and subsequently 'institutional analysis'. Pure theory is the analysis of those aspects of reality that have a high degree of persistence through time. Institutional analysis is concerned with individual and social behaviour in alternative institutional settings.

Methodological concerns

Joan Robinson once said, in effect, that her great advantage was that she had not been taught mathematics so she was forced to think instead. Economics has incorporated some aspects of mathematics – but whilst mathematics is a broader discipline that has moved forwards and onwards, neoclassical economics has remained dependent on 'old' maths. The effectiveness of mathematics in economics is considered here by Vela Velupillai, who argues that interactions in economics are too complex to be captured by a reliance on maximisation axioms. As he argues: 'The headlong rush with which economists have equipped themselves with a half-baked knowledge of mathematical traditions has led to an un-natural mathematical economics and a non-numerical economic theory.' The result, as Keynes observed in *The General Theory*, is 'symbolic pseudo-mathematical methods of formalising a system of economic analysis... which allows the author to lose sight of the complexities and interdependencies of the real world in a maze of pretentious and unhelpful symbols' (Keynes, 1936, pp. 297-8).

Velupillai argues that economists should move away from the reliance on a narrow brand of mathematics and occupy the ground between the political arithmetician and the accountant.

According to John Foster, the gulf between economic theory and historical research may result in the bifurcation of economics into applied economics and business economics. Foster argues that complex systems offer a method of understanding economic processes – such systems are ‘open systems that are irrevocably connected to an environment that contains other systems that can be complementary, competitive, combative, predictive or available as prey.’ Furthermore, Foster argues that such systems cannot be used within an orthodox framework, which depends on such restrictive assumptions as constrained optimisation.

Euclid Tsakalotos also considers the limitations of orthodox economics. In particular, he argues that political economy cannot be value-free and that if heterodox economics is to dislodge neoclassical economics it must engage directly with politics, culture and values. Tsakalotos argues that heterodox economics will fail if it tries to occupy the value-free terrain of neoclassical economics – if it did so it might expose the theoretical limitations of neoclassical economics, but it will not displace *homo economicus* as the core unit of analysis for economics and society.

Tsakalotos also argues that heterodox economics must become more interdisciplinary if it is to threaten the hegemony of neoclassical economics. Psychology is one discipline whose insights are increasingly being used in economics, developments which are examined in the paper by Peter Earl. As Earl argues, economists and psychologists have different attitudes to the synthesis depending on which discipline is dominant – and he draws a distinction between economic psychology and psychological economics. He sets out the foundations for a research programme in psychological economics that would require the rejection of many tenets of neoclassical economics and the adoption of a much wider range of research methods. For instance, Earl insists that choice is not a utility maximising activity but a purposive or goal-directed one, the research into which would require research methods from other social sciences, including questionnaires, protocol analysis and experimentation.

The importance of multiple methods of analysis is also emphasised by David Colander. He identifies the process which has led to economics becoming more technical by its focus on the ‘holy trinity’ of rationality, greed and equilibrium. But Colander takes an optimistic view of the future of economics, as he believes that modern orthodox economics is beginning to build broader and more useful foundations based on ‘purposeful behaviour, enlightened self-interest and sustainability’. He goes on to argue that the discipline of economics will shift from ‘the study of infinitely bright agents in information rich environments’ to ‘the study of reasonably bright individuals in information-poor environments’ - thus returning to Marshall’s notion of sensible people doing the best they can in an uncertain environment. Whilst one hopes that Colander’s vision of economics in the future is realised, an alternative interpretation of recent developments is not that the ‘holy trinity’ is unravelling but that its scope is being extended to new areas which orthodox economics aims to colonise.

The importance of developing appropriate microfoundations for macroeconomics is addressed in the paper by Sergio Nisticò. He provides a critique of the theories of prices and distribution in classical and neoclassical models. Furthermore, he contributes to the development of the microfoundations of Keynesian economics by developing a bold 'middle way' between Hicks's temporary equilibrium framework and a Sraffa-type long-period analysis.

Macroeconomics

Modern macroeconomics in based on the 'New Keynesian' paradigm. Many would consider that this contains little Keynesianism – rather, that it is merely a reformulation of the neoclassical synthesis. In essence, macroeconomics has been reduced to studying, first and foremost, various neoclassical models of economic growth and, second, why sticky prices or wages cause business cycles. Short-run analysis is very much relegated to second place behind that of the long period - see the ubiquitous textbook by Mankiw, the former Chairman of the Council of Economic Advisers to the US President (2003). The importance of the short run is central to Keynesian economics, as Joan Robinson (1962, p. 690) observed: 'The short period is here and now, with concrete stocks of the means of production in existence. Incompatibilities in the situation . . . will determine what happens next. Long period equilibrium is not at some date in the future: it is an imaginary state of affairs in which there are no incompatibilities in the existing situation, here and now'.

