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Chapter 2

The Economic Crisis and the Crisis in Economics

George DeMartino

Introduction

In many quarters, it has long been accepted that the discourses economists construct when theorizing do not simply mirror the external world but also define it and influence its course in fundamental ways (Gibson-Graham 1996; Ruccio and Amariglio 2003). But this insight tends to be of little interest to most economists, who hold fast to much more conventional epistemological presumptions. As every economist worth his salt knows, the world out there is what it is, for better or worse. That we might like it to be otherwise—that we might prefer a world in which people acted on altruistic rather than egoistic motivations, say—is of no theoretical relevance. In this account, good theory provides a faithful representation of the world as it is, not as the economist would like it to be. And when two theories seem to do the job equally well, economists are trained to choose that alternative that is most elegant, parsimonious and tractable. Moreover, the economist's epistemology induces the comforting belief that theoretical knowledge improves over time, yielding explanatory models that do a better and better job of capturing the world. This is an epistemology that generates faith in theoretical progress. Hence there is little need to expend time and energy examining the macro-theory of the 1930s when surely the macro-theory of the 1990s has overtaken its predecessor in its explanatory power and verisimilitude.

This way of thinking engenders the belief that the ethical imperatives associated with professional economic practice are rather obvious and even trivial. The ethical economist must do his or her best to advance the science—to extend existing economic models to cover

new situations, to test theory against the facts, and to introduce theoretical innovations when existing theory is found to be an inadequate representation of the real world. The ethical entailments of this kind of economic practice comprise principles such as objectivity (rendering the world as it is free of bias or personal convictions), truth-telling (one must not alter the data or misreport one's findings), professional respect for one's colleagues (one must not damage another's research projects) and other very basic and commonsensical dictates. Provided economists live by these rules, they and their profession are to be recognized as meeting whatever professional ethical responsibilities they may face. Indeed, over time this became the official view of the American Economic Association (AEA)'s Executive Committee on the need for professional economic ethics. When asked periodically about the AEA's code of conduct, Coats (1985, 1710–11) reports, "The usual response to enquirers was that the AEA needed no special code of ethics because the canons of correct professional practice were too obvious to require specification."

This view prevailed, at least until the outbreak of the current global economic crisis. Today, the view of economic theory as a neutral representation of the world beyond and the commonsensical ethical imperatives associated with that perspective are being abandoned at least in part by some of the most prominent economists of our era. The crisis has sparked recognition that what economists do matters in shaping the world that they purport merely to know. Paul Krugman (2009b, 37) put it this way:

> As I see it, the economics profession went astray because economists, as a group, mistook beauty, clad in impressive-looking mathematics, for truth...the central cause of the profession's failure was the desire for an all-encompassing, intellectually elegant approach that also gave economists a chance to show off their mathematical prowess.

Krugman builds upon this insight to lay substantial blame on the economics profession for contributing to the crisis—not just by failing to anticipate it, but by validating dangerous investor behaviors and obstructing reasonable attempts by government officials to regulate financial institutions and markets. Financial economist Robert Shiller (2009, 16) makes the point even more directly:

> This mania was the product not only of a story about people but also a story about how the economy worked. It was part of a story that all investments in securitised mortgages were safe because those smart people were buying them.... *To a remarkable extent we have got into*

> *the current economic and financial crisis because of a wrong economic theory*—an economic theory that itself denied the role of the animal spirits in getting us into manias and panics. (emphasis added)

These arguments suggest correctly that the influence of the economics profession in shaping the world isn't restricted to applied economists who explicitly advocate or oppose economic interventions. Rather, the work of academic economists who never venture forth from the campus, and who view their endeavor as pure theory, also changes that world. Indeed, given the peculiar status hierarchy of the economics profession which values theoretical over applied work, academic economists exert far greater influence on the world than do those economists who dedicate their lives to achieving impact.

