Lessons from the Great Recession: Reflections of a New Ph.D.

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How does one begin to articulate the impact of the Great Recession on one’s approach to economics? In the following essay I share some of the lessons I have learned from the largest recession of my lifetime. I earned my Ph.D. in 2011 so I cannot offer the wisdom of experience, only the perspective of a novice. The lessons I have learned motivate a framework that would change the way economics is typically taught and researched. Before presenting my thoughts on how economics should change it will be useful to offer a brief personal history. My opinions about how economics should evolve in response to the Great Recession are heavily influenced by the path I followed to become a professor of economics.

As an undergraduate I studied abroad in Guadalajara, Mexico. During my time in Guadalajara I was immersed in a world of extreme economic inequality. A typical day involved meeting with high-powered executives at multi-nationals and working with the poor on service projects. My desire to understand the personal, microeconomic, macroeconomic, and institutional factors that allow for some to live in abundance and others in chronic need is what compelled me to become a professional economist. In this regard I am not unique; many are drawn to the discipline because of its insights into the human condition.

My graduate studies in economics were from 2005 to 2011. The program I attended has the standard courses in micro- and macroeconomic theory and econometrics. A novel feature of the curriculum is that all graduate students take courses that expose them to heterodox perspectives and the history of economic thought. Because of this structure I learned neo-classical theory while simultaneously being aware of its many shortcomings. This duality in my training is something I deeply value. It has left a lasting impact on my convictions of what should be contained in the economics curriculum.

My journey through higher education coincides with a monument of intellectual hubris within economics, the Great Moderation. The errancy of proclaiming the taming of the business cycle began in 2007 and continues today. Had economists been more attuned to trends within the economy,
warnings like those of Shiller (2005) and Rajan (2005a & b) would have been more common. The collective voice of economists would have been less easy to ignore. As such, economists are culpable to a degree. The depth of the crisis, its magnitude, and its persistence could have been smaller. Reports on the death of economics are greatly exaggerated but there are many ways in which the discipline needs to improve.

1. Lessons Learned

In the aftermath of the Great Recession economics needs to become more holistic and humble: holistic in its practice and training, humble in its attitudes and communication. As teachers and scholars we play a vital role in determining whether the lessons of the Great Recession fade from the collective consciousness.

The training of tomorrow’s economists has a profound impact on the discipline’s future. As it stands, the standard economic curriculum (both at the undergraduate and graduate level) results in dangerous hyper-specialization. In retrospect, the housing and finance sectors are obvious examples of the fissures in understanding created by narrowly defined areas of expertise. Unfortunately, there is an even more grievous omission, the cursory treatment given to the labor market. During my graduate work I did not have a single course on the matter. The neo-classical treatment of work correctly conceptualizes labor as a factor of production for firms and a response of the individual to provide for himself or herself. But this conception is far too limited. The labor market serves as the foundation for a modern market economy and deserves more attention that it is typically given.

If economists were collectively more aware of labor market conditions many of the economic, political, and social factors fueling the housing bubble would have been noticed in real time: feeble per capita income growth, political willingness to encourage home ownership, abusive lending practices, short-termism in finance, and so on. Theories such as Rajan (2010), which hypothesize that the economic stagnation experienced by large portions of society led to political pressures to increase home ownership, likely would have emerged prior to 2007 and been more widespread. While Rajan’s theory has been criticized for mistaking correlation for causation, the plausibility of a deterministic relationship between the two is undeniable (The Economist, 2011). Being attuned to the labor market is necessary if one is to be aware of the broader health of an economy.
A second dimension of a holistic approach to economics is an awareness of heterodox theories and the history of economic thought. The Great Recession has allowed heterodox perspectives to increasingly have their voices heard. This is primarily because many of the factors that contributed to the crisis are not adequately addressed by standard theory. One must look outside the neo-classical world to sufficiently understand these factors. For example, the Austrian school should be consulted as one considers the impact of central banks in financial markets, Keynesians about the influence of fiscal policy, and Marxists in regard to the instability of capitalistic economies.

Economists are hesitant to expand their intellectual horizons because it can be disconcerting. Schools of thought often have contradictory ideologies but also contain elements of truth. Multiple dimensions of truth should not trouble the Christian economist. As Noll (2011) writes, our faith is defined by contradictions, the Incarnation being the most obvious. These contradictions are clues to a higher level of truth beyond human understanding. Acknowledging truth beyond our understanding allows us to “hold together concrete absolutism and nearly infinite flexibility” (Noll, p. 58). We can apply this flexibility to further our understanding; perspective is no longer constrained by narrow schools of thought. The end result of this process is that the lines between schools of thought will be dissipated as a deeper understanding of economic life is obtained.

