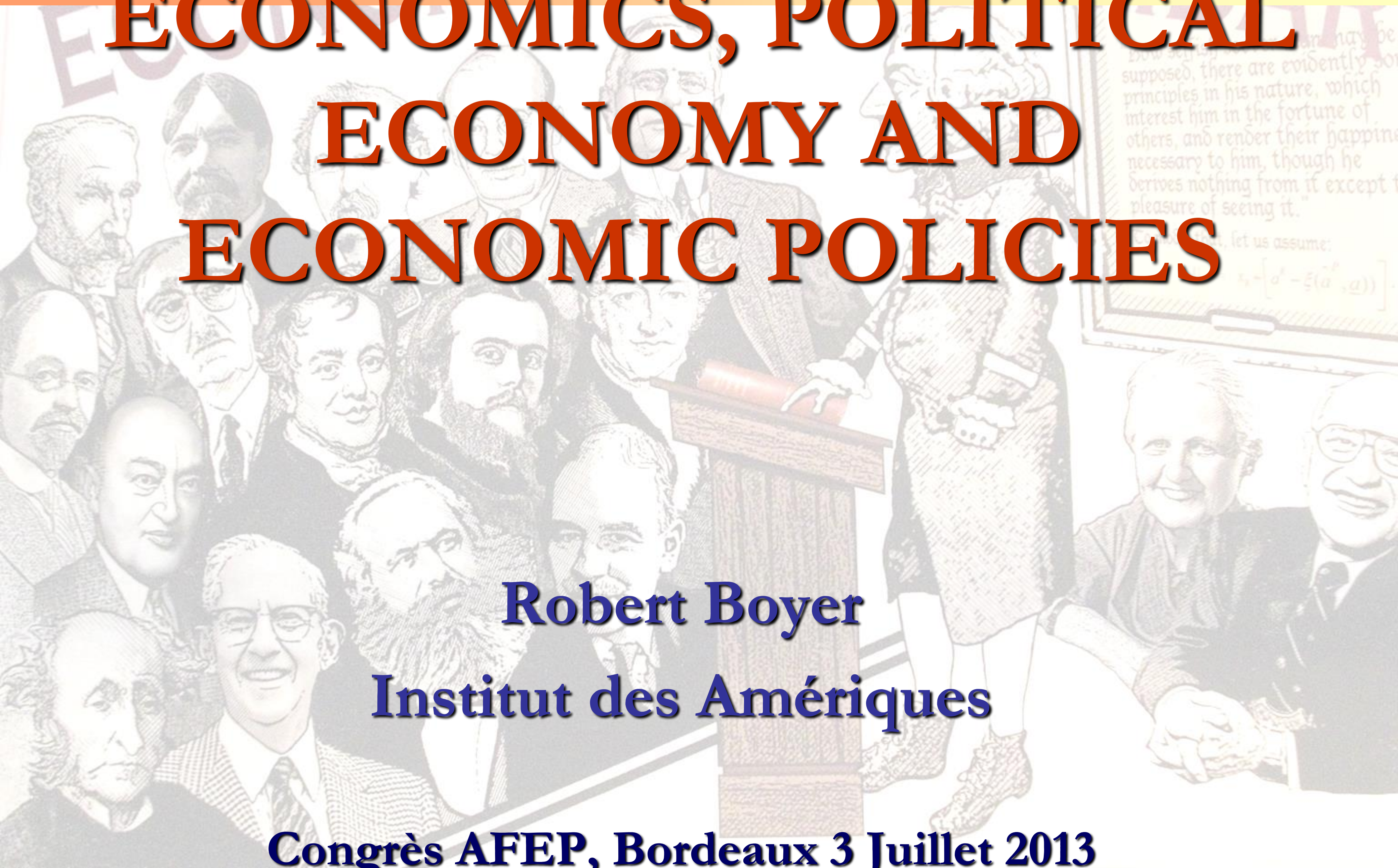

ECONOMICS, POLITICAL ECONOMY AND ECONOMIC POLICIES

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I. THE PYRRHUS' VICTORY OF MAINSTREAM ECONOMICS.

1. Economics has moved away from the humanities and other social disciplines in the direction of a natural science approach.
   - ✓ *Invention of new concepts …*
   - ✓ *Their standardisation and wide diffusion*
   - ✓ *Intensive use of quantification…*
   - ✓ *Hence mathematisation and formalisation*

- ***From grand visions to theories…***
- ***…From theories to a series of models…***
- ***…Tested by the development of specific and powerful techniques***
- ***Professionalization of economists' training***
- ***Organization of large international networks…***
- ***…Explosion of academic reviews***

o The old style: historical perspective and conceptual discussion

PROFIT, originally a vague word signifying any kind of gain to obtain which some expense or risk must be incurred, has had various narrower significations attributed to it by the definitions of economists.

Adam SMITH, when classifying the national income under the three heads of wages of labour, profits of stock, and rent of land, says that wages are "confounded with profit" when the term "profits" is applied to the whole of the gains of a working farmer or of an independent artisan. A part of these gains, he explains, is wages due to the farmer as labourer or overseer, and to the independent artisan as journeyman. Though he does not lay down any rule on the subject, it may be gathered from his refutation of the proposition that profits "are only a different name for the wages of a particular sort of labour," that he would decide how much of the gains of any particular capitalist is true profit by means of a comparison of the total with the amount earned by non-capitalists by performing similar labour (*W. of N.*, bk. i. ch. vi.). RICARDO, James MILL, and

Source:
Dictionary of Political Economy, Vol. III, p. 222-223

o The old style: an eclectic and literary approach

N., bk. i. ch. vi.). RICARDO, James MILL, and MALTHUS in his *Political Economy* did not subject the idea of profits to analysis. But Malthus in his *Definitions* (1827) divides "the gross profits of capital independent of monopoly" into (1) "net profits" or "interest," and (2) "the profits of industry, skill, and enterprise" (Definitions 34 and 35). M'CULLOCH, in the 2nd ed. of his *Principles*, makes the same division of "gross profits" into (1) net profits or interest, and (2) "wages or remuneration of the capitalist for his skill and trouble in superintending" the employment of his capital, and "compensation for such risks as it might not be possible to provide against by an insurance" (p. 506). J. S. MILL (*Unsettled Questions*, pp. 107-109, and *Principles*, bk. ii. ch. xv. § 1) treats profits as including the whole of the gains of the capitalist, whether due to the mere possession of capital, or to that and the performance of labour and the undergoing of risk. FAWCETT (*Manual*, bk. ii. ch. v.), JEVONS (*Primer*, p. 52), Marshall (*Principles*, vol. i. 1st ed. p. 142, 3rd ed. p. 156) adopt the same course. Some writers, however, e.g. ROGERS (*Manual*, ch. xi.), B. PRICE (*Practical Political Economy*, ch. v.), C. L. Shadwell (*System*, p. 158), follow Adam Smith's plan of regarding as profits proper only that portion of the capitalist's gain which he may be supposed able to obtain without personal labour and if fully insured against risk, while F. A. WALKER, on the other hand, desires to apply the term "profits" only to the other portion of the entrepreneur's gain, namely, that which is over after deducting interest on all the capital he employs, whether it belongs to himself or to another person (*Political Economy*, 1885, p. 247). In practical life the term "profits" is used in all three senses with almost equal frequency. It would be applied without hesitation (1) to the total gain of an individual capitalist employing none but his own capital, and personally performing all necessary labour of management (Mill's profits), (2) to the gains of a joint-stock company or private firm in the case of which all labour of management was paid for by fixed salaries (Adam Smith's true profit), and (3) to the net gain of an entrepreneur employing no capital of his own (Walker's profit).

Source: *Dictionary of Political Economy* (1988), Vol. III, p. 221-223

oThe new style: quantification and formalisation.

Kalecki has a macroeconomic theory of pricing which yields a determinate share of profits in total output. He does this by exploiting the marginal revenue equals marginal cost conditions of equilibrium for the neoclassical firm. By then exploiting the simple idea that the ratio of price to marginal revenue departs from one to the extent that the price elasticity of demand is below infinity he connects price to marginal cost via the demand elasticity. Thus

$$p = mc(1 + \eta^{-1}) \tag{3}$$

where mc is the marginal cost and η is the elasticity of demand. The coefficient $(1 + \eta^{-1})$ is called the degree of monopoly. To the extent that η^{-1} departs from zero, the firm is a monopolistic one.

This is a partial equilibrium, microtheoretic derivation of the p/mc ratio and its generalization to a macroeconomic level has proved to contain problems (Mitra, 1954). The main problem is that if (3) is supposed to refer to a specific firm, its elasticity of demand is not a constant but a function of the firm's own and its rivals' strategies. A determinate and tractable aggregation procedure for many jointly dependent p/mc ratios is not possible. It has however been found possible and empirically fruitful to interpret pricing decision as a mark-up above average cost.

$$p = (1 + k)ac \tag{4}$$

where ac is average cost and k is the mark-up ratio. The similarity of (4) to Keynes's Fundamental Equation in (1) is striking i.e. $\pi = k/(1 + k)$. But while (1) is an identity, (4) could be thought of as an equation where the profits come from producers' price setting behaviour.

But how are these profits sustained or in Marx's terminology realized? This is where the aggregate demand relations become important. It would be through the spending behaviour of the profit receivers that profits can be sustained. This was already clear in Keynes' invocation of the widow's cruse parable whereby a Wicksellian cumulative dynamic process can sustain growing profits as long as capitalist spend (i.e. dis-save) while keeping up their investment expenditure. By starting with the Marxian SER, Kalecki was able to derive this as an *equilibrium* relation.

Kalecki's macroeconomic theory is best seen in terms of Kaldor's generalization. Kaldor takes the two class/two good model and integrates profits into a theory of growth and distribution. Let R be total profits ($\equiv \pi Y$) and W be the total wage bill ($= wL$). Then

$$Y = R + W \tag{5}$$

$$I = S = s_w W + s_c R \tag{6}$$

Equation (5) is a national income identity, whereas (6) combines the Saving–Investment equality with a decomposition of total savings into workers' savings ($s_w W$) and capitalists' savings ($s_c R$) with the $s_c s_w$ being saving propensities and $s_c > s_w$. From (5) and (6), we can derive

$$R/Y = \pi = (s_c - s_w)^{-1}(I/Y) - s_w(s_c - s_w)^{-1} \tag{7a}$$

and

$$R/K = \rho = (s_c - s_w)^{-1}(I/K) - s_w(s_c - s_w)^{-1}(Y/K) \tag{7b}$$

Source: *The New Palgrave. A Dictionary of Economics* (1988), Vol. III, p. 1018-1019.

oThe new style: a possibility to test and select theories.

The restriction that $s_w = 0$ is of course arbitrary and thus makes the result under (8b) somewhat unrealistic. Pasinetti (1962) generalized the Kaldor argument by allowing workers as well as capitalists to save and own capital. Thus total capital K could be held either by capitalists K_c or by workers K_w but since capitalists make output and investment decisions workers were assumed to have loaned K_w to capitalists. In terms of the distinction we made above capital as productive equipment is *controlled* by capitalists but capital as a financial asset is *owned* by both workers and capitalists, and capitalists pay workers a rate of interest i on the loaned capital. Thus instead of (7a) and (7b), we get

$$\begin{aligned} R/Y = \pi = (s_c - s_w)^{-1}[(I/Y - s_w) \\ + r(s_w s_c (I/K)^{-1} - s_w (Y/K)^{-1}] \end{aligned} \quad (9a)$$

$$\begin{aligned} R/K = \rho = (s_c - s_w)^{-1}[(I/K - s_w(Y/K)) \\ + r(s_w s_c (I/K)^{-1} - s_w)] \end{aligned} \quad (9b)$$

If we now put $r = \rho$, (9a) and (9b) degenerates to

$$\pi = s_c^{-1}(I/K) \quad (10a)$$

$$\rho = s_c^{-1}(I/K) \quad (10b)$$

The Pasinetti result has been derived by an alternative route by Samuelson and Modigliani (1966) who do use a neoclassical aggregate production function. Their purpose was to point out that the Pasinetti result was a special case of a more general result and that a dual to Pasinetti's theorem – an anti-Pasinetti theorem – could be derived from a slightly alternative formulation. All the assumptions of Pasinetti's theory are retained except that profits and wages are now derived from the marginal productivity conditions and a constant return to scale, two factor production function.

Let the production function be

$$\bar{Y} = f(\bar{K}) \qquad f' > 0, \quad f'' > 0 \quad (11)$$

Here $\bar{Y} = Y/L$, $\bar{K} = K/L$, i.e. output per worker and capital per worker. By the standard rules of marginal productivity theory we have that wage and rate of profit are determined as

$$\rho = f'(\bar{K}) \quad (12a)$$

$$w = f - \bar{K} f'(\bar{K}) \quad (12b)$$

In the production function, there is no distinction as to who owns the total capital stock – capitalists or workers. The savings augment the amount of capital owned by workers and capitalists,

$$S_c = \dot{K}_c = s_c f'(K) K_c \quad (13a)$$

$$S_w = \dot{K}_w = s_w [Y - f'(K) K_c] \quad (13b)$$

Source: *The New Palgrave. A Dictionary of Economics* (1988), Vol. III, p. 1018-1019.