That economists change the world about them through their theoretical and not just their applied work suggests that the profession faces challenges of a professional ethical nature that it has historically ignored and even suppressed.[1] Recognition of influence (intended and unintended) implies that the basic list of dos and don'ts that implicitly have guided economists' behavior is woefully inadequate; that the ethical challenges of economic practice are much more complex than we have heretofore believed. Influence over others necessarily entails ethically complex matters—whether it is a teacher's influence over a student, a doctor's influence over a patient, a public health official's influence over the physical well-being of a community, or an economist's influence over the life chances of all those who populate the economy. All of this has been brought into sharp relief during the current crisis. Economists are now beginning to confront the nature of their influence and the depths of their culpability in creating economic freedoms and opportunities, but also economic constraints, vulnerabilities and even trauma.

All of this raises a difficult and yet pressing question: to what degree has the economics profession acted ethically in the fulfillment of its professional responsibilities? In the case of the current global economic crisis, it is now widely understood that economists made important and consequential mistakes. They failed to appreciate the extraordinary risks associated with the new financial instruments and practices that had emerged over the past several decades and that spread rapidly during the 1990s and after, or the consequent need for stricter government supervision of financial markets. No one put it better than former Federal Reserve Chair Alan Greenspan, who in testimony before the U.S. House Committee on Oversight and Government Reform Congress on October 23, 2008 admitted that

he made a fundamental error: "I made a mistake in presuming that the self-interest of organizations, specifically banks and others, was such that they were best capable of protecting their own shareholders." Speaking of a "once in a century credit tsunami" he continued "[t]hose of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself especially, are in a state of shocked disbelief" (Andrews 2008). But error is inevitable in all of the professions; it arises from the condition of epistemic insufficiency that governs professional practice. Error alone does not imply professional ethical failure. Ascertaining whether the profession failed to meet its ethical duties requires a different kind of evaluation. But how should we make it? What should we look at, and on what basis might we draw the conclusion that the profession met or failed to meet ethical obligations that necessarily attend economic practice?

In what follows I will advance the case that the economics profession did indeed act unethically in the period leading up to the current economic crisis. It needlessly put into jeopardy the economic security of the most vulnerable individuals and communities across the globe, without their consent. This argument presumes that the profession could and should have acted differently—that its behavior was wrong-headed and, ultimately, terribly consequential. Making this case adequately would require a depth of analysis into the meaning of professional ethics and the conduct of the economics profession over the long sweep of its history that I cannot undertake here (but see DeMartino, forthcoming). Instead, I will offer a series of observations, each of which taken individually and all of which taken together represent *prima facie* evidence that our profession comported itself in a manner that fails the test of well-established professional ethical principles.

Financial Liberalization and Maxi-Max

From the 1980s onward mainstream financial economists pressed for financial liberalization in the global South and in the developed economies (Grabel 1996). This prescription involved privatization and deregulation within the financial sector, removal of capital controls, an increase in permissible leveraging, increasing allowance for banks to assess their own riskiness, and so forth (Johnson 2009). In the context of the United States, financial liberalization involved removal of restrictions on financial institutions that were intended to prevent conflicts of interest and systemic risk. The institutional interlinkages and financial innovations that followed outstripped the regulatory apparatuses that were in place to police them.

Economists not only pressed for the removal of existing financial regulation but also resisted new government oversight of the financial assets and market contracts that proliferated from the 1990s onward. Alan Greenspan consistently reassured policymakers and the public about the sufficiency of market mediation to discipline financial markets. In 1998 Greenspan blocked the efforts of Brooksley E. Born, head of the Commodity Futures Trading Commission (CFTC), to regulate derivatives markets. To prevent a repeat regulatory effort, Greenspan then pushed Congress to "strip the CFTC of regulatory authority over derivatives" (Goodman 2008). Treasury Secretary Lawrence Summers also used his substantial influence in the Clinton White House to oppose financial regulation. These and other leading economists believed that the new financial assets shifted risk to those agents most willing and best able to bear it; that on balance financial innovation which allowed for extensive and sophisticated hedging strategies served to make financial markets more complete, robust and safe; and that most steps by the government to stiffen financial regulation would cause harm to the economy while failing to reduce risk. As financial activity became more complex Greenspan became ever more confident. In 2004 he argued that "Not only have individual financial institutions become less vulnerable to shocks from underlying risk factors, but also the financial system as a whole has become more resilient" (Greenspan 2004).

