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"The Economic Crisis: The Crisis of Economics?"

Abstract

Has the economic crisis uncovered serious unresolved problems with standard economic models? This question has been discussed with increasing concern both among economists and non-economists. The continuously large interest for the research ideas of our new Centre in the media is just one sign of this common concern. While I am pleased that the debate has started, I am not equally pleased with the way a fairly balanced discussion often turns into a catchy headline. This is also one reason why I think it is important to bring the discussion back to the Department where it primarily belongs.

Therefore the idea of the seminar is to debate the recent economic crisis, the large imbalances that preceded the crisis, and why most economic models failed to see the approaching crisis. I shall discuss whether this failure can be traced back to the common assumptions of the rational expectations hypothesis, the representative agent, and the efficient market hypothesis, i.e. the assumption of a small world economy. This is of particular interest as the assumption of non-routine change and imperfect knowledge (central to Imperfect Knowledge Economics) provides an explanation for such imbalances, due to the fact that IKE is consistent with persistent movements away from long-run benchmark values (equilibrium values). Hence the interesting question is whether we could have done better if we had opened up our models to these more realistic assumptions. The idea with my talk is not to be critical to much of the excellent research done at our Department but to discuss in a constructive, balanced, friendly and open manner whether we can identify directions for how our models should be improved to be able to meet the significant challenges our world is facing.

The presentation is based on a nontechnical lecture I gave for Information one week ago and uses graphs and various charts to illustrate the basic arguments. The discussion will cover aspects which go beyond the research focus of our INET centre for IKE research, but is broadly in line with the discussions going on within the INET network. I shall also spend some time at the end of my talk discussing why I have become increasingly concerned about the present economic situation and its future prospects.