

ROYAL ECONOMIC SOCIETY

NEWSLETTER

Issue no. 144

January 2009

ROYAL ECONOMIC SOCIETY

Rediscovering aggregate demand

Given the momentous events of 2008, especially the second half, it is hardly surprising that an economists' *Newsletter* should finally give some attention to developments in the real economy. What is surprising though is the amount of unsolicited material on the 'crisis' that has found its way to the editorial office. We publish here only a small selection. The first is an extract from Paul Krugman's introduction to the new edition of Keynes's *General Theory*. This was originally planned to mark Krugman's award of the Nobel Prize, but it is so extraordinarily prescient of events that were to unfold within two years of its writing that it is hard to believe that Keynes/Krugman were not commenting with hindsight. The second is the 3-way debate between Oswald, Blanchflower and Taylor (at Oswald's suggestion we should stress). What this shows is the general failure of economists to predict the crisis (though one might pause to reflect on whether 'failure to predict' is really a loose translation of 'failure to do anything about it'. And in fairness it is difficult to see what the most farsighted economist could have done to forestall the disaster). There is a hint in Blanchflower that economists *collectively* might have made a difference if they had not been so fixated on price stability as the only game in town and ignoring the lessons of the *General Theory* and Krugman's introduction. At the very least, we may expect to hear less in future of the proposition that aggregate demand has no lasting effect on real variables.

In addition, we have Alan Kirman's annual letter from France, in which he continues the theme of the need for reform of research funding in France. (The results of the UK's latest Research Assessment Exercise were published as this issue went to press. We shall report on that in the April issue). Also of note is the report of Professor Helpman and his colleagues, foreshadowed here in July 2008, that forms the International Benchmarking Review of UK Economics.

In this issue —

• <i>Economic Journal</i> - Editors' Report	3
• <i>Econometrics Journal</i> - Editors' Report	7
• Letter from France	9
• On economic models	12
• The Helpman Report	13
• Krugman on Keynes	14
• Obituaries	17
• Economists and the crisis	18
• RES News	23
* Conference diary	25

NEWSLETTER

Published quarterly in

January, April, July and October

Editor

Prof Peter Howells,
School of Economics,
UWE Bristol,
Coldharbour Lane,
Bristol BS16 1QY,
UK

Fax: +44 (0)1722 501907
Email: peter.howells@uwe.ac.uk
mail@sarum-editorial.co.uk

Administration Officer

Mrs Amanda Wilman,
Royal Economic Society,
School of Economics and Finance,
University of St. Andrews,
St. Andrews, Fife, KY16 9AL, UK

Fax: +44 (0)1334 462444
Email: royaleconsoc@st-and.ac.uk

Newsletter - subscription rates

The *Newsletter* is distributed to members of the Society free of charge. Non-members may obtain copies at the following subscription rates:

- United Kingdom £5.00
- Europe (outside UK) £6.50
- Non-Europe (by airmail) £8.00

Next issue

Newsletter No. 145 - April 2009

Articles, features, news items, letters, reports etc. should be sent to the Editor by:

15 March 2009

Items concerning conferences, visiting scholars and appointments should be sent to the Administration Officer by:

16 March 2009

Contributions from readers

The *Newsletter* is first and foremost a vehicle for the dissemination of news and comment of interest to its readers. Contributions from readers are always warmly welcomed. We are particularly interested to receive letters for our correspondence page, reports of conferences and meetings, and news of major research projects as well as comment on recent events.

Readers might also consider the *Newsletter* a timely outlet for comments upon issues raised in the *Features* section of *The Economic Journal*. We can normally get them into print within three months of receipt.

Visit our website at:

www.res.org.uk

Designed by
Sarum Editorial Services
www.sarum-editorial.co.uk

The Economic Journal

— Editors' Report

The Managing Editors make their Annual Report to the Council of the Royal Economic Society in November. The 2008 Report was presented on their behalf by Andrew Scott. A shortened version appears below.¹

The most attractive feature of being an Editor is helping to improve and then publish interesting papers. This can be the only way of raising the profile of any journal — grander strategic visions are liable to lead to frustration due to the fact the editor is purely an intermediary between submitting authors and their readership. The best way therefore of assessing a journal and its health is to read the issues and form a judgement.

Ultimately as editors that is the only way we can be judged. However, in this report a different perspective is produced — a record of the operational and logistical performance of the *EJ*. My hope is that having considered these statistics any reader will reach the conclusion we have performed efficiently and well. Sadly these statistics and tables can't capture the more important dimension of the intellectual liveliness of the *EJ*.

Editorial changes

The only change on the editorial front was Leonardo Felli stepping down at the end of his four year term. Under Leonardo's stewardship the journal saw a substantial increase in theory submissions and publications. Since last November David Myatt has been dealing with all new micro submissions and we look forward to further success in this area. David has already taken on his role with enthusiasm and purpose and achieved very fast response times to authors such that the large stockpile of theory submissions mentioned in last years report is now effectively reduced. With myself now beginning a second four year term and Antonio Ciccone, Steve Machin and Steve Pischke all continuing the Editorial team has been in place for several years and is experienced in the ways of the journal.

Whilst the main editors showed considerable continuity the shorter term nature of Associate Editor appointments means there has been considerable turnover here. We say farewell with much thanks to their contribution to Daron Acemoglu, Luca Anderlini, Robin Burgess, Guido Lorenzoni, Albert Marcet, Marc Melitz, Enrico Moretti, Ben Polak, Helene Rey and Luigi Zingales. We welcome aboard as Associate Editors Oriana Bandiera, Nick Bloom, Martin Ellison, Ray Fisman, Nicola Gennaioli, John Morgan, Ricardo Reis, Georg Weizsacker and Catherine Wolfram.

Progress over the year

Submissions

Over the last year (1st July 2007 to 30th June 2008) we received a total of 700 submitted papers — essentially the same as the year before. After several years of 10 per cent growth or more it would appear that the level of submissions has stabilised. — see Tables 1 and 2.

The geographical distribution of submissions also remains little altered — a small percentage fall in UK submissions was offset by an increase from Continental Europe. Field categories also showed some minor variations leading to a broadly similar pattern as before. The largest category was Microeconomics which attracted 137 submissions (compared to 130 the year before), Labour Economics was the next largest with 92 (88) followed by International, Monetary and Development.

Editorial Processing Time

A trend that has been noted in past reports has been the rise in papers which are summarily rejected rather than sent out to referees. This proportion has now risen further — from 37 per cent last year to just over 50 per cent. We have commented previously that this is in part a conscious decision to conserve on referee resources. I suspect the increase in summary rejects also reflects the experience of the editorial board. After several years in the role the ability to detect papers that would appeal to referees and our general readership and identify those that won't is sharpened. The result is more summary rejects of papers not purely on grounds of quality but also in terms of fit. With so many field journals proliferating we recommend to a number of authors that their paper would be better suited elsewhere. Raising the summary reject rate has helped encourage swift turnaround and made better use of referees but it is not our intention to see any further increase.

The increase in summary rejects has helped us reduce our average turnaround time for all submissions yet further — down to 10.3 weeks compared with 14.7 the year previously and 25 weeks five years ago. The improvement is not entirely due to increases in summary rejects — we have reduced from 22 per cent to 8 per cent the stock of papers which take us more than six months to process

thanks to David Myatt’s appointment. Further we have also reduced the average time taken to receive referees reports — from 9 to 8 weeks.

Table 1: Geographical distribution of submissions July 2005 - June 2008

Region	1.7.07 - 30.6.08	1.7.06 - 30.6.07	1.7.05 - 30.6.06
UK	106 (15%)	127 (18%)	110 (17%)
USA & Canada	205 (29%)	202 (29%)	213 (33%)
Europe	277 (40%)	259 (37%)	224 (35%)
Others	112 (16%)	116 (16%)	95 (15%)
<i>Total</i>	700	704	642

Acceptances

Over the past year we accepted a total of 74 papers which if we compare with the 700 submissions received in the year gives a naïve measure of an acceptance rate of 10.4 per cent. Given the large increase in submissions we have experienced in recent years even though our acceptance rate declined we did find ourselves with a large stock of accepted papers to be published. This led to the prospect of 18 months between acceptance and publication but through publishing additional issues in each of the past years this lag has now declined to around 10 months.

Rankings

Citation rankings continue to play an ever prominent role in assessing journals. Given that the *EJ* performs reasonably well in these rankings we are not averse to this importance although we are also mindful of the pitfalls of focusing on any one particular measure.

For 2007 our impact factor (citations made in papers published in 2007 to *EJ* papers published in 2005 and 2006) fell from 1.629 to 1.548. The journal received 3 fewer cites than the past year but published 6 more articles and so saw its impact factor fall marginally. Such small fluctuations are well within standard error bands of transient shocks and the *EJ* has maintained broadly its ranking position and score over the past four years. However due to the clustering of journals around the same citation score, small changes in score can bring about sharp changes in relative position and this year we fell from 18th place to 24th place. Whilst the *EJ* saw a fall in our citation impact in terms of total citations (not just those in 2007) we saw a sharp increase — up from 3999 the previous year to 4504.

Citations can vary from year to year for many reasons and these fluctuations are probably not worth considerable scrutiny. For instance, theory papers tend to gather fewer cites than other papers and so the fact that we have published more theoretical papers recently might help explain some of the decline. Reviewing citations across journals two distinctive features of the *EJ* reveal themselves. The first is the large number of papers we publish – 97 in the year under focus whereas the *Journal of Political Economy* published 27, the *Quarterly Journal of Economics* 44, *Review of Economic Studies* 47 and only the *American Economic Review* publishing more – 184. Therefore in terms of total citations the *EJ* was 9th. The second distinguishing feature compared with journals with higher citations concerns the geographic distribution of authors published in the journal. Perhaps not surprisingly the *AER*, *JPE*, *QJE* have around 85-90 per cent of their publishing authors as being based in North America with around 5 per cent from each of the UK and Continental Europe. However even the *REStud* shows a strong North American bias with 70 per cent being US based, 17 per cent from Continental Europe and 8 per cent from the UK. By contrast the *EJ* has 45 per cent North American authors, 22 per cent European and 30 per cent UK.

Table 2: Subject Breakdown of Submissions July 2005 – June 2008

	1.7.07 - 30.6.08	1.7.06 - 30.6.07	1.7.05 - 30.6.06
General Economics and Teaching	18	9	13 (1)
Methodology/History of Thought	10	6	6
Maths & Quantitative Methods	57	66 (4)	97 (18)
Microeconomics	137 (1)	130 (5)	118 (22)
Macro & Monetary Economics	72	76 (1)	87 (6)
International Economics	73	70 (1)	65 (8)
Financial Economics	36 (1)	37 (1)	40 (3)
Public Economics	30	33 (2)	36 (2)
Health, Education & Welfare	40	45 (1)	24 (3)
Labour & Demographic Economics	88	92 (3)	56 (7)
Law & Economics	6	6	5 (2)
Industrial Organisation	27	23 (1)	33 (4)
Business Economics	8	6	1
Economic History	2	4	4
Economic Development	66	78 (3)	32 (3)
Economic Systems	4	5	5
Agricultural/Natural Resources	9	10 (1)	5
Urban, Rural & Regional Economics	9	5	8
Other Topics	8	3	7
<i>Total</i>	700 (2)	704 (23)	642 (79)

acceptances in parentheses

RES Prize and *EJ* Lecture

The RES prize for the best paper published in 2007 was awarded to Michele Piccione and Ariel Rubinstein for their paper ‘Equilibrium in the Jungle’. We are also pleased to announce the inaugural winner of the Austin Robinson Prize for the best paper published in the journal by an economist within 5 years of graduating with a doctorate. This prize was awarded to Andrew Sweeting of Duke University for his paper ‘Market power in the England and Wales Wholesale Electricity Market 1995-2000’.

The RES prize for 2008 will be announced soon and is to be decided by a committee of Professor Sir John Vickers, Professor Guy Laroque of University College, London and myself. The 2008 winner of the Austin Robinson Prize will also be announced soon – this prize is selected by the Editorial team of the journal.

The *EJ* lecture at the RES Annual conference was presented by Hyun Shin of Princeton University and was entitled ‘Securitisation and Financial Stability’.