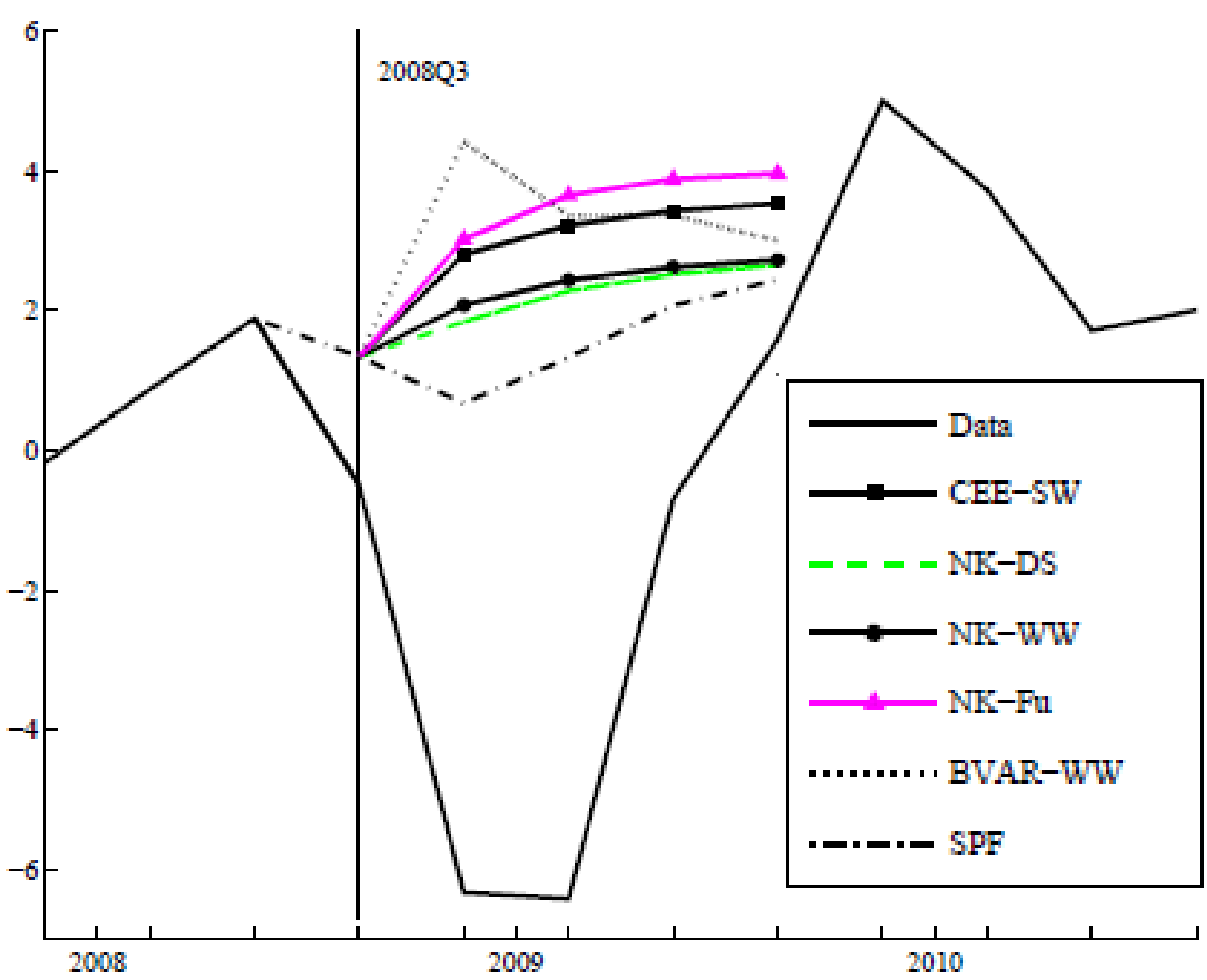
2. The pride of economists: their discipline is progressively becoming a science.

- ✓ *Natural scientists looking at economics recognise their tools and style of reasoning*
- ✓ *Rational choice theory is exported to many other social sciences, such as sociology, history, political analysis.*
- ✓ *This claim to science makes economists the top advisers of governments, central banks,…*
- ✓ *Economists claim credit for the merits of a fast and non-inflationary growth in the 2000s.*

3. **The present crisis is dissipating these illusions.**
   - ✓ ***The inability to predict any of the recessions since the 80s.***
     - **An example: OECD *Economic Outlook* from 1984 to 2007.**

       The forecasts published on June each year have never been able to anticipate a recession that came in the following quarter.

✓ ***The macroeconomic profession was unable to anticipate the brutal downturn associated with Lehman Brothers' bankruptcy.***

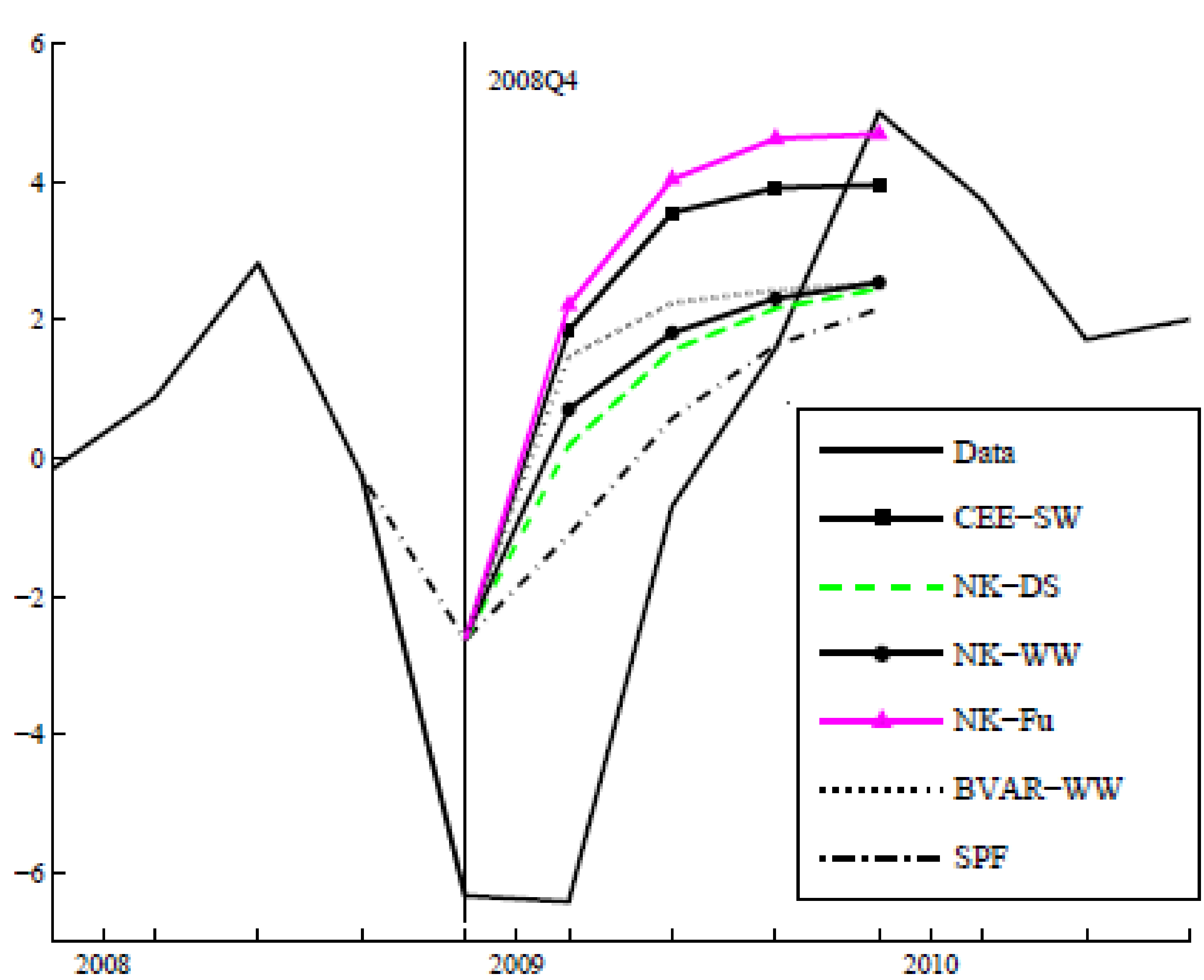


Output forecast made on third quarter 2008

Source:

Volker Wieland (2010), Model comparison and Robustness: A proposal for policy analysis after the financial crisis, WP Goethe Uiversity Frankfurt, November 28th.

o It will be a mild and short recession

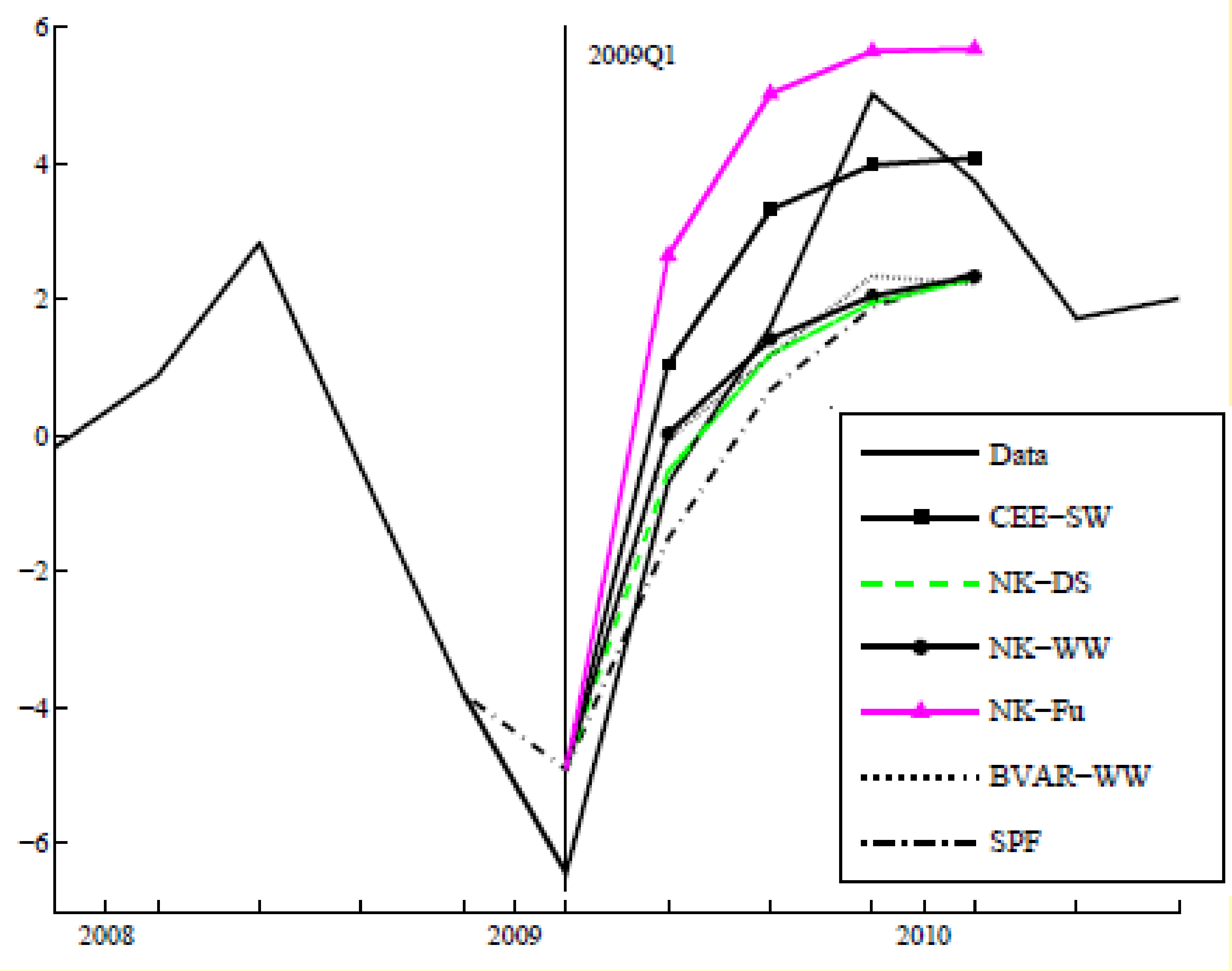


Output forecast made in the fourth quarter 2008

Source:

Volker Wieland (2010), *ibidem*

o The recession is deeper, but the recovery stronger

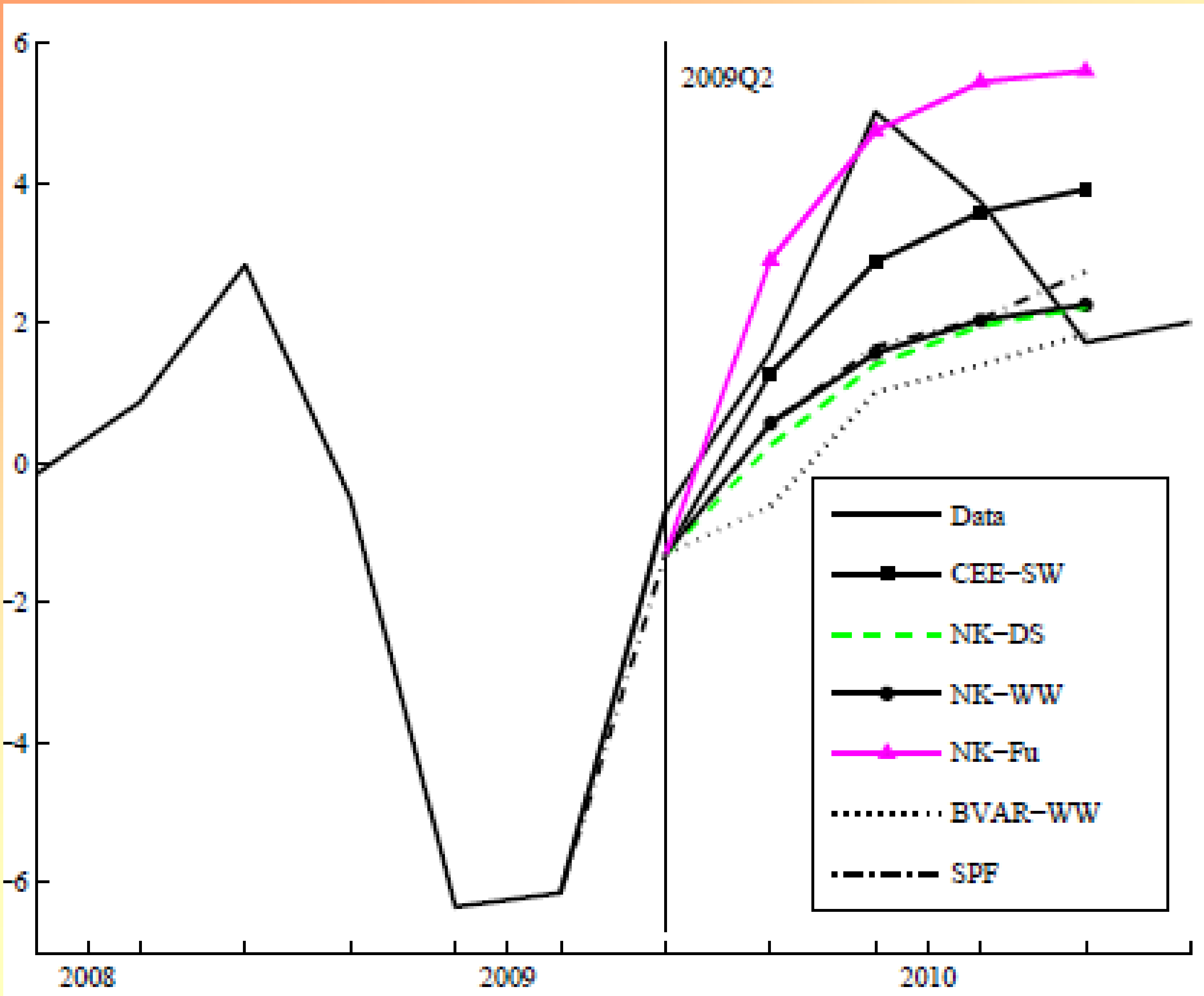


Output forecast made in the first quarter 2009

Source:

Volker Wieland (2010), *ibidem*

o At least the recovery is correctly forecast, but not the subsequent slowdown



Output forecast made in the second quarter 2009

Source:

Volker Wieland (2010), *ibidem*

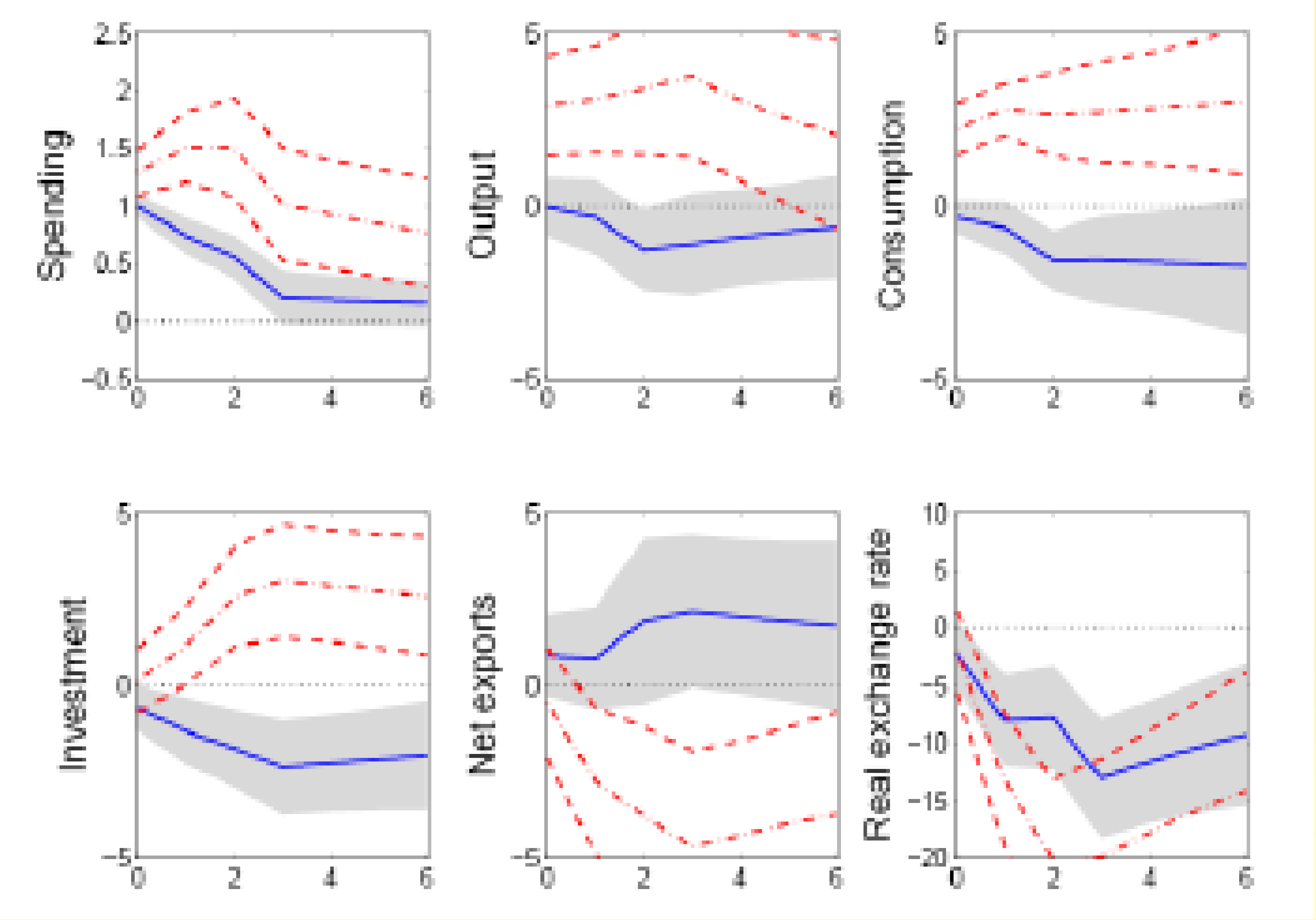
- ✓ ***A second function of models: to detect causalities in order to assess the impact of an exogenous change***

  Macroeconomists disagree about the impact of the recent fiscal stimulus

  - **Keynesian models: the multiplier is about 1.6**
  - **DSGE typical models: this multiplier is much lower than 1, around 0.3**
  - **Pure Ricardian equivalence hypothesis: private consumption reduction strictly compensates extra public spending, the multiplier is equal to 0**
  - **During a severe financial crisis, the over-indebtness may trigger highly pessimistic expectations: the multiplier is negative.**

✓ The extreme fragility of multipliers

o Normal times and financial crisis



Source:

Giancarlo Corsetti (2010), *What is right (and left to do) in macroeconomics? A lot, December.*

About the cognitive origins of the Euro crisis

It is dangerous to trust an irrelevant macro-economic theory that discards the very possibility of a systemic crisis

Table 1 - The consequences of the new classical macroeconomics upon the assessment of the viability of the Euro

Hypotheses	Mechanisms involved	Consequences of Euro	Degree of realism
1. Exogenous money created by Central Bank	•Typical monetarism •Neutrality of money in the long run	Price stability is the first objective of Central Bank	In modern financial system, endogenous money creation
2. Full employment equilibrium	•Perfect adjustment by prices and wage flexibility •Only voluntary unemployment	Basically no inflation / unemployment trade off	Large and steady involuntary unemployment in many EU economies
3. Symmetric shocks will prevail over asymmetric, country specific shocks	Thus a common monetary policy will fulfil the bulk of macroeconomic adjustments	Euro-zone can be viable even if it is not an optimum for monetary unification	Significant endogeneity of productivity at the national level
4. Rational expectations for all actors: - Firms, households - goverments	The economic policy rule associated to the Euro will affect all private and public strategies	The irreversibility of Euro is crucial for its credibility	Adaptation of firms and banks… But governments play a domestic political games
5. The same size for all	Existence of generic economic adjustments common to all member-States	The Euro will speed up a nominal and possibly real convergence	The Single Market has generated a deeper division of labour, hence heterogeneity

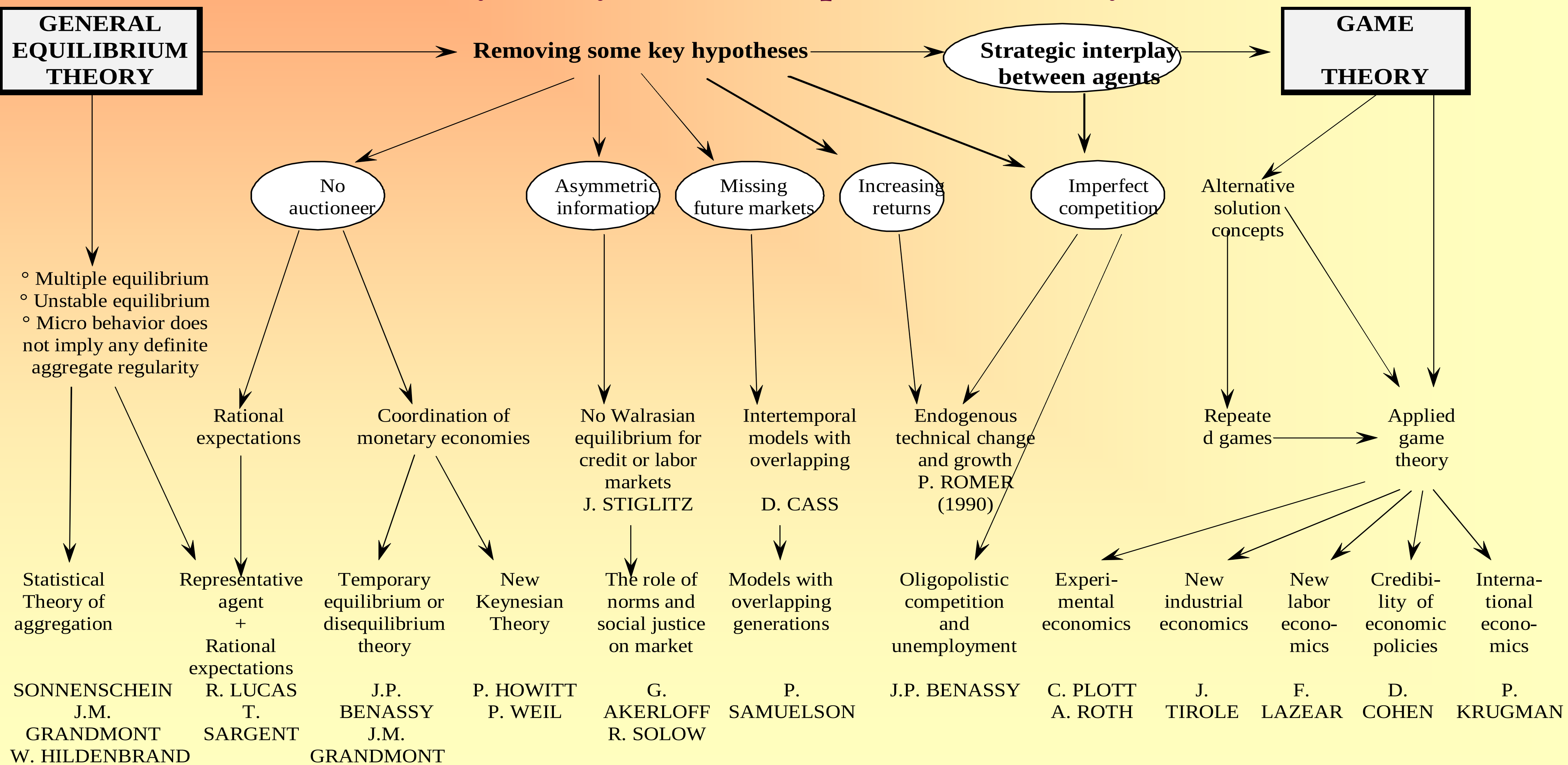
✓ *But what role is left for theories and modelling?*

- **Forecasting: a longstanding illusion**
- **Explaining the functioning of contemporary economies: no consensus even for some basic mechanisms**
- **Simply a thought experiment: creating abstract economic worlds in order to assess the relations between their configurations and their static or dynamic properties.**

THEORETICAL MODELS AS ECONOMIC FICTIONS

➢Each theoretician invents his own imaginary world in which his hypotheses apply

Diagram 1 – From general equilibrium theory to game theory: analyses by domains but not any theory for the complete economic system



- ✓ ***On the same issue, each sub-field develops independently and therefore the profession as a whole presents contradictory results and recommendations***
  - **First example: Keynesian versus Real Business Cycles models on taxation and public spending**
  - **Second example: the impact of securitization on financial stability, positive for quants, negative for asymmetric information theoreticians**

- **The contradictory nature of "economic knowledge" is widely perceived outside the profession, for instance by novelists**

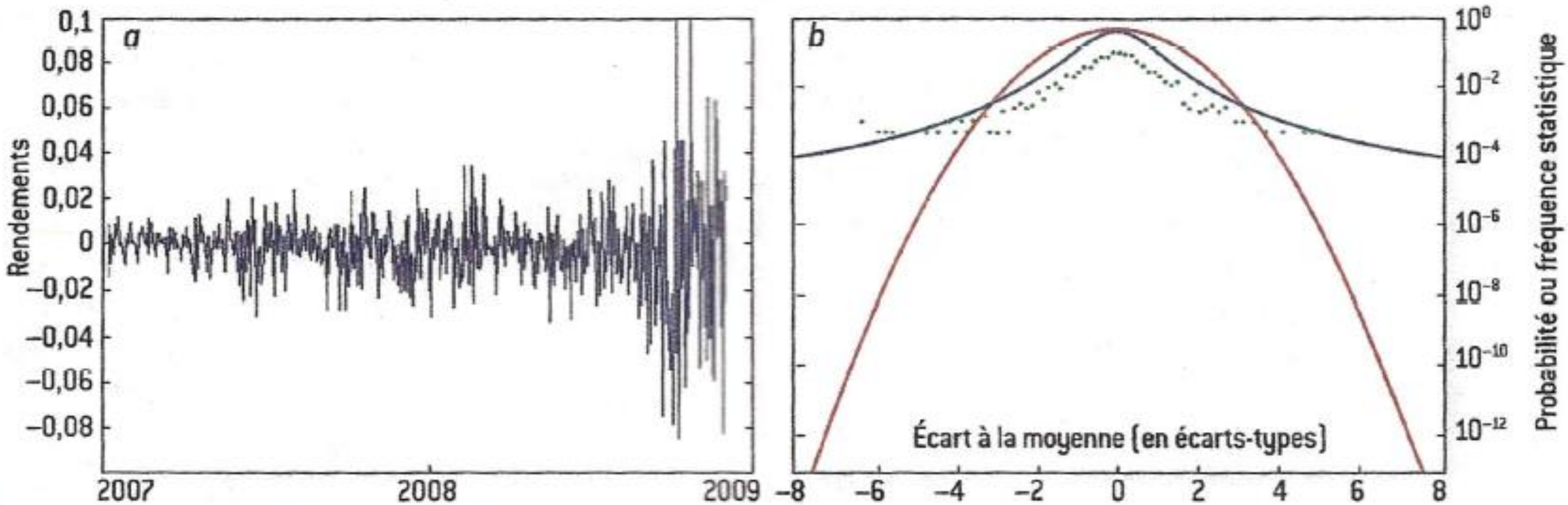
"L'intérêt d'Hélène pour l'économie avait beaucoup décru au fil des ans. De plus en plus, les théories qui tentaient d'expliquer les phénomènes économiques, de prévoir leurs évolutions, lui apparaissaient également inconsistances, hasardeuses, elle était de plus en plus tentée de les assimiler à du charlatanisme pur et simple. Il était même surprenant qu'on attribue un prix Nobel d'économie, comme si cette discipline pouvait se prévaloir de la même rigueur intellectuelle que la chimie ou que la physique." **p. 327.**

"Helen's interest in economics had been eroding drastically over the years. Increasingly, theories attempting to explain economic phenomena and predict their evolution appeared to her equally inconsistent and dubious; she was tempted to equate them to pure and simple charlatanism. It was even surprising to give a Nobel Prize in economics, as if the discipline could claim the same intellectual rigor as chemistry or physics."

