



THE INSTITUTE OF ECONOMICS, RUSSIAN ACADEMY OF SCIENCES

THE POVERTY OF ECONOMICS IN REACTIONS TO CHANGES: THE NEED FOR A NEW SYNTHESIS?

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MOTIVATION

- **The increasing complexity and dynamics** of natural and socio-economic processes are in advance of the possibilities for economic theory to reflect and explain them. A response to such challenges is to develop a theoretical synthesis building a broader theoretical framework to describe new economic reality.
- **Theoretical synthesis** means that new doctrines, the necessary revision of basic premises and the renewal of methodology are integrated into already existing theoretical knowledge (well known examples are modern synthesis or neo-Darwinian synthesis in biology as well as the synthesis of quantum physics).



MOTIVATION cont.

- What have been the results of theoretical syntheses in **Neoclassical Economics (NE)**? Did they create an adequate research framework for understanding the new reality?
- What are the possibilities for **Heterodox Economics (HE)** to develop necessary synthetic concepts?
- We try to answer these questions from **a methodological point of view**, that is, considering whether methodological foundations are means, or obstacles, in solving the problems.



OUTLINE

- Intradisciplinary syntheses in NE - the neoclassical synthesis of 1940-50s and the new neoclassical synthesis of the 1990s.
- Paradoxes and methodological limits of intradisciplinary syntheses in NE.
- The prospects for new syntheses in Economics.
- Conclusion.



Intradisciplinary syntheses in NE - the neoclassical synthesis of 1940-50s and the new neoclassical synthesis of the 1990s



NEOCLASSICAL SYNTHESIS (NS)

- The essence of NS of the 1940-50s was the combination of Keynesian ideas for short-term analysis of economy and neoclassical economic ideas for the long-term analysis.
- NS became a more relevant theoretical answer to the problems of the Great Depression and substantiated the need for state participation and regulation of the economy, primarily in the monetary sphere.
- The practical consequences of NS were the support and justification of numerous programmes of state regulation of the capitalist economy, which were quite successful before the 1973–75 recession triggered by the 1973 oil crisis.



WHY NEW NEOCLASSICAL SYNTHESIS (NNS)?

- Then in the 1970s approaches based on NS failed to explain and manage new economic phenomena, mainly stagflation. This situation was interpreted as a crisis of Keynesian regulation of the economy.
- Also, the internal theoretical contradiction of NS was identified: Walrasian microeconomics with equilibrium of markets and general equilibrium cannot be aggregated into Keynesian macroeconomics, where markets do not come to equilibrium.



NEW NEOCLASSICAL SYNTHESIS (NNS)

- NNS (*Goodfriend, King, 1997; Woodford, 2009; Laffargue, Malgrange, Morin, 2012*) was formed in the 1990s at “the intersection” of new Keynesian economics (which contributed nominal rigidities) and new classical (macro) economics (which contributed the methodology behind the real business cycle theory).
- The main result of this synthesis was the development of dynamic stochastic general equilibrium (DSGE) models. Currently, DSGE models are the most popular in neoclassical economics and are widely used in practice, particularly by a number of Central Banks. However, no major central bank in the world uses the DSGE model as the main economic model (*Korinek, 2017: 11*).



Achievements and failures of NS and NNS

- On the one hand, both syntheses have strengthened the explanatory capabilities of neoclassical theory, including in connection with the development of a new class of mathematical models.
- On the other hand, in the course of these syntheses, it was not possible to resolve the well known and continuously discussed theoretical difficulties, and this we call the paradoxes of syntheses (from ancient Greek παράδοξος - unexpected, strange).



Paradoxes and methodological limits of intradisciplinary syntheses in NE



Paradox 1: low predictive potential of NE

- After NS, such unpredictable situations were the stagflation of the 1970s and the oil crisis that hit the economies of Western countries.
- After NNS, the dot-com crisis of the early 2000s and the Great Financial Crisis of 2008/09 turned out to be unpredictable phenomena.
- As a result, “the DSGE approach has come under heavy fire” (*Korinek, 2017:1*). Experts note that they are not adapted to the study of cyclical fluctuations, and therefore are “powerless in terms of their forecasting and anticipation. So, a stabilization policy based on DSGE models will always be subjective” (*Stolbov, 2012: 18*).



Paradox 2: the totality (universality) of the market model of the economy

- This model does not take into account the specifics of the socio-cultural and material-natural conditions in which economies develop.
- Therefore, neoclassical economic models are non-historical and “do not contain anything that would distinguish market economies from Soviet-type economies or from the economies of Ancient Rome and medieval China” (*Baumol 2001: 84*).



Paradox 3: the problem of *classical dichotomy* has not been resolved.

- The principle of *classical dichotomy* (Schumpeter, 1954) and the associated idea of money neutrality means considering the real and monetary sectors of the economy as not having a direct impact on each other.
- Orthodoxy “failed to go beyond real analysis” (Hein, 2008).
- Therefore, NNS is a “new classical counter-revolution” in economic theory “and a” Samuelsonian cousin “of NS (Foley, 2014: 4-14), during which there is a return to a more complex *proforma* approach but still economically incomplete version of *classical dichotomy* (Foley, 2014: 17).



