

ECONOMICS FIT FOR THE QUEEN: BARRIERS AND OPPORTUNITIES

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Chapter 9

*In Defense of Post-Keynesian and Heterodox Economics: Response to their Critics*

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## ABSTRACT

The widespread failure of economists to predict the 2008 credit crunch and subsequent Global Financial Crisis led the United Kingdom's Queen Elizabeth II to ask what had gone wrong. Mainstream economists offered a reply that contained elements of truth but it did not concede that there is any need for fundamental reform of how the discipline is taught and the kind of research that is conducted. This chapter critically examines ways in which the degenerating mainstream research program can attempt to fend off claims that major changes are needed. It also considers barriers to curriculum change in economics and the incentive structures that work against economics becoming more pluralistic and focused on real-world problems. More positively, it considers, in the light of the success of modern behavioral economics, how careful marketing might enhance the prospects for reform being achieved in economics. In particular, it emphasizes potential for strategies based on stealth and pluralistic applied economics.

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### **Introduction**

The economics of financial markets and macroeconomic fluctuations has become a contested area, with economists from various perspectives publicly arguing their positions in multi-signature letters to newspapers (see Keegan 2010). In the UK, this also involved letters to Her Majesty the Queen, one of which suggested that the economy could benefit from Her Majesty requesting monthly briefings from government ministers on the economic pitfalls that might lie ahead (see Allen 2010). These attempts to include the Queen in debates about the state of the economy and of economics resulted from Her Majesty showing a personal interest in this area. During a visit to the London School of Economics in November 2008, she asked why the economics profession had failed to predict the credit crunch that has become known as the Global Financial Crisis (GFC).

A financial crisis had, in fact, been publicly predicted by a number of economists of various persuasions, including Martin Feldstein, Raghuran Rajan, Nouriel Roubini and Robert Schiller in the US, Roger Bootle, Wynne Godley, Stephen King and Andrew Oswald in the UK, and Steve Keen in Australia. However, on 22 July 2009, following a forum held at the British Academy on 19 June, the Queen was sent an answer in the form of a three-page letter signed by two members of the Academy, Professors Tim Besley and Peter Hennessy (2009). On the final page of this letter the problem was summarized as follows:

Everyone seemed to be doing their own job properly on its own merit. And according to standard measures of success, they were often doing it well. The failure was to see how collectively this added up to a series of interconnected imbalances over which no single authority had jurisdiction. This, combined with the psychology of herding and the mantra of financial and policy gurus, led to a dangerous recipe. Individual risks may rightly have been viewed as small, but the risk to the system as a whole was vast.

So in summary, ... the failure to foresee the timing, extent and severity of the crisis and to head it off, while it had many causes, was principally a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole.

This letter can be read as implying that misguided economic analysis underpinned the economic reforms of the 1980s that, amongst other things, freed up the workings of financial markets in many countries, resulting in the conditions that produced the GFC. These reforms were driven by politicians such as Margaret Thatcher who had picked up Friedrich Hayek's view about why socialism is inherently inferior to a free-market economy (see Yergin and Stanislaw 1998). For Hayek, decisions taken by individuals would produce spontaneous order in the economy as a whole. Socialist planners who attempted to coordinate economic activities centrally would do this less well because of the complexity of the economy: they would not be able to gather and deploy all the information used by decentralized individuals in a market economy.

While Hayek may have been right about the shortcomings of socialism, his analysis did not actually demonstrate that a decentralized market economy would necessarily grow in an orderly manner. However, despite recognizing that the local rationality of a mass of dispersed, specialized decision makers does not necessarily add up to macroeconomic coherence, the Besley/Hennessy letter did not suggest that economists might have done better if they had followed an institutionalist/complex systems approach and taken account of how positive feedback loops might lead to cumulating processes rather than equilibrium. Nor did it suggest that there could be a place for psychology in the training of economists, despite mentioning the “psychology of herding” and saying that:

[M]ost were convinced that banks knew what they were doing. They believed that the financial wizards had found new and clever ways of managing risks. Indeed, some claimed to have so dispersed them through an array of novel financial instruments that they had virtually removed them. It is difficult to recall a greater example of wishful thinking combined with hubris.

Six weeks later, on 10 August 2009, ten senior heterodox economists sent a very different reply to Her Majesty (Dow *et al.* 2009). Unlike the Besley/Hennessy letter, the heterodox economists’ letter laid some of the blame for the extent of the crisis on the nature of mainstream economics and therefore argued for major changes to the economics curriculum. It accused leading economists of having turned the discipline into a branch of applied mathematics in which technique is pursued for its own sake. It suggested that there is a need to broaden the discipline to allow room for

more critical perspectives that reflect knowledge of other fields such as economic history and psychology.

Although parts of the Besley/Hennessy letter conveyed a sense that the GFC was an outcome of a historical process affected by psychological factors and system complexity, this chapter will argue that it is most unlikely that the GFC will lead to any major internally driven change within to the core training that economists receive. This is despite the fact that heterodox approaches—such as institutional, evolutionary and psychological economics, and Post-Keynesian macroeconomics—offer significant ingredients for understanding how to reduce the risk of future crises in the global economy. Indeed, many proponents of these approaches had anticipated something along the lines of the GFC, albeit without a precise date or calendar of events, via their familiarity with the financial instability hypothesis proposed by the late Hyman Minsky (1975, 1982, 2008).

It was pessimism about the prospects for internally-driven reform in economics that lay behind the Dow *et al.* letter (which was instigated by Professor Geoffrey Hodgson, editor of the *Journal of Institutional Economics*). It was hoped that the letter might serve as a device for getting external pressure for reform. Of course, its signatories did not expect Her Majesty to initiate anything after considering it but they hoped that it might at least lead to wider public debate about the state of economics and how what is going on in economics classrooms relates to the state of the economy.

This chapter brings together material from Earl (2010) and Earl and Peng (2012) to examine the need for economics to change in the directions advocated in the Dow *et al.* letter to the Queen and considers both pessimistic and optimistic perspectives on the potential for this change to take place. It begins by considering how mainstream economists can construct a case for saying that there is no crisis in economics despite the GFC. It then provides a critique of this construction and shows that it points to the need for precisely the kinds of changes advocated in the heterodox economists' letter. Next, it critically consider attempts to fend off the heterodox perspective via claims that mainstream economics actually is changing in precisely the directions suggested, as evidenced by the rise of "behavioral economics." This is followed by two sections that consider barriers to change within the academic environment: first, the problem of opening up the economics curriculum and, secondly, the hiring and promotion processes for academic economists. Thereafter, the chapter adopts a more upbeat perspective, reflecting on what might be achieved by heterodox economists if they see the problem in terms of marketing their ideas to the mainstream and pick up lessons on how brand management contributed to the success of behavioral economics in the past two decades. Before moving to concluding comments, the chapter shows how strategies involving stealth might be used to get heterodox material into the curriculum and mainstream journals, as well as considering opportunities for producing a much more unified research program that has a bigger voice than that achieved by the disparate groups of heterodox economists.

## **Scope for denying that there is anything wrong with economics**

The Besley/Hennessy letter has a contrite tone that has been characteristic of the economics establishment during the GFC. However, if mainstream economists wish to claim that the GFC does not signal a need to change economics, they can readily change their demeanor and start asserting that if only more attention had been paid to their ideas, we would not be in the current mess. In doing so, they can put a positive spin on the state of economics despite the state of the economy and can assert that the GFC is evidence of the great *power* of the core ideas of modern microeconomics.

