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APPLIED HISTORY, APPLIED ECONOMICS, AND ECONOMIC HISTORY

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Applied History, Applied Economics, and Economic History[*]

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Abstract

As a new field of academic enquiry, applied history has a unique opportunity to learn lessons from other applied fields. In this essay, we set out how we think applied historians can learn from the mistakes of applied economists and economic policymakers in their use, and abuse, of economic theory and economic history. What we call the New Applied History has the potential to improve the way policymaking is conducted. But only if its practitioners understand the power, and limitations, of theory. We apply our ideas to the case of budgetary policymaking in the United States.

Keywords: applied history, budgetary policy.

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1. Introduction

A series of recent crises in Western civilization appear to challenge our capitalist economic systems and democratic decision-making processes. Resolving these crises requires new and useful insights into government, business and civil society. The demand for new solutions to these intractable problems provides history scholars with unique opportunities to shape public discourse by drawing on their analyses of the past. But while there is demand for such “applied history”, there is precious little supply. There remains a professional distaste among academic historians for producing policy-relevant historical knowledge (Crowcroft, 2018). Their fear is it is too easy to ‘pick and choose what you want’ and justify practically anything by appealing to one or other interpretation of past events (Macmillan, 2008, p. xiii). Now more than ever this fear needs to be overcome if academic history hopes to change its reputation, fair or not (cf. *The Economist*, 2019).

Applied approaches to historical scholarship are not new. Military history, at least the kind taught at military schools, is inherently applied in the way it is communicated to, and used by, practitioners – something the field has long had to grapple with (see, esp., Howard, 1962). The field of business history also developed in an applied way, as a means of teaching future corporate leaders attending business schools about the drivers of business success and causes of business failure (see, esp., Chandler, 1977). There is even evidence of a field explicitly calling itself applied history emerging in the interwar period (Conrad, 2002). But as historians embraced postmodernism, this field morphed into something unrecognisable. What used to be called applied history has now become “public history”, a field that is concerned with communicating historical knowledge to non-academic audiences rather than applying historical knowledge to current matters.

While postmodernism has some attractive features – such as its critical stance towards sources and its reflection on the position of the historian – it has proved largely incompatible with the idea that scholars can approach history deductively and draw generalisable conclusions. This leaves space for new approaches which use historical precedents and analogues to address pertinent social and economic problems faced by policymakers, business executives and civil society leaders today. And, of course, does so in ways which avoid the criticisms of the history profession. Only then can we hope to highlight where popularly drawn precedents and analogues are useful, and where they are not – where history is being abused (Allison and Ferguson, 2016). We think while public history is all about preserving the past to ensure we understand “how we got here”, this “New Applied History” should be about exploiting the past to answer “where we should go next”.

2. Hierarchies of Knowledge

As a brand new field of academic inquiry, applied history has the unique opportunity to learn the lessons of other applied fields from across the humanities and social sciences. We think the lessons from economics in particular are stark. The division of economics into separate “core” and “applied” fields is over a century old and can be linked to the English historical school of economics (Backhouse and Biddle, 2000). This division became all-but institutionalised, with the core consisting of microeconomic and macroeconomic theory, and fields like labour economics, development economics and public economics constituting applications. Most economics students are still taught economics as a hierarchy, with economic theory at its apex, followed closely by the mathematics necessary to formulate and manipulate this theory, relegating applications of economic theory to real-world problems to optional final-year courses (see, e.g., curriculum review in: Earle et al., 2016).

The hierarchical division of economics, which in many places has impoverished the discipline by rendering it too “otherworldly” to be useful at undergraduate level, has recently led to demands for pedagogical reform from both students and employers (Coyle, 2012). The first fruit of this reform movement is a new open-access principles textbook which does not have this hierarchy (The CORE Team, 2017). While the artificial division between core and applied fields has yet to be fully overcome by economists, we are convinced that the writing is on the wall for those who teach the field in purely abstract mathematical ways. The corollary of this development should be that historical educators should ditch their professional wariness about the “relevance” of history and teach applied history alongside more conventional approaches to their discipline (cf. Green, 2016). This new applied field can in our opinion be easily integrated into the existing university history curriculum. But it may take some time to convince historians to adopt such an approach. In the meantime, we think it is important those already interested in applied history prepare pedagogical material that is ready-to-implement in the classroom.

