Challenges to the mainstream economics worldview could change economic policymaking

I had always thought it was a matter of expediency that outside of academic settings, economic practitioners never discussed or spoke of the theoretical models they would have learned in their education. The macroeconomic models, especially at the graduate level, were often very technical or mathematical, rendering it too complex and unappealing to the non-economist. Best to just focus on common economic indicators, trends and analysis that was fairly intuitive and easily communicable to their audiences; policymakers, the business community and public at large.

Being a financial market practitioner with an economics background, I also never found any occasion or need to tap into any of these models. Things were always moving fast with so much happening at the same time. There was the comfort of the efficient market hypothesis that loomed in the background, saying that basically no one can beat the market. But behavioural sciences have long successfully challenged the economics notion of 'rationality' that underpinned this theory. People make decisions based on many factors and influences. Many of these, despite being reasonable, do not meet the rationality assumption that is required for the efficient market hypothesis to hold. Empirical research itself was not able to validate this theory.

The validity of these models wouldn't really matter to the real world if they just stayed in the academic field. But eventually, economics can and does influence government and public policy. Economics graduates and academics became policy makers and economic consultants. Some would go on to take up very influential roles at central banks, governments and international organizations such as the International Monetary Fund, World Bank and many more. They would bring along the influences of the dominant macroeconomic theoretical approaches such as the Dynamic Stochastic General Equilibrium (DSGE) models which centres around rational expectations, an optimising, representative agent operating in a world with perfect markets. Money, the banking system and finance may or may not exist as these do not matter to the real economy. These mathematical models are applied across the whole spectrum of economic interest; growth, consumption, international trade, business cycles etc. The setup eventually supports an ideologue that markets are self-correcting, governments should not interfere or intervene in markets or in macro management of the economy. Deregulation, liberalisation and free markets become the key bywords of economic policy positions or prescriptions. For us, the Asian Financial Crisis had long ago cast strong doubts on these theoretical assertions and our policy approaches have already responded to these. As a result, we would often come into conflicting positions with these open and liberal market views that were continued to be espoused by international organizations and their developed country stakeholders, international financial industry players and lobby groups.

But the Global Financial Crisis had seriously exposed the shortcomings of these mainstream macroeconomics and their policy positions. Difficult it is to believe, as the world was facing an economic calamity of monumental proportions, according to the many critiques, the prevailing economic theory had nothing to contribute. In these models, it could not have happened. Many even viewed financial deregulation, a key policy contribution of the mainstream macroeconomics, as a primary cause of the crisis. These have led to a new movement and rethinking in economics. For example, in the UK, the Institute for New Economic Thinking, a non-profit organization was founded in 2009 for this purpose. It has grown to support many academics, researchers and partner with universities including the University of Oxford to develop economics that better reflect realities. These have started by looking into alternative economic theories outside of the mainstream that nonetheless still existed and were pursued by a small minority of academics, known as heterogeneous economics. The economics field is thus changing and evolving as it does every few decades. The cause has always been quite similar, when theory has disconnected from and can no longer explain reality. But given the enormity of the task and the strength of the status quo that still prevails in many institutions and universities, we are probably a long way still. In the meantime, empirical evidence becomes even more critical in policy thinking and formulation.

Where does this leave us. We have never been hesitant in charting a different course in policy making. Whether the selective capital controls in 1998, non-internationalizing the ringgit, rejecting inflation targeting, aggressively curtailing of the offshore ringgit derivatives, rebalancing the ringgit foreign exchange market; we would always look towards the evidence and what works best for our circumstances. If anything, these developments further strengthen our position in adopting this approach. Differing from the best policies or practices advocated by international organizations, finance and industry lobbies is not necessarily detrimental. Many of these advocated positions, after all, were derived from what is now a growingly discredited body of economic theories and conclusions. In many places now, they are no longer accepted.

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