Table 3: Response to authors

	1.7.07 - 30.6.08	1.7.06 - 30.6.07	1.7.05 - 30.6.06
Letters sent to authors inviting revision			
Within:			
1 month	7	0	0
2 months	1	0	1
3 months	4	0	4
4 months	5	4	13
5 months	10	2	15
6 months	6	4	13
7 months	8	3	11
8 months	4	4	0
Longer	41	43	34
<i>Total</i>	86	60	91
Letters sent to authors rejecting papers			
Within:			
1 month	364	286	231
2 months	23	33	20
3 months	69	44	52
4 months	71	50	50
5 months	52	68	64
6 months	30	51	35
7 months	11	32	23
8 months	11	29	14
Longer	75	50	79
<i>Total</i>	706	643	568

Conference volume

The conference volume is edited by myself and Steve Machin. The conference volume statistics are not reported in the Appendix but a total of 75 papers were submitted, 33 of which were summarily rejected without seeking referees’ advice. The remaining 42 all received at least one referee’s report (in most cases at least two) and a total of 14 revisions were accepted, including the invited talks of Professors Fehr and Shin.

The integration of the conference volume with the main volume is now complete. The two have the same editors and are edited to the same standard and so we have now dropped the separate pagination for the two. The timescales for submissions remain distinct — the conference volume has twelve months between submission and publication.

The year ahead

The past year has seen a number of tasks achieved (reducing theory backlog, further improving turnaround time, full integration of the conference volume, reducing the stock of accepted papers by publishing more issues) and also shows signs of stability in a number of other areas (number of submissions, distribution across field and geographic origin). After four years in charge the journal is operating very much in the manner we would hope. Looking forward we therefore have a number of aims. The first must be the one stated every year since the *Journal’s* inception — to further improve the quality of the journal and publish papers that are of interest to our readership.

The second is to try and be innovative in the way we encourage and deal with submissions. The publishing world is going through a number of changes and it is our intention to contribute to this. One initiative we are set to introduce is to allow submitting authors to include with their submission reports they may have received from previous journals. We hope in this way to help speed up submission procedures and utilise refereeing information more effectively. Economics is also going through a fertile intellectual period — the rise of behavioural economics, a focus on experimental work and greater connection with other social sciences including political science — and it is our intention to make sure that the *EJ* participates fully in these interesting debates.

Features

(from Stephen Machin)

This brief report summarises the current position of the ‘Features’ part of the *Economic Journal*. Details of the next two issues in February and June 2009 are given below.

In addition, we have a number of Features (7) and articles (5) currently in the refereeing process and have several book reviews taking place.

EJ Features: February 2009

Feature: In-Work Benefits in a Cross-National Perspective (TBC)

Introduction

Mike Brewer, Marco Francesconi, Paul Gregg and Jeffrey Grogger

The Effects of Work-Conditional Transfers on Marriage and Child Well-Being: A Review

Jeffrey Grogger and Lyn A Karoly

Welfare Reform and Lone Parents in the UK

Paul Gregg, Susan Harkness and Sarah Smith

The Effects of In-Work Benefit Reform in Britain on Couples: Theory and Evidence

Marco Francesconi, Helmut Rainer and Wilbert van der Klaauwe

Optimal Income Taxation of Lone Mothers: An Empirical Comparison of the UK and Germany

Richard Blundell, Mike Brewer, Peter Haan and Andrew Shephard

Articles

Economic Reasoning and Judicial Review

Justice Stephen Breyer

Introduction

John Vickers

Fear, Unemployment and Migration

David G Blanchflower and Chris Shadforth

The Rise and Fall of Asylum: What Happened and Why?

Timothy J Hatton

Book Review Feature

One Economics Many Recipes (Princeton University Press) by Dani Rodrik

James Robinson (Harvard University)

Robert Feenstra (University of California, Davis)

John Temple (Bristol University)

Table 4: Institutional Subscriptions at 30 September 2008

Region	2007	2008 (at 30 Sept.)
United Kingdom	165	163
Europe	615	572
USA	590	548
Canada	63	44
Aus/NZ	64	64
Japan	270	256
China	72	67
Rest of World	390	361
Total	2221	2075

EJ Features: June 2009 (provisional)

Feature: Meade Centenary Conference (TBC which papers in due course)

Dependent on how many papers in Meade Feature some or all of the following accepted papers will appear.

Data Feature: EU KLEMS Database

Output, Input and Productivity Measures at the Industry Level: The EU KLEMS Database

Mary O'Mahony and Marcel Timmer

Articles

Mobile Call Termination in the UK

Mark Armstrong and Julian Wright

Reaching for the Stars: Who Pays for Talent in Innovative Industries?

Frederik Andersson, Matthew Freedman, John Haltiwanger, Julia Lane and Kathryn Shaw

Book Review Feature

Identification for Prediction and Decision (Harvard University Press) by Charles F Manski

Anthony Lancaster (Brown University)

Oliver Linton (London School of Economics)

Note:

A full copy of the report, with all the statistical data, can be obtained from: royaleconsoc@st-and.ac.uk

In the light of recent events...

In the light of current events and the debate over 'keynesian' solutions to the present crisis readers might wish to note two newly reavailable publications. They are both available to RES members at the special prices shown. These represent a discount of approximately 25 per cent on the full price.

The first is a reprint of the paperback version of:

John Maynard Keynes, *The General Theory of Employment Interest and Money* (Palgrave Macmillan for the RES, £15) with an introduction by this year's winner of the Nobel Prize for Economics, Professor Paul Krugman.

The second is a reissue in paperback of:

Susan Howson and Donald Winch, *The Economic Advisory Council, 1930-1939; A Study in Economic Advice during Depression and Recovery* (Cambridge University Press, £30.50).

See also p 24 below.

The Econometrics Journal

— Editor's Report

The Managing Editor, Richard J Smith made the Annual Report, covering the period July 2007 to June 2008, to the Council of the Royal Economic Society in November. In a new departure, we are pleased to be able to include a summary of that report.

The Econometrics Journal was established in 1998 by the Royal Economic Society with the original intention of creating a high-quality refereed journal with a standard of intellectual rigour and academic standing similar to those of the pre-existing top international field journals for econometric research such as *Econometric Theory*, *Journal of Applied Econometrics*, *Journal of Business and Economic Statistics*, *Journal of Econometrics* and *Review of Economics and Statistics*. As a journal of the Royal Economic Society, *The Econometrics Journal* seeks to promote the general advancement and application of econometric methods and techniques to problems of relevance to modern economics.

Recent progress

Impact factor

The first data from the ISI Citation Index on *The Econometrics Journal* became available for 2007. The journal impact factor is 0.479 with the immediacy index at 0.034. The first of these data ranks *The Econometrics Journal* at 122 out of 191 economics journals. Overall these statistics are disappointing especially when viewed against competitor journals, e.g:

Econometric Theory 0.748 (84)
Journal of Econometrics 1.990 (13)
Review of Economics and Statistics 1.724 (17)
Journal of Applied Econometrics 1.094 (49)
Journal of Business and Economic Statistics 1.129 (46)

Royal Economic Society Annual Conference 2008

The Econometrics Journal organized a Special Session on Financial Econometrics at the RES Annual Conference 2008 at the University of Warwick. Papers were presented by Frank Diebold (University of Pennsylvania), Glenn Rudebusch (Federal Reserve Board), Enrique Sentana (CEMFI) and Neil Shephard (University of Oxford). It is expected that versions of these papers will appear in a Special Issue of *The Econometrics Journal*. Special Sessions associated with *The Econometrics Journal* will be arranged at subsequent RES Annual Conferences.

Special Issues

New Year 2008 marked the tenth anniversary of *The Econometrics Journal*. To celebrate this event a Special Issue is being commissioned by inviting contributions from a number of senior scholars in econometrics in all areas. A number of papers have already been accepted and will appear shortly on *The Econometrics Journal* website. It is anticipated that the Tenth Anniversary Special Issue will appear towards the end of 2008 or at the beginning of 2009.

Book and Software Reviews

Various publishers have been contacted concerning the possibility of reviews of econometrics texts and monographs appearing in *The Econometrics Journal*. The Books Reviews Editor will commission occasional reviews commencing 2009. It is anticipated that the Software Reviews Editor will commission a review of a leading econometric software package in the near future. The Software Reviews Editor is in contact with the publishers with the intention of archiving data associated with applications published in *The Econometrics Journal*.

Table 1: Geographical distribution of submissions

	<i>Submissions</i>	<i>Resubmissions</i>
UK	20	0
USA and Canada	40	2
Europe	39	5
Rest of the world	40	0
	139	7

Publicity and Marketing

In addition to displays at major conferences Wiley-Blackwells organised events at the Joint ASSA Meetings, New Orleans, January 2008, and the Econometric Society European Meetings, Milan, August 2008. As the geographical distribution of submissions emphasises it remains the case that *The Econometrics Journal* continues to have relatively little impact in North America

which is the crucial constituency for improving the standing of the journal. The ISI Citation Index impact indices reinforce this observation. Although the Editorial Board can undertake various initiatives to attempt to ameliorate the situation it is difficult to do so if the econometrics community remains unaware of these developments.

Publishers

The Editorial Office again met with Michael Brown, Senior Commissioning Editor Business, Finance and Economics, and Phillipa Sumner, Associate Marketing Director Social Sciences and Humanities, of Wiley Blackwells to review progress and to discuss marketing and other issues connected with *The Econometrics Journal*. To highlight the Tenth Anniversary of *The Econometrics Journal* a virtual issue of the journal was published on-line with selected highlights published in the first ten volumes.

rately presented. These data have now been deleted from Editorial Express®.

Statistics

Submissions

A total of 139 new submissions were received under Editorial Express®. This total represents a very modest increase of 5 (3.7 per cent) over that reported in 2007. Additionally there were 7 resubmissions received during this period.

Decisions

A total of 119 decisions were made by the Editorial Board appointed in 2007. Of these 58 (48.73 per cent) were screen-rejections. Of the 61 papers not screen rejected, 30 (49.18 per cent) were either return for resubmission or acceptance decisions, the remainder being rejections.

Overall, 88 papers or 74.78 per cent of decisions were either screen-rejections or rejections. A total of 2 papers were accepted by the current Editorial Board. The high number of screen-rejections reflects the determination of the Editorial Board to drive up the standard of submissions and accepted papers in order to establish *The Econometrics Journal* as top international general field journal for econometric research. The previous Editorial Board rejected 5, returned for revision 16 and accepted 31 papers.

Table 2: Time to decisions, 1st July 2007 - 30th June 2008

Days	All decisions	Screen rejections	Non-screen rejections	Non-rejections
30	58	55	3	0
60	6	3	3	3
90	11	0	11	5
120	28	0	28	14
150	8	0	8	4
180	3	0	3	2
210	3	0	3	1
240	2	0	2	1

Waiting time since submission	All decisions survivor function	Non-screen rejections survivor function	Non rejections survivor function	Rejections survivor function	All resubmissions survivor function
30 or less	0.51	0.95	1.0	0.93	0.75
60 or less	0.46	0.9	0.9	0.93	0.25
90 or less	0.37	0.72	0.73	0.73	0.0
120 or less	0.13	0.26	0.27	0.27	0.0
150 or less	0.07	0.13	0.13	0.13	0.0
180 or less	0.04	0.08	0.7	0.10	0.0
210 or less	0.02	0.03	0.3	0.03	0.0
240 or less	0.0	0.0	1.0	0.0	0.0

Editorial process

Further adaptations of Editorial Express® to the purposes of *The Econometrics Journal* were necessary and again occasioned some effort on the part of the Editorial Office. It had been our intention to fully incorporate the data on submissions associated with the previous Editorial Board into Editorial Express®. However, this proved impossible under the current arrangements as the inclusion of these data prevented reports for the current period being accu-

Decision durations

The mean estimate for time to decision in days was 48 (40, 16, 105) for all decisions with 92 (105, 87, 124) for non-screen rejections, 94 (105, 87, 131) for non-rejections and 30 days for resubmissions. The figures in parentheses are the median, first quartile and third quartile estimates. Kaplan-Meier estimates of the stratified survivor functions for time to decision are also presented. These data indicate an improvement in decision performance over 2007 and 2006 previously which can be primarily attributed to a more intensive screening of submissions.

Letter from France 2009

Les Universités Françaises

In his own look at the financial crisis Alan Kirman paints a rather unflattering picture of orthodox macroeconomics in France and calls for some of the humility that Andrew Oswald asks for (below, p 13) before reporting on the latest attempts to reform the funding of research.