There are, of course, signs that things are already changing in this direction. But as the *Applied History Project* at the Harvard Kennedy School makes abundantly clear, the emerging New Applied History has thus far concerned mostly issues of high politics and military grand strategy. We think there is significant potential for the project’s scope to be broadened to other areas where individuals with executive power have to weigh evidence and make decisions. The realm of economic policy is the most obvious. While there is no specific reason to limit the audience of applied history to government policymakers, we choose to discuss this group because these individuals are essentially already making decisions based on some understanding of history that matters in the moment. Consequently, it is important that professional historians seek to engage fully with their process.

The field of economic history is full of policy-relevant material which can be adapted as pieces of applied history. Here again applied history can learn its lessons from applied economics, where there has been a long engagement with economic history, but with mixed results. It is this relationship on which we focus in the remainder of this essay. We draw in particular on the work of John Neville Keynes, a British economist who, like his more famous son John Maynard Keynes, spent much of his career affiliated with Cambridge University. We then apply these lessons to a case study in which the role of norms, values and ideologies is particularly evident in executive decision-making: the policymaking process of the executive branch of the United States government.

3. The Scope and Method of Applied Economics

Backhouse and Biddle (2000: p. 15) describe a conventional wisdom in economics that researchers ‘wishing to shed light on some concrete situation do so by taking a previously developed theoretical model “off the shelf” and tinkering with it’. We already see this idea set out in the applied economics course developed by Phelps Brown and Wiseman in the 1950s, who define applied economics as an applied science in which practitioners use already established economic laws ‘to explain particular circumstances or events, or to predict the consequences of particular courses of action’ (Phelps Brown and Wiseman, 1964, p. 3). Economic theory is to them the ‘equipment of general application’ (p. 4), but it is for them important to understand the ‘limitation of the application of theory to practice’ (p. 11).

In this model of applied economics, the direction of influence runs from theory to application, but rarely the other way around. This deductive approach was institutionalised with the separation of applied economics from theoretical economics in the immediate post-war period, a separation exemplified by the establishment of a separate department of applied economics at the University of Cambridge. For much of the second half of the twentieth century, economic theorists may have appealed to “stylised facts” when they motivated their mathematical models of the economy, but these were rarely actually facts; it would be far more accurate to label these “stylised fictions”.

The recent empirical turn in economics can be dated to the mid-1990s and can be seen as a reaction to this conventional wisdom. For example, Card and Krueger (1994) challenged the theory-to-application link by showing that the prevailing theory that minimum wages leads to unemployment had no empirical basis and should therefore be discarded. An integration of applied economics into economics proper ensued – completed in the UK, perhaps, by the merger of Cambridge's two economics departments, in 2004. More recently, applied economists have turned towards historical applications, using historical settings and historical data to re-evaluate established theory, and even generate new theory. This historical project has great potential, but has thus far had mixed results (see, e.g., Acemoglu et al., 2001, versus Albouy, 2012).

The discipline of (political) economics has long been characterised as a big debate between competing schools of thought, each with different epistemologies, pedagogies and even ideologies (Chang, 2014). Modern applied economics is in some sense a rediscovery of the "historical school of economics", which was popular in UK economics departments at the turn of the twentieth century. In his 1917 treatise *The Scope and Method of Political Economy*, John Neville Keynes attempted to reconcile this historical school with other approaches to the discipline. His book, which had an incredibly long gestation because of the heavy criticism its draft received from his Cambridge colleagues Alfred and Mary Marshall (Skidelsky, 1983), constitutes a series of stand-alone essays, each taking on different aspects of the then nascent field of economics. The book represents Keynes's only substantial contribution to economics and was not well received by his contemporaries (Skidelsky, 1983), but we think it should be read more widely today because it sets out several practical ways in which economists, historians and moral philosophers can work alongside and together to improve our understanding of the economy. We think Keynes's taxonomy of political economy has proved to be somewhat prophetical in that it describes the big issues faced by those advocating a more central role for historical approaches to economics pedagogy today (cf. Blum and Colvin, 2018).