One of the foundations of the New Keynesian paradigm is NAIRU (the ugly acronym for the Non Accelerating Inflation Rate of Unemployment). The origins of the NAIRU can be traced back to Rowthorn's conflict theory of inflation published in the *CJE* in 1977. But the more recent vintages have reconfigured Rowthorn's original contribution into an equilibrium framework which is much closer to, but not the same as, the monetarist natural rate (see Layard, Nickell and Jackman, 1991). The paper by Philip Arestis and Malcolm Sawyer returns the analysis of the inflationary process to its roots in conflict over shares in income. Arestis and Sawyer stress the importance of investment as a higher capital stock leads to the 'inflation barrier' being at a higher level of employment and a higher real wage (on this, see also Kalecki, 1943 and Rowthorn, 1999). An important policy implication is that unemployment is primarily caused by lack of productive capacity and low levels of aggregate demand, and not labour market rigidities.

Arestis and Sawyer evaluate the significant regional differences in unemployment and argue that such differences are due to spatial differences in the level of demand and capacity. The issue of regional variations in unemployment in the UK is evaluated by David Webster, who provides a critique of the notion of labour market hysteresis. Many NAIRU models incorporate this mechanism by which increases in unemployment become embedded in the long run, thereby increasing the NAIRU. One of the most frequently cited propagating mechanisms of hysteresis is the impact of unemployment on employability, which increases long-term unemployment.[1] The logic of this argument is that long-term unemployment can only be corrected by labour market policies that target the 'employability' of the long-term unemployed. Webster

[1] It is argued that the rise of the long-term unemployed can cause hysteresis through loss of skills, discouraging labour market search, and acting as a screening device which discourages employers from employing those that have been unemployed for a long time. There are other hysteresis mechanisms such as changed wage bargaining through insider-outsider behaviour and the impact of capital scrapping on productive capacity. There is also the possibility of positive hysteresis where running the economy at a high level of demand creates beneficial supply-side changes, but these are less frequently analysed in the literature.

shows that the empirical evidence does not support this notion and that causation runs the other way, with a rise in total unemployment causing a rise in long-term unemployment. And, in accord with the Arestis and Sawyer analysis, the spatial variations in economic activity can be traced to variations in the level of demand (which in turn reflect the geographical legacy of deindustrialisation). Thus policy in the UK, with its excessive focus on 'employability', has been driven by inappropriate models, inadequate analysis of the data and a lack of understanding of economic geography (on support for this, see Fothergill, 2005).

Jan Schnellenbach addresses the lack of pluralism in debates in modern macroeconomics. In his paper he considers the importance of the Dahrendorf thesis that 'diversity is…at the very heart of a world that has abandoned the need for closed, encompassing systems'. But, despite the recognition of 'varieties' of capitalism and a choice of different of paradigms of economic analysis, neoclassical economics continues to dominate the evaluation of economic processes and policies.

The paper by Alex Millmow describes the emergence of the orthodox paradigm in Australia. Millmow describes the evolution of Australian economics from its initial heterodox beginnings to its succumbing to the 'fatal embrace' of American economics. The UK has followed a similar path, with orthodox economics now dominating the teaching, research and recruitment activities of universities. Economic policy in the UK has also followed this direction: the Chancellor of the Exchequer, Gordon Brown, has referred to policy being based on 'post neoclassical endogenous growth theory' (although there is nothing 'post' neoclassical about such models: they are firmly neoclassical in construction and implications) and that the Government's economics is 'post-monetarist' (Brown, 2001). In essence, UK policy is based on a twenty-first century version of Say's Law. And now the European Union is being inculcated with neoclassical economics and the importance of moving towards the 'American model' (see Sapir *et al.*, 2004).

Microeconomics

The changing nature of work and employment is analysed in the paper by Damian Grimshaw and Jill Rubery. They argue that neither the new institutionalist nor the Marxist approach to employment relations and organisational structures is adequate to explain the increasing fragmentation and diversification of employment relationships. Often, employment relations are analysed from too narrow an organisational perspective, and inter-organisational analyses often neglect the importance of employment relations. Instead, Grimshaw and Rubery argue for a dynamic approach that takes account of workers' resistance. They argue for considering the development of a 'countervailing power to protect and promote the interest of workers within a capitalist system that may be continuously shifting between integrated and non-integrated work'.

The changing nature of work and the issue of employability have been central to the transition economies of Eastern Europe. The paper by Anton Nivorozhkin provides insights into the impact of labour market programmes in Russia, which have been influenced by the Western industrialised countries' focus on improving the supply-side of the economy. Nivorozhkin's results indicate that training programmes had a short-lived positive effect which disappeared after one year. Such results are consistent with the analysis in the paper by Arestis and Sawyer, and that by Webster, that show that labour market programmes are insufficient for increasing employment and generating economic growth.

The most common measure of household prosperity is money income, yet this is deeply flawed as a measure of prosperity, let alone well-being. The paper by Edward Wolff, Ajit Zacharias and Aresena Caner improves on such indicators by developing a more comprehensive measure of household well-being which includes household wealth and the benefits to households of government expenditure in addition to money income. Using data from the United States, the paper suggest that the distribution is substantially altered when money income is adjusted in this way. In particular, adding measures of household wealth *increases* inequality and adding public consumption *decreases* inequality. The paper shows the important role that public expenditure (excluding transfer payments) can have in decreasing inequality (on this, see also the discussion of the preference for public goods by Schnellenbach). The paper is timely, as the growing social fissures and inequalities in American society caused in part by retrenchment of public expenditure have been tragically highlighted by the aftermath of hurricane Katrina.

