

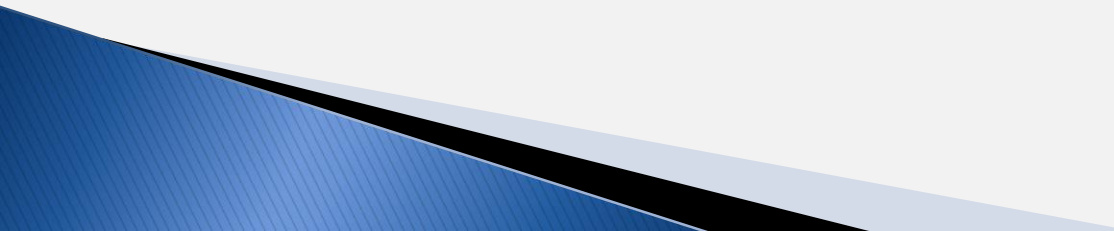
Alternative Perspectives on Macro Theory and Some Policy Implications

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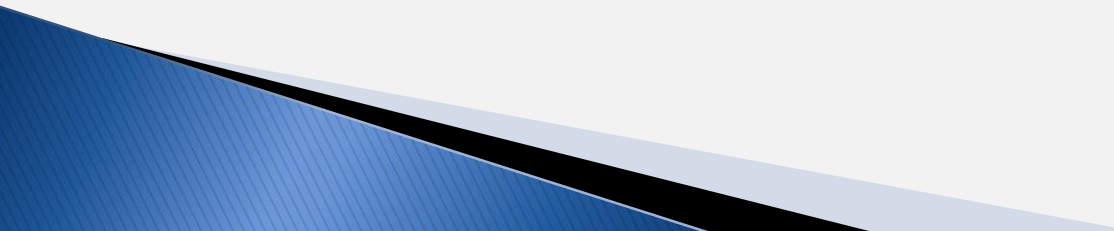
Maekawa Lecture
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Introduction

- ▶ “We are in a colossal muddle.....“ JM Keynes
 - ▶ The current crisis was generally unanticipated
 - ▶ ... which had important implications for policy
 - ▶ ... but also for macroeconomic theory?
 - ▶ Keynes versus Hayek, or Keynes and Hayek?
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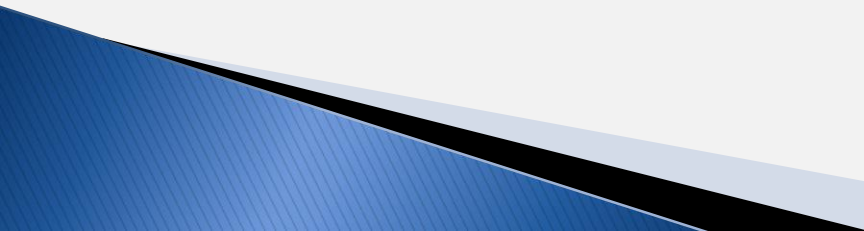
Modern Macroeconomics and its Practical Shortcomings

- ▶ New Classical, New Keynesian and DSGE models
 - ▶ Have spread from academic circles into central banks
 - ▶ Analytically tractable but based on many simplifying assumptions:
 - ▶ A self-stabilising economy, rational expectations, efficient markets, and the irrelevance of money and the financial system
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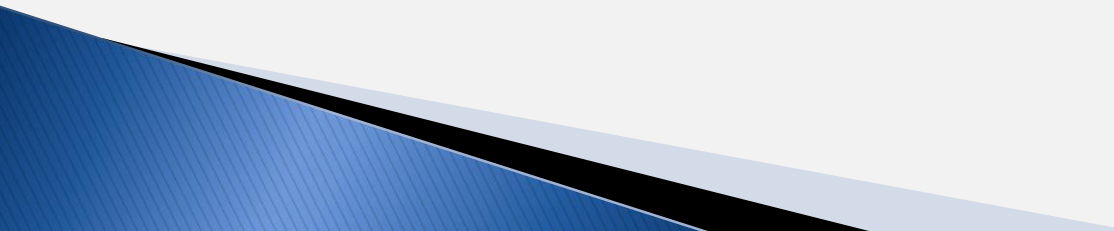
Applied Keynesian Models and their Practical Shortcomings