The “spin” involves characterizing the origins of the GFC with reference to principal–agent problems, the “lemons” problem and moral hazard in financial markets—in other words via the theoretical analysis of markets with asymmetric information for which George Akerlof, Michael Spence and Joseph Stiglitz were jointly awarded the 2001 Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel. This approach was being used to analyze failures of financial institutions two decades ago (see Milgrom and Roberts 1992: ch. 6). It assumes that economic agents are greedy and unscrupulous folk who respond rationally to market incentives and take calculated risks, but that they differ in their access to information. From this perspective, the roots of the GFC lie in the fact that intermediaries frequently did not have incentives conducive to ensuring that those who were given credit could service their debts in the long term, while the penalties for defaulting were not onerous enough to make it rational to try to avoid taking on debts that looked like they would be problematic to service. Many sub-prime mortgage debts were subsequently securitized and sold, and then sold again and again, on the basis of misleading credit



ratings prepared by rating agencies that succumbed to conflicts of interest. Once the bad debts started to surface, interbank lending collapsed, along with much lending to firms, especially small firms, because of banks could no longer distinguish between good and bad credit risks. Their reluctance to lend could cause defaults by firms that normally would have been able to meet their obligations.

This perspective implies that financial crises will tend to recur unless markets and financial products are re-engineered to change incentives and remove conflicts of interest. To some extent we may expect there will be changes of these kinds, as the wider awareness of the prevalence of these kinds of problems may result in financial institutions and regulatory bodies making greater use of economists who have expertise in these areas.

### **Deconstructing the spin**

Such a rationalization of the GFC is no doubt partially correct: there were indeed dysfunctional sets of incentives facing consumers, mortgage brokers, credit-card companies, bankers, derivatives market participants and credit rating agencies. For example, if US personal bankruptcy laws enable bankrupt consumers to keep their cars and house contents when their houses are repossessed, it makes perfect sense for people who have little hope of servicing debt to sign up for a mortgage and credit cards in the knowledge that they are likely to default. This may be their one chance to get a decent car and big-screen TV. Going bankrupt has few consequences for their future credit ratings. Likewise, the mortgage salesperson who is rewarded for signing up clients rather than for the successful completion of the mortgage contract many

years later has little incentive to be concerned about a client's long-term capacity to service the debt. Senior bankers have little incentive not to put their firms at risk of long-term failure when pursuing performance bonuses in the short term: if a bank eventually does get into trouble, there is a good chance it will be too big to be allowed to fail and will be bailed out by the State if not by a former rival that sees it as a rational investment in avoiding problems of contagion that would arise if it were allowed to default on its liabilities.

However, such spin by the economics establishment diverts attention from the potential benefits of taking a more pluralistic approach to the subject. These benefits can be seen if we deconstruct this reconstruction of events. The deconstructionist method involves focusing on what *could have been said but was not*, rather than on what was actually said, as a the key to understanding a piece of analysis—just as cynical consumers deconstruct real estate advertisements by looking for what is left out rather than having their enthusiasm sparked by what is being said. The principal-agent/moral hazard story of the GFC omits some dimensions that seem potentially rather important.

First, although the GFC has been a particularly severe, it is by no means the only financial crisis since 1929 Wall Street Crash. In fact, over the past four decades there has been a succession of smaller financial crises containing ingredients that have been identified as significant in the GFC: the mid-1970s secondary banking and real estate crises (Dow and Earl 1982: ch. 12; Earl 1990: 285–90), the 1980s savings and loans crisis and yuppie-era boom/bust associated with financial deregulation (Earl 1990: 201, 287–8, 295–7; Mayer 1992; Milgrom and Roberts 1992: 170–6; Shiller 1989),

and then the Asian economic crisis/dot.com bubble (Shiller 2000/2005). It would be completely erroneous to suggest that the GFC is different because of its global nature. The 1970s crisis had global aspects—for example, some of the bank failures were associated with foreign exchange speculation and offshore property speculation—while the global side of the Asian economic crisis of 1997 is set out in Thomas Friedman’s (1999) bestseller on globalization. In fact, if we take a long-term historical perspective on the history of capitalism we find that these kinds of financial crises have been occurring for centuries (Kindleberger and Aliber 2005).

There is no evidence that economic agents generally have been learning enduring lessons about system-wide risks and financial instability. We should not be particularly surprised by this, given the absence of learning about financial crises in the economics classroom: the yuppies who populate the dealing rooms burn out and move on/up to other roles, so each crisis involves a different set of decision makers at each layer, as well as often also involving new financial instruments. If learning about financial instability is to occur, the best time is before people becoming players in financial markets. Not all of them will necessarily be graduates of economics, or even graduates in any area, but social networking is likely to result in danger signs being widely recognized if a significant proportion of those who embark on careers in the financial sector have been taught about financial history and Minsky’s financial instability hypothesis. This is conceptually far easier to teach, and more likely to engage students, than topics such as IS-LM models, aggregate supply and demand analysis, real business cycle theory, and so on, that fill up the core of teaching in macroeconomics. If the will is there, it is perfectly possible to teach the economics of financial instability in introductory macroeconomics courses that tend to be

compulsory not merely in economics programs but also in business degrees more generally. (DVDs of television documentary series and films such as *The Ascent of Money* (Ferguson 2008), *Money as Debt* (Grignon 2008) and *Addicted to Money* (McWilliams 2009) provide excellent video material to supplement traditional lectures.) But this has not happened; it has not been allowed to get in the way of teaching formal macroeconomic models in which the financial sector hardly figures at all or where there is a separation between “monetary” and “real” aspects of the economy.

Secondly, the mainstream story does not have a place for institutions and institutional change in the generation of financial instability except insofar as they determine whether or not there are information asymmetries that cause moral hazard and principal–agent problems. Such institutions can include laws that regulate financial firms as well as conventions for how business is done. As far as mainstream economics is concerned, regulations—such as those specifying what financial institutions are required or allowed to do as regards who gets loans, the composition of balance sheets, or the kinds of loans that a bank can make if it is not an investment bank—are simply additional constraints that decision makers contend with when engaging in constrained optimization. Likewise, if banks use formulaic or checklist-based procedures for simplifying the process of deciding who gets loans, these are simply to be seen (via Baumol and Quandt 1964) as optimal rules of thumb. Changes in such rules occur as optimal adaptations to changing market conditions.

If such an attitude to institutions is adopted, there is the risk that economists will fail to consider how financial market behavior may be affected by institutional change.

The analysis thus remains couched in general terms rather than being conducted mindful of particular kinds of changes that are taking place. Hence, institutional evolution in, say, home mortgage lending fails to attract economists' attention. This is despite the fact that the implications for financial stability can become rather drastic if there is, say, a change in policy from home loans being limited to two-and-a-half times the prime earner's annual salary with a 20 per cent deposit, to lending three times joint annual gross household income with a 10 per cent deposit, to being willing to lend 125 per cent of the value of the property with scant regard to the borrowers' incomes. Failure to possess and consider such institutional knowledge may not only result in failure to anticipate financial meltdown; it may also result in more mundane errors such as arguing that rising property prices mainly reflect population growth and/or shortages of land releases for new building: property comes to be seen as suffering from lack of affordability rather than being expensive because finance is so readily available.

Thirdly, the "spun" story of the GFC provides no consideration of the impact of psychological factors on the changing propensity of consumers to get into debt or to attempt (as many are now doing) to pay it off. The widely taught "permanent income" and "lifecycle hypothesis" models of consumption and saving are based on rational choice theory, with the consumer working out an optimal long-term strategy for consumption in the face of probabilistically predictable fluctuations in income associated with the availability of work or returns from self-employment (for example, variations in farmer income caused by changes in weather and crop prices), and expected and actual changes in earnings due to promotion, tax policy and the receipt of windfalls and bequests. If consumers are tending to take on more debt,

rational choice theory does not try to understand this in terms of changes in attitudes to being indebted, or changes in wants that can be satisfied by debt-financed expenditure. The theory is based around the assumption of a given preference ordering, so it has to leave these factors out.

Over fifty years ago, George Katona (1960) and his colleagues at the University of Michigan Survey Research Center were already highlighting and exploring empirically the significance of consumers' psychology in the determination of aggregate demand. In the modern world, consumption is a function of willingness to spend rather than tightly constrained by given budgets. Many households enjoy significant discretionary income and access to personal credit. Modern consumers often replace their durable goods long before these are worn out and not worth repairing. Taken together, these factors allow great discretion in the timing and direction of spending. Katona's work led to the development of consumer confidence indices by banks in many countries, but it remains absent from standard macroeconomics textbook discussions of the consumption function.