We focus on how Keynes viewed the distinction between theoretical and applied approaches to economics, and the lessons this holds for "mainstream" and applied history. We start with his essay on the relationship between political economy and sociology. Here Keynes laments a so-called 'separatist view' among some scholars in which the core of the economics discipline constitutes a general body of theory obtained through abstract reasoning, without knowledge of, or reference to, the economic facts (Keynes, 1917: pp. 55-57). Meanwhile, in his essay on the relationship between political economy and morality, he describes applied economics as 'the application of economic theory to the interpretation and explanation of a particular economic phenomena' (Keynes, 1917: p. 180). This application of theory is achieved through a process of compromise, adjustment and simplification. Keynes was secular with respect to whether applied economics should necessarily lead to policy prescriptions. And while he acknowledges the difficulties of doing so, he was of the view that positive (what is) and normative (what should be) insights should be separated from one another.

In addition to his views on the emerging divisions within political economy, Keynes also pleaded for a more intelligent engagement between economics and the allied field of economic history. He highlighted three uses of economic history to an economist: (1) to illustrate and test theory; (2) to teach the limits of economic theory; and (3) as a basis for generating new theory (Keynes, 1917, pp. 121-122). Taking the example of the Black Death, Keynes argues that it affords economists an opportunity to study 'on a large scale the effect on wages of a sudden diminution in the supply of labour', in addition to ascertaining the general conditions under which wage rises are 'likely to be permanent' (p. 123). But Keynes then warns economists about the use and abuse of historical data, cautioning them not to misinterpret them: 'many unrecorded and unsuspected influences may also have been in operation' (p. 124). He also warns economists about the decontextualisation of economic theory: 'separated from their context, [economic theories] are apt to lose a good deal of their force, while there is at the same time a certain liability to exaggeration' (p. 124). '[Economic history] calls attention to the shifting character of economic conditions', and shows how as these conditions vary 'some at least of the principles by which economic phenomena are regulated vary also' (p. 125). He opines that this idea was universally accepted by his contemporaries. Unfortunately, we think this idea has been lost; modern applied economists making use of historical data must take heed of Keynes's advice.

In addition to setting out how economists can learn from historical scholarship, Keynes also highlights how historians can usefully benefit from economics, in particular the way economists make use of theory: 'it teaches historians which kinds of facts are likely to have an important economic bearing' (p. 128). He warns that the historian's 'narration of events is influenced by [his] theoretical views' (p. 128) and therefore argues it is important that 'the theoretical position taken by the historian should not be disguised' (p. 129). He highlights the interdependence of economic theory and economic history, and therefore the influence of economic history on the development of economic ideas – the history of economic thought (pp. 130-131). Building on Keynes, it is this use and abuse of theory by economists and historians that we focus our essay on next.

4. Economic History and Dangers of Universal Theory

An economic theory, when it is most helpful to policymakers, is universal in its applicability across space and time. It is truly a general theory. Such a theory is, of course, the stuff of dreams and nightmares; a truly general theory is generally only theoretically true. Sure enough, the study of general theory as a research methodology is as old as economics itself. For instance, Carl Menger (a founder of the "Austrian school of economics") held that the difference between economic theory and economic history was the focus on the general versus the specific (Menger, 1883). The purpose, therefore, of theory was to uncover the reoccurring observations behind many events. The purpose of history was to examine the exact causes of some event.

While developing general theory is difficult, we are not advocating that this endeavour is something economic theorists should shy away from (cf. Gilles, 2018). But the theorist must follow Keynes (1917) and make *good* use of history; it is critical for theorists to establish a feedback loop between economic theory and economic history, a process of abduction which allows theorists to move ever closer to their universal theory asymptote (Colvin and Wagenaar, 2018). To paraphrase Richard Feynman (1967: Part 7), the theorist must learn from the historian through an iterative process of revising and resubmitting until their guesses match the evidence. If they fail to do so, then their theory becomes nothing more than an ideology, with any policy descriptions derived from that theory relying merely on assumptions about reality that may or may not have any factual basis.