Michel Houllebecq. 2010. *La carte et le territoire*, Flammarion: Paris

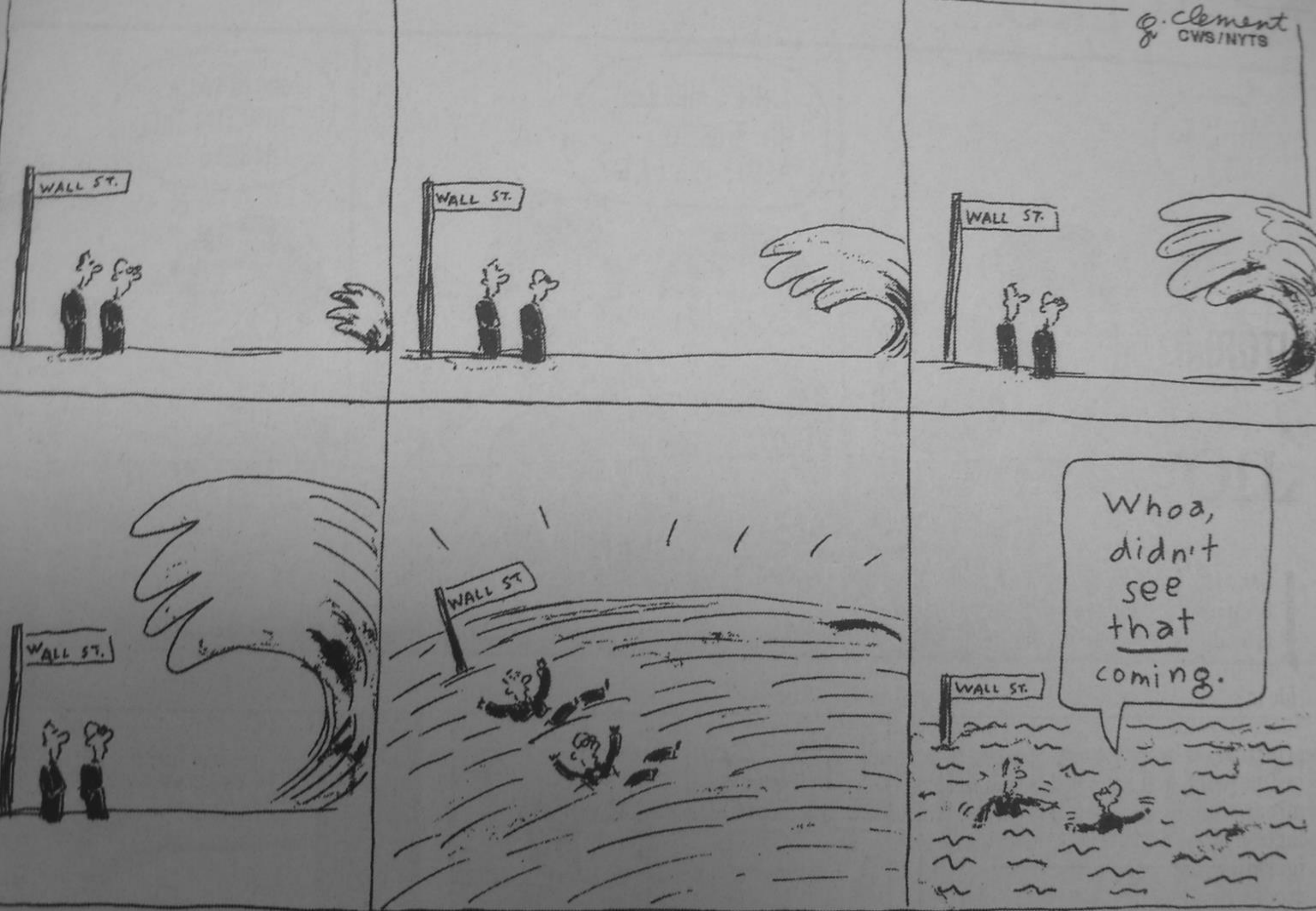
- ✓ ***None of the ad hoc models is tested rigorously: no example of any theory falsified and rejected by negative empirical results***
  - **First example: new endogenous growth theory assumes unitary increasing returns to scale, the probability of which is 0.**
  - **Second example: the pricing of options assumes that rates of return follow a Gaussian law, whereas they obey to a Student distribution**

The benign neglect of Popper's falsification strategy: postulating a Gaussian law instead of a Student for stock market rates of return



1. LES RENDEMENTS JOURNALIERS de l'indice Dow Jones en 2007 et 2008 *(a)* ont une distribution statistique *(les points dans b)* qui est plus proche d'une loi « à queues épaisses », telle la loi de Student de paramètre 3 *(en bleu)*, que d'une loi gaussienne *(en rouge)*. Les trois distributions représentées ont le même écart-type et la même moyenne.

Source : Cont Rama (2009), "Risques financiers: quelle modélisation mathématique?", *Pour la Science*, n° 375, Janvier, p. 25.


G. Clement
CWS/NYTS
WALL ST.
WALL ST.
WALL ST.
WALL ST.
WALL ST.
WALL ST.
Whoa, didn't see that coming.

✓ ***Since "anything goes", the only limits to new theorizing are the imagination of the economists and the diversity and size of their tool kits***

- **First consequence: an increasing balkanization of economics.**

- **Second consequence: general irresponsibility concerning the relevance of contemporary research**

  "Personally I was right, only my colleagues were wrong"

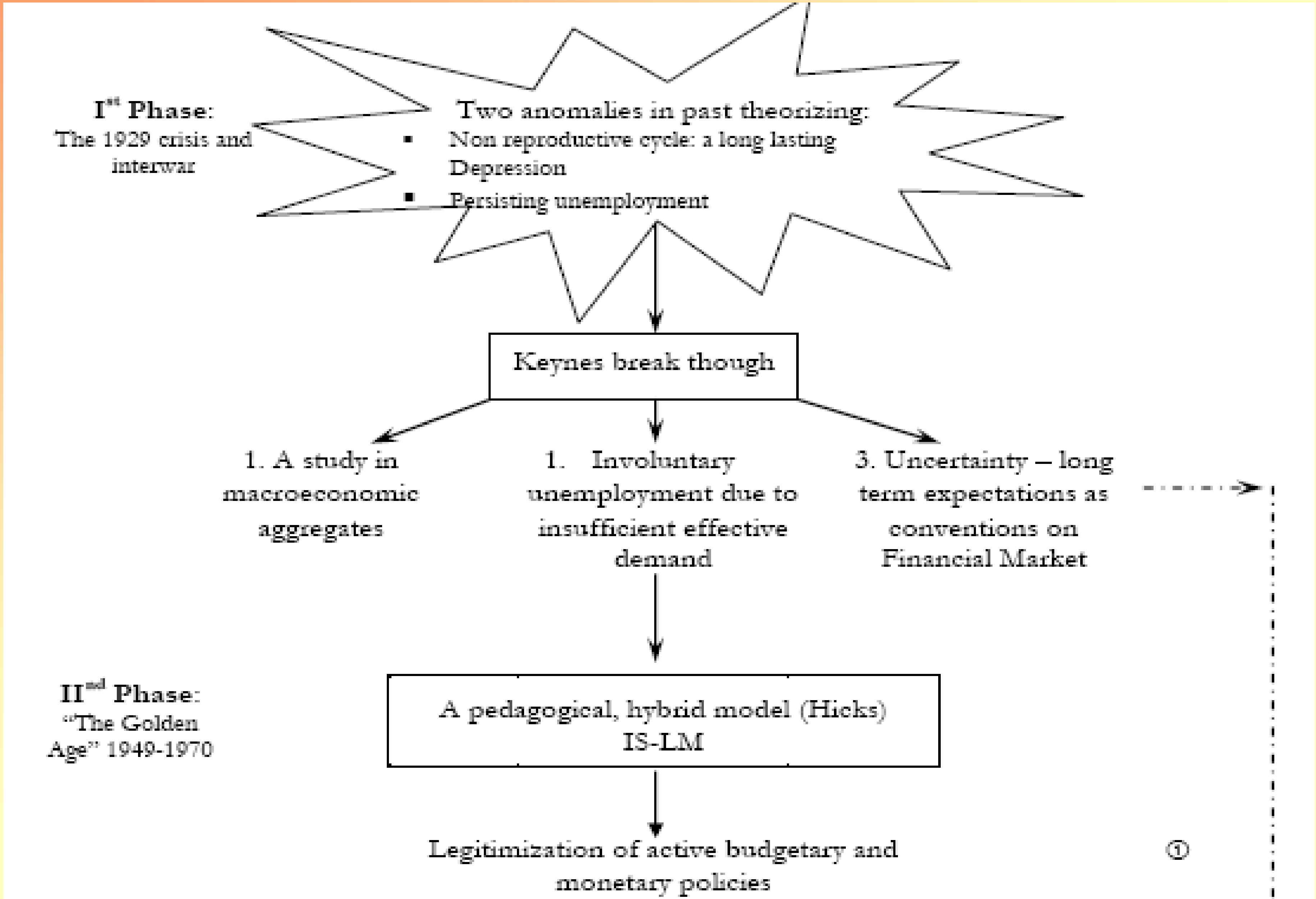
A sentence frequently heard about the present crisis

A COMPLETE ANOMY IN THE INTELLECTUAL DIVISION OF LABOR

II. THE NEW CLASSICAL MACROECONOMIC THEORY: A CONTRIBUTION TO ECONOMIC POLICY FAILURES.

1. A brief history of macroeconomics since John-Maynard Keynes' *General Theory*

➢ Keynes: the search for relevance and the role of conventions



➢ The demise of the Keynesian legacy: academic controversy and post-1973 stagflation

IIIrd Phase:
The crisis
1970 - 1989

Two destabilizing factors:

2. The real economy: Acceleration of inflation, stagflation
3. The academic world. How reduce the gap between micro and macro?

Imperfect statistical aggregation Hildenbrandt, Grandmont

Neowalrasian Macro

Disequilibrium theory Clower, Barro, Benassy

Monetarist theory Friedman

No Long term legacy

Lucas

Defeated: the ad hoc hypothesis of fix prices

Defeated by the Financial innovations

②

➢ A macro-economy with micro-foundations: a representative agent

②

IVth Phase:
1990 – 2007
The second
Golden Age

②

Real Business Cycle Model

H1. Representative agent: one firm, one household
H2. Long term neutrality of money
H3. Productivity shocks and "efficient depression"
H4. Rational expectations: agents are trained statisticians