Though Katona's work hardly ever made it into macroeconomics textbooks (a rare exception is Ackley 1961), many economists currently in their fifties or sixties typically would at least have been taught the psychologically-inspired "relative income" model of the consumption function offered by Duesenberry (1949). As Frank (2005) has observed, Duesenberry's analysis has "mysteriously disappeared" from the curriculum. If it reappeared, it might prompt students of economics to consider the possibility that mortgage stress could be a consequence of consumers having raised their aspirations from, say, a three-bedroom, one-bathroom home to a four bedroom

home with an en-suite bathroom and a media room after seeing homes to which some of their social circle have upgraded.

From the standpoint of mainstream economics, there is no need for a psychological perspective on saving and debt, despite the existence of an extensive literature on these topics within economic psychology (see Lea, Webley and Levine 1993; Wärneryd 1999). As well as ignoring social relativities, rational choice theory does not prompt consideration of the possibility that changes in households' indebtedness are affected by changes in social norms regarding whether being in debt is a good or bad thing, or whether it is wise to presume that the prices of their homes will keep rising and it is safe to take some of their home equity and use it for consumption via an increased mortgage overdraft. It allows for social interaction in terms of "information cascades" between people but not "decision rule cascades" (Earl, Peng and Potts 2007).

If one adheres to the rational choice/constrained optimization view, rising ratios of indebtedness must reflect either a relaxation of constraints on getting into debt or changes in other personal circumstances such life expectancy and retirement age, or social welfare provisions that affect the trade-off between consumption today and in the future. Such factors may indeed have empirical significance but that does not provide a basis for professors to operate in a non-pluralistic manner and fail to alert their students to alternative views with socio-psychological foundations and the empirical work in respect of them. A potential starting point for bringing in the alternative approaches is to point out that, with rising life expectancy and the risk of cuts in State support of retirement because of the costs of dealing with an ageing

population, we should have been seeing a rise in savings ratios in developed countries, rather than people spending, in the run up to the GFC, as if there were no tomorrow.

Fourthly, the view of the GFC as an outcome of rational, selfish responses to changing constraints and opportunities in an environment characterized by principal-agent problems upholds the mainstream perspective by assuming consumers are financially literate enough for this to be a good approximation for how they choose. Long before the GFC emerged, Shiller (2000/2005) was expressing concern that irrational exuberance was driving up property prices: most consumers seemed to be failing to look at the boom mindful of elementary notions of compound interest and exponential growth. Had they done so, they would have recognized that a boom based on house prices rising faster than incomes logically is unsustainable.

In mainstream economics, even the poorly educated person who is a sub-prime mortgage candidate is seen as acting “as if” well aware of the details of the mortgage contract and of bankruptcy law, and with a good understanding of how compound interest will blow out a credit card balance if the monthly bill is not repaid in full. Mainstream economists have not demonstrated that this is a good approximation, whereas the vast majority of subjects in a recent study by O’Shea (2010) failed comprehension tests on real-world credit contracts. Following Earl and Potts (2004), an alternative choice scenario might be one in which consumers outsource their risk preferences to the financial institutions. In other words, consumers may sign up for debt contracts on the basis that the firms offering them would have done calculations



about their ability to service the loans and would not offer loans to people who have a high chance of consequently going bankrupt.

### **Behavioral economics as a means of defending orthodoxy**

According to Colander, Holt and Rosser (2004a, 2004b, 2007–08), modern mainstream economics is no longer a neoclassical monolith. Rather, it is a complex adaptive system of competing ideas from which economists select those that seem to work and reject those that have been discredited. The rise of the sort of “behavioral economics” surveyed in Wilkinson’s (2008) recent textbook is consistent with this view and is significant in relation to attempts by outsiders to argue that the economics curriculum requires radical reform. Mainstream economists can concede that there are some shortcomings in the “rational agent” perspective but then argue that they are addressing them by bringing findings from psychology into economics. For evidence of this, they can point to their hiring newly minted PhDs whose work employs the behavioral approach.

The explosion of interest in behavioral economics might seem to imply a genuine interest in making changes in economics in situations where empirical anomalies have been exposed. However, a more cynical reading of the situation runs as follows. The modern behavioral approach first started to take off in finance (see the major anthology edited by Shefrin 2001), where knowing how markets actually function enables a lot of money to be made. In economics, by contrast, there was a long period of resistance to acknowledging major anomalies (as with risk aversion, discussed in Rabin and Thaler 2001). Behavioral economics became fashionable only after Rabin

and a few others managed to get papers into the top US economics journals. Their success in winning these trophies led others to consider the possibility of emulating them to advance their own careers.

Within modern mainstream economics, the behavioral approach entails incremental improvement rather than radical innovation. It is a sign that some principles in the core of the mainstream economics research program are being deemed more important than others, but the conventional core is retained (Berg and Gigerenzer 2010). There is no systematic attempt to bring psychology into economics but instead constrained optimization is modified to allow for preferences and/or perceptions to be distorted as per a set of “heuristics and biases” that have been uncovered in empirical work. Constrained optimization is retained but the price of achieving this is that the independence of economics from psychologists’ findings is sacrificed. It is a partially pluralistic research strategy, for most economics continues to get done on the basis of full rationality assumptions but some is done mindful of the potential significance of heuristics and biases. (For a more extensive analysis of the kind of pluralism that is being adopted within mainstream economics, see Davis 2006.)

Though this is being called “behavioral economics” it is, as is evident from Sent (2004), very different from an earlier version of behavioral economics that takes in much more from psychology and other social sciences and rejects optimization. Ironically, the new behavioral economics achieved public notice via articles by Lowenstein (2001) and Uchitelle (2001) in the *New York Times* two days after the death of Herbert A. Simon. Simon was a founding figure in old behavioral economics, the originator of the concepts of bounded rationality and satisficing and winner, for

these contributions, of the 1978 Alfred Nobel Memorial Prize in Economic Sciences. The *New York Times* journalists failed to make any connection between Simon and the new breed of behavioral economists about whom they were writing, and Simon's approach remains almost completely invisible within the new literature.

As a sign of what is happening in the new behavioral economics, consider the weighty 740-page reader edited by Camerer, Lowenstein and Rabin (2004). Simon is mentioned a mere four times: the first three cases refer to his notion of "procedural rationality" with no references and only the last cites any of his work and makes any connection with his concept of satisficing (for which there is no index entry); bounded rationality is only referred to on three pages (all in the same paper). Moreover, the first page of the introductory chapter is perfectly explicit about it being a limited departure from the dominant way of thinking, for cases where the standard model does not fit the facts:

At the core of behavioral economics is the conviction that increasing the realism of the psychology underlying economic analysis will improve the field of economics *on its own terms*—generating theoretical insights, making better predictions of field phenomena, and suggesting better policy. This conviction does not imply a wholesale rejection of the neoclassical approach to economics based on utility maximization, equilibrium, and efficiency. The neoclassical approach is useful because it provides economists with a theoretical framework that can be applied to almost any form of economic (and even noneconomic) behavior, and it makes refutable predictions. Many of

these predictions are tested in the chapters in this book, and rejections of those predictions suggest new theories.

(Camerer *et al.* 2004: 1, emphasis in the original)

From the standpoint of the methodology of scientific research programs advocated by Lakatos (1970) as a means of understanding how scientific disciplines change, this is a very clear statement of an intention to modify auxiliary hypothesis in the protective belt of the mainstream/neoclassical hard core. Though they may talk cheerfully about rules of thumb in everyday life, these economists are not about to pick up the radically innovative agenda of Simon and abandon constrained optimization; rules of thumb have to be discussed (if they are discussed at all) “as if” they are optimal, in the manner of Baumol and Quandt (1964), not within a satisficing framework.