Unfortunately, some of the most influential of economic models are applied under the impression that they are universal when they are not. They have influenced norms, become ideologies and dictated government policy. This includes reliance on the Phillips Curve during the period of "full employment budgets" of the 1960s and 1970s (Winfree, 2019). Macroeconomic policy has been governed by the twin goals of low unemployment and stable prices for much of the post-World War II period. In fact, these remain part of the Federal Reserve's "dual mandates" alongside moderate long-run interest rates. During this period, the Phillips Curve played a pivotal role in guiding fiscal and monetary policy development, supporting the notion of a trade-off between inflation and unemployment. For example, the basic model suggests that higher levels of inflation would raise wages, which in turn would encourage more people to work (Phillips, 1958).

Of course, Phillips's original contribution was partly applied, not theoretical; rather than developing a universal law, he had discovered a negative correlation between the level of unemployment and rate of change of money wage rates for a particular space and time: the United Kingdom between 1861 and 1957. The relationship also works for some other spaces and times; for example, the relationship describes the data for the Netherlands during the interwar period (Colvin and Fliers, 2019). But, as Phelps (1967) already argued, it has proven impossible for governments to *permanently* trade higher inflation for lower unemployment.

The root of Phelps's observation was that only *nominal* wages will increase when the central bank increases the money supply. This will cause some workers to accept jobs because they have not taken into account the *real* purchasing power of their wages. However, in the long run, it is real wages that matter. Buchanan and Wagner (1977) suggested that once inflationary policies become predictable, they lose any power over unemployment and no longer become stimulative.

The Phillips Curve really speaks to the dangers of supposedly universal theory. Indeed, Lucas (1976) observed that we cannot make policy based on the assumption that certain parameters remain fixed relative to their historical behaviour. This includes the relationship between inflation and unemployment (Turnovsky, 2009). In other words, the Phillips Curve breaks down when would-be workers cannot be "tricked" into accepting a higher nominal wage because they know it will not make them any better off. Today, many macroeconomic models include an "expectations augmented" Phillips Curve to adjust for the expectations of the government's ability to change inflation and the long-run level of employment. This new Phillips Curve is basically a vertical line; in the long-run, there is no trade off.

The incorporation of expectations, using ideas involving the psychology of how people respond in a dynamic world including learned behaviour about how governments responded historically, fundamentally changed the way economists design macroeconomic policy. However, not all policymakers listen to economists in designing new economic initiatives. Rather, the establishment of economic policy involves an awful lot of "muddling through". This has always been the case: an example from early twentieth-century history is the way in which central banks set their monetary policy in relation to the gold standard (Colvin and Fliers, 2019). In what follows, we develop another demonstration: the federal budget-making process in the US since the 1940s.

5. Case Study: Budgetary Policy in the United States

There is a substantial literature on the history of the government budget process in the US. Wildavsky (1964) suggests that the budget process is best understood as a development around political rather than simply economic determinations. Practitioners have argued something similar, such as David Stockman, Reagan's Director of the Office of Management and Budget, who claimed that budgeting decisions and politics are inseparable. Both Wildavsky (1964) and Lindblom (1959) have argued that the budget process developed incrementally in response to events of the time.

The intrinsic political struggle over spending, taxes, and debt can be broken down into what Schick (1980) has described as the ‘parts against the whole’ or what Stewart (1989) has called “distributional” versus “aggregational” problems. Distributional problems are, essentially, electoral and result in the determination of “who gets what”. Aggregational are “what happens when all the budgetary pieces are added together”. Throughout much of early US history, spending bills were just an accumulation of the resolution of distributional problems. However, most budget reforms since the enactment of the Budget and Accounting Act of 1921 can be seen as an attempt to resolve aggregational with distributional problems. Stewart (1989) suggests that the budgetary conflicts can be interpreted as rising from the tension this resolution has created. Winfree (2019) proposes that aggregational problems include debt management and macroeconomic policy.

Wildavsky (1988) describes budget policy as reflective of a series of compromises between groups with different preferences, including preferences towards federal debt. In other words, we cannot escape normative questions in establishing economic policy to the extent that the government’s finances are perceived as an endogenous component of the economy (Winfree, 2019). A separate but related point is that it is impossible, and possibly hazardous, to treat the establishment of economic policy as if it is exogenously determined by economists who are separate from the democratic process (Levy and Peart, 2016; Winfree, 2019).

