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## **Economics Methodology and the Financial Crisis: A RE – Examination**

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### **Abstract:**

*This paper focuses on the vigorous campaigns for a paradigm shift in economics teachings and practices following the global financial crisis of 2007 to 2008. It examines the various issues raised by the proponents of real world economics, especially complaints of the Cambridge-27 Students, the French Students, among others. It draws attention to the inability of economics in solving the real world economic problems due to the current method of teaching and practice of economics. This paper is skewed towards the need to re-design university economics curriculum that would make the teaching of economics to be more relevant and realistic in solving problems of our economic system which are complex, evolving, and unpredictable.*

**Keywords:** *Financial crisis, methodology, heterodox economics, orthodox economics, monism*

### **1. Introduction**

The global financial crisis of 2007-2008 was attributed to the sub-prime mortgage crisis that commenced in the United States of America and spread to other sectors of the financial system and the economy at large. The crisis spread to other countries as the affected institutions began to recall their loans to financial institutions and other business organization in those countries. Consequently, countries with strong business connections with financial institutions in the United States suffered the first-round effect of the crisis, while other countries came to be affected later through the processes of international trade, finance and investment (Akpakpan, 2010).

Empirical studies have revealed that the United States housing bubble burst which gave rise to the financial crisis was not without any warning. Studies such as Kritayanava (2008) and Shuttleworth (2008), stressed that during the period of boom, financial institutions, their supporting ideologies, politicians and regulations would not want to hear of caution as it was considered anti- capitalism. Fiakpa et al. (2008), opined that power without control produced natural results, as expected, with the loss of balance between financial market liberalization and financial regulation due to the circumvention of standards and traditional regulations regimes in an attempt to ensure the safety of the financial system.

Following the global financial crisis of 2007-2008, many works have emerged in the literature linking the crisis to the method of teaching and practice of economics dominated by mainstream neoclassical economics doctrines.

Akpakpan (2010), for instance, traced the problem to the prevailing “free market “economics doctrines that guides the teaching and practices of economics in most schools and countries today and is preferred, supported, and promoted by some of the powerful countries and international economic institutions. Supporting this notion, Colander et al (2009), viewed the crisis as a ‘systematic failure of academic economics’, while Shah (2009), opined that, ‘the financial crisis was as a result of a system heavily grounded in bad theories, bad statistics, misunderstanding of probability and ultimately greed’. After the global financial crisis, the campaign for a paradigm shift in economics has become more vigorous.

The various literatures on the issue of financial crises and economics center on the inability of the mainstream neoclassical economics to predict and solve economic problems of the present society, while few studies looked briefly at the students’ complaints and protest regarding the teaching of Economics in Universities. This paper seeks to outline and discuss the campaigns and various issues raised by the students and other proponents of real world economics.

The rest of the paper following this introduction is structured as follows: Section 1.1 presents the theoretical and conceptual framework, section 1.2 highlights the issues concerning the teaching and practice of economics, while the conclusion forms the main thrust of section 1.3.

#### ***1.1. Theoretical and Conceptual Issues***

According to Dequech (2007), mainstream neoclassical economics refers to economic ideas characterized by the following features:

- i. Emphasis on rationality and the use of utility maximization.
- ii. The emphasis on equilibrium or equilibria.
- iii. The neglect of strong kinds of uncertainty and particularly of fundamental uncertainty.

It is to be noted that Leon Walras and William Stanley Javons in the 1870s took economics onto a mathematical path, assisted by Hicks in 1939 with later consolidation effected by Samuelson in 1947 (Yeunglamko, 2011). Thorstein Veblen was apparently the first economist to coin the term 'neoclassical economics' in 1900 (Aspromourgos, 1986). At that time, Veblen referred only to a common utilitarian approach and the common assumption of a hedonistic psychology. Therefore, the mainstream neoclassical economists employ sophisticated technique through the use of mathematical models, among others in order to explain and solve the economic problems of the society.

Over the years, there have been several critics of the dominant neoclassical school doctrines, teachings and practices. But a more recent critique came from the French university economics students in year 2000 which spread to the United States, Australia and New Zealand. The main complaint was that the mainstream economics taught to students in most universities of the world, had become a branch of mathematics disconnected from reality (Skidelsky, 2015).