From the perspective of the new behavioral economics it can be argued that decision-makers are more likely to end up making financial errors than standard economic thinking would predict. In sizing up risky options, they are prone to edit probabilities, over-emphasizing the importance of low probabilities and underweighting high probabilities. Decision makers in the real world are also prone to engage in hyperbolic discounting—that is, they will tend to discount the immediate future at a higher rate than they discount the more distant future—rather than discounting exponentially. These tendencies will result in some consumers being overly willing to risk going bankrupt by spending heavily with their credit cards in order to consume in the present. The gross front-end loading will persist and produce time-inconsistent behavior since, as they move through time, they will discount the immediate future at a higher rate than they imagined they would when looking ahead in earlier periods:

instead of paying off their debts as they planned, they add to them. They act, in short, as if addicted to consumption.

An implication of this line of thinking is that if more people had read inexpensive books such as the guide to avoiding the impact of heuristics and biases in financial decision-making offered by Belsky and Gilovich (1999), fewer people would have suffered financial embarrassment. The fact that only a tiny fraction of the population did avail themselves of such opportunities can itself be read as evidence of hyperbolic discounting: people generally must have been unwilling to incur the upfront costs of searching for tools to improve their decision making capabilities or, if they came across them, were reluctant to invest a mere \$13.00 (the cover price of Belsky and Gilovich 1999) to reduce the risk of losing thousands of dollars.

The typical story of hyperbolic discounting told in modern behavioral economics seems superficially quite a reasonable, but it involves an analytical contradiction. On the one hand it presumes people are not smart enough to see that they will over-consume and display time-inconsistent preferences if they discount hyperbolically, whereas on the other hand it presumes they act “as if” they are smart enough to do all the computations required to size up the net present value of consumption today versus reduced future consumption based on their hyperbolic discounting strategy. By contrast, old behavioral economists expect that, depending on the context, people will either suffer from Simon’s “bounded rationality”, or they will not. If people are short of the computational capacity required to see that hyperbolic discounting will involve time-inconsistent preferences, then perhaps it might be wiser to recognize that they may let their credit cards accounts get into a mess not because their calculations based

on hyperbolic discounting lead them to make a succession of time-inconsistent choices but because they *fail to look* very far into the future and *do not do* any complex calculations. Instead they act in a cavalier manner as if no trade-off is involved and as if they can cross the repayment bridge when they come to it. The heterodox perspective from old behavioral economics is not simply a rewording of the new behavioral story: rather, it is a different story that does not involve constrained optimization over a set of tradeoffs. Moreover, it opens up the prospect of even bigger risk of financial default.

For heterodox economists who have long been employing and advocating the approach of the old behavioral economists, watching the rise of new behavioral economics is an experience akin that suffered by a European art-house movie director whose film is re-made Hollywood-style and in the process is “dumbed down” and has its ending changed. The heterodox economists do not deny the empirical facts that are central to the heuristics and biases literature; on the contrary, they were accepted within the old behavioral economics literature before many of the proponents of the new behavioral economics had even graduated from high school (see readings 9, 10 and 13 in volume I and reading 9 in volume II of the collection edited by Earl 1988). Rather, they are frustrated that the new breed are being so selective in what they choose to learn from psychology and by the new breed’s failure to pick up what heterodox economists and economic psychologists have already done using a much richer range of psychological inputs.

## **Barriers to curriculum change in economics**

In principle, it is perfectly possible to reform what happens in the economics classroom even if most economists prefer to carry on writing papers based on traditional perspectives or making the kinds of incremental innovations within the existing research program that are epitomized by the new behavioral economics. In the classroom, at least, there could be a wholeheartedly pluralistic approach to teaching of economics that presented research programs with different core concepts. This kind of pluralism would be very different from the half-baked version that is emerging within mainstream economics research where some modeling is done assuming full rationality and some is being done as constrained optimization that is distorted by heuristics and biases. Exposure to heterodox approaches would help students understand more clearly how orthodoxy works, and vice versa. Such an education could be provided without diluting the intellectual content, though its delivery would need to be handled carefully in order to be well received by students whose thinking styles were of the dualistic kind and who were not used to scientific debate (see Earl 2008).

Although critics of mainstream economics have characterized standard textbooks as “toxic” and set up a website (<http://www.toxictextbooks.com/>) to expose their shortcomings, it is not the unavailability of suitable alternative texts that is stopping curriculum reform in economics. Textbooks to facilitate pluralistic teaching of economics have been around for many years (for example, Dow 1996; Earl 1995; Earl and Wakeley 2005; Himmelweit, Simonetti and Trigg 2001; Snowden, Vane and Wynarczyk 1994; along with others referred to as non-toxic at the toxic textbooks

website and on its Facebook discussion board). There is also no shortage of complementary readers, reference books and “companion” works produced by heterodox economists—partly because publishers such as Edward Elgar have noticed that heterodox economists make much more use of books relative to their journals-focused mainstream colleagues. Rather, the barrier to innovative, pluralistic teaching of economics is that, for all of their preaching of the benefits of choice, when it comes to teaching, most academic economists choose not introduce their classes to alternative perspectives.

Mainstream economists may do this quite deliberately or because they, too, were taught in this way and remain oblivious of alternatives. The latter group’s behavior is a sign that they have not actively checked to see whether there are alternative approaches to economics. Members of this group most likely have no heterodox colleagues and what they read fails to refer to alternative approaches to economics. Consciously or not, they indoctrinate members of their classes by presenting the language of the subject as if no rational person would question it (for a case study, see Dawson 2007).

It is going to be very difficult to open up mainstream economists to the idea of allowing pluralism into the economics classroom if those in power in departments of economics are senior professors who are primarily interested in playing with models, in the sense of doing applied mathematics, rather than in the real world. As things stand, undergraduate programs in economics are contorted by a focus on making sure that prospective honors and graduate students can handle heavy-duty articles in mainstream journals, even though the great bulk those who take economics typically



are terminating students, often from business degree programs. Making space for alternative perspectives would not only open up the possibility of students favoring heterodox approaches. It would also limit the amount of time they could spend covering the technical side of the dominant approach.

From time to time, of course, the policies and procedures handbooks that managers of modern universities use as their operational bibles will require economics degree programs to be reviewed. Such reviews provide opportunities for internal dissidents to make proposals that can be put before external stakeholders rather than simply being voted down by the mainstream majority at departmental meetings. Even if departments whose economics programs are being reviewed consist entirely of mainstream economists, there is still scope for external stakeholders to try to insist on changes of the kind that were suggested in the letter sent to Her Majesty by the ten heterodox economists.

Unfortunately, it seems from an information economics perspective that the crisis in economics shares some of its foundations with the GFC, for these avenues for reform are limited by problems of agency associated with asymmetric information. At best, a course is an experience good (whose benefits cannot be ascertained until after it has been consumed) but often university courses are credence goods (whose benefits remain unclear even after consumption). They therefore have to be selected on the basis of trust.

Internal representatives on review panels can argue that freedom of choice within a degree is a good thing and will enhance student enrolments, and hence that

introducing additional compulsory courses to cover economic history and the psychology of choice is a bad thing. They can also argue that while any requirements that core courses are taught in a pluralistic manner might not do so at the expense of reduced intellectual demands, it would certainly come at the cost of reduced technical content. They can then argue that this will result in graduates having less well-developed technical capabilities than those coming out of mainstream programs and hence that the university's economics graduates will be at a disadvantage in the market for jobs that place a premium on modeling and number-crunching skills. If courses in heterodox economics and economic history already exist as electives but are taken only by a tiny minority of students, the mainstream economists can argue that students clearly are voting with their feet and that, if anything, these courses should be discontinued and the resources used more productively elsewhere.