La crise

I thought when I had to write this piece that the subject was evident. Last year, I mentioned the fact that France was far from immune to the subprime phenomenon and that things were not looking good. I have to confess also that I sold the few shares that I had in August 2007 when the CAC 40 was at 6200 and that today it is at 3100. Until I sat down to write this piece I was convinced that I was going to write about how French macro-economists had, in the light of the developing crisis started to seriously rethink their models. I was under the illusion that they might move to the sort of position that I sympathise with and would suggest that the economy should be viewed as a complex adaptive system. In particular, the central feature of such systems is that the aggregate does not simply mirror the average behaviour of the agents who make up the system and who interact directly with each other. In these systems phase transitions and the associated 'crises' are intrinsic and not to be treated as something due to external shocks. Such a view would lead us to have a very different position concerning regulation. The latter is not there to try to force the behaviour of the system back to the path that might have been predicted by our macro-economic models but rather to mediate the consequences of the more subtle feed-backs inherent in the system. What we have to be concerned with is out of equilibrium dynamics and the behaviour of systems in which interaction is the central feature and not something which we can 'incorporate' into our existing models as an extra bell or whistle. David Hendry is someone who has long and outspokenly made arguments of this sort for econometric modelling and I hoped that I might see a shift in his direction on the French scene.

Pas du tout! What we have observed here is a systematic abandoning of both theoretical reasoning and ideology and a move towards purely pragmatic reasoning. As one economist in Paris said, you should not worry about the design of the boat when it is sinking, although he was referring to the financial system rather than the economy! The other thing that we hear constantly is 'exceptional measures for exceptional circumstances'. What exceptional means in this context is an interesting question, though one interpretation is that it means something that would not occur in our models.

My sad conclusion is that French macroeconomists have happily taken up the role that Bob Solow has described as that of a plumber, somebody who knows little about how

it works but knows, or believes he knows, how to fix it! There seems to be no sense of shame that the forecasts made a year ago should turn out to be so utterly wrong. This is, in part, because people pay little heed to what macroeconomists say and thus forget very rapidly what was said. There are, however, a number of journalists who do not let the economists off so lightly. A recent article in the *Canard Enchaîné*, cited in detail the statements made by a prominent macro-economist who not only teaches in a major French institution but is also the chief economist of a large bank. As the article points out, the economist in question, published a piece in the house journal of his bank in March 2007 entitled, 'financial markets are capable of believing anything'. His list of these foolish beliefs was :

- There will be a liquidity shortage
- The Chinese economy will experience a significant reduction in its growth rate
- There may be a recession in the US
- Firms' profits will decline
- The subprime crisis will trigger off a crisis in the banking and finance sector in the US

He dismissed these fears with a wave of the hand, asserting that 'all these assertions are totally unfounded, the credulity and the absence of sang froid on the part of financial markets are remarkable.' The *Canard* goes on, unkindly, to note that in the period since his piece was published the shares of the bank that employs this economist have fallen by 85 per cent and that, nevertheless, he is still a member of the French President's economic advisory council! What is more he still gives firm and uncompromising advice on how the government should act. As somebody said, economics is one of the few disciplines where intimidation is an accepted way of convincing one's audience. An appeal to mathematical sophistication and a certain arrogance seem to be thought of as an adequate way to conceal the conceptual inadequacy of the underlying models, though to be fair the economist in question is not much in the habit of referring to models. So, on the subject of heart-searching by French macro-economists, I have little to say, economic models and the economy pursue their independent ways here. The only glimmer of hope is that there is an evident public dissatisfaction with the macroeconomists whom they have to put up daily on the television and the radio and these authorities have recently been referred to as 'guignols', clowns, a reference to a popular satirical television puppet show which mocks the mighty ferociously.

I had the privilege of taking part in a round-table organised by the Association Française de Sciences Economiques recently, on how to improve the teaching of economics in France and the discussion was essentially of an ideological nature, with the defenders of the thought of various illustrious predecessors trying to defend their point of view. There was also some discussion of previous crises and, in particular of the Great Depression and how we got out of it. One line of argument advanced was that we have experienced this sort of turmoil in the past and we shall undoubtedly come out of this crisis with all flags flying. My simplistic conclusions were that it is useful for students to study both the history of thought and economic history although this is far from a fashionable view. Secondly, they have to have a good training in, what is often referred to here, as mainstream economics, since otherwise they will have no idea what economists are saying or why. Max Planck once said, 'physics is not about discovering the laws that govern the universe, it is what physicists do'. The same thing could be said about economics. However, my last point was that we might want to indulge in some thinking about how to develop models in which crises are endemic. It is not enough to say that we have seen all this before without saying why. French academic audiences are quite polite but it is not at all clear that they were convinced by this.

In any event, it is not obvious that any progress on the theoretical front is likely in France in the near future. Just to give one example, there was no research project on the crisis submitted, in response to a very recent call for proposals on any subject in economics, put out by the Agence Nationale de Recherche. The closing date was in November so, by then, many potential candidates must have had a good idea of what was happening.

Les Universités Françaises

Given all this, I will turn to one of my favourite themes that of the French University system. As I have mentioned already, one of the aims of Sarkozy's presidency was to make the system function better. Two things have happened this year, in an effort to make a movement in that direction for both the university and research systems. Firstly there has been a 'reform' of the university system, which grants autonomy, or rather more autonomy to the universities. Secondly the French Science Foundation, (the CNRS) is in the process of being overhauled and possibly quietly dismantled. What I will try to do in rest of this year's letter is to explain why the system desperately needs reform, what has motivated the reforms that are being proposed and how much progress has been made.

The French University system is based on two fundamental principles. Firstly, anyone who has a baccalaureat can get a place at the university of his choice, and secondly all universities are the same. Before going any further I should make two obvious comments. The fact that one can choose where to go but without any accompanying aid, unless you are extremely poorly off, means that only

the better off move to universities far from home. Why should they want to do this since all universities are equal? Obviously because they are not. La Sorbonne, even though it has fallen on hard times, is not the equivalent of the Université de Clochemerle. Thus, at the risk of boring the reader who read last year's letter, I have to repeat that the whole system is hypocritical.

A timid move to improve things was the university reform embodied in a law promulgated last year. This put a great deal of power in the hands of university presidents who now choose the committees that will decide on the attribution of posts and give the universities a certain degree of financial autonomy. The problem here is that there is little or no guarantee that the university presidents will be other than local barons ruling their fiefdom and handing out presents to the faithful. An ex-president of my own university is now in Africa where he fled after having been sentenced to jail for 'détournement de fonds' and other criminal offences. This does not reinforce my confidence in the idea that universities will move in the right direction by reinforcing the powers of university presidents.

The first move has to be to differentiate universities. Students have different needs and desires and universities have to be able to choose which of those they want to cater to and to choose the appropriate students. On the other hand students should be able to choose which establishment suits their needs. The idea that what is needed is an adequate matching mechanism seems to be too obvious to need further explanation. One can have a long debate about whether a kind of open market is appropriate or some central clearing mechanism such as the UK's UCCA would be better. In any event nothing could be much worse than the current system in France, where the selection is done by failing the majority of students in the first year.

To quote the statistics for 2007 from the OECD, of 100 students who enter the university, 21 end up with no diploma of any sort and 15 turn towards some more technical form of training. This is a very poor way of selecting, it is costly, unsatisfactory for those who teach and humiliating for many students who see their initial university experience as a disaster. It is interesting to note that France spends less on each university student than most OECD countries but more on each university degree awarded

Differentiating universities would certainly make sense in making real choices available to students. It would also enable one to dispense with the notion that institutions that focus on teaching rather than research are necessarily inferior. It is worth bearing in mind that among the most expensive establishments in the US are the liberal arts colleges where research is not a priority. Suppose that one did create an academic landscape with very different institutions. Perhaps, one could think of the Californian system as a reasonable model. The immediate objection in France would be that it would not be possible for stu-

dents who reveal their talent late to transfer to a more demanding establishment. In the French context, the transfer to the Grandes Ecoles from the university is virtually impossible and nobody objects to this. Secondly, in the Californian system, for example, there are real possibilities for such transfers. Just to give one example, in 2006 Berkeley accepted nearly 2000 students who transferred from other universities which suggest that inter-university mobility is possible and that the doors to the best research oriented universities do not need to remain closed.

Once the distinction between universities is accepted and research funds flow to those who focus on that activity, there would be a way open to solve the two major problems with the French higher education system. The Grandes Ecoles could be integrated into the university system and the CNRS could play a more meaningful role.

The CNRS

Let me then, to conclude, come to the CNRS. As it is, it recruits young researchers at the assistant professor level, immediately after completing their PhD and gives them a research job for life. It is clear that this practice will lead and has led to employing some people who do no research at all. Thus, there seems to be a good argument for moving these people into other employment. But where should they go? The obvious answer is into the university or IUTs where they could devote their energy to good teaching, (since they currently have tenured jobs it would be hard to dispense with them, though it has to be admitted that they may not make good teachers either). Currently, a major change is being made, half of the posts now opened by the CNRS will be jobs for 5 years with one third of the normal teaching load but with no guarantee of remaining in such a position. This is clearly a shift towards removing the permanent researchers and one finds it hard to quarrel with this.

What are the arguments that have been given against this start of a move towards the dismantling of the CNRS in its current form? The first is that the only place where good research is done is in the research groups recognised and funded by the CNRS. This assertion does not justify the existence of the CNRS as a body with full-time research employees. Of the top 20 economists with French affiliations in the REPEC rankings, (as questionable as any other) only one is a full time CNRS researcher, (English by the way). The others have many different French style jobs such as Ingénieur des Pont et Chaussées, and there are actually more university professors than CNRS researchers.

The second argument is that these CNRS funded research groups are the only guarantee of quality in the system. But what a perverse way to obtain this result! One has research groups recognised as being of a good level, hidden in universities all of which are supposed to be identical. Much better to allow universities to be differentiated and to give funds to good research departments. This

would solve another problem. The French complain bitterly that they are unfairly treated by the Shanghai rankings since the points for each article are divided between their research group and the university with which the group is associated. Getting rid of the CNRS in its current form and integrating the research groups into the universities would solve that problem at one stroke. In the current situation why should someone who works full time for the CNRS and belongs to a research group affiliated with a university have all his research attributed to that university? Again if he was temporarily given a research job by the CNRS this would be reasonable, since his real employer would be his university. Once again the transformation of the CNRS from large scale employer to fund giving agency as is the case in most other countries, seems to be eminently reasonable. This transformation is gradually taking place, large amounts of research money are now given out by the ANR, the agence nationale pour la recherche, for specific projects and this money is replacing that which was previously given by the CNRS to research groups.

Another result of the reform would be to increase the number of university posts as the CNRS was merged and the government may be tempted, and indeed is being tempted to do just this. The new temporary research positions are financed by taking posts from the universities. This would result in an overall decrease in the number of higher education jobs since the number of full time CNRS posts is dwindling, which would be in contradiction to the government's claims about what it wants to do.

The last argument against dismantling the CNRS is that the universities are simply incapable of acting as research oriented institutions. The answer to that is obvious, Engage in a real reform of the universities.

The current position is that the CNRS is being reorganised into National Research Institutes in the major research areas. Computer science will disappear into an existing institution the INRIA and the life sciences will, at least in part, merge with the INSERM the national medical research organisation. The fate of the Science de l'Homme et de la Société is unclear, it seems that to keep the researchers quiet there may be some sort of second level institute but, if the universities were to be reformed, it would make no sense to maintain the CNRS as it is.

The government has, it has to be said, moved towards a reorganisation of the research system, though it has done so in a rather devious way. It negotiates with the parties concerned while pushing through its measures anyway. But this is the way the Sarkozy government acts and it is so active on all fronts that the opposition to any change never has time to organise itself. The argument is simple, 'we were elected to reform and that's what we are going to do!' Unfortunately, the resultant programme is not as well thought out as it might be and we have a piecemeal result depending on where is the line of least resistance rather than where is the best outcome. Still, at least we cannot say, 'plus ça change, plus c'est la même chose.'

On economic models

As we reported many years ago in our one hundredth issue (January 1998), the current format of the Newsletter owes a great deal to Sir Austin Robinson who, in 1989, suggested that it should provide a space for RES members to comment on issues raised in The Economic Journal's Policy Forum section. In fact, this has very rarely happened, although the facility remains available. This comment by George Walendowski at Los Angeles City College is an exception.

In reviewing some of the articles in the November 2008 issue of *The Economic Journal*, I thought it would be appropriate to make some observations and comments. Specifically, there are two major issues of concern associated with relying too heavily on economic (mathematical) models. The first issue is that these models base their conclusions on limited assumptions which, in turn, create two problems: (1) general conclusions cannot logically be made from limited premises; and (2) only a narrow, rather than a broad, conclusion can be reached which may be of little practical value.

The second issue associated with relying too heavily on economic models concerns the human factor. Mathematical models cannot quantify human emotions which we know are involved in making economic decisions.

