# Excellence in Economics

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**Is there any "Excellence in Economics"?**

**It is a question remarkably similar to the one a former chairman of mine posed whenever he got sight of me: "Prospects? ARE there any prospects?"**

**Yes, Mr Chairman, lots, if only you know where to look.**

**In the early 1920s, Bertrand Russell, the philosopher, described his conception of HUMAN excellence to include qualities such as fearlessness, independence of judgment and emancipation from the herd.**

**I am sure we would like to look for these qualities in all economists. But also, taking our cue from academia, I would imagine the key question for economics to be "have we added to knowledge, to understanding, to improving our management of the world"?**

**For that reason I would define 'excellence' simply as 'a job well done'.**

**One could quickly take care of Excellence in Economics by simply holding a roll call of all 64 Nobel Prize winners in economics since the Prize was instituted in 1969. With perhaps an addendum of the many earlier economists worthy of winning this coveted accolade but that missed out prior to 1969, in each instance providing a brief one-paragraph description of their main achievement in life.**

**That would easily take care of a morning and give you all the excellence you might ever want. But instead of that shortcut, I prefer to examine the real world facing us and see where that leads, though all the while keeping all those Nobels in view and in mind.**

**The recent global crises offer much perspective for our purpose, as much their onset as the responses thereto.**

**We may also want to examine and contrast our own economic achievement with that of others, why we are a 3.5% growth economy with 35% unemployment instead of a 7% growth economy with 10% unemployment, never mind being a 3% growth economy on a much higher general standard of living with only 4% frictional unemployment.**

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**Just over 80 years ago, a massive US financial crash (1929) quickly spread around the world, in which the Dow Jones Industrial Average on Wall Street fell by 85% peak-to-trough. It was followed by a horrific economic depression that lasted for over a decade, within four years creating 25% unemployment in the US.**

**Nearly as bad as the 1870s and 1830s US depressions.**

**And though the entire world wasn't fully drawn into this 1930s maelstrom, and some countries started to come back from it faster than others, and some of the recuperation came from within and some of it was policy induced, ultimately war preparation and actual war finally eradicated all evidence of this Greatest Depression of all times.**

**Except, that is, psychologically on men's mindsets. There the scars would last indefinitely, at least for some. And luckily so, for where would we be today, had it been otherwise?**

**Today one realizes, reading about what happened then, that at the time there mostly was little excellence in economics. As Hyman Minsky (1975) wrote:**

**"The standard economic theory of the time – the classical school – had failed to predict the coming of the depression, to understand why it took place, to explain its depth and duration, or to offer useful guidance to policy".**

**Having said that, Minsky was quick to point out that**

**"some economists trained in the classical theory were offering what would now be considered valid policy advice while others were offering what would now be considered nonsense. However, the valid advice was based upon intuition and observation (or good sense), not upon any integrated theory. These economists were unable to offer persuasive arguments for the validity of their advice".**

**So not all was nonsense at the time. Some people had the good sense to offer what turned out to be sound advice for a situation few really understood.**

**That in my book qualifies as 'excellence'. But could we do better and actual understand what we are doing?**

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This particular horror (The 1929 Great Crash and the Great Depression that followed) occurred some 150 years after Adam Smith had published "The Wealth of Nations", the first real systemic attempt to describe the rudimentary workings of a market economy.

In the subsequent 250 years much was to change as size and complexity changed out of recognition. The nature of economics was to try and describe what was thought to be happening, how it all worked, with many contributors in turn adding their thoughts, building up what ultimate would be a large store of knowledge, time-tested.

And yet throughout this long period of centuries, financial crises and economic recessions and even depressions would happen with great regularity.

It was only after WW2 (even more so than during La Belle Epoch in the late 19th century) that a few decades of relative calm could be observed, and one of the greatest spurts of economic development ever, both in terms of recovery from war ravages and catch-up growth as previously dormant regions joined the global mainstream.

Yet even during this period of relative calm regular financial interruptions would keep occurring.

The relative stability of the modern post-war period was mostly ascribed to superior understanding and the policies accordingly formulated. Yet stable high growth combined with low inflation came abruptly to an end in the late 1960s, with the 1970s seeing new global turmoil.

The subsequent three decades turned out better once again, especially since inflation steadily moved lower while long growth expansions were achieved, and large parts of the world became integrated for the first time through a complex, greatly intensified, globalization phenomenon (whose rich antecedents stretched back at least over a 1000 years).