Therefore, in June 2000, the students grouped themselves into a movement for the reform of university economics teaching in France and broadcast through a web-based petition entitled: 'An Open Letter from Economics Students of the Universities of France', addressed to Professors and those responsible for the teaching of the discipline and by July 2000, the letter had been signed by more than 500 students.

According to Fullbrook (2003), the students petitioned against the following;

- i. The lack of realism in economics teaching
- ii. The uncontrolled use of mathematics 'as an end in itself' thus making economics an 'autistic science' lost in 'imaginary world', instead of being a useful tool for better understanding of economic realities.
- iii. The lack of a pluralism of approaches to the study of economics as a consequence of the heavy emphasis on the neoclassical approach as if that were the only economic truth.
- iv. The dogmatic teaching style in economics, which leaves no place for critical and reflective thought.

The debates aroused so much interest that the French government, through the then French Minister of Education (Jack Lang), set up a commission to investigate the teaching of economics in French universities and Jean Paul Fitoussi was appointed as chair, with the report due within twelve months (Yeunglamko, 2011). In September 2001, the Fitoussi commission submitted its report with the following recommendations:

- (i) The organization of a multidisciplinary curriculum for at least the first three years of undergraduate studies.
- (ii) Debate on economic issues to be integrated into the structure and content of economics courses, not only through theory and statistics, but also through institutional and historical facts.
- (iii) The shift from contrived and artificial exercises to the production of essays, oral presentations and student debates. Teachers were also required to assist students in preparing these projects.

Similarly, in support of the campaign for a paradigm shift, the Ph.D. economics students at Cambridge University known as the 'Cambridge - 27', published their position called 'Opening up Economics' in June 2001 (Fullbrook, 2003). By 'Opening up Economics', they mean, becoming mindful of the limitations of the competing approaches to understanding economic phenomena, learning their domain of applicability, and using the best methods for the question at hand rather than restricting research done in economics to that based on one approach only. In September 2001, a cognate petition appeared, that resulted from a meeting of 75 students, researchers and professors from twenty - two nations who gathered in Kansas City for a week to discuss on the state of economics. Other campaigns by university students for a paradigm shift were, the March 2003 Harvard Students Manifesto, and the April 2008 University of Notre Dame students' open letter (Yeunglamko, 2011).

Notably, the economics students at the University of Manchester published a manifesto advocating an approach that begins with economic phenomena and then gives students a toolkit to evaluate how well different perspectives can explain it rather than with mathematical models based on unreal assumption. Significantly, Andrew Haldane, Executive Director for Financial stability at the Bank of England, wrote the introduction (Skidelsky, 2015).

The Manchester students argued that the mainstream within the discipline has excluded all dissenting opinions, and the global financial crisis of 2007 - 2008, is arguably the ultimate price of this exclusion. Alternative approaches such as post- Keynesian, Marxist, Austrian economics, among others, have been marginalized. The same can be said of the history of the discipline.

The aim, according to the students should be to bridge disciplines within and outside of economics. The Manchester students believed that economics should not be divorced from psychology, politics, history, philosophy and so on. The students are especially keen to study issues like inequality, the role of ethics and fairness in economics as opposed to the prevailing focus on profit maximization. The idea is that such intellectual cross-fertilization would help students understand recent economic phenomena better and improve economic theory.

In an interview in 2013, Edward Fullbrook stated that, in the years leading up to 2008, the approaching financial crisis was not visible through the 'Old Paradigm Economics' window. But the New Paradigm economists such as Steve Keen, Nouriel Roubini, Dean Baker, among others, using a sophisticated analysis, warned about the global financial crisis if corrective measures were not taken.

In the analysis of the global crisis, Akpakpan (2010), opined that the events that brought the financial crisis were made possible by the economic system we operated. The rules of the system, especially minimal government and freedom of private resources owners to seek maximum private profits with their resources, created conditions for the problem. Particularly, financial liberalization created conditions for speculative financial transactions and other unhealthy practices by financial institutions that triggered the crisis. Sub-

prime lending and trading in financial assets, including national currencies, occurred largely because of lax regulations resulting from the role of minimal government.