- ▶ Empirical IS/LM in its various guises
- ▶ Has never been good at turning points
- ▶ Because it treats the future as an extrapolation of the past
- ▶ And largely ignores the influence of the financial sector

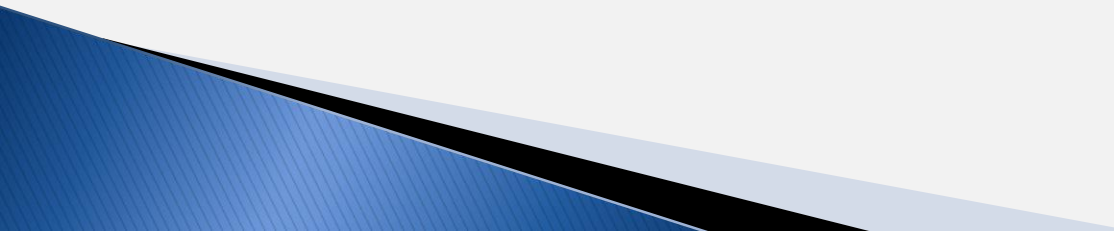
Credit, Stocks, “Imbalances” and Crises

- ▶ None of the above models incorporate multi period considerations (like moral hazard) and non-linear outcomes
 - ▶ Insights from the Austrians; excessive credit leading to “malinvestments” and eventual crisis
 - ▶ A broader set of “imbalances” explaining the current crisis; which is not over yet
 - ▶ Insights from Minsky; the Wiley Coyote moment
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Some Suggestions for Macro Theory

- ▶ Improving the practical usefulness of existing macro models will not be easy
 - ▶ Focussing on credit driven imbalances (debt and other excesses) has promise
 - ▶ Modelling financial instability is only part of the challenge
 - ▶ As is the modelling of “inefficient“ financial markets
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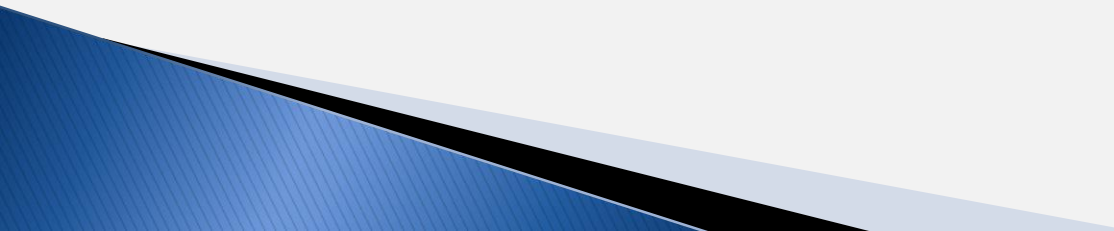
Some Implications for Macro Policy (1)

- ▶ Implications in **normal** circumstances:
 - ▶ Recognize that price stability is no guarantee of good macro performance; the particular problem of productivity growth
 - ▶ Lean against credit driven “imbalances”
 - ▶ Be more tolerant of minor downturns
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Some Implications for Macro Policy (2)

- ▶ **Negative** implications in **current** circumstances:
- ▶ Fiscal stimulus and its limitations
- ▶ Monetary policy and its limitations
- ▶ Support for the financial system and its limitations
- ▶ Support for jobs and its limitations
- ▶ **Conclusion:** a bias towards exit and against exacerbating existing imbalances

Some Implications for Macro Policy (3)

- ▶ **Positive** implications in **current** circumstances:
 - ▶ Not all global spending categories are debt constrained
 - ▶ Private and public investment offer scope for stimulus
 - ▶ Debt burdens can be reduced through structural reform and debt writedowns
 - ▶ Inflation is an unhealthy alternative for reducing debt burdens
 - ▶ **Conclusion:** there is a way out, but a more lengthy one.
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A Methodological Postscript

- Formal modelling work (“science“) must increasingly reflect the complexity of the real world.
- We need more practical attention (“engineering“) to economic history, the history of economic thought and other methodologies
- We need to admit to great uncertainties about how the economy actually operates
- All of which leads to more “humble“ policy objectives:
- Above all, **do no harm.**