Greenspan's faith in the market stemmed in large measure from his conception of the ways in which market mediation generates the trustworthy behavior upon which it depends. Referring nostalgically to an earlier period in U.S. history, when government intervened far less in economic affairs, Greenspan (2005) said:

> Trust as the necessary condition for commerce was particularly evident in freewheeling nineteenth-century America, where reputation became a valued asset. Throughout much of that century, laissez-faire reigned in the United States as elsewhere, and caveat emptor was the prevailing prescription for guarding against wide-open trading practices. In such an environment, a reputation for honest dealing, which many feared was in short supply, was particularly valued. Even those inclined to be less than scrupulous in their personal dealings had to adhere to a more ethical standard in their market transactions, or they risked being driven out of business.

In Greenspan's view government intervention is unwise because it stifles economic innovation and, equally importantly, undermines trust among market actors by diminishing the return to reputation

(see Zak 2008). It is also unnecessary not only because the market induces ethical behavior even from rogues, but also because market actors face a disciplining mechanism far wiser, more compelling and efficient than that provided by any government regulators.

I want to suggest that in the case for financial deregulation economists were guided implicitly by a utopian "maxi-max" decision rule. I also claim that application of this principle is entirely inconsistent with any viable body of professional ethics. What, then, is maxi-max?

The maxi-max decision rule instructs a decision-maker to select that policy option that "has of its many possible consequences one which is better than any possible consequence of any other available action" (Nozick 1974, 298). Selection under this rule is driven entirely by a comparison of the best possible outcomes promised by each of the potential courses of action without regard to the probability of that outcome actually materializing. This principle is extraordinarily aggressive since it considers just the one desideratum of maximum possible payoff in policy choice. As a consequence, it is a thoroughly utopian decision rule. Maxi-max recognizes risk explicitly, since it characterizes each policy option as a probability distribution of payoffs. But it then dismisses the matter of risk entirely in policy selection.

On what grounds can we conclude that the economics profession was in the grasp of maxi-max in the position it took on financial deregulation? From the 1990s forward Alan Greenspan and other leading economists resisted government regulation of the new financial instruments and practices on the exclusive grounds that liberalized financial markets promised greater rewards than any alternative regime. The profession's unequivocal advocacy of financial liberalization gave the impression that it would be foolish to forego the efficiency that legislative reticence promised. In this view no other policy regime (even at its best) could yield the benefits that would flow from financial liberalization.[2] Moreover, there was no debate over whether these benefits would indeed materialize, or whether the policy entailed appreciable risk to the economy in the event that it failed (in one respect or another). There was simply no need to consider other regulatory regimes, their respective risk profiles, and the damage that each would induce in the event of its failure. In possession of an available first-best policy option that was fully expected to succeed, all of that seemed beside the point.

Economists do not typically think of themselves as utopian—let alone revolutionary. The language of economic discourse is steeped in explicit recognition of trade-offs that necessarily entail

costs and benefits. The economics profession understands itself as advocating marginal improvements in existing affairs that are based on hard-headed calculations of gains and losses, risks and returns. That there are no free lunches is deeply inscribed in neoclassical economic thought. And yet, in one of the most important policy issues of the past quarter century, leading members of the profession abandoned its historic prudence and advocated unequivocally for a policy regime that entailed enormous risk simply on grounds that its promised payoff would exceed that of any other alternative regime, full stop. Absent here was any serious consideration of the risk profiles of aggressive financial liberalization or any of the alternative regulatory regimes that were available. Leading economists simply assumed, absent any investigation into the likelihood of policy failure, that the regime they had reason to advocate would indeed succeed. Hence, consideration of the consequences of policy failure was deemed to be beside the point.

