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Economic History and Economic Theory

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Abstract

Can economic history manage without economic theory? And can economic theory get along without economic history? These are the two questions that will be addressed here. If we look at what the situation is actually like in both the Norwegian and international research communities today, the basic outline of an answer becomes quite evident: Economic history is strongly and quite significantly influenced by economic theory, and there is little reason to believe that the discipline will be able to manage gracefully without economic theory in the future.

But this dependence is not mutual. Economic theory has, at least over the last two research generations, received rather limited input from economic history. Most academic economists have little exposure to economic history, and I do not think this is seen as a pressing problem among practitioners of the economics profession. Nevertheless, I believe that many economists would benefit from studying more economic history. I will come back to this in my conclusion, after taking a closer look at the relationship between economic theory and economic history as it has developed over time.

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1. The influence of economic theory on economic history

Can economic history get along without economic theory? My answer is thus a definitive no. That many may try is another issue. It is also possible to ride a bicycle blindfolded - if one sticks to riding in a straight line on unchallenging terrain. And even then it is not recommended.

But what I'm thinking about is basic, general theory as a part of an interpretive framework when we study economic relationships and trends in the past. If we look at general accounts such as David Landes' *The Wealth and Poverty of Nations* and Barry Eichengreen's latest book, the textbook-like *The European Economy Since 1945*, we see that they are packed with economic theory and perspectives in their attempts to understand and approach complex trends. There are few models and t-values in their books, but they are theoretically inspired to the highest degree. We find the same in texts such as Francis Sejersted's "En teori om den økonomiske utviklingen i det tyvende århundre" [A theory on the economic development of the 20th century] and John Hicks's *A Theory of Economic*

History. Both Landes and Eichengreen attempt to present a simplified explanation, not a general theory, that will explain the main characteristics of development over a period of time. And their theses are constructed using argumentation that rests on economic theory, implicitly and explicitly.

I would like to point out two reasons why the historian who studies the economic development of the past and its actors cannot avoid economic theory: First, without theory it becomes difficult to understand and explain key characteristics of economic development; likewise, an absence of theory makes it equally difficult to understand how the key actors perceived their world and how the actions they took may have been part of a larger pattern.

Let's look at the politics of the Norwegian krone in the 1920s as an example. The goal of the government in 1920 was to bring the inflated krone back to the gold standard, as was the case before the First World War. At that time, the krone had only 40 percent of its previous value in relation to gold and gold-based currency after the war. The gold parity was reestablished after a period of deflationary policies, with large economic and social costs.

Most historians who try their hand at explaining this period understand that people in debt were hit hard by the government's policies. Most also understand that those who produced goods in Norway and received their sales revenue in foreign currency landed in trouble. But with respect to questions of how the currency policy affected the burden of the national debt, the expenses and income of the merchant fleet, or the standard of living of the workers with different types of wage agreements, we find confusion and lack of clarity in a number of accounts.[1] This is not surprising, since here we quickly enter complex territory. And it is not just the interpretations that are more difficult to make for an historian who is poorly equipped theoretically. Very specific information from archives and statistical sources are needed to investigate these problems. Without a solid understanding of how deflationary policies affect households and business, the historian will neither be motivated nor able to carry through a time consuming investigation of such questions.

The second reason why theory is important is thus that one must understand the perceptions and actions of the actors to be able to present an analysis that does them justice. In this context, it is naturally the historical theories that matter - the prevailing theories of the time about how the economy worked, and how a consumer, firm, or state should act. In the case of the currency policy of the 1920s, we understand that the state followed a judicial and normative principle that the krone had to be brought back to its original value, which was even stipulated in the legislation. The purely political considerations, and the doubts that arose in the mid 1920s, are well studied. However, in the volume of existing historical accounts of unions and firms we find little discussion about how actors felt they should respond to the deflation of the krone about which the

[1] The desire to have a continued good relationship with my colleagues means that both here and throughout this essay I will exercise caution in citing references.

government issued a clear warning early in the decade, and which was finally implemented early in 1928. Does this mean that the firms in question did not believe that the policy would be implemented, or that they did not believe that there was any way they could avoid being hard hit by the impact of the policy? When the firms demanded a reduction in wages, the unions often protested. Was this because they wanted a real increase in wages regardless of the circumstances? Or was this because they did not completely understand that the sharp drop in prices would give them a higher standard of living even though their wages dropped somewhat in absolute terms? And how did they consider the relationship between their own actions and the future of the firms they negotiated with?

When numerous accounts of firms and organizations of the 1920s give surprisingly little consideration of such issues, I believe we can look to shortcomings in the historian just as much as in the historical actors. Conducting an institutional history often demands delving very deeply into the source material. The historian then focuses on a small part of what the source material can offer. This is what the historian is able to understand and give meaning to. If historians fall short with respect to understanding how their actors perceived economic interrelationships - such as the future exchange risk and how they could protect themselves -- they risk losing important nuances, and the actors can appear more ignorant than they actually were.