I have taken four examples from the November 2008 issue of *The Economic Journal* to illustrate my point. In the first example, Brunello and Rocco make the following three assumptions in their model of educational standards:

- 1 'Attaining the standard requires that students spend individual effort...The individual cost of effort depends on innate ability' (p. 1869).
2. '...each household in this economy consists of a mother and a daughter' (p.1870).
3. 'We exclude liquidity constraints by assuming that each household can freely borrow against the future income of the daughter...' (p. 1870).

The problem with the first assumption is that ability alone will not necessarily achieve the required educational standards, but both ability and motivation are prerequisites. In addition, households consist of more than just a mother and a daughter. Also, there is no such thing as unlimited liquidity.

In the second example, Mitchener and Weidenmier in reference to the gravity model state that 'The model thus predicts that, all else equal, larger economies ought to trade more than smaller economies and those that are located closer to each other will also experience greater trade' (p. 1808). The problem is that in the real world 'all other things (conditions)' are not equal.

In the third example, Hordahl, Tristani and Vestin point out that 'The model we employ can be seen as a simplified ver-

sion of that proposed in Christiano...The firms are monopolistic competitors and only use labour for production' (p. 1940). Obviously, the model does not reflect real-world conditions due to its reliance on simplified assumptions.

In the final example, Caggese and Cunat state: 'Previous literature has mainly focused on the effect of financing constraints on fixed capital investment. We focus instead on the employment decision of firms' (p. 2042). Once again, we see a model making a limited assumption. The economic world simply just does not work this way.

The true objective of economics is its application to real-world conditions. Yet, the mathematical models used overemphasize sophistication and minimize assumptions—the two extremes do not offset one another. I believe Klemperer (p. 2) makes a valid argument when he states: 'Some academics also need to widen the scope of their analyses beyond the confines of their models which, while elegant, are often short on real-world detail. Marshall always emphasised the importance of a deep "historical knowledge of any area being investigated" and referred again and again to the complexity of economic problems and the naivety of simple hypotheses' (the quote within the quote is taken from Sills p. 28). Klemperer (p. 25) further states that '...the main lesson of this paper is that the blinkered use of economic theory can be dangerous...remember that the most sophisticated theory may not be the most relevant.' This sound advice needs to be more readily accepted by academicians and economic theorists.

In summary, my main point is that no economic model, regardless of the amount of mathematical sophistication employed, can quantify all the necessary conditions required to make proper economic decisions. In other words, the examples I have used indicate that different models making different assumptions result in different conclusions. Therefore, which model is the correct one? The question then is: 'What conclusion(s) would be drawn from a single economic model applying the different assumptions simultaneously?' The answer is that probably the conclusion reached would be different than the ones reached in the different economic models due to the interactions of the combined assumptions. Economic conditions (assumptions) are not mutually exclusive. I believe the more realistic approach to viewing the economic environment is through the study (analysis) of history which is too often ignored.

The Helpman Report

In the July issue of the Newsletter, we reported on the visit to the Society's Annual Conference of an international team of economists led by Professor Elhanan Helpman of Harvard University¹ as part of their preparation of an International Benchmarking Review of UK Economics.² Their Report was published in November 2008 and its main findings are summarised below.

The main finding of the Helpman Report is that economics research in the UK is exceptional by international standards, second only to the United States, and thriving. Moreover, UK economics research has high policy impact, based on top-quality applied work and strong relationships between the academic and policy communities.

'First and foremost, the research achievements of UK scholars are exceptional by world standards; the UK economics profession is more prominent than any other country's except for the United States. UK scholarship has been very influential in a number of important fields, such as labour economics, public economics, and economic development, and it has attained world leadership in microeconometrics.

'While maintaining strength in the areas that are doing well is important, it is also important to strengthen a number of fields that are doing less well. The Panel feels that macroeconomics requires particular attention, because it is a core subject of the discipline and it is lacking in a number of dimensions in the UK. Although microeconomic theory is doing better than macroeconomics, it too needs improvement in order to fulfil its mission as a core subject.

'Improvements of fields cannot be achieved by earmarked research funds alone; the remedy has to involve the recruitment of high-quality scholars. For this reason research funds should be tied to recruitment.

'Curiosity-driven research, theoretical and empirical, should not be discouraged by the format of submissions of research proposals, such as the requirement of references from final users of research output. The ESRC needs to make a bigger effort to inform researchers that such references are not mandatory and should be provided only when appropriate.

'The panel supports the move to a 2+2 format of post-graduation education. In addition, we recommend developing a support system that will provide talented PhD students with financial security during the entire period of their studies.

'The training of PhD students can be enhanced by co-operative networks of economic departments, and countrywide specialised PhD courses offered in the spring or summer.

'Economic research in the UK is very influential outside academia and has a large impact on policy. This is a major achievement that results from the high-quality of applied work and the healthy relationships between researchers and policymakers.'

The review process was managed by a Steering Group composed of senior academics, funders and research users under the chairmanship of Professor Sir John Vickers (University of Oxford and President of the Royal Economic Society). Speaking for the Steering Group, Sir John responded that, 'The Steering Group warmly welcomes this thorough and rigorous assessment of the state of economics in the UK, and is delighted with the panel's positive endorsement of the strength of the discipline...All of the report's recommendations will be considered fully,

“ First and foremost, the research achievements of UK scholars are exceptional by world standards; the UK economics profession is more prominent than any other country's except for the United States. ”

and where areas of relative weakness have been identified the organisations involved will work together to address them. We hope that the report will be debated by all those with an interest in the development of economics in the UK, and that it will provide a focus for extending the enormous contribution described by the international panel.'

Notes:

1. Other members of the panel were Professors Manuel Arellano, CEMFI, Spain; Andreu Mas-Colell, Universitat Pompeu Fabra, Spain; Hyun Shin Princeton University; Guido Tabellini, IGIER, Università Bocconi, Italy; Philippe Weil ECARES, Université Libre de Bruxelles, Belgium.

2. The ESRC and the RES, in consultation with the Conference of Heads of University Departments of Economics (CHUDE), had agreed in 2007 to work in partnership to benchmark the quality and impact of research in the UK against international standards. This is the third in a series of ESRC sponsored assessments that is covering major social science disciplines in the UK.

Krugman on Keynes

In 2007 the Royal Economic Society (in conjunction with Palgrave Macmillan) published a new edition of J M Keynes, The General Theory of Employment, Interest and Money,¹ with a new introduction by this year's winner of the Nobel Prize for Economics,² Paul Krugman. In that introduction, Krugman argued that while some aspects of the The General Theory are better understood against the peculiar circumstances of the 1930's, the fundamental ideas are widely accepted — 'we are all Keynesians now'. Since that introduction was written, there have been dramatic changes in the world economy which make The General Theory even more relevant. To mark Krugman's honour we are printing a shortened version of his essay.

The message of Keynes

It is probably safe to assume that the 'conservative scholars and policy leaders' who pronounced *The General Theory* one of the most dangerous books of the past two centuries have not read it. But they are sure it is a leftist tract, a call for big government and high taxes. That is what people on the right, and some on the left, too, have said about *The General Theory* from the beginning.

But Keynes was no socialist — he came to save capitalism, not to bury it. And there's a sense in which *The General Theory* was, given the time it was written, a conservative book.... Keynes wrote during a time of mass unemployment, of waste and suffering on an incredible scale. A reasonable man might well have concluded that capitalism had failed, and that only huge institutional changes — perhaps the nationalization of the means of production — could restore economic sanity. Many reasonable people did, in fact, reach that conclusion: large numbers of British and American intellectuals who had no particular antipathy toward markets and private property became socialists during the depression years simply because they saw no other way to remedy capitalism's colossal failures.

Yet Keynes argued that these failures had surprisingly narrow, technical causes. 'We have magneto [alternator] trouble' he wrote in 1930, as the world was plunging into depression. And because he saw the causes of mass unemployment as narrow and technical, he argued that the problem's solution could also be narrow and technical: the system needed a new alternator; there was no need to replace the whole car....

Stripped down, the conclusions of *The General Theory* might be expressed as four bullet points:

- Economies can and often do suffer from an overall lack of demand, which leads to involuntary unemployment
- The economy's automatic tendency to correct shortfalls in demand, if it exists at all, operates slowly and painfully
- Government policies to increase demand, by contrast, can reduce unemployment quickly

- Sometimes increasing the money supply won't be enough to persuade the private sector to spend more, and government spending must step into the breach.

To a modern practitioner of economic policy, none of this — except, possibly, the last point — sounds startling or even especially controversial. But these ideas were not just radical when Keynes proposed them; they were very nearly unthinkable. And the great achievement of *The General Theory* was precisely to make them thinkable.

How Keynes did it

....Keynes's struggle with classical economics was much more difficult than we can easily imagine today. Modern macroeconomics textbooks usually contain a discussion of something they call the 'classical model' of the price level. But that model offers far too flattering a picture of the classical economics Keynes had to escape from. What we call the classical model today is really a post-Keynesian attempt to rationalize pre-Keynesian views.

Change one assumption in our so-called classical model, that of perfect wage flexibility, and it turns back into *The General Theory*. If that had been all Keynes had to contend with, *The General Theory* would have been an easy book to write.

The real classical model, as Keynes described it, was something much harder to fix. It was, essentially, a model of a barter economy, in which money and nominal prices do not matter, with a monetary theory of the price level appended in a non-essential way, like a veneer on a tabletop. It was a model in which Say's Law applied: supply automatically creates its own demand, because income must be spent. And it was a model in which the interest rate was purely a matter of the supply and demand for funds, with no possible role for money or monetary policy. It was a model in which ideas we now take for granted were literally unthinkable.

If the classical economics Keynes confronted had been what we call the classical model nowadays, he would not have had to write Book V of *The General Theory*, 'Money-wages and prices'. In that book Keynes confronts naïve beliefs about how a fall in wages can increase

[Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel, 2008](#)

To Paul Krugman

...for his analysis of trade patterns and location of economic activity.

employment, beliefs that were prevalent among economists when he wrote, but play no role in the model we now call ‘classical’.

So the crucial innovation in *The General Theory* is not, as a modern macroeconomist tends to think, the idea that nominal wages are sticky. It is the demolition of Say’s Law and the classical theory of the interest rate in Book IV, ‘The inducement to invest’. One measure of how hard it was for Keynes to divest himself of Say’s Law is that to this day some people deny what Keynes realized — that the ‘law’ is, at best, a useless tautology when individuals have the option of accumulating money rather than purchasing real goods and services. Another measure of Keynes’s achievement may be hard to appreciate unless you’ve taught introductory macroeconomics: how do you explain to students how the central bank can reduce the interest rate by increasing the money supply, even though the interest rate is the price at which the supply of loans is equal to the demand? It is not easy to explain even when you know the answer; think how much harder it was for Keynes to arrive at the right answer in the first place.

Mr Keynes and the moderns

There is a widespread impression among modern macroeconomists that we have left Keynes behind, for better or for worse. But that impression, is based either on a misreading or a non-reading of *The General Theory*. Let us start with the non-readers, a group that included me during the several decades that passed between my first and second readings of *The General Theory*.

If you do not read Keynes himself, but only read his work as refracted through various interpreters, it is easy to imagine that *The General Theory* is much cruder than it is. Even professional economists, who know that Keynes was not a raving socialist, tend to think that *The General Theory* is largely a manifesto proclaiming the need for deficit spending, and that it belittles monetary policy. If that were really true, *The General Theory* would be a very dated book. These days economic stabilization is mainly left to technocrats in central banks, who move interest rates up and down through their control of the money supply; the use of public works spending to prop up employment is generally considered unnecessary. To put it crudely, if you imagine that Keynes was dismissive of monetary policy, it is easy to imagine that Milton Friedman in some sense refuted or superseded Keynes by showing that money matters.

The impression that *The General Theory* failed to give monetary policy its due may have been reinforced by John Hicks, whose 1937 review essay ‘Mr Keynes and the classics’ is probably more read by economists these days than *The General Theory* itself. In that essay Hicks interpreted *The General Theory* in terms of two curves, the *IS* curve, which can be shifted by changes in taxes and spending, and the *LM* curve, which can be shifted by changes in the money supply. And Hicks seemed to imply that Keynesian economics applies only when the *LM*

curve is flat, so that changes in the money supply do not affect interest rates, while classical macroeconomics applies when the *LM* curve is upward-sloping.