Numerous anomalies in the simulations of calibrated simple model

A new-Keynesian approach: adjustment costs, price and wage inertia

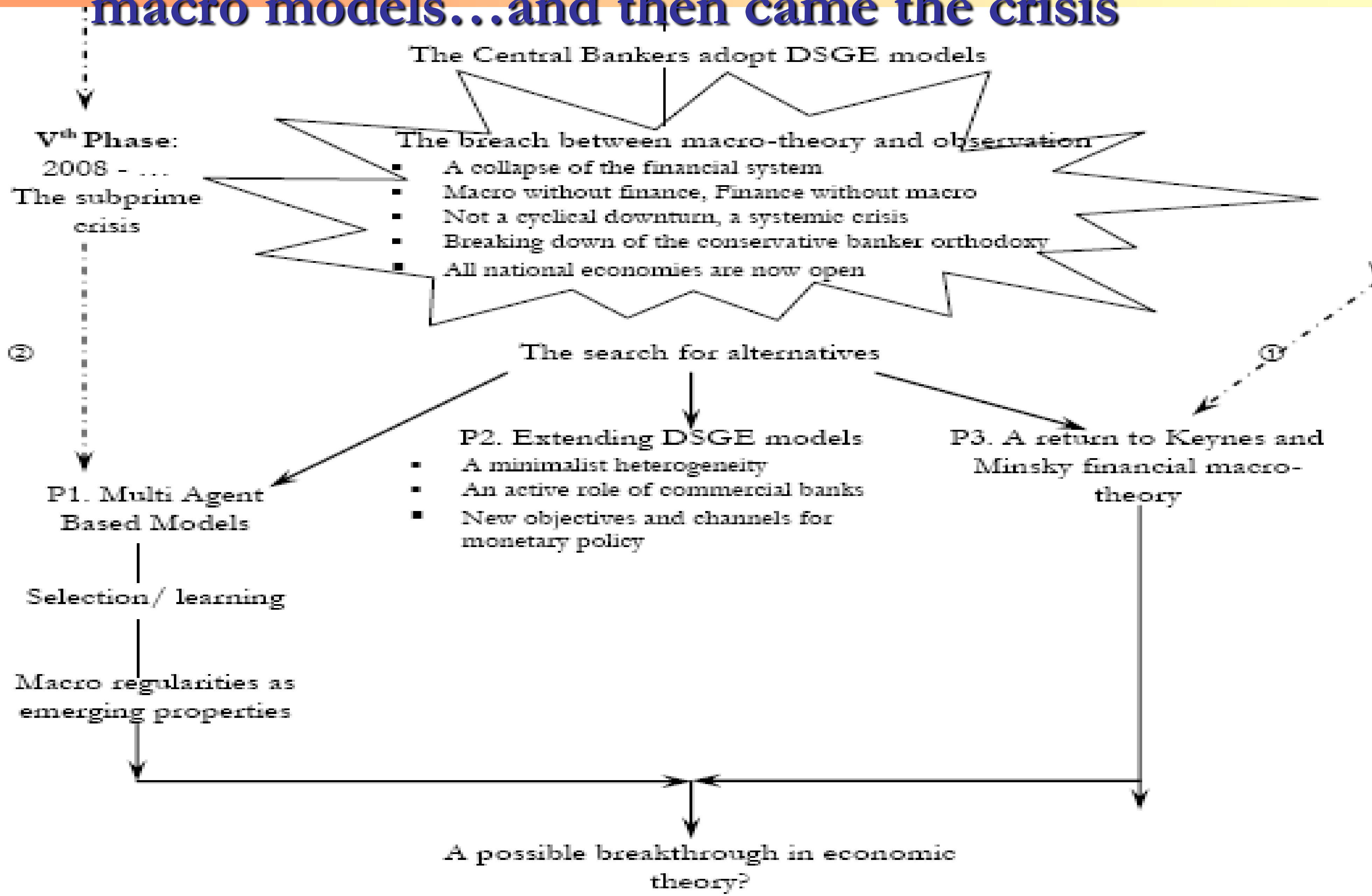
②

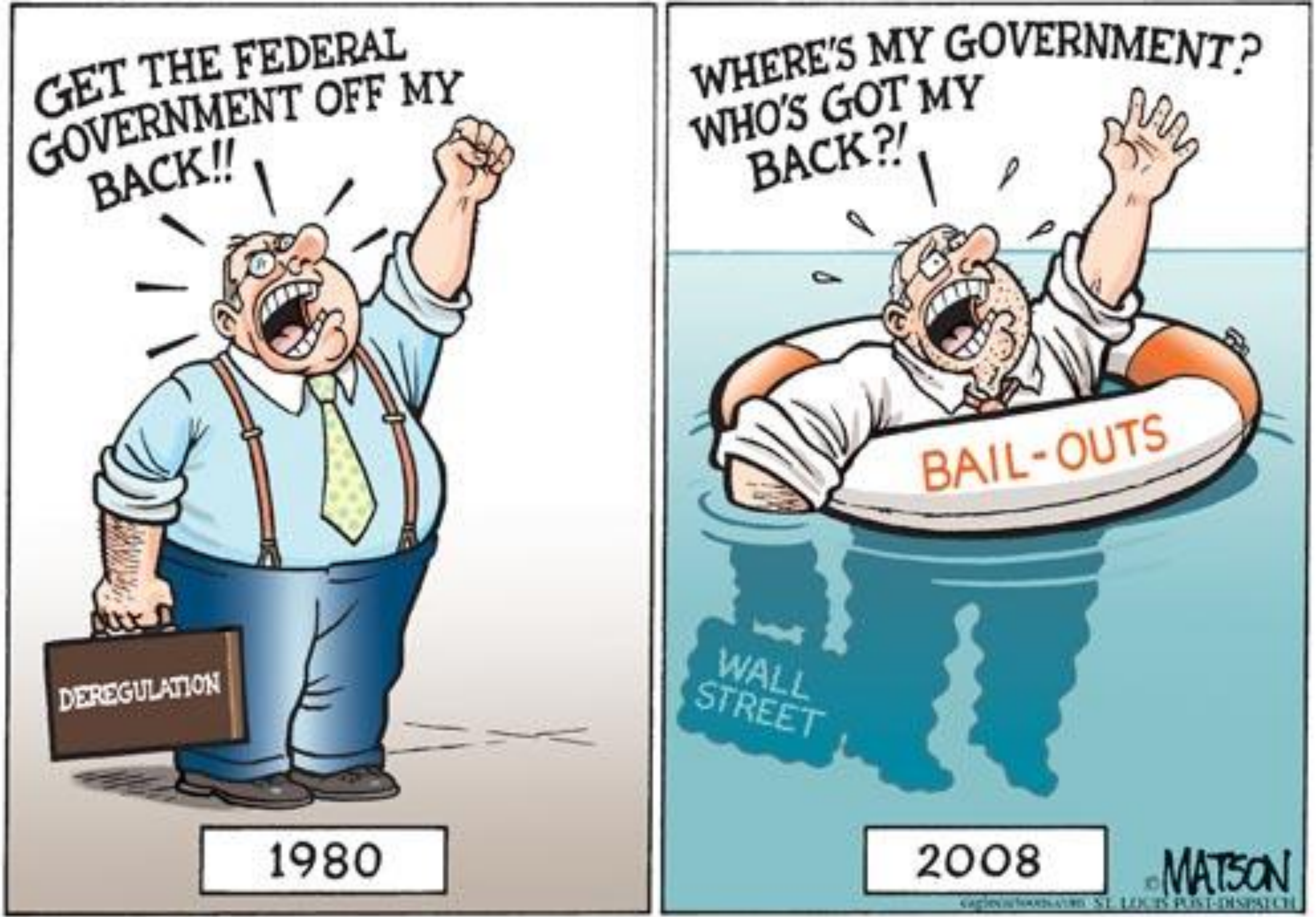
DSGE Models
A new synthesis

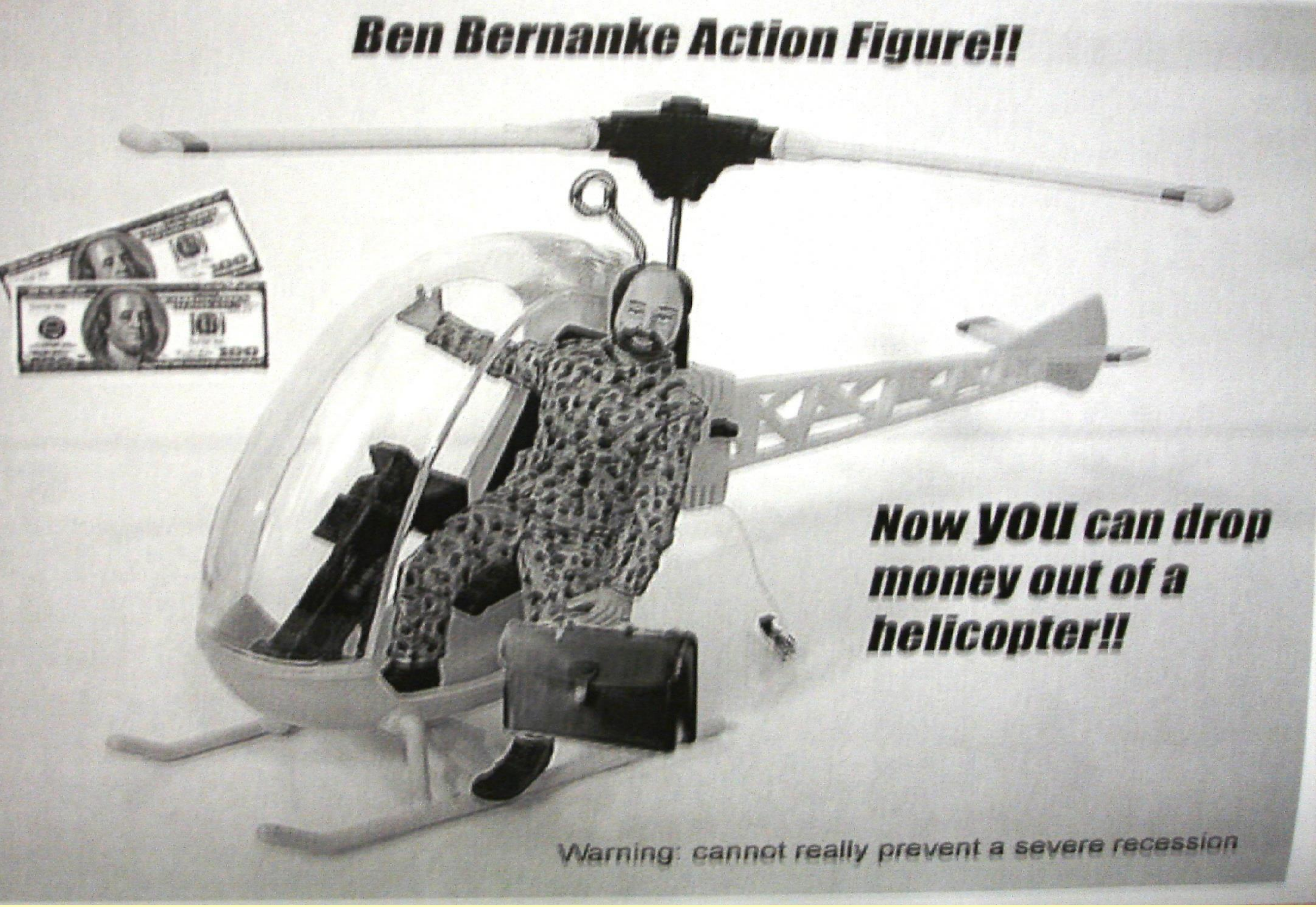
IS-LM are the reduced forms of these models

②

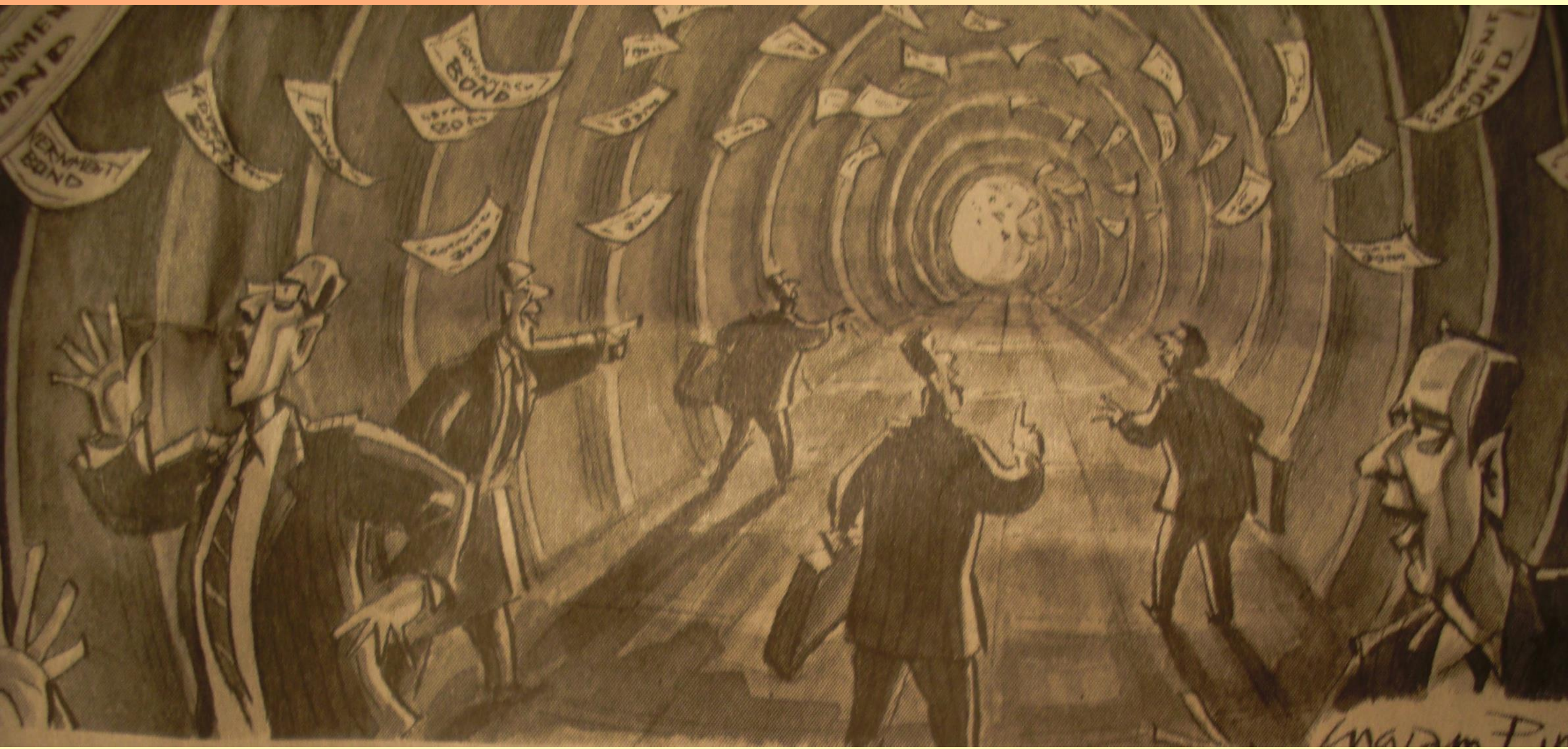
➢ The central bankers legitimize absurd and irrelevant macro models…and then came the crisis




GET THE FEDERAL GOVERNMENT OFF MY BACK!!
DEREGULATION
1980
WHERE'S MY GOVERNMENT? WHO'S GOT MY BACK?!
BAIL-OUTS
WALL STREET
2008
©MATSON


Ben Bernanke Action Figure!!
Now YOU can drop money out of a helicopter!!
Warning: cannot really prevent a severe recession

The credit is given to banks and not to households and the firms: no recovery of credit to the non-financial sector



III. THE PRESENT CRISIS : A TRUMP FOR A RENEWED POLITICAL ECONOMY

1. An alternative approach is possible and required

- ✓ ***Money is created via the credit supply by banks***
- ✓ ***Financial markets create socially relevant expectations about economic activity, however irrational they might turn out to be***

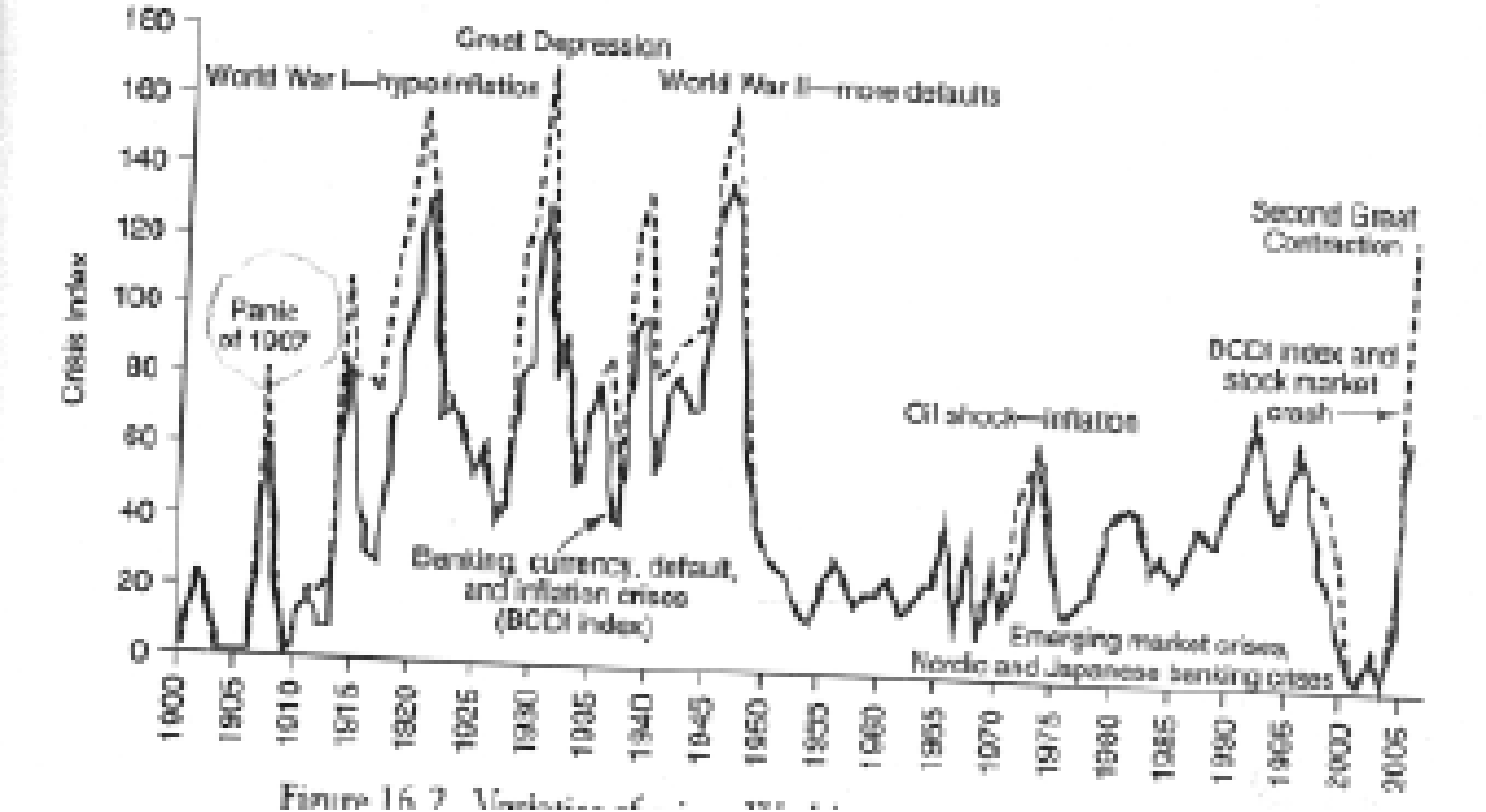

THE BUFFALO NEWS CAGLECARTOONS.COM ©2009 ADAM ZYGLIS
WE'RE IN A RECESSION. IT MAY BE A SMART TIME TO BUY...
BUY?!
BYE. ARE YOU LEAVING?
DID SHE GET FIRED?
LAYOFFS! THIS IS SO DE-PRESSING!
DEPRESSION?
WE'RE IN A DEPRESSION?
SELL! SELL!