There is perhaps reason to specify that this way of seeing the importance of using economic theory in economic history is somewhat different than the much discussed distinction between "traditional" economic history and the new direction from the 1950s: New Economic History (NEH). Of these two schools of thought, it is the latter that is simplest to define. New Economic History emerged and still stands as a branch of economics, and is informed by the theories and methods of this discipline (Merok and Lange 2006). "Traditional" economic history is more pluralistic in its selection of methods. It is often focused on explaining isolated events or change over time and normally concerned with the actors' motives, values, and perceptions. This is economic history for historians -- in the sense that research in this field is primarily directed at other historians, and only to a small degree at economists. In international and national comparisons, there is also a fairly clear distinction between the two directions, which of course appear under slightly different names. In some places, economic history is part of the economics discipline. This is the predominant solution in Sweden. In Norway, we have one community for economic history that is largely built on economics, and this is at the history community at the Norwegian School of Economics and Business Management in Bergen. Otherwise it is the "traditional" economic history that dominates at Norwegian institutes of learning.

As I see it, however, the distinction between NEH and traditional economic history does not follow the dividing line between economic history and economic theory. As mentioned earlier, it is not always the case that all research in "traditional" economic history is equally well grounded in theory. But nor is this the case for historical research inspired by economics. Economists that are searching historical material for something they can count and measure, might see this a bit differently. When they are turning to the past with their disciplinary toolbox wide open, it is easy to believe that they are bringing economic theory into their interpretation of the past. This is where I think there is a very common misunderstanding of economics being reduced to simple models and estimation techniques. But I would like to remind the reader that we had rather comprehensive statistical research on economic relations for a very long time until the discipline of economics began to more systematically be interested in statistical data in the inter-war period (Lie and Roll-Hansen 2001, ch. 4). This research, branded by the Dutch economist Tjalling Koopmans as ‘measurement without theory’ in a critical comment, was often interesting, and it was methodologically advanced, but it was characterized by a lack of interest in general theory. Today we have researchers in economic history both abroad and home that spend their time establishing indexes and time series and then looking for some research question of relevance for their numbers and indexes (Simkins 1999). Nothing wrong with that, but this research can often get along just fine in the total absence of, or at least with a very superficial understanding of, economic theory. This is precisely why it has its limitations as an independent contribution to economic-historical research, even though it can provide very useful contributions to the historical statistics available.

2. The influence of economic history on economic theory

Can economic theory get along without economic history? The answer is a conditional yes: economic theory today builds on economic-historical research only to a very small degree. And it gets along just fine, to the irritation of some and satisfaction of others.

There is perhaps reason to remember that this has not always been the case. Economic history has an origin that is very closely connected to the discipline of economics. In the German tradition, economic history is in many ways the mother of economics. Through the marginalist revolution and birth of a new type of economic research that studied economics on the basis of general, simplified assumptions about how actors behave, a new kind of research came about, one that broke from the broad, historically based interpretations of economic development. The so-called Methodenstreit in Germany and Austria revolved around this very relationship between a strongly established historical school and the earlier neoclassicists in Germany and especially Austria.

The British classical tradition disappeared gradually with the appearance of marginalism. But also here there were key practitioners who protested against economics having an individualistic and partly ahistorical point of departure. Alon Kadish has studied the origin of economic history as a specific research discipline in Great Britain. The first "pure" economic historian, Cambridge economist William Cunningham, received his position through his skepticism to the dominant position achieved by the economic theories of his colleague Phillip Marshall. His increasingly weak position internally in Cambridge eventually forced him to consider himself a historian. He probably still thought of himself as an economist - in the Ricardos, Mathus, and Mills sense of the word. In Marshall's Cambridge, however, he had to become either an old fashioned economist or a modern-oriented historian. And he preferred the latter (Kadish 1989).

An institutional division between economic history and economic theory was thus created. But the distinction was not as sharp or as deep as it later became. A number of prominent economists were still historically oriented. Joseph Schumpeter and Eli Heckser are clear examples of researchers with a historical and institutional foundation in their research. Prominent economists were also strongly schooled in the history of theory, where the thinking of previous economists was studied in detail - including ideas that were no longer regarded as relevant for modern economic research. This reflected a perception that economic and economic-historical research were written for the same public, even though the authors had chosen different specializations.

Today the situation is different. In a relatively recent article in the *Journal of Economic Methodology*, Filippo Ceserano (2006) has an article about precisely this relationship between economic history and economic theory. His conclusion is that the flow of ideas between the disciplines has been more or less one way throughout the entire post-war era. Economic theory has thoroughly penetrated economic history, but only in very limited areas has economic history influenced economic theory.