But in this implication Hicks was both excessively kind to the classics and unfair to Keynes. I have already pointed out that the macroeconomic doctrine from which Keynes had to escape was much cruder and more confused than the doctrine we now call the ‘classical model’. Let me add that *The General Theory* does not dismiss or ignore monetary policy. Keynes discusses at some length how changes in the quantity of money can affect the rate of interest, and through the rate of interest affect aggregate demand. In fact, the modern theory of how monetary policy works is essentially that laid out in *The General Theory*.³

Yet it is fair to say that *The General Theory* is pervaded by skepticism about whether merely adding to the money supply is enough to restore full employment. This was not because Keynes was ignorant of the potential role of monetary policy. Rather, it was an empirical judgment on his part: *The General Theory* was written in an economy with interest rates already so low that there was little an increase in the money supply could do to push them lower.

Many of today’s most prominent macroeconomists came of intellectual age during the 1970s and 1980s, when interest rates were consistently above 5 per cent and sometimes in double digits. Under those conditions there was no reason to doubt the effectiveness of monetary policy, no reason to worry that the central bank could fail in efforts to drive down interest rates and thereby increase demand. But *The General Theory* was written in a very different monetary environment, one in which interest rates stayed close to zero for an extended period.

Modern macroeconomists do not have to theorize about what happens to monetary policy in such an environment, or even plumb the depths of economic history, because we have a striking recent example to contemplate. There are hopes as I write this that the Japanese economy may finally be staging a sustained recovery, but from the early 1990s at least through 2004 Japan was in much the same monetary state that the US and UK economies were in during the 1930s. Short-term interest rates were close to zero, long-term rates were at historical lows, yet private investment spending remained insufficient to bring the economy out of deflation. In that environment, monetary policy was just as ineffective as Keynes described. Attempts by the Bank of Japan to increase the money supply simply added to already ample bank reserves and public holdings of cash while doing nothing to stimulate the economy. (A Japanese joke from the late 90s said that safes were the only product consumers were buying.) And when the Bank of Japan found itself impotent, the government of Japan turned to large public works projects to prop up demand.

Keynes made it clear that his skepticism about the effectiveness of monetary policy was a contingent proposition, not a statement of a general principle. In the past, he believed, things had been otherwise. ‘There is evidence

that for a period of almost one hundred and fifty years the long-run typical rate of interest in the leading financial centres was about 5 percent, and the gilt-edged rate between 3 and 3 ½ percent; and that these rates were modest enough to encourage a rate of investment consistent with an average of employment which was not intolerably low.’ [307-308] In that environment, he believed, ‘a tolerable level of unemployment could be attained on the average of one or two or three decades merely by assuring an adequate supply of money in terms of wage-units.’ [309] In other words, monetary policy had worked in the past — but not now.

Now it is true that Keynes believed, wrongly, that the conditions of the 1930s would persist indefinitely — indeed, that the marginal efficiency of capital was falling to the point that the euthanasia of rentiers was in view. I will mention why he was wrong in a moment.

Before I get there, however, let me consider an alternative view. This view agrees with those who say that modern macroeconomics owes little to Keynes. But rather than arguing that we have superseded Keynes, this view says that we have misunderstood him. That is, some economists insist that we’ve lost the true Keynesian path — that modern macroeconomic theory, which reduces Keynes to a static equilibrium model, and tries to base as much of that model as possible on rational choice, is a betrayal of Keynesian thinking.

Is this right? On the issue of rational choice, it’s true that compared with any modern exposition of macroeconomics, *The General Theory* contains very little discussion of maximization and a lot of behavioural hypothesizing. Keynes’s emphasis on the non-rational roots of economic behaviour is most quotable when he writes of financial market speculation, ‘where we devote our intelligences to anticipating what average opinion expects average opinion to be.’ [156] But it is most notable, from a modern perspective, in his discussion of the consumption function. Attempts to model consumption behaviour in terms of rational choice were one of the main themes of macroeconomics after Keynes. But Keynes’s consumption function, as laid out in Book III, is grounded in psychological observation rather than intertemporal optimization.

This raises two questions. First, was Keynes right to eschew maximizing theory? Second, did his successors betray his legacy by bringing maximization back in?

The answer to the first question is: it depends. Keynes was surely right that there is a strong non-rational element in economic behaviour. The rise of behavioural economics and behavioural finance is a belated recognition by the profession of this fact. On the other hand, some of Keynes’s attempted generalizations about behaviour now seem excessively facile and misleading in important ways. In particular, he argued on psychological grounds that the average savings rate would rise with per capita income (see p. 97.) That has turned out to be not the case at all.

But the answer to the second question, I would argue, is clearly ‘no’. Yes, Keynes was a shrewd observer of economic irrationality, a behavioural economist before his time, who had a lot to say about economic dynamics. Yes, *The General Theory* is full of witty passages about investing as a game of musical chairs, about animal spirits, and so on. But *The General Theory* is not primarily a book about the unpredictability and irrationality of economic actors. Keynes emphasizes the relative stability of the relationship between income and consumer spending; trying to ground that stability in rational choice may be wrong-headed, but it does not undermine his intent. And while Keynes didn’t think much of the rationality of business behaviour, one of the key strategic decisions he made, as I have already suggested, was to push the whole question of why investment rises and falls into the background.

What about equilibrium? Let me offer some fighting words: to interpret Keynes in terms of static equilibrium models is no betrayal, because what Keynes mainly produced was indeed a static equilibrium model. The essential story laid out in *The General Theory* is that liquidity preference determines the rate of interest; given the rate of interest, the marginal efficiency of capital determines the rate of investment; and employment is determined by the point at which the value of output is equal to the sum of investment and consumer spending. ‘[G]iven the propensity to consume and the rate of new investment, there will be only one level of employment consistent with equilibrium.’ [28]

Let me address one issue in particular: did Paul Samuelson, whose 1948 textbook introduced the famous 45-degree diagram to explain the multiplier, misrepresent what Keynes was all about? There are commentators who insist passionately that Samuelson defiled the master’s thought. Yet it is hard to see any significant difference between Samuelson’s formulation and Keynes’s own equation for equilibrium employment, right there in Chapter 3: $\phi(N) - \chi(N)$ [29]. Represented graphically, Keynes’s version looks a lot like Samuelson’s diagram; quantities are measured in wage units rather than constant dollars, and the nifty 45-degree feature is absent, but the logic is exactly the same.

The bottom line, then, is that we really are all Keynesians now. A very large part of what modern macroeconomists do derives directly from *The General Theory*; the framework Keynes introduced holds up very well to this day.

Editor’s Notes:

1. Strictly speaking, the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel
2. The book is available to members at a discount. See p 24 below.
3. See, for example, the diagram in *Bank of England Quarterly Bulletin*, May 1999 p. 163. The ECB publishes a diagram which is virtually identical but interestingly, in the light of recent events, it begins with the need for the central bank to be able to influence market rates. See *The Monetary Policy of the ECB, 2004* (Frankfurt: ECB) p.43.

Obituaries

Michael Peter Ward

Michael Ward, one of the world's most experienced and widely travelled development economist/statisticians, and a Life Fellow of the RES, died of a heart attack on 18 October 2008, aged 69 years. Over a long career, working in more than 30 developing countries and on the national accounts of many more, he helped to create or improve basic economic statistical systems nationally and internationally.

Michael obtained his first degree in economics and statistics at the University of Exeter. After graduating he was appointed in 1963 to the Department of Applied Economics in Cambridge.

Whilst at Cambridge he undertook assignments for the Overseas Development Administration including the establishment of the first Bureau of Statistics in Fiji as well as providing advice to Tonga and other islands in the Western Pacific, and was also Director of Studies in Economics and Dean of Selwyn College.

In 1972, he moved to the Institute of Development Studies in the University of Sussex and for three years provided statistical support and advice to most of the countries of Southern Africa. He was then appointed a Fellow of IDS where he led a project on statistical needs of developing countries and worked with Dudley Seers on using life expectancy as an integrating concept for social indicators. He also spent six months in Thailand evaluating the impact of sharp increases in oil prices on the Thai economy.

From 1982-85 he worked at the OECD on international comparisons of national accounts. Two of his early influential monographs were written for the OECD — *The Measurement of Capital*, an essential basis for growth accounting, and *Purchasing Power Parities and Real Expenditures in the OECD*, a meticulous examination of the problems of making accurate cross-country comparisons of economic performance in OECD countries.

From 1985 until 2000 he was on the staff of the World Bank as a senior economist in both operations and policy areas. His work combined support for another large range of countries especially in the Asean region with further pioneering work on the measurement of poverty, income distribution, environmental accounting and developing and applying purchasing power parity measures to national accounting data in developing countries.

In addition to many technical reports, manuals and papers, Michael published more than 60 articles in aca-

demical journals. His recent book, *Quantifying the World*, was praised as a seminal work which analysed the political economy of international statistical efforts and priorities. In 1999 he was awarded the President's Medal of the International Statistical Institute for 'outstanding contributions to international statistics'. A year later he was elected President of the International Association for Research in Income and Wealth.

Michael had a wide circle of friends in many parts of the world. He was greatly respected for the warmth of his personality. He was as sensitive to people in all situations as he was to the needs and differences in the many countries in which he worked. He liked his food, especially meals with good friends and professional colleagues. He leaves a wife, Rosemary, a son Andrew, and two daughters, Rachel and Kylie as well as six grandchildren.

Sir Richard Jolly

Institute of Development Studies, University of Sussex

This is a shortened version of an obituary that appeared in The Guardian, 13 November 2008. We are grateful for permission to use it.

EEFS2009

European Economics and Finance Society

Call for papers

The eighth Annual EEFS Conference, will be held in Warsaw, Poland on **4th - 7th June 2009**

The theme of the Conference will be:

Current Challenges in the Global Economy: Prospects and Policy Reforms

The Conference will focus on changes in the global economy and the European Integration process.

After the conference, participants will have the opportunity to submit their papers to several established journals that will publish peer-reviewed special issues of EEFS conference submissions.

Abstracts of papers and/or session proposals should be submitted electronically by **January 30th, 2009** to the scientific committee of the conference as attachments (doc or pdf format) at the following email address:

eefs@eap.gr

Proposals for complete sessions are also encouraged. Each session should be made up of three papers.

Further details regarding submissions and all aspects of the conference can be found at: www.eefs2009.pl

Economists and the crisis

Andrew Oswald, David Blanchflower and Mark Taylor reflect on different aspects of the current financial upheavals. It is striking that each, independently and without any prompting from the editor, concludes with the thought that economists have a lot to learn and should be suitably humble in future.

Herds, Houses, and the Crisis - Andrew Oswald¹

If you sail on a flat sea for long enough, you start believing you made the sea flat.

Recent events have reminded us — especially central bankers, home buyers, investors and economists — of the risks inherent in an economic system. In different ways, we have all learnt a little humility (in 2003 and 2004 I argued that a large housing crash was likely, but I got its timing wrong). As economists, we have to accept part of the responsibility for what has happened. It is the job of experts to prevent crises in the domains in which they are meant to be expert. In this sense, economists have let down the country. Some will favour mental gymnastics that allow us to shrug off responsibility and blame. But in my view the grown-up thing is to admit it, swallow our pride, and work out how the profession can do better next time.

Four points

First, for reasons explained below, herd behaviour lies at the heart of all this. Economists think too little about herds. That needs to change.

Second, economists should have spoken up more about the dangers of the international housing bubble. We ought to have publicised the attached UK graph and repeatedly explained to ordinary citizens that the lesson of history was that a housing crash was likely. Even those economists who wrote articles and made speeches saying — I sat through one made in the middle of the decade to 500 Warwick students about to buy their first home — that it was not a bubble should have shown audiences this graph and at least warned them of the possibilities. It is hard to see how we can avoid some culpability here. As I write this (early in December 2008), new numbers came out this morning showing that UK house prices fell more than 2 per cent in the last month. It is tricky to know how long this will go on, but we are still quite far from trend.

Third, the triumphalism over the last decade of some Monetary Policy Committee members was not sensible. It is easy, I accept, to be wise after events. Let's be more cautious next time and wait for many more data points to accrue.

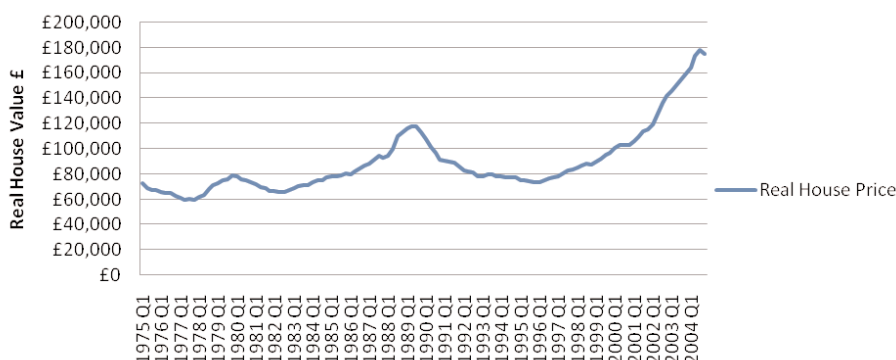
Fourth, it is not true, despite the views of our critics, that economists gave no warnings. At the start of 2008, the usual annual Financial Times poll of economists reads in retrospect as full of worries, but it is true that we did not think a disaster was probable.