Revolutionaries typically embrace the maxi-max decision rule, to be sure, so convinced are they that they have in hand the uniquely correct blueprint for society that will bring about the utopia that they seek. Were we discussing revolutionary ethics (if there is such a thing) we might conclude that maxi-max is an entirely appropriate decision rule. Moreover, it is entirely appropriate for individuals to embrace maxi-max in deciding their own, private affairs (provided their resulting behaviors do not put others at appreciable risk). But in the world of *professional ethics*, where professionals are given extraordinary authority to make decisions that bear on the rights and welfare of others, maxi-max has no place. As Nozick (1974, 298) argues,

> Everyone who has considered the matter agrees that the maxi-max principle... is an insufficiently prudent principle which one would be silly to use in designing institutions. Any society whose institutions are infused by such wild optimism is headed for a fall or, at any rate, the high risk of one makes the society too dangerous to choose to live in.

No established body of professional ethics makes space for maxi-max. Indeed, it is difficult to imagine how it possibly could. To the contrary, professional ethics across the professions emphasize the antithetical principle of harm avoidance—such as medicine's principle of *Primum non nocere*. Moreover, professional ethics today generally emphasize the need for prior informed consent when a professional's

actions involve risk to or substantial impact on those whom the professional hopes to serve. In contrast, maxi-max is a principle that entails total indifference to the matter of risk and that does not require prior informed consent (on the paternalistic grounds that the professional knows best). I would suggest that by embracing maxi-max in policy deliberations of the highest significance and impact—in deliberations over the need for and content of financial regulation—the economics profession violated the tenets of any imaginable body of professional economic ethics.

The Allure of Theoretical Elegance

Up until the crisis Greenspan was regarded widely as among the most successful Chairs of the Federal Reserve in U.S. history. His success stemmed in part from his refusal to commit to any particular monetary (or other) rule in conducting bank affairs (Andrews 2005, Mankiw 2006). Instead, he was renowned for gathering relevant data from all promising sources and factoring diverse kinds of information into nuanced judgments about the state of the economy and monetary policy. But in the matter of financial regulation he broke with the pragmatism that marked his leadership of the Federal Reserve to stake out a position that was extraordinarily rigid and even doctrinaire. In this matter his thinking was very much in line with mainstream economic thought, which advocated the efficient market hypothesis (EMH) with striking unanimity despite the recurrence of economic events and growing body of empirical evidence that should have called that hypothesis into question (e.g., Shiller 2003).

Paul Krugman has been particularly caustic in his assessment of the profession's failures leading up to the crisis. As the quotation cited above (taken from a cover essay in the *New York Times Sunday Magazine*) indicates, he blames the profession's fascination with theoretical elegance as the chief cause of its attachment to theoretical constructs that distort rather than elucidate economic events. The EMH in particular seduced mainstream financial and macroeconomists over the past several decades. According to the EMH the market price of an asset at any moment reflects correctly all existing available information regarding its underlying fundamentals. From this perspective, asset price volatility is explained by reference to the arrival of new information that bears on these underlying fundamentals. Even if some market traders are irrational and fail to value assets properly, the market as a whole will correct for any temporary price distortions that result from irrational investing.

The EMH implies that since the liberalized market discovers the correct price of assets on its own there is no basis for government intervention that would restrict the creation of new assets or regulate their exchange. No matter how complex financial assets become, the market will divine their correct price and risk profile owing to the incentive that market actors have in getting it right. Hence Ben Bernanke could claim as late as 2006 that "The management of market risk and credit risk has become increasingly sophisticated.... Banking organizations of all sizes have made substantial strides over the past two decades in their ability to measure and manage risk." (Bernanke 2006b). A consequence of this reasoning is the expectation that asset markets (if not the prices of individual assets) will remain stable over time in part because new information that bears negatively on one asset might have a negligible or even an offsetting effect on other assets. Government regulation that interferes with market price formation can only induce the financial fragility and instability that the regulation is intended to prevent.

The EMH came to inform not just neoclassical financial and macroeconomic theory but also the New Keynesian thought that emerged in the 1980s. We find little attention in New Keynesian theory to asset market bubbles or risks of systemic financial crisis. In Krugman's view such disturbances were off the economists' radar owing to the professional fascination with theoretical elegance and parsimony that led the mainstream in the profession to disregard the recurring financial crises of the past two decades. In the view of Willem Buiter, former Chief Economist at the European Bank for Reconstruction and Development, these trends "have set back by decades serious investigations of aggregate economic behaviour and economic policy-relevant understanding"; as a consequence, most " 'state of the art' academic monetary economics" is, in his view, "useless" (Buiter 2009).