The world was on a new roll.

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The first rudimentary institutional requirements for a successful capitalist market economy had been accumulated painfully slowly over centuries, in various parts of Europe and especially England.

When England's economy finally started to 'grow' in the modern sense, by investing growing capital surpluses and increasing its productivity through increasingly rapid technical innovation, the power of compound interest started to work its magic of lifting output, income and living standards for those so participating and their dependents.

Over time the state would increasingly, through political changes, ensure that those not fully participating at least obtained a share in the riches so unlocked.

If England was the first country to fully benefit from such organized enrichment from within (as well as supplemented through trade specialization from without), other modernizing countries would increasingly also be readying themselves institutionally and start copying, until in our day few regions are not part of this worldwide system of development.

Along the way, market capitalism encountered challenges, most notable from state capitalism and communism. But these models of development, although sometimes very powerful in a limited historic context, ultimately did not prove to have the flexibility, resilience and adaptability that the combination of political democracy and economic market capitalism had to offer. The latter proved the superior combination.

This, at least, has been true to our day. Whether it will continue to prove true into the future is another matter.

Throughout this entire modern attempt of 200 to 300 years duration, economics often gives the impression of a succession of well-intending observers trying, but never quite succeeding in fully explaining human economic behaviour at all times, and by implication how to guide it to prevent costly mistakes or detours.

On this score one especially keeps wondering, following the latest global financial crises and recession fallout, now three years in the works, in which some 50 million people lost their work globally, millions lost their homes and pensions, and trillions were written off in assets lost while trillions were added to public debt burdens in a heroic effort to prevent a copycat repeat of what had happened after 1929.

And yet one mustn't be too severe, for knowledge, like wisdom, can only come in stages.

In 1929-1933, they didn't know why it happened and basically didn't know how to address it, thereby incurring the full brunt of the subsequent collapse and its prolonged workout.

Today we didn't see the 2007/2010 events coming either. Except that quite a few people intuitively realized something was brewing (for if something is too good to be true it usually is, as Herbert Stein used to say).

A handful of individuals (literally) had the courage of their convictions and acted on such insight and made $1bn a piece or multiples thereof and were the true pockets of excellence in a global ocean of ignorance.

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However, when Fed chairman Ben Bernanke delivered an address to the Bendheim Conference at Princeton University on 24 September 2010 something else showed up.

According to him, it wasn't so much theory (science) that had been found wanting in the recent global crises (except in some respects requiring more study) as that it was system engineering and public and private management of affairs that could have been (much) better.

True, like 1929 and what happened thereafter, economic practitioners didn't see this one coming either, yet the occurrence was ultimately on a par with 1929 and the 1930s (in fact many times bigger, given a world economy by now at least 100 times bigger and more complex).

Yet according to Bernanke, established theory has proven itself and works quite well in 'non-crisis' periods. Rationality and standard utility theory does a good job of describing daily behaviour under reasonably certain conditions ('stability' by another word). So consider that well done, thereby earning the moniker 'excellence'.

But the problem remaining concerns crisis conditions, in particular the behaviour of economic agents in times of profound uncertainty. This is best characterized as wholesale recoiling in response to shock events followed by flight to safety, pulling down the roof of the temple in panicky asset fire sales and enormously destructive, defensive, universal economic withdrawal.

**If the danger is big enough, one doesn't stand and fight but simply flees. If all do so, all is lost.**

**Also, Bernanke asked what starts asset bubbles, what allows them to continue in the presence of (supposedly) rational participants, and what (importantly) ends them?**

**How does market liquidity behave under stress?**

**And what are the implications of financial instability for macroeconomics and monetary policy? What are policymakers supposed to do once instability strikes?**

**These are profound questions.**

**One perhaps shouldn't criticize the Fed and other major central banks unduly.**

**They may not have seen the crisis coming, even if the BIS (the central banks' central bank) had for long been most vocal about some banking trends.**

**Yet when the moment came, and they finally realized what they had on their hands (financial system failure due to private and public mistakes, followed by wholesale defensive economic withdrawal) they knew what to do to prevent total collapse.**

**This time it was to be different. If they did not see the crisis coming, at least they knew what to do to arrest it and to turn the tide. At least, that is their firm conviction to date (at least in public).**