For such rhetoric by mainstream economists not to be successful, non-economists at high levels in universities need to possess expertise about the state of economics and know who has expertise on alternative perspectives. Otherwise, the rhetoric is likely to be endorsed by external review panel members chosen on the recommendation of the mainstream-dominated department whose programs are being reviewed. Lack of knowledge of the diversity of thought within economics is also likely to afflict stakeholders such as alumni representatives (who are products of the programs under review) and employer groups (whose representatives may have been satisfied with the graduates they had hired but were oblivious of the benefits they might have achieved by hiring graduates with a more rounded economics education).

In the unlikely event that the degree review process concludes with requests for reforms, information asymmetries continue to be an issue that may limit change in what happens in the classroom. A head of department who wishes to allow things to continue much as before can turn a blind eye to the difference between what was asked for and what is actually delivered in the classroom by department members who similarly are reluctant to change. Little may actually change without careful monitoring by external groups or an active student body who, despite what they are being taught, have a sense that they deserve something very different.

There is thus a classic double-bind problem preventing heterodox economics and economic history from becoming core parts of the economics curriculum: the only way in which rational choices can be made about the merits of heterodox approaches to economics versus orthodox ones is for *both* approaches to be taught in the core of the program and subjected to empirical examination.

Matters are no better at the graduate level. Coursework is being added to PhD programs outside North America, to make them more like the US model. This typically entails “rigorous” courses so that even more difficult articles can be read in the core mainstream journals, rather than courses designed to open graduate students’ eyes to alternative approaches to economics. This also means that potential PhD students of heterodox economics are required to master the orthodoxy before they can turn their attention elsewhere. Postgraduate heterodox economists thus have to be very seriously committed and technically gifted, to put up with and survive all this rather than abandon economics programs and do their PhDs in other disciplines, such as marketing, entrepreneurship, international business or political science. Unless this

trend is reversed, fewer heterodox PhDs will be produced than in the past and as senior heterodox economists retire there will be no new blood to replace them as critics of the mainstream and advocates for change.

### **The role of research audits in preventing change in economics**

It is not just the one-sided teaching of economics that is likely to limit the presence of heterodox ideas and personnel within economics departments despite the shock of the GFC. Anyone who enters academic economics with the capacity to operate as a mainstream economist and who is in the game for fame and fortune—rather than as a humble seeker after truth who is interested in making a difference—will not rationally choose a heterodox approach even if they are aware of it. For example, it pays to be a behavioral economist of the new kind rather than someone who takes bounded rationality seriously and sees decision-makers as rule-using agents who cannot compute, discover and/or identify optimal solutions in many problem situations and who instead are trying to cope with life's challenges by using simplified models (as economists do) and discovering satisfactory solutions. The key driving force here is the widespread tendency to rank, and fund, academic departments according to their performance as measured by the rankings of journal articles published by their members of staff (see Lee 2007).

Scholars whose work is unlikely to win a place in the top-ranking journals will thus be ranked lower than those whose works conform to the templates of papers in these journals and thus stand a chance of success if submitted to them. A paper stands little chance of acceptance with the top-tier journals unless it contains a mathematical

“model.” A typical mainstream theory paper thus is based on creative insights that can be summarized in a few sentences or a couple of paragraphs, which are then spun out and “proved” in 25 pages or so of mathematics. Papers that consist of “essays” of a traditional kind, containing page after page of economic argument that is not couched in formal notation, are not viewed by the elite journals as serious pieces of economics. In this environment, about all that those who have “job market papers” that are short of mathematical content can do to make themselves look more appealing as researchers is to write using LaTeX. The distinctive look of a LaTeX paper, combined with the set-up costs of learning how to use LaTeX, may serve as a signal that they also do work in the preferred highly mathematical idiom.

Now, of course, within the top-tier generalist journals, the majority of articles are often applied contributions rather than pure theory (in the period 1991-1995 only 25 of 281 articles published in the *American Economic Review* were pure theory: see Dasgupta 2002). However, if empirical work is based on unfamiliar economic theory it will be disadvantaged: articles may need to be far longer in order to introduce it to referees and persuade them to take it seriously, but the length may then be a barrier to publication since, even if referees are persuaded, a cut-down version would leave readers bemused. Hence, even if referees of mainstream journals are open to fresh approaches, those whose applied work is conducted from heterodox perspectives will have a much bigger chance of getting it accepted in heterodox journals where related work has already been published, with which the normal readership will be familiar.

For those who get on to the treadmill of a position in an economics department, the incentive structure remains the same as at the hiring stage: what matters most is where

one publishes, not its real-world relevance as signified by its use in public or business policymaking or citation in applied papers, or by it serving as theoretical foundations for works that have these kinds of impacts. The ability to demonstrate real-world relevance certainly *is* important when attempting to win research grants, but so, too, is one's standing in the discipline: even if the panel that determines the allocation of grants comes from a wider disciplinary field, a heterodox economist's credibility may suffer if panel members are presented with reports by assessors who are mainstream economists and which emphasize the applicant's lack of publications in top-tier journals.

There is little incentive to contribute to the development of capacity within the broader discipline to address real-world issues via writing textbooks and editing books that serve as resources to facilitate the teaching of the kind of economics advocated in the letter sent to Her Majesty by the ten heterodox economists. Despite the GFC, along with evidence that Schumpeterian processes of creative destructions and structural change are going on in the real economy, the trophies of academic economics normally do not go to those who produce heavily cited contributions using evolutionary economics. Instead, rapid advancement is more likely to be awarded to those who continue to write arcane articles about equilibrium conditions or competitive games played with fixed rules and no surprises—articles that are mostly cited in similar articles, often by their own authors.

In sum, the academic job market in economics seems to heterodox economists to be rotten to the core. Mainstream economics insists that the axiom of Archimedes holds—in other words, that a shortfall in one area can be compensated for by a

superlative performance elsewhere so that “everything has its price.” However, appointments and promotions committees and the elite journals appear increasingly unwilling to make trade-offs that give equal treatment to bright economists from different persuasions and with different comparative advantages. Instead, they appear to be choosing on the basis of non-compensatory decision rules of the kind that heterodox economists write about as being commonly used in everyday life (for a discussion of such rules, see Earl 1995: ch. 4).

There is nothing necessarily wrong with journals having sets of hurdles that papers *must* meet in order to be acceptable. Rather, the problem of applying hurdles in this context is their height and ranking: real-world significance is not the first-priority test. Paradoxically, the discrimination against work that does not centre on mathematical models (or against empirical work not based on mainstream theoretical foundations) seems to have arisen precisely because journal editors initially were prepared to make trade-offs, as per the mainstream view of choice, and accepted more mathematical papers that explored the frontiers of technique at some cost in terms of their connection to reality. This was the start of a slippery slope that resulted in sight being lost of the goal that was being traded off to allow in more formal analysis. As Augier and March (2008: 103) point out,

In the longer run, the effect of a commitment to trade-offs is even more pernicious.... Reasonable people ... can come to see deeply held commitments, such as beliefs in realism and comprehension, as exchangeable goods, nice to have insofar as you can afford them but not closely linked to an

inviolable sense of self. Loss of realism becomes an affordable cost rather than a personal failure.

### **The role of marketing in shaping the uptake of new ideas**

Prospects for change in economics look far less bleak if we look at competition between ideas from a marketing standpoint and consider how heterodox approaches might be better marketed. The typically rather negative view that heterodox economists take of marketing as a discipline—namely, as providing tools that can be used to generate unnecessary wants that make consumers more socially competitive and anxious—has a positive side: if techniques from marketing can be used to manipulate consumers (for evidence of how this is done, see Hanson and Kysar 1999), then they might also be used to manipulate the choices of economists.

Marketing matters in economics, as in business and politics, because customers have limited attention, as do those in whose social circles they seek to move. A library represents a far more demanding challenge to academics shopping for ideas than a supermarket presents to those shopping for groceries. Capturing attention for economic research involves much more than one's choice of keywords or title or making sure that one publishes in journals included in databases such as ECONLIT. Economists whose lists of references show they are keep the wrong kind of company and who show ignorance of the codes of conduct of particular scholarly groups will be denied admission to such groups, just as they would be denied admission to a classy nightclub if they presented with scruffy colleagues and wearing the wrong kind of clothing.