In their advocacy of financial liberalization, then, influential academic and applied economists reflected a general consensus that had long prevailed among mainstream financial and macroeconomists. With the resurgence of neoclassical orthodoxy during the 1970s Keynesian insights about the potential volatility of unregulated financial markets had been put aside by the profession's most prominent members. As Krugman explains, "A general belief that bubbles just don't happen" had swept the profession, including its New Keynesian wing that had "come to dominate teaching and research."

> By 1970 or so...the study of financial markets seemed to have been taken over by Voltaire's Dr. Pangloss, who insisted that we live in the

> best of all possible worlds. Discussion of investor irrationality, of bubbles, of destructive speculation had virtually disappeared from academic discourse. (Krugman 2009b; see also Stiglitz 2009a, b)[3]

The consensus view on the virtues of financial market self-regulation informed the policy stance of Ben Bernanke once he took over as Chair of the Federal Reserve just as it had his predecessor. In the years immediately preceding the crisis Bernanke worried much more about the instabilities that might arise from the behavior of Freddie Mac and Fannie Mae, owing to their status as Government Sponsored-Enterprises (GSEs), than he did about disruptions emanating from unregulated financial institutions. In May of 2006 he spoke of the virtues of "financial innovation and improved risk management" including "securitization, improved hedging instruments and strategies, more liquid markets, greater risk-based pricing, and the data collection and management systems needed to implement such innovations." While recognizing risks associated with financial innovation, he argued that

> these developments, on net, have provided significant benefits. Borrowers have more choices and greater access to credit; lenders and investors are better able to measure and manage risk; and, because of the dispersion of financial risks to those more willing and able to bear them, *the economy and financial system are more resilient.* (Bernanke 2006a, emphasis added)

In June of 2006, Bernanke wrote: "Today, retail lending has become more routinized as banks have become increasingly adept at predicting default risk by applying statistical models to data, such as credit scores" (Bernanke 2006b).[4] In response to a question about whether there was need for increased regulation of hedge funds Bernanke told Congress on July 20, 2006 that

> the best way to achieve good oversight of hedge funds is through market discipline, through the counterparties, through the investors . . . at this point I think that the market discipline has shown its capability of keeping hedge funds well disciplined. . . .[5]

Under these conditions those who continued to harp on the risks of serious economic turmoil were easy to ignore. Among others, the list of dissenters includes Chicago's Raghuram G. Rajan (2005) who presented a prescient paper at a 2005 Kansas City Federal Reserve Bank gathering at Jackson Hole to celebrate the work of Federal

Reserve Chair Alan Greenspan. Rajan argued that financial developments during Greenspan's tenure had made the world far riskier and that financial crisis could be in the offing. In response Lawrence Summers said that he found "the basic, slightly lead-eyed premise of [Mr. Rajan's] paper to be misguided" (Lahart 2009a), while Federal Reserve Governor Donald Kohn "said that for central bankers to enact policies aimed at stemming risk-taking would 'be at odds with the tradition of policy excellence of the person whose era we are examining at this conference'" (Lahart 2009b). The list also includes Yale's Robert Shiller whose warnings about the pending housing crisis were ignored by Federal Reserve and other economists despite the rich empirical work he had done to cement the case, and despite the fact that he had been among the small minority of economists who had correctly identified the bubble in high-tech stocks in the late 1990s; Andrew M. Lo, the director of the MIT Laboratory for Financial Engineering, who presented a paper in 2004 at a National Bureau of Economic Research conference that "warned of the rising systemic risk to financial markets and particularly focused on the potential liquidity, leverage and counterparty risk from hedge funds" (cited in Lohr 2008, 5); Dean Baker, co-director of the Washington-based Center for Economic and Policy Research, who argued consistently from 2004 onward that the housing market was in a bubble; Morgan Stanley's Stephen Roach, who identified a housing bubble as early as 2002 and who in 2004 criticized the Federal Reserve for having become a "cheerleader when financial markets are going to excess" and having pursued "the ultimate moral hazard play that has turned the world into one gigantic hedge fund" (Roach 2004); and New York University's Nouriel Roubini, who argued from 2004 onward that a deep recession and financial crisis were imminent. All of these warnings were summarily dismissed by the vast majority of economists in academia, government and beyond.