“ Would you, in the middle of the decade, have predicted that a crash was likely? ”

To return to point 1, in my judgement it was herd behaviour that began the crisis. Downward overshooting by the herd remains a danger as we go into 2009 and onwards.

Why do herds form? I do not believe it is greatly to do with learning from others, which is the standard model of herding, in so far as we have one (a nice summary of that literature is available in Chamley 2003). I think that literature is mostly a red herring.

UK Real House Prices



Data sourced from the Nationwide Building Society

Average house prices deflated by the RPI; data series deliberately stopped then.

The reasons for herd behaviour

Herding happens when relative position matters. Real-life utility functions contain relative things, like income, as arguments.

People paid extraordinarily high prices for houses, even though not justified by fundamentals, because they felt they were trailing behind the Joneses. Brokers sold unsound mortgages because they had to keep up with rival brokers. Money managers — often remunerated on their relative performance against other managers — traded shares with the same motive. People were frightened about being left behind in their particular pecking order. Humans care deeply about rank.

Conventional economics contains little recognition of such actions. The word ‘herd’ does not appear in most textbooks. In consequence, those texts do not offer an intellectual framework that could have predicted, or can help policy-makers in, our current dilemma.

The research journals are not much better. Since 1970, on an electronic count, only 3 out of the last 8000 articles in the *Economic Journal* discuss herd behaviour; 2 out of 2000 articles in the *Quarterly Journal of Economics*; and 4 out of 1500 articles in the *Journal of Financial Economics*. It would be difficult to prove that this is a reason why the world is in a mess. But common sense suggests that the lacuna is a contributing factor. Just as before the Great Depression, economists and central bankers have been using the wrong model of human behaviour.

In my judgment, it will be necessary to rework economics. We are going to have to bring the idea of relative comparisons and herd behaviour into the centre of our thinking. A good place to start is William Hamilton’s article on defensive herding in the 1971 *Journal of Theoretical Biology*. It is about real herds and why animals cluster together for relative safety. I would like to hope that some contribution is also made by work by

Andrew Clark and myself in, for example, the 1998 *Journal of Public Economics*. We argue that convexity leads to deviance while concavity leads to people following others. Mathematically, this is nothing to do with learning; it is instead the product of humans caring about where they rank in a hierarchy.

As Miller and Stiglitz (2008) argue, we will also have to have, more broadly, a different macroeconomic apparatus.

Finally

In a world with herd behaviour, there is an intellectual case for government intervention to internalize the externalities created. The cool-headed individuals of our unrealistic traditional textbooks do not need to be regulated. Unfortunately, herds do.

A bit more humility from our profession is called for in future.

Note:

1. University of Warwick. I am grateful to Richard Cooper for excellent research assistance, and I thank Liam Graham and Christophe Chamley for helpful discussions.

References:

- Chamley, Christophe (2003) *Rational Herds: Economic Models of Social Learning*. Cambridge: Cambridge U P.
- Clark, Andrew E. and Oswald, Andrew J. (1998) ‘Comparison-Concave Utility and Following Behaviour in Social and Economic Settings’, *Journal of Public Economics*, 70, 133-150.
- Hamilton, William H. (1971) ‘Geometry for the Selfish Herd’, *Journal of Theoretical Biology*, 31, 295-310.
- Miller, Marcus and Stiglitz, Joseph. (2008) ‘Leverage and Asset Bubbles: Averting Armageddon with Chapter 11’, unpublished paper, Warwick University.

The UK Economy - David G Blanchflower¹

I argued throughout 2008, including in speeches in April and October that the MPC needed to be aggressive in cutting interest rates to prevent the UK entering recession.² Over the last three months, Bank Rate has been cut to two percent, its lowest level since 1951. Bank Rate was cut by 50bps in October, 150bps in November, and 100bps in December. Throughout 2008 I held the view that without aggressive cuts, the UK faced the prospect of a relatively deep and long-lasting recession — primarily because it has greater dependence on the financial sector, a bigger house price bubble, and a higher growth in household debt than in the United States. Unfortunately, these three interest rate cuts were not sufficiently timely to prevent the UK from entering recession.

The NBER recently dated the start of the recession in the United States to December 2007, when payroll employment started to fall, even though this does not conform to the technical definition of a recession (‘two quarters of negative growth’). I would date the start of the UK’s recession to April 2008, when LFS employment started to fall (even though this date does not conform to the tech-

nical definition of a recession either — GDP growth was zero percent in the second quarter of 2008, and minus 0.5 percent in the third quarter).

The UK has been buffeted by two economic forces. The first was higher global energy and food prices, which posed an upside risk to inflation and the possibility of a wage-price spiral if inflation expectations became entrenched. Inflation did rise, reaching 5.2 percent in September (its highest level since 1992), but it fell back to 4.5 percent in October. I expect it to fall back very sharply to well below the MPC’s two percent target in 2009. Oil has fallen to \$45 a barrel since its peak of \$147 a barrel in summer 2008. There has been no wage-price spiral. The UK labour market is far more flexible than it used to be — few wage settlements are now explicitly inflation-linked, and union power has diminished. Workers are more concerned about keeping their jobs (which is dependent on firms’ employment intentions and profitability) than they are with wages. Wage growth is now falling, the fear of unemployment is rising, and household inflation expectations have plummeted.

Inflation expectations did rise as inflation increased, but are now falling even faster than inflation. November's Citigroup survey, for example, showed a record plunge in short-term inflation expectations — from 2.9 percent to 0.9 percent, well below the Bank's inflation target.

The second economic force — the global credit crunch — posed a much more worrying downside risk to inflation and output. This risk has materialised. Policy-makers are now faced with unprecedented global financial turmoil — money markets are dysfunctional, banks are not willing to lend to each other unless at the very short-term, governments globally have been recapitalising financial institutions, and several institutions have collapsed. There has been a dramatic fall-back in risk appetite, and chronic concerns over the credit-riskiness of the financial institutions themselves. Financial institutions have made huge losses, and written-down the value of complex risky assets (such as mortgage backed securities and their derivatives). Dependence on short-term funding, often through sales of securitised assets (whose markets have dried up) has left many institutions exposed to tightening credit conditions.

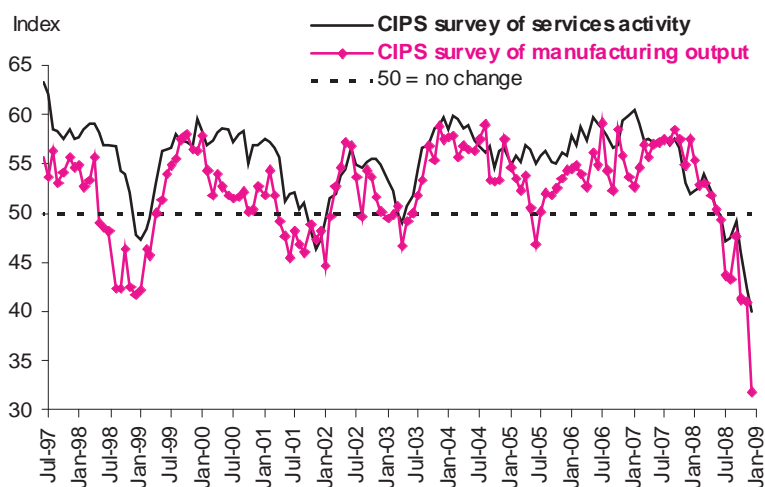
But I believe the impact of the credit crunch on the real economy was broadly predictable. Developments in the UK closely followed those in the US, but with a six-to-nine-month time lag. There was a synchronised downturn in many UK business surveys around the beginning of 2008; this should have led us to realise sooner that the UK economy was entering recession. A similar pattern (the turning of business surveys) occurred in the US a few months earlier. We are now starting to see the impact of the credit crunch on the wider economy: in the third quarter, UK GDP contracted by 0.5 per cent, the biggest contraction since the early 1990s. I expect growth in the fourth quarter of 2008 and first quarter of 2009 to be worse. Unemployment has risen at its fastest pace in seventeen years: LFS unemployment rose to 1,825,000 in September 2008, or 5.8 per cent. I expect unemployment to continue to rise through 2009 and into 2010, probably to over three million. And I believe the impact of constrained credit conditions has yet to fully feed through to the broader economy, particularly to investment by firms. Lending to households and firms is likely to be reduced further in the near term.

This is because of the 'collateral effect': higher interest rates push down on equity and house prices, eroding the value of firms' and households' collateral. This makes firms and households riskier prospective borrowers, so lenders tighten credit availability further. There has been considerable tightening in mortgage lending in the UK, and significant falls in house prices. Firms appear to have

been drawing on pre-committed lines of credit (that banks have financed through sales of foreign assets), but once these lines are exhausted then firms will be fully exposed to tighter credit conditions. Investment is likely to fall back sharply, and there is a growing risk that firms will close, net job creation will fall and redundancies will increase.

The construction sector has been particularly exposed to the effects of the credit crunch: activity has fallen sharply and is unlikely to pick-up until residential and commercial property prices stabilise. We might expect growth in UK exports given sterling's depreciation, but global demand is slowing, as many other economies enter recession. This is a global shock. Annual UK sales of new cars fell 36.8 per cent in November, the steepest fall in nearly thirty years. And the CIPS survey of manufacturing output fell by a record amount in November; the survey already stood at its lowest level since it began in 1991. The CIPS survey for services was also at an historic low in November. The CBI Distributive Trades Surveys, and surveys conducted by the British Chambers of Commerce, the Engineering Employers Federation, and the KPMG/REC Report on Jobs also confirm the dire news.

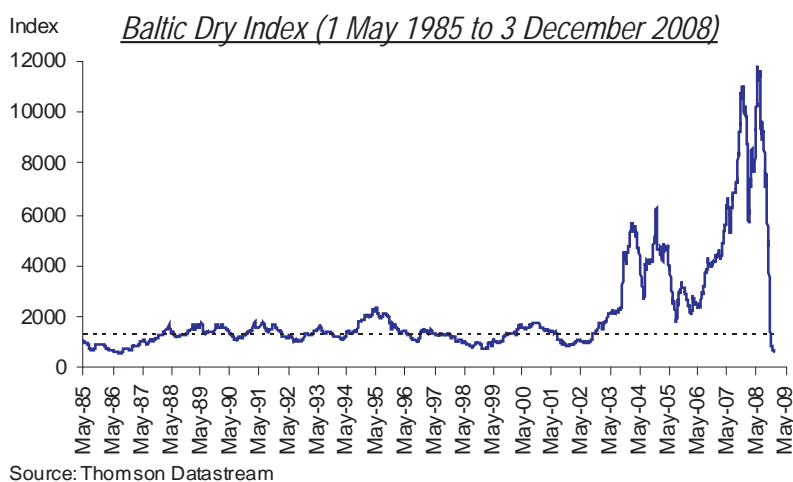
CIPS surveys of UK manufacturing and services, 7/97 - 11/08



Source: CIPS/Markit

The Baltic Dry Index (a measure of the price of shipping dry goods such as grain and iron ore) is widely viewed as a leading indicator of global demand. The Index has fallen 94 percent since its peak in May 2008, and has fallen every day in the two weeks to 3rd December. In part, this fall is a result of the difficulties in obtaining trade credit. During the second half of 2008 there have also been dramatic price falls in a whole range of commodities and foodstuffs. The extent of the price falls to December 4th 2008 from their 2008 peaks for a representative group are reported below (source: Datastream).

Falling oil and commodity prices have now started to feed through the supply chain. In the Bank of England's November 2008 'Inflation Attitudes Survey', seventeen



per cent of respondents said they expected prices to fall over the next year, compared with only two percent in the previous survey (conducted in August 2008).³

Aluminium	-3.1%	Nickel	-72.8%
Cocoa	-33.3%	Soya oil	-57.0%
Coffee	-30.1%	Soya beans	-50.2%
Copper	-62.6%	Soya meal	-44.2%
Corn	-56.5%	Sugar	-27.1%
Cotton	-48.5%	Tin	-54.1%
Crude oil	-70.8%	Wheat	-69.1%
Lead	-71.2%	Zinc	-59.8%

Economies do bounce back from recessions — the UK economy will ultimately return to prosperity. But I believe it has entered recession, and I am concerned that inflation will fall below one percent, possibly even turning negative, causing the MPC to write to the Chancellor explaining why inflation is below the Bank's inflation target. The 2.5 percent reduction in VAT announced by the Chancellor in November's Pre-Budget Report will push inflation down further in the near term. In circumstances when there is a danger of deflation and policy interest rates are approaching the zero bound, it is appropriate to consider the use of alternative policy measures, including quantitative easing.⁴

The Sub-Prime Crisis - Mark Taylor¹

The subprime crisis is — at the time of writing — an ongoing global financial crisis whose proximate cause was the collapse of the US housing price bubble but whose origins are embedded in the global regulatory and financial structure that has evolved since the 1980s and the financial environment that has evolved over the past decade or so.