This holistic approach is not confined to increasing the supply of ideas at one’s disposal. Ideas matter, but they need to be tested and refined with rigorous quantitative analysis. Theory and quantitative analysis should respond to one another. In order to effectively develop these skills in students, the process cannot be confined to a single course. Working with data and statistics requires a tremendous amount of exposure and repetition. The process should begin in principle-level courses as students gather data, analyze averages, and work through simple algebraic problems. These experiences provide the foundation to build upon in more advanced courses. As we enter the age of big data it is vital that our courses facilitate numerical tools being applied appropriately.

The second lesson is the need for humility. The notion of “The Great Moderation” should forever serve as a testament to the dangers of intellectual arrogance. Economists allowed themselves to believe they had “figured it out,” a dangerous mindset because of its root in pride. Accepting this narrative, whether implicitly or explicitly, reduces the subjects economists study to puzzles with solutions, as if the economy were a problem set waiting to be solved. If business cycles could be tamed
what other problems could be overcome with the economist’s toolkit? This mindset forgets that economists study people. Human actors, the unknowable path of history, as well as unique institutions and cultures combine to ensure economists will never “figure it out.” The very notion of the Great Moderation should have sounded warning bells across the discipline. This is likely not the last time the discipline will slip into a false sense of complacency induced by its technical prowess. Moving forward, a modicum of appreciation for Hayek’s (1989) pretense of knowledge would yield tremendous dividends.

Humility should compel us to be honest about what we do and do not know. The current cultural climate in the United States does not value the nuanced insights humility requires. Incendiary comments and arrogance rule the day. A renewed appreciation for the art of academic discourse is desperately needed. The Economist (2013) rightly points out that the current way economists engage one another is a black eye for the discipline. The true cost of this breakdown in communication is not trivial. When academics would rather demonize, point fingers, and proselytize, the advancement of truth suffers. By not holding ourselves to a higher standard we make it harder for economic truths to be heard. I believe this is a contributing factor to the dismissive attitude the general public has to the insights of economists (Sapienza and Zingales, 2013). It is our responsibility to model and facilitate academic discourse. We should not shy away from contentious issues but rather give them space in our courses and research.

2. Looking Forward: Income Inequality

The final portion of the essay is devoted to exploring how the aforementioned lessons may be applied to income and wealth inequality. President Obama identified these issues as “the defining challenge of our time” (The White House, Office of the Press Secretary, 2013). (Since this presentation, Pikketty’s Capital in the 21st Century has become a bestseller in the United States. An economist should never miss an opportunity to highlight an accurate prediction!) Whether this is the case largely depends on society’s perception of the issue. If economic inequality becomes perceived as the outcome of elites enriching themselves via a beggar-thy-neighbor economy there will be political responses. Democracy as a political structure facilitates the rules of the game being changed as the electorate sees fit. As Rodrik (2013) argues, ideas profoundly influence policy formation. Therefore the perception, regardless of whether it is
accurate, of an issue has profound political and economic ramifications. One does not have to stretch the imagination too far to envision responses to economic inequality that will significantly lower macroeconomic growth and performance for years to come.

In order to conceptualize what a holistic and humble consideration of income and wealth inequality may look like consider a story from The New York Times. Navarro’s (2012) “In New York, Having a Job, or 2, Doesn’t Mean Having a Home” is an example of the type of narrative that can deeply influence public attitudes. In this front-page article Navarro introduces the reader to the working poor in New York City. Ms. Manzueta serves as an example of someone in this group. She is a single mother with a two-year old daughter, living in a homeless shelter, and holds two jobs. The article is not a thorough academic analysis but a compelling personal story. It is nearly impossible to read about Ms. Manzueta and not feel troubled. The emotional response to her plight is that the United States’ economy is deeply dysfunctional. Put alongside the excesses of Wall Street and Silicon Valley our notions of equity are rightly offended.

Economists have an obligation to consider the many economic and political causes to growing economic inequality. The literature on this subject reflects this reality and so should our classes. Students need to be introduced to the full scope of causes in order to have a proper appreciation of each. The role of crony capitalism, education, globalization, technological change, changing family structures, and so on need be considered. In doing so, students gain a better understanding of the complexity of the issue. It moves from a “problem” with a “solution” to a multifaceted phenomenon. Recognizing complexity allows us to further illuminate the trade-offs inherent with policies designed to alter inequality. A natural outcome of this process is that we come to recognize our own personal notions of equity. With all these elements in place the totality of the issue at hand begins to be appreciated.

3. Conclusion

Economists should tout their successes while being mindful of their failures. The dramatic improvements in the quality of life since the Industrial Revolution have the fingerprints of our discipline. Unfortunately, so do the Great Recession and our willingness to not engage the causes of it as they took root. The economist as an educator and scholar stands as a guardian to the discipline. To ensure it continues in its successes and learns from its mistakes economists need to engage in holistic analysis and humble
communication. It is no small task, but one the discipline must take up if it is to continue its vital role of facilitating human flourishing.

Endnote

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References