Dismissing warnings about potential disaster within its domain is not a luxury that an ethical profession can indulge. Instead, ethical professional conduct requires relentless attention to what might go wrong, what anticipatory steps the profession can take to avert crisis, what might be the consequences for society if things do go wrong, and what remedial actions might be called for in the event that crisis cannot be averted. This is what we would expect of public health officials, who face the responsibility of preventing pandemics, or engineers, who face the responsibility of averting ecological disaster. If they fail to meet this burden, we expect them to suffer consequences.[6] It stands to reason that we should expect the same of

our own profession and its members. And in the instant case, we find gross negligence rather than the diligence that professional economic practice requires.

Group Think, Intellectual Bubbles and the Crisis

In the instant case, the professional ethical failure attaches to the profession as much as or even more than to individual economists. Leading economists during the period prior to the crisis were by no means pariahs who ignored the best judgments of their profession. Instead, their conduct was fully consistent with established economic orthodoxies. The problem lay with a profession that had by then come to accept such orthodoxies too readily, and to ignore contrary views.

The consensus around the desirability of financial deregulation (and the consequent dismissal of the warnings of the dissenters) in the years preceding the crisis is particularly troubling since economics has had at its disposal for over a century the resources necessary to think carefully about the risks posed by liberalized financial markets (Galbraith 2009). The Marxian tradition features systemic capitalist crisis as one of its central insights and has produced compelling accounts of the major crises of the 20th century. At the same time post-Keynesian thought (including the work of Hyman Minsky and those whose work appears in the *Journal of Post-Keynesian Economics*) has examined at length the crisis tendencies of liberalized financial markets and the need for close government oversight. Moreover, there is by now a well-established historical record of recurring financial bubbles and crises extending back many centuries that has been explored carefully by economic historians and other scholars (Kindleberger 2000; Shiller 2005). Add to this the compelling recent insights from behavioral finance, information economics and agency theory for which several Nobel Prizes have been awarded in recent years (Eichengreen 2009) and which give good reason to worry about liberalized financial markets, and the dire warnings offered by respected economists in the years preceding the crisis, and one must conclude that the mainstream in financial and macroeconomics exhibited extraordinary closed-mindedness in matters where nothing less than open and critical inquiry would pass professional and ethical muster.

In Eichengreen's view, shared by Simon Johnson (2009), the profession was led astray by financial and other inducements to provide powerful market actors with the analyses that they wanted to hear rather than what they should have been told. Other explanations

focus on the substantial "psychic costs of nonconformity" which induced a tendency among economists to join rather than buck the intellectual herd that was pronouncing the efficiency and stability of financial markets (Eichengreen 2009). Shiller writes of his own insecurity in raising the idea that housing prices had become unstable during his tenure on the economic advisory panel of the Federal Reserve Bank of New York from 1990 until 2004. He warned about the bubble "very gently and felt vulnerable expressing such quirky views. Deviating too far from consensus leaves one feeling potentially ostracized from the group, with the risk that one may be terminated" (Shiller 2008, 5).

In contrast, Krugman lays much of the blame for conformance across the profession on the advocates of the EMH who resembled "fervent political activists—or members of a cult."