Christine Greenhalgh further explores the inadequacies of free market capitalism, arguing that it is biased against supplying the needs of poor consumers, and biased against the development of green technology. The bias against supplying the needs of the poor is due to the combination of inequalities in wealth and the crowding out of the needs of the poor by the demands of the rich for time-saving and luxury goods. The bias against the development of green technology is a consequence of the high value placed on the time of current generations of workers against those in the future (on this see also the discussion by Earl on hyperbolic discount rates). Greenhalgh suggests more radical policies are needed to redress the perversities of the capitalist system, including a radical redefinition of rights that puts greater weight on user rights and responsibilities compared to ownership rights.

Development

Much of modern development economics has been infiltrated by neoclassical economics, which insists that unencumbered market forces can ensure allocative efficiency. The term 'Washington Consensus' has often been used to describe the application of such 'neoliberalism' or 'market fundamentalism' to developing countries.[1] The paper by Jang-Sup Shin considers the differences between the universalism of the orthodox approach compared with the more context-specific heterodox approach. Shin develops Weber's argument against the possibility of universal theory, as the human capacity for knowledge is finite relative to the infinity of mechanisms at work in real world. The paper concludes that the future task of development economics lies in recombining existing theories and developing new complementary theories that will be appropriate for developing countries (on this, see also Pasinetti's two-stage method).

Alexander and Sheila Dow contribute to development economics by providing a methodological critique from a critical realist perspective. As with the analysis by

[1] The term 'Washington Consensus' was first used by Williamson (1990) although he has questioned the subsequent use of the term (Williamson, 2000).

Shin, they criticise the universalism in orthodox development economics. Furthermore, they adopt a bold middle way – with critical realism viewed as occupying the ground between modernism and postmodernism. They develop their analysis using Scotland as a case study (a novel choice for development, although not for regional economics). They argue that critical realism allows the development of a structured pluralist approach whereby underlying causal mechanisms identified in one context may provide the starting point for analysing causal mechanisms in others. This is an important initiative, since much of the critical realist literature has yet to engage with, or contribute to, economic policy.

The paper by Renée Prendergast evaluates some of the contributions by Amartya Sen and in particular, his concept of freedom. Prendergast argues that there are tensions and contradictions in Sen's analysis that it is not possible to resolve. In particular, Prendergast argues that Sen's separation of the opportunity and process aspects of freedom creates problems and that this has led to Sen pronouncing on the moral value of processes independently of their consequences.

A number of the papers in the volume stress the importance of incorporating values more explicitly into economics, especially as they vary across societies. The paper by Wanna Prayukvong considers the impact of the incorporation by economic agents of Buddhist values in which the meaning of self is wider than the individual and includes society and nature. Using a case study approach, Prayukvong suggests that Buddhist values lead to more sustainable economic development with more desirable social outcomes. This is in marked contrast to the outcomes of free market capitalism identified by Greenhalgh.

Conclusion

The papers in this Special Issue of the *CJE* are examples of the vitality and progressive thought in heterodox economics. But now is the time not just to talk to ourselves – or just to win academics battles. Heterodox economics needs to engage more fully with public discourse and must influence public policy more directly.

The inspiration for this Special Issue and the conference that preceded it was the pluralism and usefulness that characterised economics at Cambridge. But recent changes at Cambridge suggest a retreat from relevance and a tightening of the neoclassical noose. The Faulty of Economics and Politics has become the Faculty of Economics – with the 'Politics' discarded like as unwanted cumbersome appendage. And the Department of Applied Economics (DAE) – the source of some of the best of Cambridge economics – no longer exists. The death sentence to the DAE is a first rate example of the vapid and disingenuous language deployed by some of the *apparatchiks* at Cambridge. The University's General Board (the body responsible for the academic and educational policy of the University) were concerned that: 'the existence of a Department with a focus on research in applied economics, and operating separately from the main Faculty, does not facilitate the development of an integrated research programme, encompassing the full range of a modern economics department, and aspiring to the highest standards of excellence' (*Cambridge University Reporter*, 2004). This is a report on a Department that produced some of the highest standard of excellence in applied economics – a Department that has been led by Dick Stone, Brian Reddaway, Wynne Godley, Alan Hughes and David Newbery (the report fails to acknowledge any of the major contributions of the DAE, read it at http://www.admin.cam.ac.uk/reporter/2003-04/weekly/5970/25.html). And what has replaced the DAE – well, as yet, nothing apart from a vacuum.

But Cambridge Economics is thriving, with the Cambridge Political Economy Society and the *CJE* acting as the hub for the growth and development of heterodox economics. In many respects, Cambridge is fortunate to have a critical mass of economists and others in cognate disciplines undertaking research into issues that inform or are related to economics. In many other universities, and perhaps more importantly in the policy domain, the orthodoxy remains omnipotent. It is the responsibility of those of us who are in communities that can resist the neoclassical tide to orientate economics back to being useful to society rather than just a means of solving mathematical puzzles.

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