Attempts by economists to position themselves and their work in particular ways may affect and be affected by how they and/or the kind of work they do are branded in the minds of their audiences. A brand is an information-economizing device that allows people to make very rapid assessments of what they are likely to get if they purchase and/or give attention to a particular product. Such expectations may be about how it will mean they are viewed by others who see them using it, and about the kinds of interactions it will permit them to make with particular groups or individuals. By associating ourselves with particular brands, we get branded, too: we get known as being particular kinds of economists because of the societies in which we participate and the company we keep when we publish. Those who know us by our brand shorthand will be able to predict both our choices of areas of economic problems to analyze and how we go about analyzing them. Likewise, we use our brand shorthand to summarize what kind of economics we practice to people who do not know us but who might hire us or be interested in publishing our work.

In marketing their ideas or labor power, economists choose which stimuli to send out to their intended audiences. But although these stimuli may provide *opportunities* for them to be seen as they hope they will be seen, how they will *actually* be seen depends on the set of templates that their audiences use for forming perceptions and the connotations that they attach to particular templates (Hayek 1952; Kelly 1955). Though a marketer may be trying to create a particular brand image, it is actually the audience who ultimately does the branding by deciding how to construe the signals they pick up, both from the marketer's campaign and from other sources. If the incoming stimuli do not constitute a pattern that matches the onlookers' templates for

“economics,” then these onlookers will be unable to classify it as economics. If the set of stimuli fits no single template perfectly, but fits several templates to some degree, it may be categorized as a hybrid form. Therefore, if mainstream economists use templates that are so restrictive as to enable them only to see their kind of economics as “economics,” they will see heterodox economics as something other than economics, such as political science or sociology. By contrast, other economists, with less restrictive templates and a wider range of templates to call upon, may be able to recognize not merely “heterodox economics” but also constituent brands, such as “Post-Keynesian economics.”

Economists can invite their intended audience to see their work in a particular way via their choice of title, introduction and conclusion and/or in their covering letter when they submit it to be considered for publication. How they attempt to position their work may make all the difference: it is one thing to offer a work as, say, “a radically different way of approaching the subject to replace flawed conventional thinking,” versus inviting the intended audience to see it as, in effect, “a means of enhancing the predictive capacity of an existing approach by making only minor adjustments to its normal practices.” While the former may be intended, it may be much wiser to dress it up as the latter to give it a chance of being accepted, with its real implications only later becoming apparent.

Heterodox economists may thus need to position their work differently to different target audiences. It may be fine to criticize the mainstream approach when marketing heterodox contribution to other heterodox economists and funding bodies not dominated by mainstream economists, but completely wrongheaded if one is trying to

invite mainstream economists to change their ways. To seduce the mainstream, heterodox economists should not use an explicitly combative “battering ram” approach; rather they should employ a Trojan horse strategy, offering something that the mainstream economists will be likely to find acceptable and fail to see as opening the door to the eventual abandonment of their present approach.

Scope for doing this arises because heterodox approaches to economics all overlap in some degree with mainstream economics (as is shown at length in Earl and Peng, 2012). These areas of overlap, which differ among alternative heterodox approaches, provide starting points for dialogue with mainstream audiences. If heterodox economists begin engaging with mainstream economists on common ground rather than with a focus on their areas of difference, they have the opportunity to operate rather like the “foot in the door” salesperson who, having got a conversation started, uses carefully scripted patter to overcome the prospective customer’s likely objections.

### **Branding and positioning lessons from behavioral economics**

The changing status of “behavioral economics” in the past two decades provides a telling case study of what can be achieved by careful positioning and brand management and of the opportunities that can be lost if these issues are mishandled. From our earlier discussion of behavioral economics in relation to the GFC, it may appear that what Sent (2004) has labeled “new behavioral economics” has been accepted purely because it does not violate the hard core of the mainstream research program, unlike the earlier approach for which Herbert Simon was awarded the 1978

Alfred Nobel Memorial Prize in Economic Science. However, if Simon and his colleagues had played their hand differently, today's economists might be at least be operating in a pluralistic manner and embracing their approach as a legitimate way of addressing economic puzzles, especially in contexts involving complexity and uncertainty.

“Old behavioral economics” has languished despite having started off in the top journals in the mid-1950s and despite the seminal book by Cyert and March (1963) on the behavioral theory of the firm (which registers over 14,000 citations on Google Scholar—the vast majority not in economics) appearing in a new edition in 1992. Herbert Simon and his colleagues got the old behavioral economics started with contributions in a style that was at least as formal as contemporary constrained optimization models. Simon also was well networked with leading economists of the time and these connections proved useful en route to his success with the Nobel award: he writes that his election in 1976 as a Distinguished Fellow of the American Economic Association (of which he had never been a member) came after Kenneth Arrow “had educated the younger economists on the selection committee on who I was and on my standing as a Fellow of the Econometric Society” (Simon 1991: 321–2). By this stage, however, Simon had long since realized that a satisficing-based approach to economics was not being taken up and had concentrated his research on cognitive psychology and computing science.

Towards the end of his life, Simon acknowledged that his intentions had been misunderstood:

[F]ew of the economists, even those who find my approach most congenial, seem at all aware that the psychological research and computer modeling I have been doing (for 45 years!) is not unrelated to the tasks of building an economics for the real world, but is a simple continuation (“by other means,” as Clausewitz said of war) of what I had been doing since the beginnings of *Administrative Behavior*: trying to provide a theoretical and empirical foundation for human decision making. As a consequence of this oversight, the view still prevails that bounded rationality is a critical, not constructive, approach that has little positive to say about how decisions are actually made and problems actually solved.

(Herbert Simon, in an email to Peter Earl, 9 February 2000)

Simon had also unwittingly let a major marketing opportunity slip away when debating with Milton Friedman in 1963 over the latter’s contention that the pressure of competition ensures that only those who do maximize profits survive: he seemed unaware that Friedman had misrepresented Alchian’s (1950) argument—which was actually that survival only requires sufficient fitness relative to the opposition and which was therefore entirely consistent with a satisficing analysis (see Kay 1995). As he commented, when this was brought to his attention, “It is difficult enough to beat Milton in debate without handicapping oneself by muffing a strong point” (Herbert Simon, in an email to Peter Earl, 18 February 2000).

By the late 1970s, when Simon once again became visible in economics, the subject had changed and the Nobel citation made it plain for all to see that his work rejected the assumption of the omniscient profit-maximizing entrepreneur and was therefore at

odds with the constrained optimization template of the new generation of economists. Worse still, in his later publications in economics Simon was not only arguing against optimization but also doing it via words rather than with heavily mathematical papers.

In the 1980s, despite—or perhaps even because of—Simon’s Nobel award having publicized the nature of his contribution, it was not easy to achieve status by doing behavioral economics of a kind that did not fit the conventional template. Richard Thaler is now probably the most influential and heavily cited of all the new behavioral economists. However, even though he was being less radical than Simon in his theoretical stance, he found it difficult to win acceptance for his early work in which he exposed the empirical shortcomings of mainstream consumer theory and tried to show how Prospect Theory, recently developed by psychologists Kahneman and Tversky (1979), could provide a better way of making sense of consumer choices. His struggles were outlined in a *New York Times* article by Roger Lowenstein (2001), who noted that:

Thaler's first paper on anomalies was rejected by the leading economic journals. But in 1980, a new publication, *The Journal of Economic Behavior and Organization*, was desperate for copy, and Thaler's "Toward a Positive Theory of Consumer Choice" saw the light of day. "I didn't have any data," he admits. "It was stuff that was just true."

