Book Review: Economics After The Crisis: Objectives and Means

by Blog Admin

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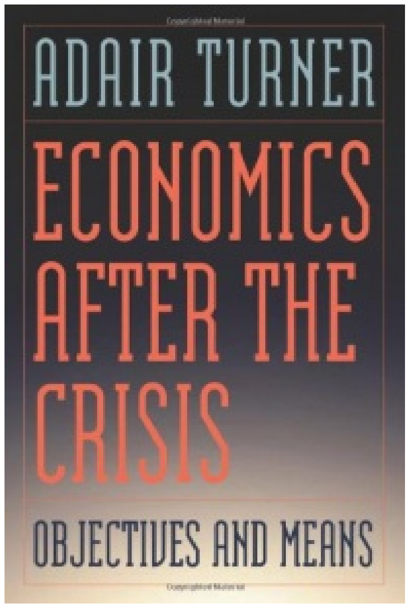
*In **Economics After the Crisis**, **Adair Turner** writes that the crisis of 2008-2009 should prompt a wide set of challenges to economic and political assumptions and to economic theory. Turner argues that the faults of theory and policy that led to the crisis were integral elements within a broader set of simplistic beliefs about the objectives and means of economic activity that dominated policy thinking for several decades. Reviewed by **Alastair Hill**.*

Economics After The Crisis: Objectives and Means. Adair Turner. MIT Press. April 2012.



With the Deputy Governor of the Bank of England Paul Tucker's hopes of assuming the top job at Threadneedle Street significantly dented having been embroiled in the recent LIBOR scandal, many now see Lord Adair Turner, the current Chairman of the Financial Services Authority, as the front-runner. Yet despite being former vice-chairman of US bank Merrill Lynch and an ex-Mckinsey consultant, his appointment as the Bank's next Governor would likely make many in the City rather uneasy. Taking up his role as Chairman of the financial services industry in 2008, Lord Turner has since made clear his views on the practices and structure of the financial industry, and spared little when criticising the policy-makers and politicians who presided over this culture. Most sensationally back in August 2009 Lord Turner made a stunning attack on the financial services industry, saying that it had grown too big, and much of what it now does is "socially useless". He also backed taxes on banks as a way to tackle the city's excessive bonus culture, as well as lending tacit support to plans for a Tobin Tax if increased capital requirements are insufficient.

Often dismissed as a fashionable leftie by his critics, Lord Turner's swift departure from the 'light touch regulation' rhetoric of his predecessors towards a much more interventionist tone is sometimes easily dismissed by many on the right. However, in his newly published book, which brings together the three Lionel Robbins lectures he delivered at the London School of Economics in October 2010, Lord Turner cements his position as one of few British public intellectuals who has given serious thought to our current economic predicament, and more fundamentally, what it means for the academic discipline of economics itself.

Central to these lectures is a rejection of the pre-crisis economic orthodoxy of neo-classical economics which saw as its objective the maximisation of growth, assuming a direct link between per capita income and welfare. As a means to this it saw the loosely regulated expansion of financial markets. In contrast, Lord Turner's first two chapters question these objectives and means respectively, before his third chapter builds recommendations for policy-makers and academic economists alike.

Lord Turner's first chapter looks at the conventional emphasis of maximising growth in pre-crash financial policy making. "This shared assumption across the political spectrum was that economic growth – both in GDP and in per capita GDP – would result directly in increasing well-being, welfare, happiness, or whatever word we use". Against this, Lord Turner argues that there is simply not the empirical evidence to support this assumption, arguing that in developed Western economies the empirical evidence would suggest that we cannot be confident GDP growth will necessarily deliver significant and sustained increases in welfare.

Part of the reason for this failure to deliver any increases in welfare is to do with changing production activity. Based on Roger Bootle's distinction between distributive and creative activities, Lord Turner asserts that much production activity in modern economies is now distributive, in that rather than creating new wealth, it simply re-allocates resources between two parties. For example, the financial trader who bets well makes money at the expense of the one who bets badly. While most activity in modern economies is partly distributive, and partly creative writes, however Lord Turner notes that in more developed societies the propensity for highly able individuals to become engaged in zero-sum distributive activities vastly increases.

A final and related point in this section is the issue of inequality. In the dominant economic discourses a high level of inequality was seen as acceptable on the basis that it allowed a lightly regulated market economy to flourish and deliver faster increases in GDP growth. In contrast Lord Turner highlights that in developed societies with increasing levels of distributive activity much wealth is concentrated at the top, with little of the so-called 'trickle-down effect'. He suggests that not only are average incomes not significantly increasing, but also that "inequality can be a major cause of anxiety and unhappiness that no amount of growth can dispel".

In his second chapter Lord Turner looks at the means used to achieve this aim of constantly increasing growth, namely free and lightly regulated financial markets. Such policy-making was informed by a dominant economic discourse which saw all economic actors as inherently rational, and viewed widespread growth and intensification of financial markets as a positive development, in that it increased both efficiency and in hindsight rather absurdly; their stability. Under the neoclassical model, the vast increase of credit derivatives and structured credit markets over the last two decades was seen as delivering greater price transparency which delivers greater market efficiency and took us closer to the efficiency maximising equilibrium. In other words, the intensification of financial activity and new and increasingly complex financial products were lauded as making markets more efficient, and by pooling and dispersing risk, as increasing financial stability. While there was a counter-discourse in the academy building on Keynes and Minsky's notion of inherent uncertainty and that financial markets can be subject "to self reinforcing swings of irrational exuberance and then despair", it was largely ignored.

While Keynes wrote famously that "practical men, who believes themselves to be quite exempt from any intellectual influence, are usually the salves of some defunct economist", Lord Turner suggested that in fact recent decades have been characterised by very able individuals in policy-making, Government, regulatory bodies, and risk-management departments in Banks who instead actively gravitated to a highly technical and mathematical discipline of economics which offered them apparent certainty. With the advent of the financial crisis such certainty has clearly been disproved he concludes from his first two lectures.

In his third chapter he asserts that there are clear lessons must be learnt from the recent crisis. On a more instrumental level he suggests that inequality should be recognised as a political issue, and not just ignored in favour of considerations of economic efficiency. Secondly he asserts that we should aim to counteract "any large and obvious tendencies for proliferation of purely distributive activities". It is clearly on these considerations that Lord Turner's comments on city bonuses and "socially useless activity" are built upon.

Alongside these more instrumental considerations, Lord Turner also illustrates that he has thought extensively about what the recent crisis means for the discipline of economics itself. His conclusion is particularly reminiscent of an article which still sticks vividly in my mind by Antole Kaletsky back in 2009, in which Kaletsky asserted that "not only have economists failed to guide the world out of the financial crisis, they were also primarily responsible for leading us into it. Either economics has to be abandoned as an academic discipline – or it must undergo an intellectual revolution".

In answering this challenge, Lord Turner agrees with the suggestions of Robert Skidelsky that there is an urgent case not to jettison economics as an academic discipline, but to reconstruct it. A major deficiency in the prevailing conventional wisdom in the strand of economics which has dominated in the last two decades has been that it is overly technical, overly mathematical and sees all markets as entirely efficient and all actors as entirely rational, he asserts. Borrowing Skidelsky's insights, Lord Turner suggests that "economics should return to the wider focus on Smith, Hume, Ricardo and Keynes" and to treat the world as we see it, including its imperfections. Post crisis we need to recognise that economic policy choices are political rather than narrowly economic in nature, he concludes. The problem in the pre-crisis years was that policy-makers followed a dominant discourse of economics which was not only beyond political questioning, but which also ultimately proved to be false in its observations of how the world actually works.

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