**There are those, however, such as Pimco's co-head Mohamed El Arian, who seem to feel that one set of global imbalances (excessive private debt leverage) has been serially transformed into new excesses (excessive public debt burdens) which now look like being transformed yet again (into excessive central bank liability burdens), with the ultimate playout yet far from obvious.**

**Who would handle the next round, if central banks were to abdicate in turn?**

**That might mean we have as yet learned nothing after all, and that economics has a long way to go to really unearth all the secrets of its specific universe and make the world a safer place in which we can steadily develop and grow ever richer in a balanced manner.**

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**There is of course a historic figure, John Maynard Keynes, who addressed these problems 75 years ago, but whose ideas seemed to have been overtaken by time.**

**Yet some of those who came after him have placed a different interpretation on his legacy, claiming he was misinterpreted, and that those who took charge of the theoretical agenda in his wake essentially were still of the same persuasion as those who in 1929 were clueless as to what hit them, and yet more clueless about what to do next.**

**The modern inheritors of that earlier 'classical' view are known today as the rational expectations school, whose approach Bernanke claims to be doing quite well in non-crisis times.**

**It is, however, in crisis times that the whole show can come to a crunching halt, with collateral damage (that favourite American term) on the grandest scale, as seen in the 1930s and again today.**

**That's a stiff price to pay for knowing what you are doing in non-crisis times, yet losing much of the plot in periodic systemic crises.**

**Are these shortcomings big enough not to be simply fobbed off with a new research agenda, as compared to historic sources not as yet mentioned?**

**In particular, Keynes may have had a more realistic sense of Knightian uncertainty and how it affects financial portfolio and investment decisions and therefore economic cyclicality then perhaps generally allowed today.**

**Also, Hyman Minsky, he of Minsky Moment fame as part and parcel of the concept of debt supercycles, came up with a formulation in which stability breeds appetite for more risk taking and debt leverage which ultimately goes too far and creates unsustainable debt structures.**

**When realization eventually sets in about its non-sustainability, wholesale recoiling and asset fire sales can take place. If not short-circuited, this can spill over into real sector panic and give you depression.**

**This is essentially the same analysis as Bernanke's over 30 years later except not being mentioned by him, anywhere (except many years ago, in a footnote in Bernanke's own book about the 1929 financial crisis and**

**then not quite approvingly, for rationality was being questioned).**

**Neither mentioned are George Soros and his reflexivity idea and Nassim Taleb and his coterie of Black Swans.**

**Instead there is this studied preference for quoting at some length from academic sources rather than these populist ones.**

**One wonders why these non-mainstream ideas whose standard approach is to question rationality in market participants under crisis conditions (the euphemism is 'uncertainty') are not highlighted.**

**Is it due to any theoretical impurities or are other considerations also in play, bearing in mind the larger American public and that ultimate political oversight body, the US Congress, a sensitive relationship indeed ever since the Fed's creation back in 1913?**

**Minsky especially offers a persuasive description and explanation of what goes wrong in the long lead up to a Minsky Moment, which Bernanke apparently would like to address through yet more systemic regulation and oversight and managerial common sense, but which Minsky defines as a combination of human innovation, greed and irrationality interacting until the moment of denouement (and perhaps much beyond human control?).**

**We seem to be back at the beginning.**

**Modern development, modern market capitalism has at its core technical innovation driving productivity gains and capital accumulation. And also, lest we forget, human behaviour that likes to see itself as rational and stable but which history has shown to be prone to excesses, often anything but rational or stable (however defined).**

**Innovation follows what Schumpeter called a path of creative destruction, overtaking established technical norms with new, better ones, but with each one tested to destruction in a process of evolution remarkably akin to life itself.**

**So only the practical innovations thrive, while the bad ones ultimately fail. This gives us the distinction between stable technology (a Boeing 747, proven through and through) and unstable technology (a space shuttle, with a 1:100 launchings probability of crashing).**

**The financial sphere is no better. Driven by innovation already for millenniums, every new round of financial innovation needs to prove itself, crucially so in the presence of human behaviour (often) prone (at times) to unstable or mistaken or misguided responses.**

**The resulting accidents call forth yet more regulatory oversight and guidance, yet such rulemaking essentially is only geared to fighting the last war, not unlike the military.**

**Innovation transforms the financial reality, with or without reinforcement from human gullibility, and senior managements, regulators, politicians and the public (in that order) are usually the last to find out what brilliance has gone wrong this time, even though already fully integrated into real-life systems.**