- ✓ *Possible macro regularities emerge out of the horizontal interactions among heterogeneous agents*

- ✓ *Any macro regularity is space- and time-contingent and will finally phase out due to the opportunistic behavior of individuals who exploit it.*

- ✓ *Crises of various types are endogenous to the process of accumulation.*

- There is no room for the concept of crisis in conventional macroeconomics…but they are a recurrent phenomenon



Source : C. M. Reinhart and K.S. Rogoff (2009), p. 253

Authors	Core hypotheses	Nature of crises	Possible interpretations of the present crisis
1. MARX	• The capitalist mode of production implies a specific dynamics that f capital accumulation	• They are integral part of the accumulation process • Transformation towards finance capital and diffusion at the World level	• Basically an endogenous crisis • The expression of the domination of financial capital • The American crisis diffuses internationally
1. KEYNES	• Expectations govern firms decisions on investment, production and employment • Intrinsic difficulty to compute the fundamental value of an asset	• Unemployment as a self fulfilling pessimistic prophecy • Clear limit of monetary policy facing a systemic financial crisis	• Stability of a high involuntary unemployment even if wage are flexible • Facing a risk of depression, public budget is more efficient than monetary policy
1. MINSKY	• Endogeneity of credit booms in the emergence of speculative bubble and over accumulation	• Crises happen when hedging is overcome by speculation and Ponzi finance	• Key role of credit to financial institutions and poor households • Reemergence of Ponzi type frauds
1. WICKSELL	• The gap between monetary interest rate and the rate of return of capital sets into motion macroeconomic dynamics	• They are the outcome of a low monetary interest rate	• The victory over inflation by the conservative Central banker leads to a permanently too low short term interest rate
1. SCHUMPETER	• Productive and organizational innovations periodically re-launch accumulation • Innovators require access to credit	• The turning point from the boom to the recession is endogenous • The downward adjustment may generate a long lasting depression	• The speed of financial innovations has triggered a boom, followed by a brutal adjustment
1. FISHER	• The downward phase of the cycle does not necessarily prepare the recovery	• The deflation increases the real cost of debt repayment and thus be propagating depression	• After September 2008, general fear about a repetition of the lost Japanese decade: stagnation and deflation
1. KNIGHT	• Profit is the remuneration of risk taking	• The complete generalization of risk taking and creating unfolds a radical uncertainty at the systemic level	• What was initially conceived as hedging against risk finally triggers a speculative bubble that ends-up into a systemic crisis
1. HAYEK	• The price system is diffusing the relevant information for actors, but does not necessarily allocate efficiency resources	• With modern finance, “mark to model” and perverse incentives in the financial system, prices are loosing their informational content	• The erroneous pricing of many derivatives generates a speculative bubble, a misallocation of credit and competence, hence a systemic crisis

IV. AS MANY ECONOMIC POLICY CONCEPTIONS AS PARADIGMS.

THREE STRATEGIES IN MACRO MODELING OF FINANCE AND ITS IMPACT UPON THE REAL ECONOMY

– The deductive / Axiomatic Approach

A pure market economy

Imperfections

- Frictions
- Price rigidity
- Imperfect financial markets

An hybrid DSGE model

Ability to mimic some historical series

A technically admissible complexity

Calibration

The hidden political agenda of economics

THE PRINCIPLES

A restricted concern: Economics analyzes efficiency in the allocation of scarce resources

→

A CONJECTURE

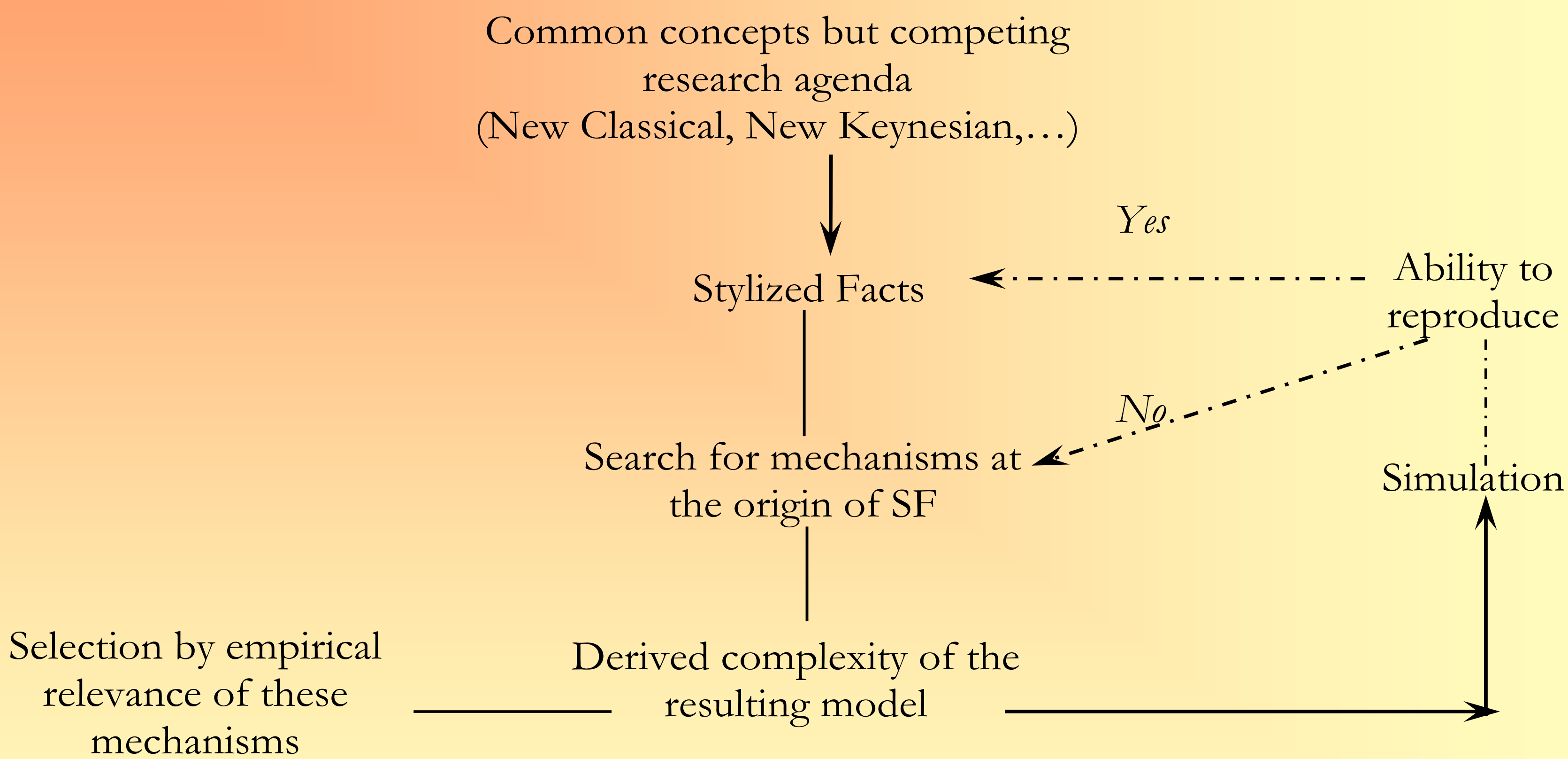
Markets are the less-inefficient coordinating mechanisms

→

A RECOMMENDATION

Extend the markets to all possible domains of society: polity, family, culture,

– An eclectic / Ad hoc method: classical / Keynesian in the Colander's sense



This strategy is rarely followed : beliefs , interests and ideologies crowds out scientific methodology

THE IDEAL

Test empirically which effects are dominant and discard those that are falsified

→

THE USUAL PRACTICE

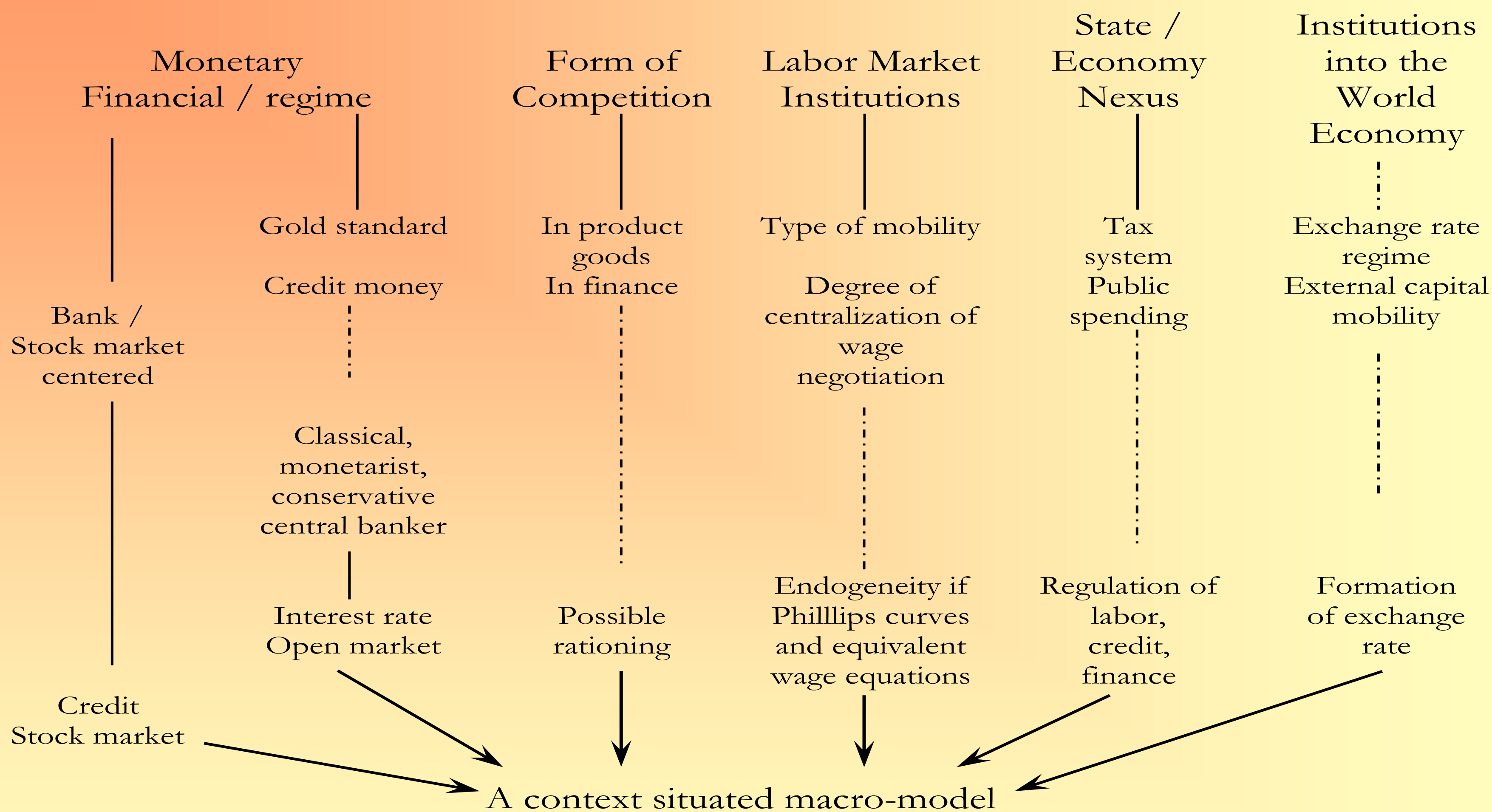
Each economic school sticks to its founding principles

→

THE OUTCOME

Governments select the theory that justifies its economic policy that is implie,d by its socio-political coalition.,

– An institutionally grounded macro modeling: A given configuration of a capitalist economy



An opening to the diversity of capitalisms but too much complexity in economic policy recommendations

THE STRENGTHS

A response to national trajectory specificity
Distinction between stable regimes and structural crisis periods.