This supports the main contention of an influential article by the then Donald McCloskey in the Journal of Economic Literature in 1976. This article explains that economists should benefit greatly from economic history, but that in reality they are more and more distanced from this field. McCloskey pointed out that economists from Adam Smith to John Maynard Keynes had a genuine economic historical orientation. The tendency of the most prominent economic journals to publish articles in economic history continued into the post-war period. But the share became smaller and smaller.

The discipline of economics has influenced economic history primarily through New Economic History. At the same time, the motivation for practitioners of New Economic History was not only to explain past trends, but also to enrich general economic theory. But this has thus succeeded only to a small degree. New Economic History has become a type of applied economics, similar to labor market economics or environmental economics, except for that it is less clear what benefit e.g. policy makers can draw from application of historical material. One of the economists who has most strongly shown interest in economic-historical works, Robert A. Solow (1985), has criticized, somewhat disparagingly, this new direction in economic history as giving rise to a type of simplified studies that were becoming more and more typical of economic research: "The same integrals, the same regressions, the same substitution of t-ratios for thought. Apart from anything else, it is no fun reading the stuff anymore."

A couple of important points must be made to balance out this somewhat dismal conclusion. In some limited areas, economic history has had a clear influence on economic theory - particularly with respect to theories about international payment systems and financial stability. Economists such as Charles Kindleberger and Hyman Minski have conducted research that in many ways erases the distinction between economic history and economic theory by analyzing and developing both in relation to the other. Several central banks, including our own in Norway, have also shown interest in financial history and in compiling long statistical series of monetary statistics. The rationale is precisely the belief that one can learn from history. Moreover, Norway has had so few major financial crises that we must look to history, not just to contemporary crises, to when we look for patterns or common features.

A little further in the outer edges of the neoclassicist core areas we find the heterogeneous discipline of "business studies," with theories about corporate development and behavior. Within this area, historians, with Alfred D. Chandler as a distinctively prominent figure, have made important contributions. Also within the study of innovation and technological development historians have provided solid research that has influenced general theory (Bruland 2003). But even though the study of economic growth has remained central within economic-historical research, the economists' development of modern growth theory has drawn little from the works of historians. Nicholas Crafts, a British economist and a key figure in the study of long-term growth processes, has expressed it thusly: "Sadly, it must be said straightaway that economic history has had little influence upon and has been relatively little affected by growth theory of postwar variety" (after Cesarano 2006).

3. Do economists have a use for economic history?

I will conclude with the following viewpoint: Economic history is more important for economists than it is for economic theory. This is because economic history is capable of offering real experience, complexity, and reflections on situations where conventional theoretical wisdom apparently falls short. Analyses of such situations provide a greater understanding, perhaps sensitivity is a good word, of the sufficiency and limitations of conventional ways of analyzing today's economy. This is an important, but unoriginal insight. This is a central point in the above-mentioned articles of Cesarano and McCloskey, and it is the background of Solow's skepticism to reducing economic history to applied economics. Economic history imparts knowledge about historical experience from periods that have been faced with intellectual challenges that are both like and unlike those we face today. And I believe it is the nuances, the breadth -- actually, the differences from other economic research -- that make economic history important to economists.

To an even greater degree I think that combined fundamental insights from economic history and the history of economic ideas provide good ballast for an economist. It can provide an understanding of the historical aspects of any situation that is to be analyzed and of the way the situation is analyzed - that is, which prevailing theories and perceptions are used to help analyze the situation. The economy was and appeared to be different during the classic gold standard, during the turbulence of the interwar period, during the postwar growth phase, during the stagflation of the 1970s, and in the recent decades when large markets were integrated in a completely different way than before. Economic concepts and theory have also undergone changes in these phases, both as a consequence of scholarly refinement and further development of existing theories, and through influence from the object of analysis, the economy.

And, naturally, this does not mean that these experiences are sufficient ballast for an economist who faces such challenges. Facing, for example, an unexpected and qualitatively new situation, such as a financial system breakdown, knowledge about previous system crises will provide insight into the kinds of consequences the crisis can create. Such knowledge will also be important for finding out how the crisis is to be resolved. But knowledge about previous events is not sufficient for resolving a new crisis in a qualitatively different situation. At least as important when facing the unknown is to be sufficiently equipped with substantial general theory.

It is an elementary insight that the world changes, and that our theories and models change as the outside world changes. More than other social scientists, however, economists have a tendency to believe that their theories are deduced from clear reasoning alone, free of empirical -- I almost said historical -- experience. This is simply not the case. And it is not just the past that has time specific constellations of economic circumstances and economic theories and models. This is also true today, early in the 2000s, which some time in the future will also be a historical epoch. An understanding of our own historicity would not just make many economists wiser, but also in all likelihood would fewer than is currently the case be cloaked in the somewhat naive arrogance that characterizes many economists with limited horizons outside their own disciplinary niche.

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