**It is like testing unproven medicines on living mass populations and so finding out what works and what doesn't.**

**How can this be? Why is it condoned?**

**As Minsky puts it, a modern market economy cannot function without credit/debt. And there can be no progress without innovation.**

**And humans are involved every step of the way, mostly rationally so, but not infrequently much less so.**

**As to how to test the safety of new financial ideas, there remains only one way and that is to try them out.**

**When these then don't immediately go wrong, and pass initial managerial and regulatory scrutiny, you may mistakenly believe you have a new winner on your hands.**

**Not unlike space shuttles which initially looked pretty cool and dependable. So much so that ere long they put America's most popular kindergarten teacher aboard shuttle 67 and then had to find out the hard way the true nature of what had been put together, in the process traumatising an entire generation of watching little ones as shuttle 67 blew up on take off. The risks involved had simply not been fully appreciated yet. That technical insight only came afterwards.**

**But when then similarly in time through growing ignorance, greed and yet more experimentation, fatal toxic variants of financial innovations come in to being**

**that ultimately succeeded in convincing an irrationally motivated audience to continue yet deeper into risk mispricing, the fat was in the fire yet again.**

**Note the crucial move from rational to irrational behaviour, something rulemaking presumably would like to prevent, but has as yet not succeeded in doing.**

**Besides, rulemaking deadens and kills in its own right, denying the innovative impulse. That's a cul-de-sac to which no satisfactory answer has been found.**

**Former Fed chairman Alan Greenspan ruefully admitted in retirement that all these fatal nonsensical financial mistakes will continue to irregularly give rise to sometimes mega systemic crises until mankind can shed the irrational aspects to its behaviour – such as fear, exuberance, greed, panic.**

**To my mind, rulemaking will never be adequate on this score as innovation is supposedly not to be lost.**

**The solution will need to be more radical than that, such as by way of future breakthroughs in genetic engineering, but by that time we will no longer be known as Homo Sapiens Sapiens. Our continued survival at ever higher levels of societal and planetary sophistication and complexity may in any case make that a non-negotiable condition, an inconvenient truth.**

**For there is no way back from where we now find ourselves and where we are still attempting to go next. There may now, with 10 billion of us looming and an increasingly aggressive planetary reality, only be a flight forward through hard science that remains as viable alternative.**

**But for that we will need skills and abilities not simply acquired at mother's knee or in grad school. Fed chairman Bernanke wants to re-engineer systems. That may only be a short-term stopgap. Longer term the solution may need to be more fundamental. We have now been served notice many times over this past century that we and our systems are capable of very expensive mistakes, not only financially and economic, but in every sphere of life.**

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**Back to the South African past where we still grapple with our $6 000 per capita income reality (much closer to $10 000 in purchasing power terms), extreme income and**

**wealth gaps, 35% unemployment and achieving only on average 3.5% GDP growth these past 100 years.**

**Is that good enough (excellent) or could we do better?**

**South Africa, like large parts globally, has already for generations been well aware of how to solve the economic problem by adopting democracy and market capitalism.**

**So far only relative few of its citizens have enjoyed the full promise of this approach yielding its rich fruits and a high level of general development.**

**South Africa's tragedy is her distorted past and her consequently distorted present.**

**We are not so much a young 16-year old democracy as that we are, like the US and much of Latin America, a young, complex 1000-year old society with rich antecedents, in our case originating in Africa, Asia and Europe that has yet to find its true bearings.**

**Undoing economic mistakes from the past and succeeding in achieving a successful society marked by minimal frictional unemployment, acceptable income and wealth gaps, a high general standard of living and productivity growth on a par with leading global societies (defined by Greenspan as 2.5% annually with our present genetic abilities) is the real challenge.**

**For that we need societal trust, non-intrusive government (freedom), excellent education, health care, housing and personal security, and wise bureaucratic rule-making (an oxymoron?).**

**Private initiative would be the engine driving innovative renewal and asset accumulation, with the state assuring fairness for the less strong members of society through bearable redistribution.**

**The gap between such an achievement, and where we find ourselves today, remains huge.**

**It is early days for claiming excellence in execution, though we can dream The Dream and know in our bones the path through the maze as others have successfully gone there before us, if not yet on this continent.**

**This is aside of much nonsense one hears daily, on a par with 1929-1940 and other eras before and since. But this**

**presumably isn't new or news, for time takes care of all failed experimentation.**

**References**

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