> In this sense efficient-market acolytes were like any other academic movement. But unlike, say, deconstructionist literary theorists, finance professors had an enormous impact on the business world—and not incidentally, some of them made a lot of money. (Krugman 2009a, 11)

Eichengreen concludes that the complicity of the economics profession in the crisis lay not in its failure of imagination, but in its failure of fortitude and independent-mindedness. For Dean Baker, the problem lay in the incentive structure operating within the profession that rewarded conformance and punished dissent:

> Taking issue with the prevailing views in the profession carries enormous risks. Economists who warned of the bubble and the threat it posed to the economy risked ridicule and jeopardized their careers.... On the other hand, when the consensus within the profession is wrong, there are no obvious consequences. None of [the economists who denied the existence of the bubble] are losing their jobs. In fact, it is unlikely that many are even missing out on a scheduled promotion as a result of having failed to see the largest financial bubble in the history of the world. (Baker 2009, 72)

Other economists point to particular features of the economics profession as cause for its recent failures. Colander et al. (2009) cite a "misallocation of research efforts" in economics that directed economists away from addressing "the most prevalent needs of society." This view of the culpability of the economics profession is shared by Wall Street insiders. Jeremy Grantham of the institutional asset

management company GMO lays much of the blame for the crisis on the doorstep of the economics profession:

> In their desire for mathematical order and elegant models the economic establishment played down the role of bad behavior.... The incredibly inaccurate efficient market theory was believed in totality by many of our financial leaders, and believed in part by almost all. It left our government establishment sitting by confidently, even as a lethally dangerous combination of asset bubbles, lax controls, pernicious incentives and wickedly complicated instruments led to our current plight. (Cited in Nocera 2009, B1, 5)

These arguments and insights compel the conclusion that the economic crisis is a joint product of the behavior of economic actors and of economists which spawned twin, reinforcing bubbles. The profession generated an intellectual bubble that overvalued the virtues of liberalized financial markets and that discounted credible theory and evidence that challenged the euphoria. This intellectual frenzy contributed to and helped to sustain an even more dangerous financial and housing market bubble. In turn, rising asset prices in the context of steady economic growth and rising prosperity substantially increased the professional and psychic costs of intellectual nonconformance among economists. Over the course of the past decade, then, the two herds came to feed off each other's success, sustain each other's optimism, and trample each other's critics. In so doing, they sowed the seeds of their mutual crisis—one borne of short-sightedness and, ultimately, hubris.

Professional Error and Professional Ethics

I must reiterate that the fact that many economists got it wrong in the years leading up to the crisis is not in itself ethically indictable. Professional judgment is always prone to error; if it were not, the field of professional ethics would be much simpler than it is. What is ethically troublesome is why and how it got it so wrong. The profession ignored readily available evidence and theory that should have given it reason to suspect that the EMH could be leading not just the profession but market actors and policymakers into dangerous waters. The group-think that Krugman, Shiller (Cohen 2009) and others explore reflected the disturbing lack of value that the profession places on pluralism. More than other social sciences economics coalesced during the latter half of the 20th century around a predominant approach that posits a particular notion of human behavior and

methodological reductionism. Economists who reject this approach are relegated to the professional periphery in terms of where they are likely to be hired and where they can publish, and what influence they can have on public affairs. Even as behavioral economists had begun to achieve standing in the profession, their insights were largely ignored when academic economists turned their attention to the most pressing policy issues.

Closed-mindedness contributed to the profession's hubris—to its failure to recognize its own limitations. It lost sight of the fact that it could commit error that induces substantial harm. The profession suppressed concerns about the risk of failure of its preferred policy regime. It therefore failed to present for the consideration of policy-makers alternative regimes that might have had more congenial risk profiles.

If economics is prone to consequential error, and if at the same time there are inadequate mechanisms ensuring learning and correction before the harm occurs, then the profession is failing to shoulder its ethical burdens. The profession has an obligation to scrutinize its institutional practices, to see how they might induce group-think and hubris and thereby discourage and even penalize independent thinking. Above all else it must consider ways to encourage among its practitioners the virtues of humility and open-mindedness regarding views that contradict their own, and to modulate advocacy of the interventions that they propose. The profession faces the related obligation to sustain pluralism.