THE LIMITS

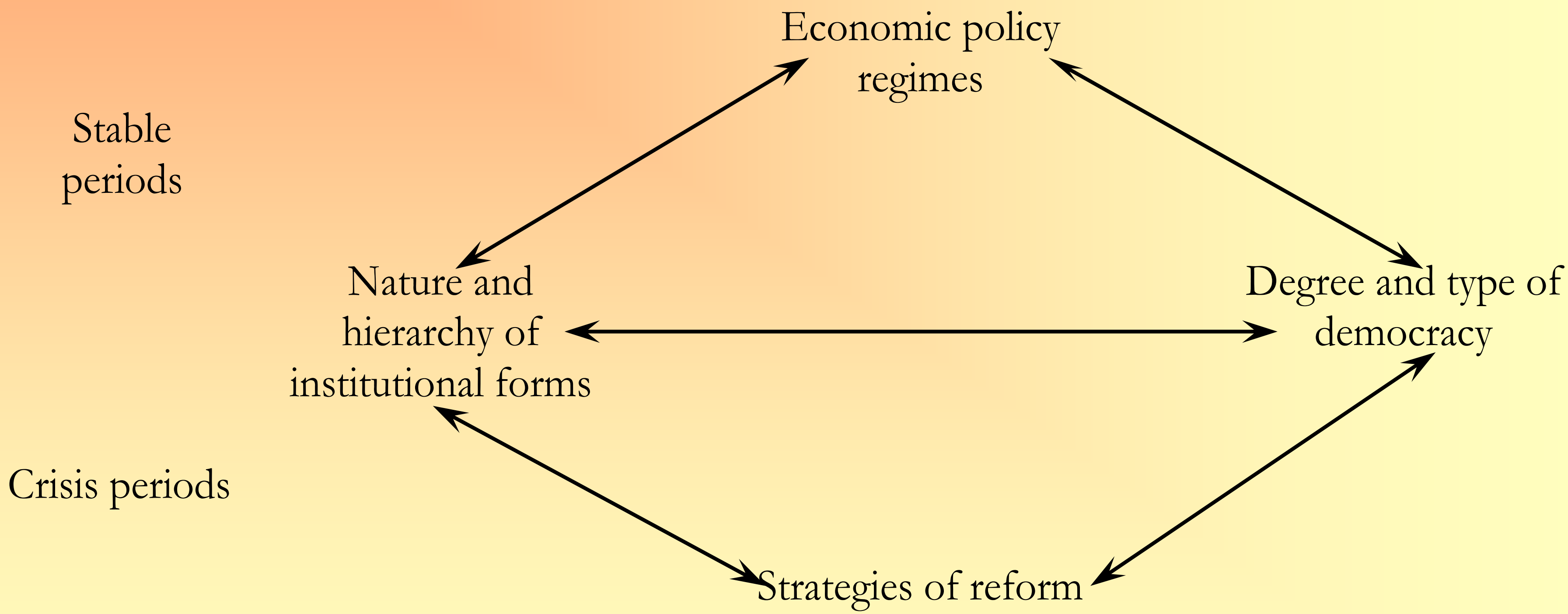
No universal one best way

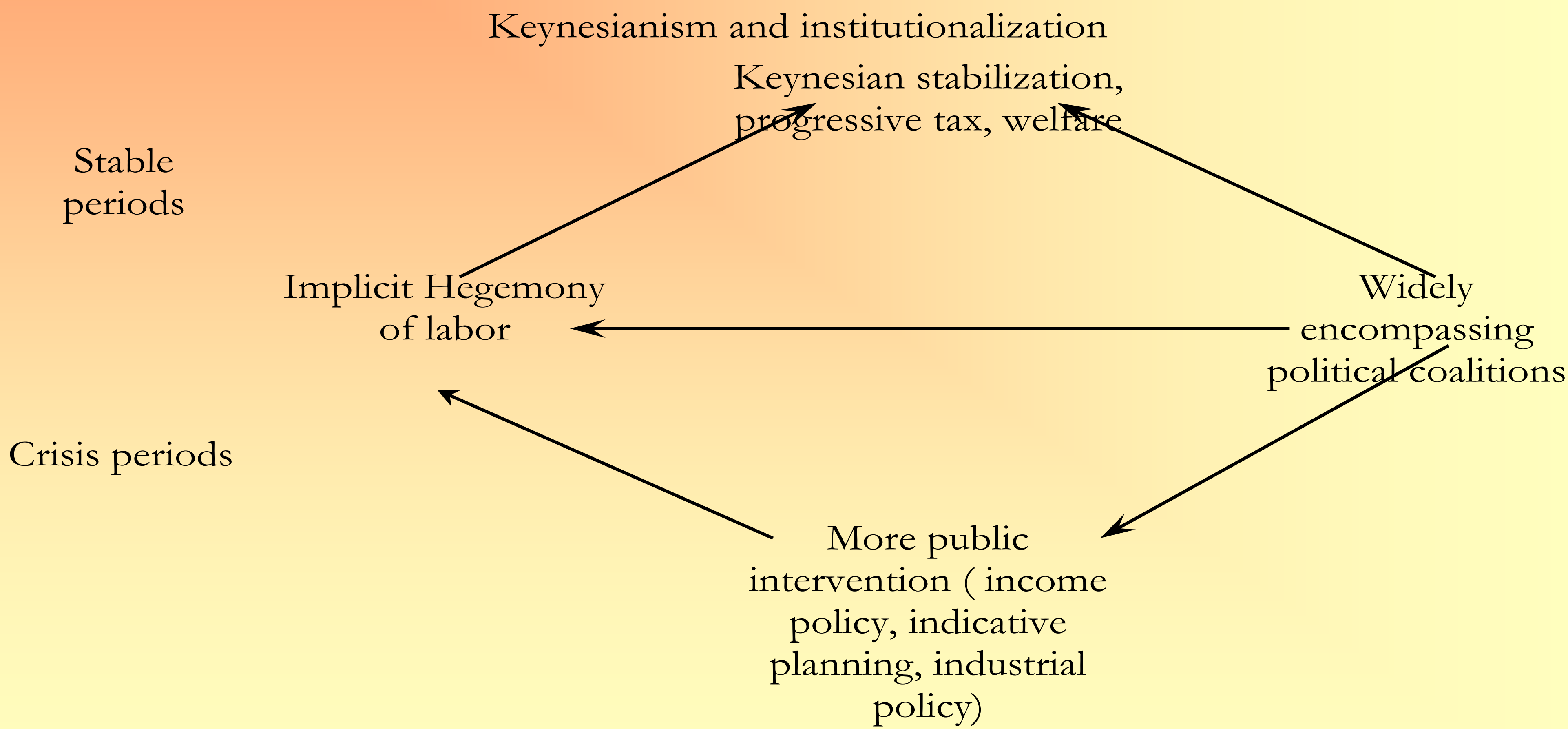
Need for policies articulating various domains, context and time specific.

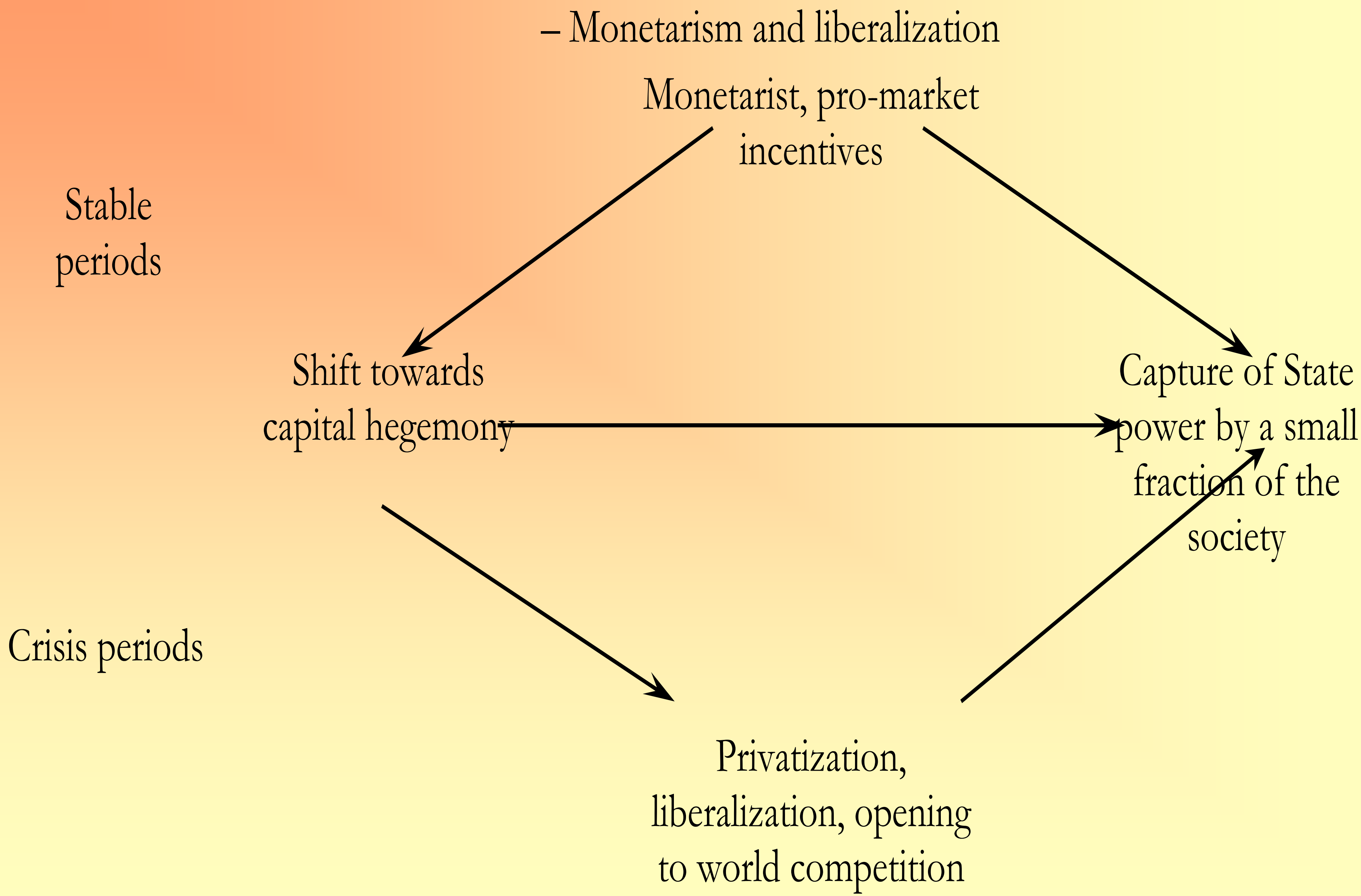
THE CONSEQUENCES

Most politicians prefer wrong but simple ideas compared with less irrealistic but complex ones. ,

A synthetic presentation of Economic Policy Regimes and Strategies of Reforms




Keynesianism and institutionalization
Keynesian stabilization, progressive tax, welfare
Stable periods
Implicit Hegemony of labor
Widely encompassing political coalitions
Crisis periods
More public intervention (income policy, indicative planning, industrial policy)


– Monetarism and liberalization
Monetarist, pro-market incentives
Stable periods
Shift towards capital hegemony
Capture of State power by a small fraction of the society
Crisis periods
Privatization, liberalization, opening to world competition

– Brands of capitalism and dominant economic policy regimes

Capitalisms / Policy Regimes	Market-led	Meso-corporatist	State-Led	Social democratic
1. General style	• Correct market failures • Promote adequate market incentives	• Coordinate private expectations and strategies • Administrative guidance	Extended regulations, Indicative planning	• Compromise among stakeholders • Pragmatism in solving problems
2. Interest mediation	Formally by democracy, Actually, by lobbying	Leading role of large firms, limited response to citizens demands	• Sensitive to government ideology • Either technocratic or clientelist	Deliberation and negotiation among all social groups and stakeholders
3. Objectives	Best trade-off between macroeconomic stability and growth	National competitiveness while preserving social cohesion	Modernization and growth	Successful insertion into the world economy in order to sustain an extended welfare
4. Privileged tools	Mainly monetary and budget policies	Education and innovation policy,	Laws, regulations, taxation, planning	• National pacts • Innovation policy • Efficient welfare

V. THE REAL ACTORS OF ECONOMIC POLICY ARE NOT THE ECONOMISTS BUT INTERESTS GROUPS AND POLITICIANS.

3. *Ideologies and political orientations play a role, but far less than professional conformity does*

- ✓ A frequent interpretation by critical and heterodox analysts.

- ✓ *De facto*, the vision is a precondition for theorizing and theories orient modeling (Schumpeter):

  - A vision: what are the actors and the issues at stake?
  - One of several theories can be built starting from this vision.
  - Many models varying in time and space can be derived from these theories.
  - The policy recommendations proposed by the economists can be loosely connected with the model.
  - Politicians always select the policies and conclusions that fit with their strategy decided for political reasons.

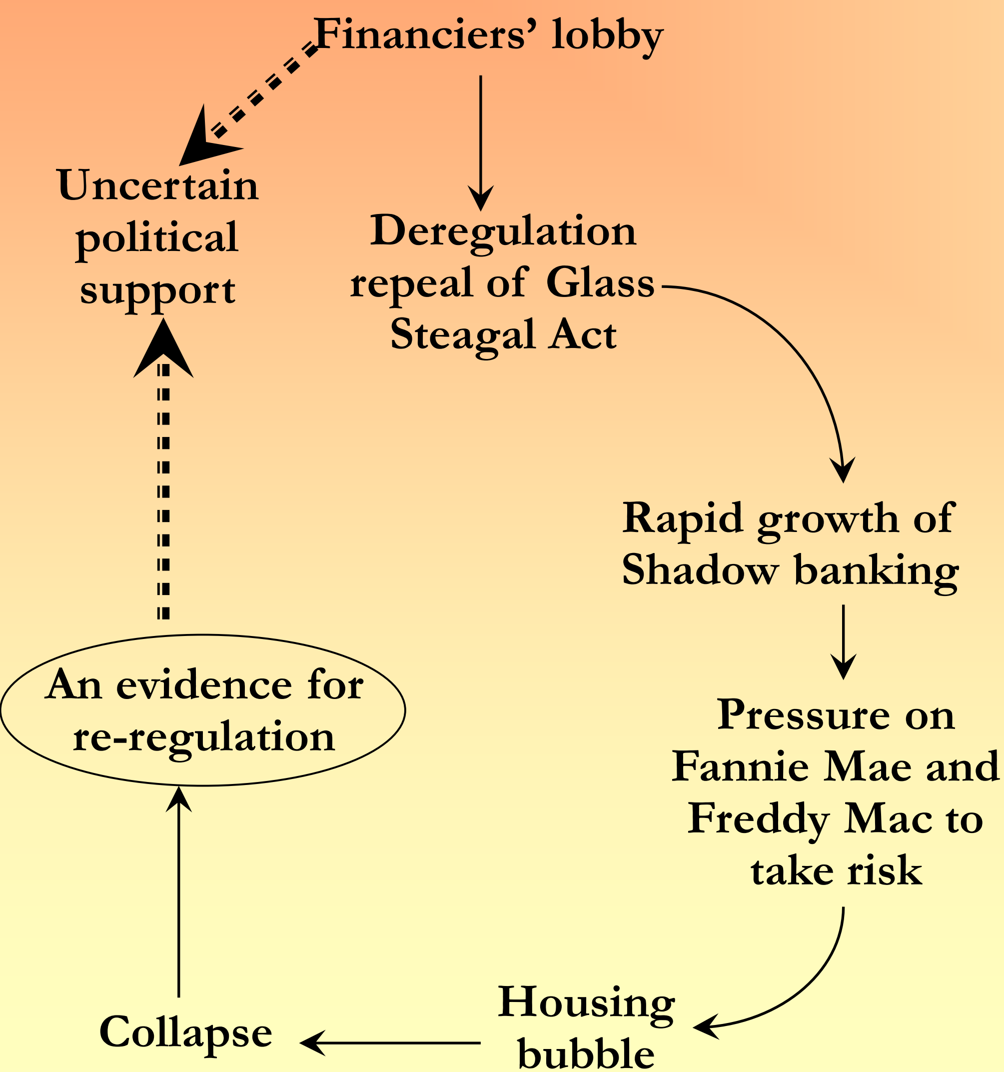
- ✓ **Nevertheless, opposite camps in economic policy may share the same analytical tools and models. Some examples:**
  - ***In the 60s and 70s, micro-theory was used as an argument in favor of market mechanisms in the US whereas in France it was a tool for efficiently managing public enterprises and collective rules.***
  - ***Both Chicago University and MIT economic departments share a common macroeconomic work horse, the DGSE framework, but differ on some hypotheses (flexible or fixed prices and wages).***

- ✓ **This is explained by the common references to an economic research field: even heterodox economists have to work within the DGSE model; whose basic hypotheses they consider as erroneous.**