'Until the financial crisis, market fundamentalism appeared to be successful. The proponents of free enterprise system defended it by showing that it is working successfully; producing and distributing desired goods and services, creating jobs, raising incomes, reducing poverty and improving living standard generally where it is allowed to work. The financial crisis exposed the failures of the system and destroyed the case for market fundamentalism' (Akpakpan, 2010). In the same vein, Professor Prabaht Patnik of the center for economic studies and planning in India as cited in Sere-Ejembi (2008), submitted that the cause of the financial crisis was located in the fundamental defect of the free market system.

## 2. Issues on the Teaching and Practice of Economics

### 2.1. The Students' Protest

The most important issues that emerged from the students' protest as outlined by Yeunglamko (2011), are as follows:

- (i) A Pluralism of Approaches in Economics: Various reasons were advanced for the need to have a multiplicity of approaches to the study of economic phenomena, instead of only the mainstream neoclassical approach. First, economic phenomena are too complex to be explained only by the neoclassical approach. To argue that this approach alone results in the true explanation of what is going on amounts to dogmatism. Second, this approach prevents proper reflection and critical thinking on the part of the students themselves which gives them no choice but to accept the mainstream material as the only economic truth.

However, in calling for a pluralism of approaches, the students did not request for the complete elimination or replacement of the mainstream approach, but exposure to fruitful debate about all possible approaches, so that the strengths and limitations of each could be assessed.

- (ii) The Excessive Use of Mathematics: The students strongly denounced the excessive use of mathematics as an end in itself, instead of seeing mathematics as one of a number of possible instruments that can be used to understand economic phenomena. They accepted that a certain amount of mathematics may be necessary, but argued that when mathematical models are axiomatic, abstract and possess little practical or policy relevance for real economic problems; these models are less than helpful and should be replaced with more realistic approaches to the study of economic problem. It was not that the students could not, or would not, engage with mathematics, but it was the lack of relevance of the mathematical approaches being taught to economic realities that was the object of student dissatisfaction.
- (iii) Economics and Reality: The students also complained that the mainstream neoclassical economics dispensed to university students is divorced from the economic realities and problems of the real world. Mathematical economic models can offer a wide array of logical results, but they cannot of themselves offer any practical, policy prescription for the actual economic problems of the present era, including the global financial crisis, high unemployment, the distribution of income, the alleviation of poverty, and the problem of underemployment.

Blatt (1983), voiced similar concerns thus: 'Mathematics is, after all, purely logical subject. One starts from a set of assumptions (axioms) and uses the rules of logic to deduce their consequences. When mathematical reasoning is applied to problems outside of mathematics itself, then the result is no better than the initial assumptions'.

### 2.2. The Role of History of Economic Thought:

The issue concerning the declining role of the history of economic thought in university research and teaching has been increasingly discussed. Dow (2002), noted that history of economic thought plays a constructive part by informing modern economists of the choice of methods and theories made by their forebears in different circumstances. As social systems evolve, the appropriate theory to represent certain phenomena must evolve too, therefore, plurality in methods including history of economic thought must be a deliberate choice.

Akpakpan (2010) added that 'history of economic thought provides the opportunity for learners to witness the development of the ideas that define the subject which is necessary for a sound understanding of the issues and debates. Due to the importance of this course, it is necessary to ensure that the debates, ideas and the criticisms of the founding fathers such as the physiocrats, the mercantilists, Adams Smith, the pre- Marxist Socialist, Karl Marx, among others, are properly explained and effectively communicated'.

Blang (2001), opined that there are two types of likeminded economist; those originally attracted by the mathematical mastery of social phenomena, and those inclined to philosophical research on these phenomena. He added that heterodox economics and history of economic thought share the latter approach and thus find themselves reflecting on similar issues. The relationship between history of economic thought and heterodox economics, is considered as a strength of history of economic thought and one of the reasons for its damnation among mainstream economics (D'Ippoliti and Rancaglia, 2015). Weintraub (2002) viewed that the traditions of heterodox economics utilize historical argumentation in ways quite different from the practices of neoclassical economist.