The role of securitisation

Many of the property mortgages taken out to fuel the housing bubble had been securitised — that is to say, bundled up and sold on, with the originator of the mortgages taking a fixed fee and passing on the risk to the next holder of the bundle. The purchasers of the mortgage-backed securities were happy to do this because they gave a high

The last decade has been described as a period of 'great stability', partly attributable to improved monetary policy. But this stability has ended with turmoil in the global financial system. The counterpart to 'irrational exuberance' in an upswing appears to be excessive credit tightening in a downswing.

Over the past decade, central banks have been analysing monetary policy using workhorse models taken from the new-Keynesian Phillips Curve literature. Such models are more in the tradition of Friedman, stressing the importance of inflation expectations. But they have little

scope for the role of financial intermediation, money supply growth, asset prices, and changes in the structure of wage-setting. These models have proved to be an extremely poor tool for monetary policy. We are experiencing the greatest financial shock in a century, and our current framework for monetary policy essentially assumed this shock could not happen. The events of the last twelve months represent a huge challenge to economists: it is probably time for a big rethink.

Notes:

1. Bruce V. Rauner Professor of Economics, Dartmouth College, University of Stirling, NBER, IZA, CESifo and Member, Monetary Policy Committee, Bank of England.
2. See Blanchflower (2008), 'Inflation, expectations and monetary policy', *Bank of England Quarterly Bulletin*, pp 229-237, Volume 48 No. 2, Q2 and Blanchflower (2009), 'Where now for the UK economy', *Scottish Journal of Political Economy* (forthcoming), April.
3. The question asked was, 'How do you expect prices in the shops to change generally over the next twelve months?'
4. For a discussion of such measures see, for example, Ben Bernanke (2002), 'Deflation: making sure "It" doesn't happen here', <http://www.federalreserve.gov/boarddocs/speeches/2002/20021121/default.htm> and Graham Turner (2008), *Credit Crunch: Housing Bubbles, Globalisation and the Worldwide Economic Crisis*, (London: Pluto).

since banks need to maintain a ratio of assets to liabilities, the whole financial system now became unstable as liquidity — basically the ease of borrowing — dried up. In this case, therefore, far from stabilising the system, banking regulation actually exacerbated the instability.

One possible remedy for this problem has been proposed by Goodhart and Persaud (2008a,b) in the form of time-varying capital requirements, so that banks' capital adequacy requirements are ratcheted up during an economic boom in order to rein in excessive leverage (reducing bubble effects) and are lowered in periods of economic downturn so that liquidity is increased just as investors are tending to become more risk averse and cautious. Deciding exactly how this is done and exactly which financial institutions should be subject to such regulation is a difficult issue since regulation of any kind always has some distortionary effect and financial markets are remarkably adept at circumventing regulation, but this does not mean this would not be a fruitful line to pursue.

Lessons for monetary policy?

Another issue arising from this episode concerns the appropriate design of monetary policy. At least one factor that had fuelled the housing bubble, both in the US and in the UK and elsewhere, was the very low level of interest rates, as the *de jure* or *de facto* adoption of inflation-targeting in many developed countries had apparently delivered low inflation that provided a platform for stable growth. There appeared to be a growing consensus among economists on both sides of the Atlantic that asset markets, including the housing market, could be left to their own devices and that interest rate policy should be directed solely at controlling price inflation, not asset price inflation. Economists should now at least reconsider whether inflation targeting needs to be supplemented by some form of 'leaning against the wind' in order to dampen asset markets that appear to be overvalued. This again is a very difficult issue. For example, in a world of

highly globalised financial markets, it is unclear whether 'leaning against the wind' by any country unilaterally would have any significant effect—suggesting the need for international monetary policy coordination and all the complications that that would entail.

Perhaps the most remarkable feature of the subprime crisis, however, was that it appeared to take the world by surprise, including financial market participants, policy makers and academics. This is not to say that certain symptoms of the impending crash had not been noticed. If one looks, for example, at policy reports such as the IMF's *Global Financial Stability Report* or the Bank of England's *Financial Stability Report* in early 2007, it is clear that the subprime market had featured on their radar screens as presenting a risk to stability, but their assessment was that the financial system was not under immediate threat. No alarm bells were sounded. This is itself somewhat alarming since, following the similar surprise at the East Asian financial crisis of a decade ago, a substantial amount of research has been done on the issue of 'surveillance' and developing 'early warning indicators' of financial crises, both at policy institutions such as the IMF and in academia. Yet we still were not able to see the looming crisis. Perhaps this is because of an inherent nonlinearity in the world, such that the interaction of economic forces generates outcomes that are highly context-specific and therefore unpredictable. If the world is unpredictable in this sense, we need to know it and at least learn to expect the unexpected. If it is not, then we need to discover more refined early warning systems.

Notes:

1. University of Warwick

References:

- Goodhart, C A E and Persaud, A (2008a), 'A proposal to avoid the next crash', Op. Ed., *Financial Times*, 30 January.
- (2008b), 'A party pooper's guide to financial stability', Op. Ed., *Financial Times*, 4 June.



The New Lecturers Workshop:

A win-win situation for economists

The RES generously sponsored two Economics Network workshops for Graduate Teaching Assistants and New Lecturers during September and October 2008. Benjamin Mitra-Kahn from City University London attended the New Lecturer workshop:

There is something very refreshing about the New Lecturers Workshop, and partly that is because it isn't just for new lecturers. This is also a chance to meet other young (career-wise) economists, a place to interact outside of the usual conference settings and a good way to network across the country. On top of that, it's free for the attendee, it's free for the department and hopefully it will be good for my students. That seems like a win-win situation to me.

Further New Lecturer and Graduate Teaching Assistant workshops will be run by the Economics Network in Autumn 2009. See the website for more details: <http://www.economicsnetwork.ac.uk/news/>

Fifth International Conference in Developments in Economics Education (DEE)

Call for papers and session proposals

Wales Millennium Centre, Cardiff, UK
9-10 September 2009

Submitting a proposal

Session proposals should include a session outline and be no longer than 250 words. The deadline for proposals is **Monday 20th April 2009**. Unfortunately we are unable to accept late submissions. For more information about the conference, including submitting papers and proposals please go to:

<http://www.economicsnetwork.ac.uk/dee2009/call.htm>

RES news items

The RES Annual Lecture

The Society's Annual Lecture was given this year by Tim Besley who is currently serving a term on the Bank of England's Monetary Policy Committee. The lecture was given to large and enthusiastic audiences in London, at the Royal Institution, on 18th November, and in Glasgow, at Strathclyde University on 20th.

The title of the lecture was 'Making Monetary Policy Work'. In the light of current circumstances, his concluding remarks which focused on lessons to be learned from the recent crisis might have seemed the most interesting. In these he stressed that the 'surprise' reduction in interest rates by 150bp in November should have been more easily anticipated by financial markets since it was based, as always, on information that was in the public domain. He also speculated that the future policy debate would include '...discussion around more direct measures to restrict leverage in financial markets and to curb excessive borrowing by some households', an issue more recently raised by the Bank's Deputy Governor Sir John Gieve.

However, for many of the audience, the earlier parts of the talk which reflected on the history of inflation and its measurement, its causes and costs as well as sources of earlier policy mistakes will have covered less familiar and interesting ground.

Tim was particularly forthright about the need for policy-makers to beware of paying too much attention to volatile commodity prices (what the old Bundesbank used to call 'unavoidable inflation') which could fluctuate sharply in response to supply side factors and to concentrate instead on core inflation. 'In understanding inflation, it is essential to differentiate between changes in relative prices and changes in the price level'. Essential indeed, but often quite difficult in practice.

The lecture can be viewed on, and pdf slides downloaded from the Society's website at:

<http://www.res.org.uk/society/lecture.asp>

Royal Economic Society 2009 Annual Conference

The 2009 Annual Conference of the Royal Economic Society will be held at Surrey University from

Monday 20th to Wednesday 22nd April, 2009

Online Registration will be open from January 2009. Further information from the RES Annual Conference web-site at:

<http://www.res.org.uk/society/annualconf.asp>

2009 Easter School

(Note: This corrects details that appeared in the October 2008 issue of the Newsletter.)

The nineteenth Easter School organised by the Royal Economic Society, with financial support from the Economic and Social Research Council, will be held at

**The University of Birmingham
from Sunday 29th March — Thursday 2nd April**

The School is intended primarily for advanced postgraduate students doing doctoral research but is also open to members of the teaching and research staff. The purpose is to enable participants to become acquainted with the latest developments in the selected fields of economics, to have the opportunity for study and discussion with two internationally renowned experts in the topics covered, and to meet other young researchers.

In 2009, the subjects of the school will be *Networks and Auctions*. The lecturers will be

**Professor Sanjeev Goyal (University of Cambridge)
Professor Paul Klemperer (University of Oxford)**

Places are available for 25 resident participants. Accommodation and meals will be provided for the duration of the course. Nominations must be made through the applicant's Head of Department and should be supported by a short CV, a reference, and a note on the applicant's research interests.

Applications should be submitted no later than **9th January 2009** by email to the Royal Economic Society Easter School Secretary, Department of Economics, |The University of Birmingham, Edgbaston, Birmingham, B15 2TT.

Email easterschool@contacts.bham.ac.uk.

Successful applicants will be informed in February 2009.

The Royal Economic Society Publications

Members Discounts

Members of the Royal Economic Society may order one of each of the Society's publications for their personal use at the special price to members. Applications should be made to the Royal Economic Society offices at the following address:

Amanda Wilman, RES Administrator,
The Royal Economic Society,
School of Economics & Finance,
University of St Andrews, Fife, KY16 9AL UK

Payment, in sterling, must accompany the order either by cheque or international bankers draft made payable to the Royal Economic Society. Direct payment may be made to our bank from overseas accounts if you contact the Administrator for details. Credit cards cannot be accepted.

Rights, Permissions and Initiatives

For enquiries about rights, permissions and initiatives relating to editions and other scholarly works sponsored by the Society, please contact The Publications Secretary c/o The Royal Economic Society office.

Published by Cambridge U P

Published Members' price, £ price, £

<i>The Works of Ricardo</i> (hb), Ed P Sraffa		
Vol VI -X* each	56.00	45.00
Vol XI index	45.00	36.00

*Vols I-V out of print

Paperback editions (not discounted) are available directly from the Liberty Fund or Amazon books in Europe

<i>An Essay on the Principle of Population</i> — T R Malthus (2 Vols. hb). Ed Patricia James	110.00	88.00
--	--------	-------

<i>Principles of Political Economy</i> — T R Malthus (2 Vols. pb). Ed John Pullen	65.00	52.00
---	-------	-------

<i>Centenary Essays on Alfred Marshall</i> (hb). Ed John K Whitaker	70.00	56.00
---	-------	-------

<i>The Correspondence of Alfred Marshall, Economist</i> (pb). Ed. John K Whitaker		
Vol I	43.00	35.00
Vol II & Vol III each	50.00	40.00

<i>Official Papers of Alfred Marshall, A Supplement</i> (hb). Ed. Peter Groenewegen	70.00	56.00
---	-------	-------

<i>The Economic Advisory Council: A Study of Economic Advice During Depression and Recovery 1930-1939</i> (pb). Susan K Howson and Donald Winch	38.00	30.50
---	-------	-------

Published Members' price, £ price, £

Published by Palgrave Macmillan

<i>The Collected Writings of John Maynard Keynes</i> (hb). Ed Sir Austen Robinson, Elizabeth Johnson and Donald Moggridge		
All the following listed volumes (each):	68.00	51.00
I, II, III		

V,VI,VII,VIII
X, XII, XIII,
XVI, XVII

XXI, XXII, XXIII, XXIV		
Volume XIX (two volumes)	130.00	67.50

All other volumes out of print

Memorial set of all 30 volumes is now out of print.