Savage (1988) suggests that budget policy setting is symbolic and reflective of larger political achievements. For example, Andrew Jackson believed that retiring the national debt was a validation of the establishment of the United States. Such motivation has driven the political pursuit of balanced budgets from presidents Washington to Reagan. However, this pursuit has also been partly driven by economic theory. Prior to the 1930s and the influence of John Maynard Keynes on macroeconomic policy, balanced budgets were seen as an effective goal of debt management. Thus, spending and tax policy often influenced one another, although this relationship has broken down since the 1960s with deficits now playing a larger role.

In fact, we find ourselves in a period where budget deficits may not be as economically destructive as we used to believe. Blanchard (2019) has suggested that when rates at which the government borrows are lower than the rate of economic growth, as they have been for considerable periods in US history, we might not need to worry so much about deficit financing as debt can be rolled over. To the extent that a gap between real and potential output exists, the negative effects of debt on welfare may be limited. The concept of rolling over debt as a beneficial strategy is not new to American fiscal policy; Alexander Hamilton suggested rollover as an effective debt management strategy in the First Report on the Public Credit issued to Congress in 1790.

At the same time, there is a literature suggesting that fiscal austerity (i.e., deficit reduction strategies) may in some circumstances *increase* economic growth. Giavazzi and Pagano (1990) and Alesina et al. (2018) both argue that large decreases in government spending can and have increased economic growth as they can be accompanied by market liberalisation, debt stabilisation, as well as other factors. Alesina et al. (2019) argue that the decisions governments make regarding the specific mechanisms for deficit reduction affects growth by changing investor confidence. These analyses highlight only one divergence in the economics literature that might affect a prescribed economic policy path. And of course, as with the work of William Phillips before them, the universality of their models is contestable; they appear to work now, but vigilance is necessary because they may no longer work in the future.

With the exception of automatic stabilisation programmes, there has never been a governing fiscal policy consistent with traditional neo-Keynesian models over a long period of time. It seems that, for the most part, politicians prefer running deficits during periods of economic growth *and* contraction. This is true even during periods where, in hindsight, fiscal policy appears to be countercyclical. For example, presidents Clinton and Obama prescribed additional fiscal stimulus measures during economic recovery only to be redirected towards deficit reduction based on political circumstances (Winfree, 2019).

6. Conclusion

What should the applied historian make of this case study besides that one should not come with too much hubris? Applying the history of economic policy to the current environment requires the understanding of a combination of politics, historical events, as well as the history of economic thought. It involves knowing the stories behind decisions about spending, taxes, tariffs, monetary policy, and debt management. To the extent that applied history can be helpful to current policymakers, it can identify deep tendencies involving the relationships between economic theory and the other factors that influence the establishment of policy. Applied history should be used alongside economic history to determine what policies might be beneficial, implementable, sustainable, and universal. Applied historians must constantly remind economic policymakers about the usefulness, but also the limitations, of supposedly universal theory.

What are the characteristics of the ideal applied historian? We think an applied historian should be able to communicate complex ideas to non-technical audiences, but must do so without compromising on academic rigour. Applied historians must learn the lessons from economic theorists, and not place "pure" historical enquiry on a pedestal above its use in decision making in the modern world. Applied historians must learn the lessons from applied economists and not abuse historical evidence to verify a theoretical point; they must think about context and contingency. And applied historians must remain wary of suffering the fate of economic history, an interdisciplinary field that has fallen between the disciplinary cracks and been almost eliminated from both economics and history curricula.

Margaret MacMillan (2008) argues that history 'aids in formulating questions, and without good questions it is difficult to begin to think in a coherent way' (p. 167); 'warns of the dangers of assuming that there is only one possible way of looking at things or only one course of action' (p. 168); and can 'inculcate a healthy propensity to question our leaders' (p. 168). Many "mainstream" historians remain professionally unable, or unwilling, to engage with MacMillan's vision. It is therefore up to the New Applied History to implement her agenda.

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