Causes of paradoxes

- Why does the paradoxical situation persist when, after both theoretical syntheses, NE did not improve the predictive potential, did not overcome the totality of the market model of the economy and was unable to solve the problem of the *classical dichotomy*?
- Because:
 - the methodological core of neoclassical economics remains unchanged;
 - the same type of mathematical models is used;
 - the reliance on micro-foundations is maintained.
- All three causes are interrelated and mutually supportive.



Methodological core of NE – *pro & contra*

- On the one hand, reliance on a “proven system” of methodological prerequisites (among them methodological individualism, the rational utility maximisation hypothesis, the market equilibrium principle, optimisation mathematics) makes it **possible to implement any ideas** and approaches into the “main body” of NE.
- On the other hand, the very set of these prerequisites becomes a kind of **"Procrustean bed"**, limiting the development of NE and explains the poverty of NE in reactions to changes. So the theoretical schemes and models in NE, building on both syntheses, retain some of the previous limitations and are insufficient to respond to the challenges of current economic practice (*Foley, 2014; Aboobaker et al, 2016; Lee, Tae-Hee, 2018; Skidelsky, 2020*).



The prospects for new syntheses in Economics



Are new syntheses in NE possible?

- Now the process of inclusion of new ideas and approaches, e.g. behavioural economics, historical and institutional analysis, neuroscience etc., is ongoing in NE.
- It allows some authors to say that the neoclassical mainstream becomes more pluralistic, and less individualistic, taking into account different types of path dependency and employing a much broader group of models and analytical tools (*Hands, 2015: 70*) so new syntheses will occur.
- Time will tell how promising these directions of synthesis are while maintaining the basic methodological prerequisites of NE.



What about opportunities for HE?

- The growth of turbulence in the world due to new risks, including the destruction of unipolarity, climate change, pandemics, etc., makes the importance of solidarity and collective structures more obvious.
- It shifts the focus of social and economic research from the individual level to the group and institutional level, from the micro-level processes to the **meso-level processes**.
- In these conditions, HE faces the challenge of defining **its own methodological prerequisites**, more adequate to the modern interdependent world and uniting studies of heterodox economists.



Interdisciplinary synthesis and new methodological prerequisites in HE

- Intradisciplinary synthesis, as the experience of two particular syntheses in NE has shown, has its "methodological limits".
- Interdisciplinary synthesis, when economics interacts with social science and humanities, may be more promising.
- The basis of such an interdisciplinary synthesis could be from **meso-foundations** in methodology, as well as **meso-level** as a main research subject.



Meso-level as a research subject

- Meso-level is understood as a specific level of the economy, at which objectification of the needs and aspirations of economic agents takes place and their transformation into independent structures (e.g. like institutions) necessary for the functioning of the entire economic system (*Arthur, 2013*) as well as their structuring and institutionalisation (*Dopfer, 2004, 2006, 2012; Dopfer, Foster, Potts, 2004; Dopfer, Potts, 2008; Elsner, 2007, 2010; Elsner, Heinrich, 2009; Kirdina-Chandler, Maevsky, 2020*).
- These structures reflect the emergent effects of the system, and they are “too complex to be satisfactorily described from a micro perspective, given our current state of knowledge” (*Korinek, 2017: 3*).
- It is in contrast to the microlevel or the aggregated macrolevel as subjects in NE.



Meso-foundations

- The economy is considered as **a dynamically developing complex system** in which mesoeconomic structures arise due to the emergent effects of economic co-evolution processes and are qualitatively different from the microlevel (*Elsner 2007*).
- Not the principle of methodological individualism but **the principle of methodological institutionalism** (*Toboso, 1999, 2001; Kirdina, 2013, 2015, 2016*), is used as one of the methodological prerequisites. It focuses on the structures and processes that regulate the social environment where economic agents operate.



Meso-foundations cont.

- Not mostly negative feedbacks but equally **positive feedbacks** are under consideration: they ultimately ensure economic growth, but also, can lead to an imbalance in the economy, including crises.
- Together with competition coordinating economic processes, other spontaneously emerging coordination mechanisms **like cooperation, redistribution, solidarity, reciprocity** etc. are under consideration (*Dementiev, 2002, 2015; Meso-economics of Development ... 2011 : 21*).
- The social conditioning of economic meso-structures and an understanding of **the social embeddedness** of economic processes is the main focus, not so much the behavioural characteristics of the economic agents.



Conclusion





Methodological obsolescence of NS and NNS?

- The remaining hard methodological core, which provided the foundations for both syntheses, is a main limitation on solving the constantly debated problems of NE (the low predictive capabilities; totality of market model; the problem of the “classical dichotomy”).
- Moreover, the previous methodology greatly enhances the ideological nature of NE, its significant "fixation" on micro-foundations, and the preservation of the optimisation mathematics of equilibrium models.
- In modern conditions, which are significantly different from those when the methodological core of NE was finally formed (mid-twentieth century), adherence to its postulates becomes a limitation on the fruitful development of economics (economic theory).



Prospects for theoretical synthesis in HE

- Awareness of the methodological foundations of any scientific direction is one of the conditions for an interdisciplinary theoretical synthesis.
- The set of methodological prerequisites presented, which we called meso-foundations, forms different methodological lenses in comparison with neoclassical micro-macroeconomics and determines the prospects for the integration of some heterodox concepts.
- This allows us to hope that theoretical interdisciplinary synthesis will take place in HE to understand better our changing interconnected world.



Thank you for your attention!

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