Thaler’s (1980) paper first began to achieve influence via psychologists, not mainstream economists (thought it was included in Earl, ed., 1988). According to Google Scholar, it is now his second most heavily cited work. Top place goes,

however, to the De Bondt and Thaler (1985) paper on stock market over-reaction, in the *Journal of Finance*, while third-placed is Thaler's (1985) paper on mental accounting, which appeared in *Marketing Science*. In other words, success came particularly by offering his ideas to audiences with a practical real-world interest: "behavioral finance" was an astute field for him to kick-start because, if his arguments were right, huge amounts of money could be made by applying them. His subsequent work for economic journals used experiments in place of anecdotes and sometimes he wrote jointly with the psychologist Kahneman, whose experimentally-grounded ideas he had used and which had been published in *Econometrica* (Kahneman and Tversky 1979). While this strategy helped win interest from mainstream economists, Thaler was also able to reach a much wider audience via his skilful use of everyday examples and anecdotes.

The importance of writing in the accepted style of one's target audience and keeping within the right circles was also well understood by Matthew Rabin, another star of the new behavioral economics. Though his citation rate and public profile are not yet quite in Thaler's league, his rise was much more meteoric. His strategy was quite deliberate, as was evident around 2000–1 when Peter Earl and Simon Kemp, who had just become editors of the *Journal of Economic Psychology*, wrote to both Rabin and Thaler to invite them to join the *Journal's* editorial board. Both were advised that their duties would be minimal but that they could serve a major role simply by joining the board and thereby endorsing the journal. Thaler accepted but Rabin declined, saying that to succeed in his mission to get psychology taken seriously by economics in general it was vital he restricted his work to the mainstream. In other words, if he associated himself with a non-core journal, he risked having his contributions to core

journals taken less seriously. Though the journal's new editors were at the time disappointed, Rabin's strategy may well have helped the *Journal of Economic Psychology* in the ensuing decade: as his impact within mainstream economics increased, so did the journal's impact factor.

It remains to be seen whether, having helped win a place for psychology within economics by positioning the new behavioral economics on the fringes of the existing mainstream, contributors such as Thaler and Rabin start building further heterodox ideas into their work and make it look more like what Simon had attempted to promote.

### **Strategies of stealth**

There is considerable potential for heterodox economists to use stealth to undermine current practices in economics. Theoretical analysis that is openly combative will not get past mainstream journal editor and referees. Nor will mainstream majorities approve openly subversive new courses. Rather than engaging in open combat heterodox economists should exploit the ignorance of the mainstream that arises from its narrow reading and limited ability to monitor what happens in classrooms. When heterodox economists present their work or proposals to their mainstream peers, they should act as if the latter are familiar with the territory rather than emphasizing radical departures. When teaching heterodox economics, they should simply call it "economics" but at the same time they should alert their students to be on the look out for other kinds of economists who seem rather less interested in the real world and more interested in playing with mathematics. Taught thus, the students may not



merely develop a strong background on how to do real-world economics but also the confidence to challenge their more “autistic” professors, unaware that it is the latter that dominate.

As an example, consider how to get old behavioral economics and evolutionary economics ideas into the curriculum. Mainstream faculty members will be aware of new behavioral economics but they will actually see it as “behavioral economics” because they are unaware of old behavioral economics. Given this, the heterodox economist should simply suggest introducing a course (or volunteering to take an existing course) in behavioral economics without mentioning the old/new issue at all—and then mostly teach old behavioral economics and related material from evolutionary economics, though taking care to include some coverage of what mainstream colleagues would have been expecting to drive pretty much the whole course, namely, the implications of heuristics and biases.

As a second example of a strategy of stealth, consider the core ideas of the price mechanism, the law of demand, and price elasticity of demand. Economists probably agree that profits and losses play a role in promoting changes in the mix of production and that elasticity of demand can be measured and differs between markets. However, in contrast to mainstream supply and demand stories, a heterodox perspective would not simply assume that markets achieve equilibrium states. Rather, it might:

- (a) Explore the coordination problems involved in achieving structural change and the role of so-called imperfections in facilitating orderly market entry or exit (via Richardson 1960/1990);

- (b) Recognize the institutional nature of markets as devices for facilitating transactions (via Hodgson 1988); and
- (c) Offer a theoretical analysis, grounded in psychology, of why there are “inelastic” responses to price changes in some cases and “elastic” responses in others (via Earl 1986).

In other words, where mainstream economists presume a particular end result and provide tools for measurement without any underlying theory beyond the mathematics of marginal revenue functions, the heterodox approach would reveal the informational challenges that market transactions entail, showing the kinds of situations in which markets will be more/less likely to function efficiently, as well as offering a theory of responsiveness to changing incentives. All of this can probably be done without any need for new course rubrics, though possibly at the cost of short-changing mainstream colleagues in the depth of coverage of some of their cherished materials. Such costs are probably quite easy for subversive economists to impose on their colleagues given the amount of redundancy in a typical “principles of economics” sequence that tries to drum the methods of constrained optimization into students by telling the same story with increasingly sophisticated mathematics over successive courses.

### **The Trojan horse of applied pluralistic economics**

It is difficult to imagine theoretical work that does not fit the mainstream template getting into the most prestigious journals in the immediate future. Attempts to find a way in by offering a pluralistic theoretical analysis of a particular problem area and

discussing the relative merits of rival approaches would founder due to the problem of length: the mathematics required to spin out a couple of paragraphs of intuition of the usual kind into a “rigorous” paper usually leaves no room for any alternative. The best one can hope for is the kind of “fiddling at the edges” work that the new behavioral economist do, which gradually enables the field to be opened up by taking mainstream research and reworking it with another, more real-world twist. This way of opening the discipline up will be slow and heterodox economists will not be able to drive it if they are not prepared or able to play the “formal model” game. For the moment, then, heterodox theory will most likely have to stay outside of the “core” journals.

The big chance for heterodox economics lies in applied work where theories meet facts rather than simply being “proved” mathematically for a stylized context. Here, pluralism has enormous Trojan horse potential. The pluralist applied economist can present as someone who is a well-read researcher with no particular theoretical axe to grind, merely an interest in finding out how a particular part of the economic system actually works. Alternative theoretical possibilities can be advanced along with their implications for which variables are necessary, their expected signs and relationships between them. After that, it is up to the data to show which view fits the facts in the context in question. In some contexts there will be complementarities between alternative theoretical approaches, so that rather than them predicting opposing signs for a given variable they permit additional variables to be incorporated into models and improvements in explanatory power. So long as the results are robust in a statistical sense, they will be hard for economists to deny even if their perspectives would not have led them to consider adding such variables.

An exemplar of this approach to empirical work is provided in Peng's (2009) study of housing renovation choices. Not only were rival perspectives on "do-it-yourself" (DIY) versus "outsourcing" decisions tested but in analyzing the "to renovate or not" decision, standard models based on "economic" variables and models that add psychological variables were both presented. The value of adding the psychological variables was striking in the case of decisions to renovate or not, and for DIY versus outsourcing, but weak when the approach was extended to the case of cost over-runs and over-capitalization. In addition to working with multiple theoretical perspectives, this study was also pluralistic in its openness to alternative statistical techniques, employing both logistic regression and cluster analysis techniques.

By being presented in a non-combative manner, pluralistic research that uses ideas from heterodox approaches and outperforms monist orthodox research strategies may become increasingly acceptable and visible in well-ranked journals. Applied economists of more orthodox backgrounds will have an incentive to follow suit as a result of seeing papers in their field that have used this method. From reading such papers, they will know where to go to source alternative perspectives.

### **Towards a unified "heterodox economics" brand?**

To ensure that such strategies end up producing something coherent and synergistic, heterodox economists need to coordinate their actions. They would be wise to construct an overarching unified research program in whose direction they will try, from different starting points, to steer mainstream economics. For this to be possible,

most of them will have to become much more widely read and eclectic than hitherto. They will have to focus on the complementarities between heterodox approaches and be prepared to learn from unfamiliar heterodox brands rather than simply ignoring them or burying the differences between them.