Available in paperback:

XIV, XXIX each	19.99	15.00
----------------	-------	-------

<i>Keynes Lectures, 1932-35</i> . Ed Thomas K Rymes	40.00	30.00
---	-------	-------

J M Keynes, <i>The General Theory of Employment, Interest and Money</i> (with an introduction by P Krugman)	19.99	15.00
---	-------	-------

Published by Oxford U P

<i>F Y Edgeworth's Mathematical Psychics and Further Papers on Political Economy</i> . Ed Peter Newman	116.00	90.00
--	--------	-------

Titles for degrees in the United Kingdom

A list of thesis titles of higher degrees in economics, taken **entirely** by thesis or dissertation and awarded in the United Kingdom during the academic year **2007-2008** will be published in the June 2009 issue of the *Economic Journal*. Degrees already awarded in **early 2008-2009** may also be included. The subject classification is that used by the *Economic Journal* for Book Notes; this classification is derived from the one devised by the American Economic Association and used in the *Journal of Economic Literature* since March 1991.

Details required for publication are:

Name of author

Title of thesis

Type of degree (MA, MSc, DPhil, PhD)

Date of award

Where thesis can be consulted

Classification (using *Journal of Economic Literature* classification)

Information should be sent by **4 February 2009** to Amanda Wilman, RES Administrator, Royal Economic Society. **Email: royaleconsoc@st-andrews.ac.uk**

Conference Diary

2009

march

March 20 *University of Reading*

CALL FOR PAPERS

*A one day conference, on **Households as economic and social institutions** to be held jointly by The Centre of International Business History (CIBH) and Centre for Institutional Performance, (CIP), Henley Business School at the University of Reading, will examine the role of households and families as economic and social institutions from both historical, theoretical, and other perspectives. Please send a brief (one side of A4) abstract, plus a short c.v. to Dr Marina Della Giusta (m.dellagiusta@henley.reading.ac.uk) for papers on current topics, or Prof. Peter Scott (p.m.scott@henley.reading.ac.uk), for historical topics by **1 February 2009**.*

March 20-21 *Londonderry, N. Ireland*

CALL FOR PAPERS

*The Households in Conflict Network is co-hosting a workshop on **Entrepreneurship and Conflict** with the United Nations University World Institute for Development Economics Research (UNU-WIDER) and the International Conflict Research Programme at the University of Ulster (INCORE). The Call for Papers is now available at:*

www.hicn.org/papers/call_WIDER_INCORE_2009.pdf

*Submission deadline: **5 January 2009**.*

For further details see

www.hicn.org or contact info@hicn.org

april

April 13-14 *Izmir, Turkey*

CALL FOR PAPERS

*Izmir University of Economics 5th International Student Conference invites papers in JEL classification(s): A, B, C, D, E, F, G, H, I, J, K, L, M, N, O, P, Q, R, Z. Deadline for paper submissions **1 March 2009**.*

Further information at: <http://ikam.ieu.edu.tr/conference/index.html>

April 17-18 *Hyderabad, India*

CALL FOR PAPERS

*International Conference on **Applied Economics and Time series Econometrics (ICAE)**. Invites papers in JEL classification(s): A, B, C, D, E, F, G, H, I, J, L, M, O, Q, R, Z. Deadline for paper submissions: **30 January 2009***

Further information at: <http://www.ibsindia.org/icaete>

April 20-22 *Guildford, England*

***Royal Economic Society Annual Conference**. Online registration from January 2009.*

Further information at: ww.resconference.org.uk

April 24-26 *Prague, Czech Republic*

CALL FOR PAPERS

Conference on Political Economy**. Papers invited in JEL classification(s): A, B, K. Deadline for paper submissions: **28. February 2009

Further information at: <http://pcpe.libinst.cz/pcpe09/>

April 24-26 *Cork, Ireland*

CALL FOR PAPERS

*23rd Annual Conference of the **Irish Economic Association** invites papers in JEL classification(s): A, B, C, D, E, F, G, H, I, J, K, L, M, N, O, P, Q, R, Z*

*Deadline for paper submissions: **16 January 2009***

Further information at: www.iea.ie

may

May 27-30 *Kastoria, Greece*

CALL FOR PAPERS

*International Conference on **Applied Economics 2009 (ICOAE 2009)**. The aim of the conference is to bring together economists from different fields of Applied*

Economic Research in order to share methods and ideas. Submissions deadline for abstracts/proposals: **27 March 2009**.

Further information: icoae@kastoria.teiko.gr or <http://kastoria.teiko.gr/icoae>
Contact name: Prof. Nicholas Tsounis

june

June 4-5 Helsinki, Finland

CALL FOR PAPERS

SUERF / Bank of Finland Conference: Housing markets - a shelter from the storm. Papers are invited in JEL classification(s): D, E, F, G. Deadline for paper submissions: **14 February 2009**.

Further information:
www.suerf.org/download/helsinki09/cfp.pdf

June 4-6 Madrid, Spain

CALL FOR PAPERS

2009 Applied Economics Meeting. Papers are invited in JEL classification(s): A, C, D, E, F, G, H, I, J, L, N, O, P, Q, R. Deadline for paper submissions: **9 March 2009**.

Further information: www.alde.es/encuentros

June 4-7 Warsaw, Poland

CALL FOR PAPERS

The 8th EEFS Conference: Current Challenges in the Global Economy at the University of Warsaw. Deadline for paper submissions: **31 January 2009**

Further information: www.eefs2009.pl/

June 10-12 Santiago, Chile

CALL FOR PAPERS

Twelfth Annual Conference on Global Economic Analysis. Deadline for submissions: **15 January 2009**

Further information:
www.gtap.agecon.purdue.edu/events/Conferences/2009

June 11-12 Namur, Belgium

CALL FOR PAPERS

New Challenges to Central Banking in the Global Financial System. Deadline for paper submissions: **15 February 2009**

Further information:
<http://perso.fundp.ac.be/~noisetb/CeReFiM.pdf>

June 11-13 Bari, Italy

CALL FOR PAPERS

12th Uddevalla Symposium 2009 on The Geography of Innovation & Entrepreneurshi. Deadline for paper submissions: **4 May 2009**

Further information: www.symposium.hv.se

June 14-16 Tallinn, Estonia

Economies of Central and Eastern Europe: Convergence, Opportunities and Challenges

Deadline for paper submissions: **15 March 2009**

Papers invited in JEL classification(s): A, D, E, F, G, H, J, K, L, M, O, P, Q, R

Further information: <http://tseba.ttu.ee/ECEE/>

June, 15-16 Marseille, France

CALL FOR PAPERS

The 8th Journées Louis-André Gérard-Varet Conference in Public Economics, organized by Institut D'Économie Publique — IDEP / Institute for Public Economics. Submissions should be sent to Professor Nicolas Gravel, nicolas.gravel@univmed.fr by **15 March 2009**

http://www.vcharite.univ-mrs.fr/idep/index_en.php?

June 17-19 Glasgow, Scotland

CALL FOR PAPERS

7th Triple Helix Conference on University-Industry-Government Relations. Papers invited in JEL classification(s): A, B, C, D, E, F, G, H, I, J, K, L, M, N, O, P, Q, R, Z. Deadline for paper submissions: **17 April 2009**

Further information: www.triple-helix-7.org

June 18-20 Galway, Ireland

CALL FOR PAPERS

Tenth international meeting of the Association for Public Economic Theory (APET) at the National University of Ireland, Galway (beginning with a welcoming reception on the evening of June 17th). Papers in all aspects of public economics and related areas are invited. Submissions deadline **15 February 2009**.

Further information: www.apet.org.

June 18-20

Berkeley, USA

CALL FOR PAPERS

13th Conference of **The International Society for New Institutional Economics**. Papers are invited in JEL classification(s): A, B, D, E, F, G, H, I, J, K, L, M, N, O, P, Q, R, Z. Deadline for paper submissions: **14 January 2009**

Further information: <http://call.isnie.org/>

June 18-20

Vienna, Austria

CALL FOR PAPERS

Econometrics, Time Series Analysis and Systems Theory — A Conference in Honor of Manfred Deistler. A celebration of Manfred Deistler's scientific achievements over a lifetime devoted to academic research and teaching at the occasion of his retirement from the University of Technology Vienna. Submit an abstract by **1 February 2009** to etsast@ihs.ac.at

Further information: <http://www.ihs.ac.at/etsast>

June 22-24

Lyon, France

APET is sponsoring a small workshop on **Public Economics: Theoretical and Experimental Approaches**. A selection of the papers presented will form a special issue of JPET edited by Charles Plott, Jean-Louis Rullière and Marie Claire Villeval.

Further information:

<http://www.accessecon.com/pubs/PETLyon09/>

22-24 June

Maastricht, Netherlands

CALL FOR PAPERS

Conference on Economic Design (SED 2009). Papers are invited in JEL classification(s): C, D, H, L, Z. Deadline for submissions **1 March 2009**

Further information:

<http://www.fdewb.unimaas.nl/SED2009/>

24-26 June

Ankara, Turkey

3rd International Conference on **Innovation, Technology and Knowledge Economics** Deadline for paper submissions: 18. May 2009.

Further information: <http://conf09.metu.edu.tr>

august

August 3-6

Athens, Greece

CALL FOR PAPERS

4th International Symposium on **Economic Theory, Policy and Applications**. Papers are invited in JEL classification(s): A, B, C, D, E, F, G, H, I, J, K, L, M, N, O, P, Q, R, Z. Deadline submissions: **12 January 2009**

Further information:

<http://www.atiner.gr/docs/Economics.htm>

september

September 24-26

Kathmandu, Nepal

CALL FOR PAPERS

IARIW-SAIM Conference: Measuring the Informal Economy in Developing Countries. Papers invited in JEL classification(s): B, I, O, Z. Deadline for submissions: **31 March 2009**

Further information: www.iariw.org/call2009.asp

2-4 September

Limerick, Ireland

CALL FOR PAPERS

39th Annual Conference of the **Regional Science Association International: British and Irish Section**. The RSAI British & Irish Section invites the submission of abstracts to be considered for the 2009 Annual Conference. Quality papers in all areas of regional science are welcome. There will be a Special Session for early career/doctoral students with prizes for the best conference paper and the best conference presentation by early career researchers. Abstracts of up to 300 words should be submitted by e-mail to the Secretary at the address below by **January 31st 2009** at the very latest. Authors will be notified of the committee's decision in March 2009.

Further information from: Don.Webber@uwe.ac.uk

Membership of the Royal Economic Society

Membership is open to anyone with an active interest in economic matters.

The benefits of membership include:

- Copies of the *Economic Journal*, the journal of the society, eight times a year.

The *Economic Journal* is one of the oldest and most distinguished of the economic journals and a key source for professional economists in higher education, business, government service and the financial sector. It represents unbeatable value for those who want to keep abreast of current thinking in economics. Issues are divided into those containing 'Articles' — the best new refereed work in the discipline — and 'Features' including symposia and regular features on data, policy and technology.

- On-line access to *The Econometrics Journal*, a new electronic journal published by the Royal Economic Society and Blackwell Publishers. The journal seeks particularly to encourage reporting of new developments in the context of important applied problems and to promote a focus for debate about alternative approaches.

- Copies of the Society's *Newsletter*. This is published four times a year and offers an invaluable information service on conferences, visiting scholars, and other professional news as well as feature articles, letters and reports.

- The right to submit articles to the *Economic Journal* without payment of a submission fee.

- Discounts on registration fees for the Society's annual conference.

- Discounted prices for copies (for personal use only) of scholarly publications.

- The opportunity to take advantage of the grants, bursaries and scholarships offered to members of the Society.

Details and application form are available from:
The Membership Secretary, Royal Economic Society, University of York, Heslington, York, YO10 5DD.

Membership rates for 2009 are £48 (\$77, €68)*

There is a reduced rate of £24 (\$39, €34) for members who reside in developing countries (with *per capita* incomes below US\$500) and for retired members. A special offer of three years membership for the price of one at this reduced rate is available to full-time students who join the Society for the first time between 2009 and 2011.

* All customers in the UK should add 7.5 per cent VAT to these prices or provide a VAT registration number or evidence of entitlement to exemption. Canadian customers please add 5 per cent GST or provide evidence of exemption. For EU members, please add VAT at the appropriate rate.

Ordinary UK member: £48 + £3.60 = £51.60
Ordinary EU member: €72 + appropriate rate
Ordinary Canadian member \$77 + \$3.85 = \$80.85
Reduced rate members: \$40.95/£25.80

If you would like to join the Society, complete the adjacent application form and return it to the Membership Secretary at the address above.

Please enter my name as an applicant for membership of the Royal Economic Society. I enclose a cheque for

..... in payment of my subscription for 2009.

Name:

.....
Address:

.....

.....

.....

Occupation.....

Date.....