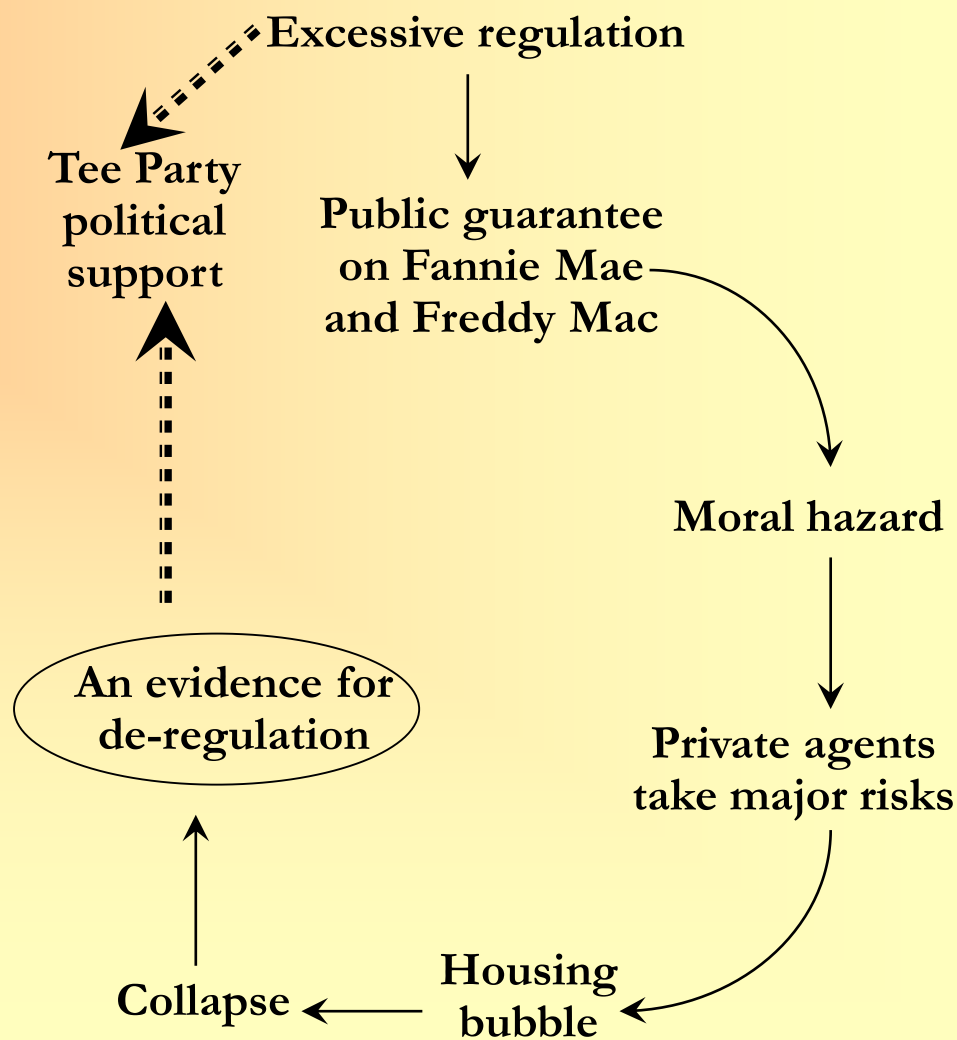
ISN'T CONFORMITY A STRONGER DISCIPLINARY DEVICE THAN IDEOLOGIES FOR ACADEMICS?

Two political parties, two opposed analyses of the crisis

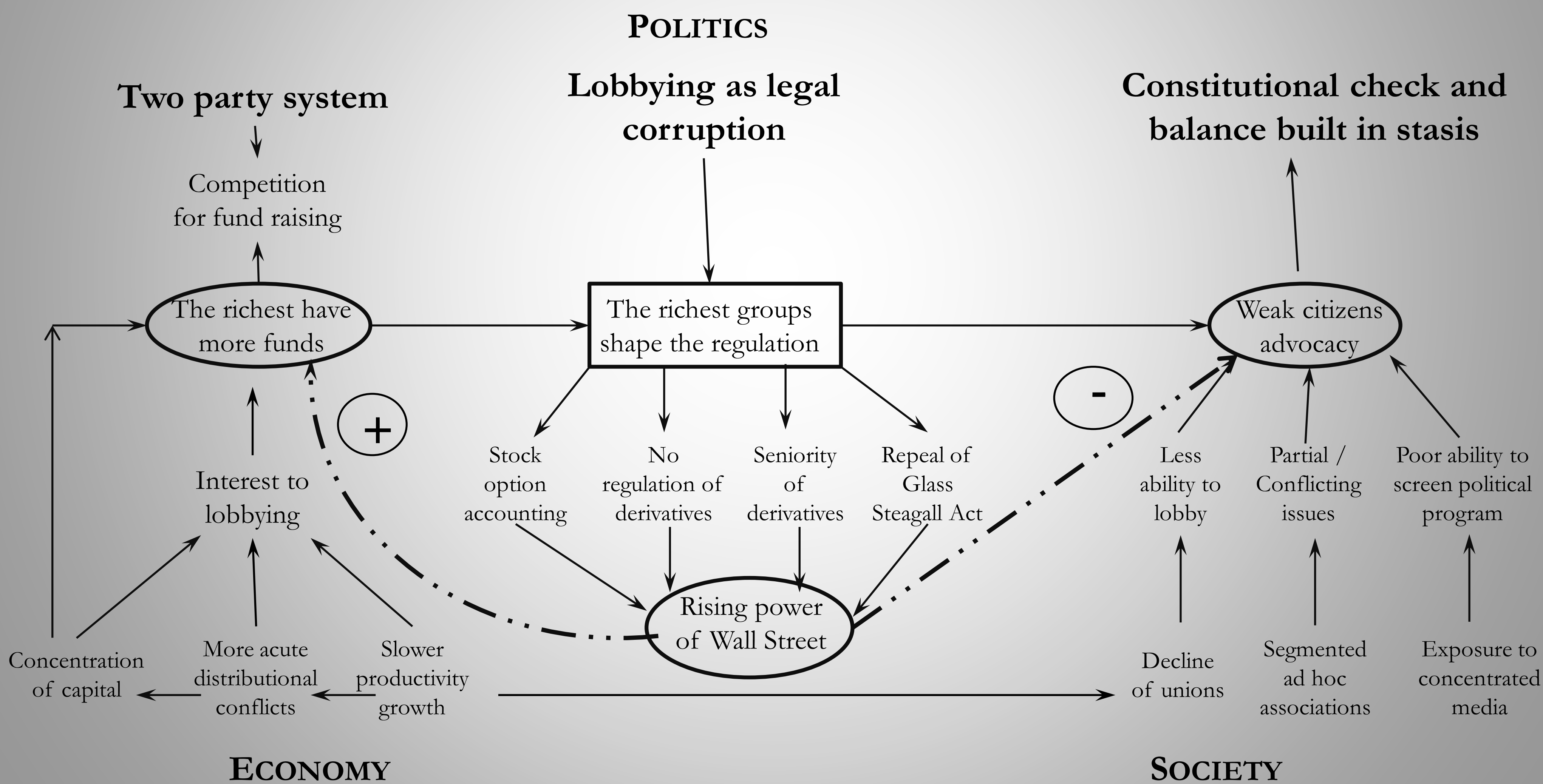
1. Keynesian Democrats

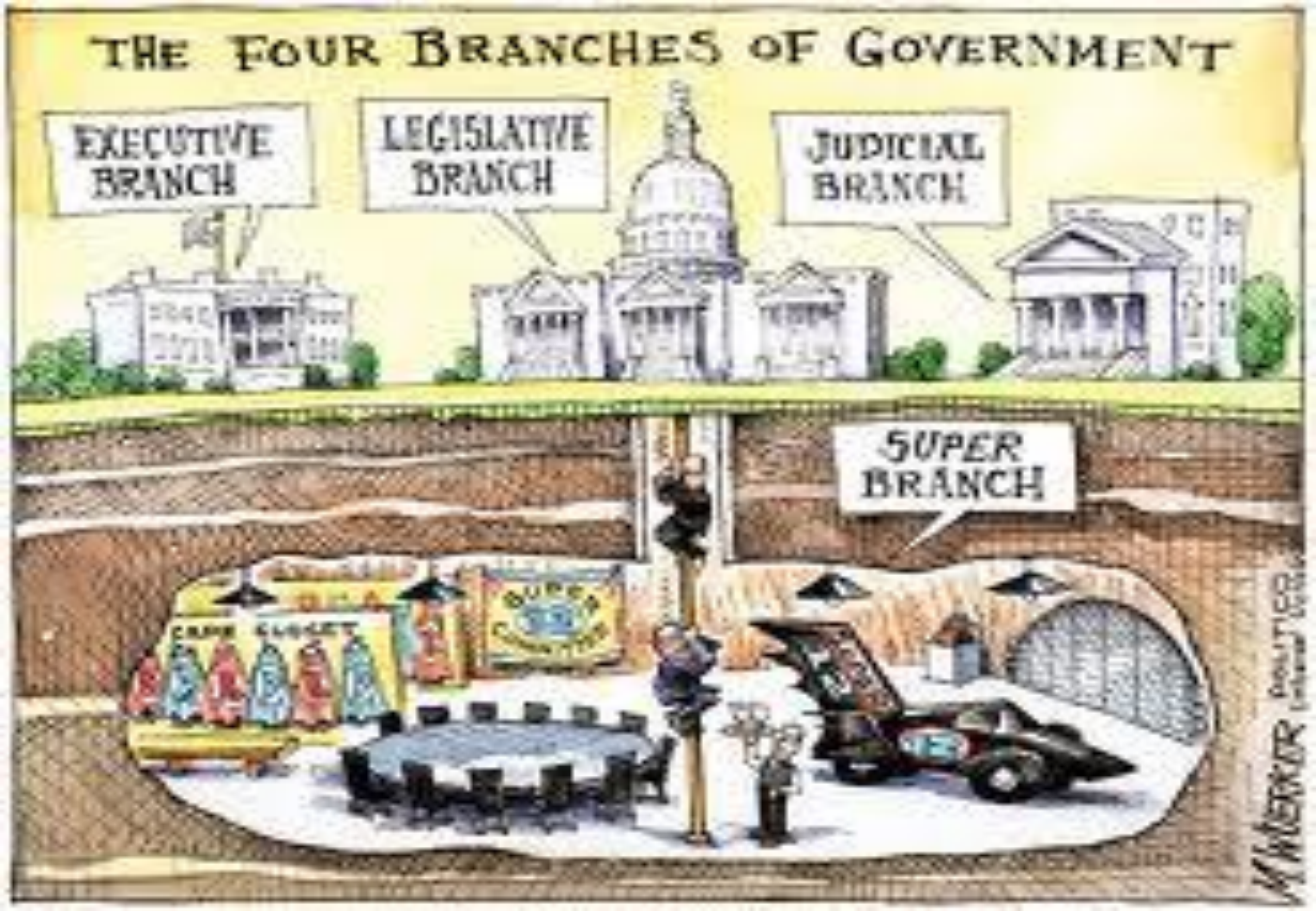


2. Pro-free-market Republicans



5. Converting economic power into the political power to shape governments policies: the US




THE FOUR BRANCHES OF GOVERNMENT
EXECUTIVE BRANCH
LEGISLATIVE BRANCH
JUDICIAL BRANCH
SUPER BRANCH


IF ALAN GREENSPAN WERE A CELEBRITY CHEF...
HORSEY
I AM SHOCKED THAT SO MANY OF YOU GOT FOOD POISONING FROM MY RECIPES!
...WHO WOULD'VE GUESSED THAT THE MARKET WOULD SELL YOU TAINTED MEAT AND PRODUCE IF WE STOPPED INSPECTIONS?

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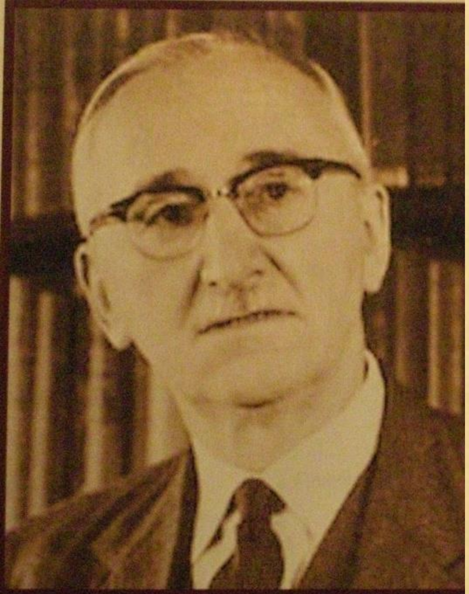

Friedrich August von Hayek
(May 8, 1899 – March 23, 1992)

The curious task of economics is to demonstrate to men how little they know about what they imagine they can design.

Hayek, *The Fatal Conceit*, 1988

Nobody can be a great economist who is only an economist—and I am even tempted to add that the economist who is only an economist is likely to become a nuisance if not a positive danger.

Hayek, *Studies in Philosophy, Politics, and Economics*, 1967

I am far from denying that in our system equilibrium analysis has a useful function to perform. But when it comes to the point where it misleads some of our leading thinkers into believing that the situation which it describes has direct relevance to the solution of practical problems, it is high time that we remember that it does not deal with the social process at all and that it is no more than a useful preliminary to the study of the main problem.

Hayek, "The Use of Knowledge in Society," *American Economic Review*, 1945

In this paper I argue that the current core of macroeconomics—by which I mainly mean the so-called dynamic stochastic general equilibrium approach—has become so mesmerized with its own internal logic that it has begun to confuse the precision it has achieved about its own world with the precision that it has about the real one. This is dangerous for both methodological and policy reasons. On the methodology front, macroeconomic research has been in "fine-tuning" mode within the local-maximum of the dynamic stochastic general equilibrium world, when we should be in "broad-exploration" mode. We are too far from absolute truth to be so specialized and to make the kind of confident quantitative claims that often emerge from the core. On the policy front, this confused precision creates the illusion that a minor adjustment in the standard policy framework will prevent future crises, and by doing so it leaves us overly exposed to the new and unexpected.

Macroeconomics after the crisis: Time to deal with the pretense-of-knowledge syndrome

Ricardo Caballero
Professor at MIT

October 2010.

V - CONCLUSION.

C1 – The intellectual failure of mainstream economics is complete but its influence upon economic policy shows an impressive resilience.

C2 – This opens an avenue for a renewed political economy but it calls for a agora where heterodox currents discuss the construction of a common platform.

C3 - In any case the role of economists in the production of economic policies is subordinate to the nature of political coalitions.

C4 – Therefore a central but quite difficult research agenda should be to open the black box of economic policy formation. What are the processes that leads to

-policy regimes along an established development mode

-reform strategies during structural crises.

C5 - By nature this is a multi-disciplinary research, that crosses both economic specialisations and many other social sciences .

C6 – This is an institutional issue about academia and not only an intellectual challenge.

C7– The present crisis opens a window of opportunity but it is already late

Thank you for your attention

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