The key for doing this may lie in the Schumpeter Prize-winning book by Potts (2000). He argues that at the most basic level of analysis what makes *all* the varieties of heterodox economics different from mainstream economics is how they see the relationships between the elements that constitute the economic system. In their various ways, heterodox economists all view the economy as a complex system that has a definite architecture because its elements are not connected to every other element. By contrast, the mainstream view attempts to make economics like Newtonian physics by treating the economic system as a mathematical “field” in which every element is directly connected, to some degree, with every other element. The “field” approach underpins the general equilibrium vision, the continuity of preference orderings and production functions and the principle of gross substitutions that lie at the heart of mainstream economics. It accounts for the general lack of interest that mainstream economists show in structural relationships—whether between ideas or people, within organizations and markets, or within the input-output matrix that maps how commodities are used to produce other commodities—and in how such relationship change through time (see further, Earl and Wakeley 2010).

It will take a major investment by a team of heterodox economists from different backgrounds to synthesize the key ideas of the various heterodox brands into a single coherent perspective. Making the most of complementarities requires not just wide

reading but also a subtle appreciation of alternative research programs. Moreover, the benefits of investing in such a synthesis are unlikely to be achieved if heterodox economists from diverse camps insist on taking their habitual ideological stances rather than adopting the more pragmatic position of seeing what they can agree upon about the nature of the economic problem and the human condition and then seeing where this leads for economic policy.

For example, Austrians could learn that they should not simply presume that market processes generated order spontaneously but that there is a serious problem of coordination. Likewise, radical political economists might continue to despise “fat cat” executive remuneration packages and yet end up with both a stronger critique of modern “managerialist” policies and a view of capitalism that includes a healthy respect for managers of large corporations due to realizing what they are up against within the modern world of Schumpeterian creative destruction. William Lazonick’s (1990, 1991) work shows just how powerful a view of industrial dynamics can be achieved by synthesizing the theoretical and historical perspectives of Chandler, Marshall, Marx and Schumpeter; it is unlikely to appeal fully to committed admirers of any one of these four but it certainly is a means of getting them to see areas where synergies are available and to separate out residual areas of differences.

It is easy to see opportunities being lost if heterodox economists who work on the firm do not emulate Lazonick’s eclecticism. Much of what is labeled as “managerialism” in the practices of corporations and government departments can be seen as the sort of policies one might design by using notions of organizational slack and X-inefficiency (from old behavioral economics), and principal–agent problems

and potential for opportunistic pursuit of sub-goals (from new institutional economics) in a neo-Darwinian manner. The use of managerialist policies to crank up workloads and create a “divide and rule” environment of fear in organizations is hardly popular with economists on the left. However, radical political economists who integrate these lines of thinking with their own perspective can argue that managerialism is based on a misunderstanding of the significance of contractual incompleteness, much of which is there to leave flexibility and avoid the costs of trying to anticipate contingencies that may never arise. Policies aimed at tightening up workplace procedures may thus be counterproductive. Moreover, to understand the origins of power, it may be useful to be familiar with economics that emphasizes the complexity of economic activities and the division of knowledge among participants.

If heterodox economists of different persuasions can feel more comfortable about the possibility of conversing amongst themselves, they can set in place the kinds of institutional frameworks that will make it harder for mainstream economists and the media to ignore them. They need their equivalent of the AEA, its annual conference and its flagship journal but have been dispersed among many small societies with their own annual conferences and journals. There will still be a place for the present heterodox journals but if there is a unifying flagship journal that is read and frequently cited by a wide range of heterodox economists it will have the biggest chance of taking on the “core” mainstream journals on their own turf, that of impact factors and journal ranking tables. Ideally, heterodox economists need a flagship journal that not only manages to signal quality by the rigorousness of its refereeing processes but which is also a freely available online publication. With the founding of the World Economics Association in May 2011 and the inauguration of its open

access and online *World Economic Review* it appears that the necessary institutional framework is at last being created.

An attempt to create a widely understood, integrated approach to heterodox economics from its current somewhat disparate set of dissident research programs needs to be handled with care, for the marketing challenges for heterodox economists take three different forms:

1. Getting other kinds of heterodox economists interested in using elements of their own particular heterodox approach.
2. Getting mainstream economists to listen to and take up heterodox ideas.
3. Getting third party groups such as university managers and grant-awarding bodies to allocate resources in ways that will permit heterodox economics teaching and research.

Moves towards an integrated approach only help in relation to the first and third of these marketing challenges. They will not help make heterodox economics appeal to the mainstream. On the contrary, any sign that the opposition are grouping together in a unified force is likely to make the mainstream all the more defensive and resistant. Quite apart from being likely to invite resistance, “heterodox economics” is a brand name that would cease to make sense if it succeeded in usurping the current mainstream.

Heterodox economists need to brand their work in a way that suggests it is compatible with, not different from, the values of mainstream economists. They need an



overarching brand name that mainstream economists cannot criticize without making mainstream work look unfit for funding. From this standpoint, Edward Fullbrook's "Real-World Economics" seems a wise choice: *we* know what *we* mean by it, even if *they* do not know of our deeper subversive hopes for changing the practice of economics, and *they* will find it rather difficult to be openly hostile to economics presented under that banner: the implication of being hostile to it as a general label is that they are not actually interested in the real world, something they dare not allow to slip out to those who fund their work.

### **Concluding comments**

In beginning with the question of whether the GFC signals the need for major changes in economics teaching and research, this chapter perhaps gave the impression that the ten heterodox economists' claims about the state of economics are something new. They are not. Claims that mainstream economics has been a failure and that the discipline is in a state of crisis have been repeatedly made over the past forty years. As is evident in Hutchison (1977), there were many claims in the early 1970s regarding the irrelevance of equilibrium economics, the need for a historical perspective and to avoid excessive abstraction and claiming too much about the potential for predicting how economic data would unfold. But economics as a discipline has gone in the opposite direction. Now we are in a situation in which the chances of mainstream economics deciding that it needs to reform itself seem about as remote as the prospect that bankers will beg for more prudential supervision and cease paying themselves huge bonuses. Critics of the mainstream are much better organized in institutional terms (with societies, websites and their own journals, and much easier

communication via email) than they were four decades ago, but there is little sign that they are having any significant impact on the economics establishment. If anything, mainstream economics is in a stronger position to resist internal pressures for change than it ever was, and it can use the growing information asymmetry between itself and the wider public regarding what it does to put “spin” on its contributions and deny it is failing.

If economics is to change for the better, pressure must come from outside, aided by dissidents from within. Non-economists on research audit panels and grant-awarding bodies will need to be persuaded to demand more evidence of economics being done with a view to helping achieve a better understanding of the real-world economy rather than promoting the development of imaginary worlds. Measuring the quality of departments of economics by their success in raising funds to conduct empirical projects is one way to do this. Using citation scores such as those from Google Scholar that cast a wider net and pick up books and book chapters more readily may be rather better than relying on journal-focused citation measures. It is probably going to be necessary for dissident economists to devote more of their energies to getting their messages across in the media (another areas where they can learn from the success of new behavioral economics) and engaging in public debate with the mainstream so that external stakeholders start to develop a healthy skepticism about what is being taught within mainstream departments of economics. Heterodox economists as a group may also be wise to spend less time on writing about method and more on practicing what they preach by developing empirically-grounded theory, doing applied pluralist research and contributing to public inquiries.

The stealthy Trojan horse approach to promoting ideas from heterodox economics to mainstream economists will take time to achieve results. This may alarm eager young heterodox economists but they should remain patient: such an approach not only has a better chance of success than the more confrontational strategies mistakenly adopted by many of their mentors over the past thirty years; it is also more likely to get them the jobs and tenure that are vital to being in a position to achieve anything in the long run. To succeed, heterodox economics will need to be pluralistic not merely in its economics but also in marketing, for different messages need to be given to different target audiences. Only when heterodox economists engage with each other and with non-economist stakeholders who control funding, should they emphasize differences from the mainstream. This may mean that different heterodox economists will need to target different audiences: those who are known to mainstream economists will not be so able as early-career heterodox economists to get away with subversive strategies.

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