

Economic reasoning

SIR - We read your briefing on the state of economics ("The other-worldly philosophers", July 18th). Our view is that the current economic calamity arises not so much from problems within our discipline as from the slavish devotion accorded it by outsiders. For example, in America it was argued that government was the source of our economic problems and that robust markets were sufficient to achieve economic goals. What has become abundantly clear is that this position is false.

Markets do not inevitably self-correct and we cannot always rely on enlightened self-interest to provide economic prosperity. Markets may require "adult supervision". The insights of our discipline were oversold by those pursuing their own objectives; qualifications and cautionary statements were ignored.

WILLIAM COMANOR
Professor of economics
University of California, Santa Barbara
TAKAHIRO MIYAO
Emeritus professor of economics
University of Tsukuba, Japan

SIR - When I was a student we studied business cycles, but the topic disappeared with the rise of mathematical equilibrium theorising. The idea that capitalism is an equilibrium system is common among Keynesian and neoclassical economists; they only differ as to whether the equilibrium is at full employment or under employment. The grand synthesis being taught makes the equilibrium stochastic and dynamic, but that is all.

Capitalism is, however, a disequilibrium dynamic stochastic system as Marx, Wick- sell, Schumpeter and Hayek have told us over the past two centuries. Richard Goodwin tried his best to present a mathematical theory of such a disequilibrium system. After this crisis we need to revive that tradition if we are not to be surprised by another crisis.

PROFESSOR MEGHNAD DESAI
House of Lords
London

SIR - The belief that working economies could be precisely represented by very abstract and simple models should have worried any liberal economist. Only a kind of religious faith in the ability of the human mind to represent the fabric of society mathematically could have led to such confidence in these models. Any economist who has read Hayek, and other conservative thinkers before him, knows that economic life is society at large, are much more complex. Macroeconomists should take models for what they are: simplified views of the world that help us think about a complex issue, but are not true representations of the complexity itself.

JEAN-LUC DEMEULEMEESTER
Professor of economics
Université Libre de Bruxelles
CLAUDE DIEBOLT
Research director in economics
Université de Strasbourg

SIR - The discipline of "institutional economics" holds that the more complex a market becomes, the more it is beset with transaction costs, information asymmetries, moral hazard, opportunism, and even predatory behaviour. This leads to short-term perspectives and excessive risks, all of which have disequilibrating consequences that can lead to market collapse. The solutions are therefore to be found in formal (and informal) rules and regulations to control or eliminate perverse incentives in the market place, and in the governance structures of financial corporations. In this respect, while current policy initiatives are broadly correct, inadequate attention is being given to changing the formal rules and framework for corporate governance.

ASHOK CHAKRAVARTI
Senior visiting lecturer
University of Zimbabwe
Harare

SIR - John Maynard Keynes was the most important of the founders of macroeconomics, though, as you implied without quite saying, he never used the term. You said that "the word did not appear in the

journals until 1945, in an article by Jacob Marschak." However, Jan Tinbergen, a Nobel prize-winning Dutch economist, used "macroéconomique" in a French journal in 1936 and J.M. Fleming, an English economist, used "macro-economic" in the *Economic Journal* in 1938. Neither is the original source.

They almost certainly learned it from Ragnar Frisch, a Norwegian economist, who with Tinbergen shared the first Nobel prize in economics in 1969. In a *Festschrift* in honour of Gustav Cassel in 1933, Frisch wielded the term "macro-dynamic" in a sense indistinguishable from macroeconomic and used the Norwegian equivalent of macroeconomics in lectures around the same time. Frisch was a great coin- er of technical terms, also giving us "econometrics".
KEVIN HOOVER
Professor of economics and philosophy
Duke University
Durham, North Carolina

SIR - I was surprised that you did not mention the Austrian school of thought. Economists trained in the Austrian framework recognised early on that the recent boom was induced by rampant credit and money creation rather than sustainable economic growth, and correctly predicted the inevitable bust. Why spend so much time focusing on the economists who got it wrong while ignoring those who got it right?
RICH TOSCANO
San Diego

SIR - Your analysis of the efficient-markets hypothesis (EMH) did not recognise the importance of distortions caused by public policy ("Efficiency and beyond", July 18th). Government policies often provide incentives to market participants to act contrary to the EMH. Tax laws, specifically those which encourage leverage while discouraging the accumulation of equity capital on balance-sheets, are perhaps the greatest deterrent to its effective operation.

Other government policies that have distorted financial markets, thereby undermining

the EMH, include shielding credit-rating agencies from lawsuits, government-sanctioned fair-value accounting rules, enforcing credit-default swaps where there is no insurable interest, mispriced deposit insurance, government-sponsored enterprises, and the over-promotion of home ownership. Minimising these distortions is key to making the EMH an everyday reality.

BERT ELY
Alexandria, Virginia

SIR - Some banks paid up to \$160m to senior executives just to get rid of them after shares collapsed and investors wised up. The economic collapse side-by-side with these obscene payments are evidence enough that the EMH is dead.
PAUL HALLWOOD
Lyme, Connecticut

SIR - When I considered taking a degree in economics almost 50 years ago, I was told that the exam questions would be the same from year to year, but that the correct answers would differ each year.

I decided instead to become an engineer.

TONY HAYS
San Clemente, California

SIR - Having used my PhD in economics as a stepping stone to the more reputable field of stand-up comedy, it would be easy for me to spend all my time mocking macro-economists. Consider, for example, that the current head of the Congressional Budget Office co-wrote a paper a few years back titled "Can Financial Innovation Help to Explain the Reduced Volatility of Economic Activity?".

YORAM BAUMAN
Seattle ■

Robert Lucas, a professor of economics at the University of Chicago, also responds to our leader and briefing in this week's Economics focus.

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