### 2.3. The Old versus the New Paradigm Economics

One of the proponents of the real-world economics (Edward Fullbrook), presented a ten- point list to distinguish between the old and the new paradigm economics. This is tabulated as shown in Table 1 below:

	<b>OLD PARADIGM ECONOMICS</b>	<b>NEW PARADIGM ECONOMICS</b>
1	Anti-pluralist (as in classical physics)	Pluralist (as in modern physics)
2	Prioritizes mathematical deductivism	Recognizes that the ontology of much economic phenomena do not fit the requirement of mathematical deductivism.
3	Beginning with a pure mathematical model, it gives economic entities definitions that make them isomorphic to those mathematical relations. (i.e. upside-down science)	Chooses its mathematics as in both classical and modern physics, on the basis of its isomorphism to real-world phenomena including construction of real-world empirical Models using real data (i.e. prioritizes the empirical over apriorism)
4	Assumes markets converge toward equilibrium and that therefore theories should be framed around the concept of equilibrium	Recognizes the importance of markets that do not converge toward equilibrium and therefore encourages theory and model development not tied to the equilibrium concept.
5	Assumes that when in equilibrium markets have cleared.	Does not presume that equilibrium is a market clearing situation.
6	Assumes economic agents have stable preference and on average behave in a maximizing manner consistent with the neoclassical definition of 'rational'	Interested in real world agent preferences and behavior, 'rational' or not and their macro consequences.
7	Assumes atomistic agents and seeks to explain all meso and macro-economic phenomena in terms of micro phenomena.	Regards agents as social beings, recognizes emergent properties and structures as fundamental to economic reality and thereby the need for a multidimensional ontology.
8	Relies on the ergodic axiom, i.e. reduces uncertainty and risk	Rejects the ergodic axiom, i.e. regards the existence of irreducible uncertainty as an ontological fact that should not be hidden.
9	Treats the planet ('resources') as a subset of the economy.	Treats the economy as a subset of the planet and of its biosphere.
10	Claims the possibility of a normative positive distinction in a monist context.	Recognizes that the application of any conceptual framework to a real world economic situation contains a normative or ideological dimension.

*Table 1: The Difference between Old Paradigm Economics and New Paradigm Economics*

*Source: Fullbrook (2013)*

According to Fullbrook (2013), of the ten points listed to distinguish between Old Paradigm Economics and New Paradigm Economics, the most important issue is monism versus pluralism. This is because, it is the choice that sets down the general framework under which the pursuit of knowledge is conducted. This choice has effect on the advancement of knowledge and human welfare. In supporting pluralism, Keynes (1933), in Yeunglamko (2011) declared thus: .... 'the master economist ... must be mathematician, historian, statesman, philosopher.... He must understand symbols and speak in words.... He must study the present in the light of the past for purposes of the future. No part of a man's nature or his institutions must lie outside his regard'.

### 3. Conclusion

In order to make economics more realistic and relevant, there is need to re-design university economics curriculum to include a pluralistic approach, rather than the current mainstream neoclassical approach only. This will satisfy students' objectives and expectations, provide a useful solution to the teaching of economics, and produce economists with strong mathematical, literary and thinking skills with a view to solving the problems of the society.

Mainstream economics today is a sophisticated technique which tends to employ mathematics in dealing with real economic problems, but mathematical economic models can only offer a wide array of logical results, and cannot of themselves offer any practical policy prescriptions for the actual economic problems of the present era. Today, the Nigerian economy is in recession characterized by high inflation, high unemployment rate and negative GDP growth (See; Akpan and Udofia, 2017), which cannot be handled with mathematical models only.

The knowledge of methodology rather than a method is important in understanding economics and economic systems which are complex, evolving and unpredictable. The need for plurality in the teaching of economics will expose the insufficiency of mathematical formalism as a methodological approach. Thus, integrating heterodox theories into economic curriculum will expand the domain of economics, including the relation of economics to other aspects of human life normally excluded from conventional economic analysis.

The French and other students' complaints about the teaching of economics should not be ignored but supported by all university economics students around the world. The economics doctrines and teaching that are imaginary, irrelevant and dogmatic in nature render economics ineffective in solving economic problems of the world (the financial crises, among others, for instance). Thus, the teaching of heterodox economics and orthodox economics should be encouraged in university economics curriculum around the world.

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