Conclusion

The economic crisis has driven home the perhaps uncomfortable point that economists unwittingly shape the world they seek to know. The influence of academic economists on the world implies an ethical burden that they might prefer to ignore. The greater the influence, the more difficult it is to argue that those who restrict themselves to pure theory are spared ethical difficulties. Academic economists might need to attend to the unanticipated effects that their work may induce. The profession faces an obligation to take account of the diverse pathways of its influence—those that are direct and intended and those that are indirect and unintended—when thinking through its professional responsibilities. The profession may face an obligation to emphasize the limits of what it has to offer even and especially in the face of high demand for its services. It may face an obligation to take steps to make it more difficult for the consumers of economic theory—be they market actors or policymakers—to pick and choose

just those theoretical insights from economic theory that best square with their objectives while ignoring the rest, to bet everything on this selective reading, and to invoke the authority of the economics profession when they do so.

The last point raises important and difficult questions about the extent and legitimacy of consumer sovereignty in the vital transaction between the provider and consumer of economic theory and advice. Rather than produce research without regard to how it might be used, the academic economist may have an obligation to follow her work out into the world, to do what she can to ensure that the limitations of her work are understood and that it is not employed in ways that cause serious harm to its users and to others. In the view of Colander et al. (2009, 6):

> Researchers have an ethical responsibility to point out to the public when the tool that they developed is misused. It is the responsibility of the researcher to make clear from the outset the limitations and underlying assumptions of his model and warn of the dangers of their mechanic (sic) application.[7]

In the case before us, concerning the culpability of the economics profession in the current global economic crisis, we find little attention by the profession to the dangers of the wares that it peddles. We find instead a herd mentality about the right way to think about financial markets and financial regulation, a dismissal of theory, evidence and argument about the dangers associated with unregulated asset markets, and perhaps most important, a severe overconfidence among the most influential economists about the extent of economic expertise. The economics profession failed to meet its obligations to society by failing to promote and sustain a diversity of views among its members over matters that are terribly complex and important, and by failing to provide market actors, policymakers and citizens with a careful assessment of the potential risks of financial deregulation and the reward-risk profiles of alternative policy regimes. These mistakes were avoidable. The failure of the profession to do so is therefore ethically indictable, especially in light of the extraordinary suffering that has been imposed on vulnerable communities the world over in the wake of a crisis that a blind faith in efficient markets helped to induce.

Notes

1. I explore this and the other matters presented here in greater depth in DeMartino (forthcoming).

2. This discussion suggests a clear linkage between maxi-max and Pareto optimality. When economists undertake Pareto evaluations of policy options that consider only the best possible outcomes of the various policy proposals under review, and then advocate for the Pareto superior policy under the assumption of maximum payoff, they are applying the maxi-max decision rule. That said, the Pareto criteria can be applied independent of maxi-max—not least, by factoring in the range of possible policy outcomes, the payoffs under each of these outcomes, etc. Doing so certainly undermines the elegance and perhaps even the usefulness of the Pareto criteria. Perhaps for that reason, the textbook treatment of policy evaluation tends to ignore these complications, and to embrace implicitly the maxi-max decision rule.
3. It is more accurate to say that the discussion of instability continued within minority traditions in economics, ranging from post-Keynesian to Marxian theory, which the mainstream simply ignored.
4. These themes recur in Bernanke's public statements and Congressional testimony well into 2007. See Bernanke (2007a, 2007b). Even in early summer of 2007, as the subprime mortgage crisis was deepening, Bernanke continued to cite the advantages of market discipline over that of government regulators (Bernanke 2007c).
5. See U.S. House of Representatives (2006, 20–1).
6. As I write, the BP Gulf oil disaster is unfolding. If it comes to light that engineers were culpable in bringing about this crisis, is there any doubt that they will face consequences—legal and professional? In contrast, those economists who contributed significantly to the current economic crisis will face no sanctions of any sort.
7. The essay by Colander et al. (2009) represents one of the best discussions by economists to date of the ways in which the practices of academic economists contributed to the current crisis. In their view economists had the means available to do better: they could and should have warned the public about the dangers associated with the use of economic models for pricing complex financial assets and hedging against market risk. For Colander et al., economists' failure to do so amounts to a violation of their ethical responsibility: the economics profession "failed in its duty to society to provide as much insight as possible into the workings of the economy and in providing warnings about the tools it created" (14). These considerations lead the authors to argue that there is a need for "an ethical code for professional economic scientists" (4).

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