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The Research Network Macroeconomics and Macroeconomic Policies (FMM)

Since 1996 the Research Network Macroeconomics and Macroeconomic Policies (FMM) has existed as a platform for analysis, research and discussion of macroeconomic issues. It is primarily based in Germany and Austria but cooperates closely with similar networks in other countries, particular in Europe. The Network is concerned to promote the revival and development of macroeconomic approaches which have tended to be eclipsed since the 1970s, especially in Germany, as a result of the dominance of neoclassical, monetarist and supply-side approaches. The Network aims to be both a platform for discussions about economic theory as well as a forum for economic policy debates: Macroeconomic theory is seen as the basis for policies which aim at high employment, environmentally sustainable growth, price stability, reduced inequality, and the elimination of poverty. In particular, the Network seeks to promote an exchange between competing theoretical paradigms.

Organisationally, the Network is based at the Macroeconomic Policy Institute (IMK), Hans Boeckler Foundation. It is politically independent. The Network's activities are directed by a coordinating committee. The main activities involve promoting an organised exchange of views between economists through an annual conference, organising publications, and providing support for younger economists. The coordinating committee maintains a web site and a newsletter. The Network is open to anyone who is interested in discussions around the research themes outlined below. As with any network, the FMM is not a membership organisation, but rather an open association of people interested in similar issues.

Economic and political challenges

At first sight, the process of globalisation appears to have resulted in very similar conditions in most Western industrialised countries. Open trading systems and highly mobile capital have – together with high unemployment – weakened the position of workers, and this has contributed significantly to a marked increase in inequality in the distribution of income and wealth. Developing countries are having a major impact on changes in the international division of labour. In Asia, China and India with their huge populations have established major centres of growth. Everywhere, technical and structural change entails widespread economic, social and ecological problems of adjustment. But a large part of the population in developing countries has as yet scarcely benefited from growth in the world economy.

Countries have had varying degrees of success in dealing with the tasks they were confronted with. Although most countries registered low inflation, there have been significant differences in the rates of growth and unemployment amongst the OECD countries. In the European Union (EU) and especially the Euro area, economic growth since the mid-1990s has been too low

to achieve a lasting reduction of unemployment. The result has been significant differences in the pattern of growth and employment, both within the EU and within the Euro area. It is also not clear whether, or to what extent, new EU members will be able to catch up with existing members. Similarly, it is questionable whether such a heterogeneous currency union as the Euro area can function in the long term. This problem needs to be addressed for both the EU and the Euro area as a whole, but it is especially important for countries with high unemployment, such as Germany.

An important point about economic policy is that the approaches that are successful in one country are not always appropriate for others. The policy of 'structural reform' (deregulation, flexibilisation of the labour market, privatisation, etc.), pursued particularly in the EU, creates more problems than it solves. By contrast, alternative institutional arrangements for achieving higher levels of growth and employment are scarcely discussed: The institutional structures which shape the process of wage and price formation, labour-market and social policy regulations, a country's international economic relations together with its exchange-rate policy all have important macroeconomic functions. For macroeconomic policy that seeks to promote growth, the interplay of wage, fiscal, money and exchange-rate policies is especially important. This is something that is often overlooked in Germany and other European countries. The role of macroeconomic policy in promoting growth either in member states or in the EU as a whole is simply not acknowledged. And if long-term growth tends to be low, the national social-security systems become overstretched: The result is a vicious circle characterised by weak growth and so-called structural reforms of the labour market and the social-security systems.

The major economic challenges in Europe include not only the persistently high levels of unemployment, but also the increasing poverty in many countries together with the rising inequality in income, wealth and opportunity. In virtually every country, the share of wages in national income is tending to decline. Although the societies as a whole are becoming ever richer, a significant sector of the population is facing a declining level of social security. These distributional issues also have macroeconomic origins and implications for policy.

The process of economic globalisation has accelerated since the mid-1970s as a result of the policies of liberalisation and deregulation pursued by many countries and supranational organisations, especially as regards financial markets. Although this might have brought some undeniable gains, it has also created many unresolved problems. National states have lost a considerable degree of economic sovereignty, or failed to make full use of the policy space which still remains. Supranational integration and international cooperation, in any case difficult, are not advancing and in some respects actually in retreat. Relatively strong international economic growth since the mid-1990s has been accompanied by rising international macroeconomic imbalances, the risks of which have been insufficiently appreciated. In most countries, the financial sector has been subject to major expansion, usually as a result of reduced regulation, and has grown more rapidly than the productive and commercial sectors. At the same time, the fragility of the financial system has increased. The risk of financial crises has increased, and not only in developing countries. Financial crises are transmitted internationally more rapidly than before, and they are having a greater macroeconomic impact. Another major international economic challenge concerns the question of global warming and climate policy. Energy supply and climate policy are clearly issues that can only be advanced significantly at an international level. All in all, the process of globalisation poses new challenges for macroeconomic research, and for what have been, traditionally, nationally-based notions of economic policy.

Without a renaissance in thinking about the economic system as a whole, without appropriate macroeconomic theories and policy instruments, the great economic challenges at a national, a European and a global level cannot be resolved. The prevailing approaches to economic theory, which have led to a dominance of microeconomic theory, are in no way adequate to meet these challenges.

Discontent with the prevailing academic approach to economics

In the 1970s, the ‘standard Keynesian’ approach based on the neoclassical synthesis, which had previously predominated internationally, was displaced by monetarism. Both approaches shared the view that, in the presence of nominal rigidities and/or adaptive expectations, the level of output and employment could be influenced, at least in the short term, by macroeconomic policies. In the long term, however, the economic system tended to full-employment, or, for the monetarists, to the ‘natural’ level of unemployment, which could only be reduced by supply-side policies. According to this view, monetary policy then only influenced the price level, or inflation. The proponents of the neoclassical synthesis were, however, much more sceptical than the monetarists about the stability of the private sector and the demand for money, and therefore emphasised the importance of short-term stabilisation policies.

The new classical school, which gained influence at the end of the 1970s, shared the view that economic fluctuations were due to monetary factors. Macroeconomic policy could therefore have a short-term impact on the real economy, but only if the policy was unexpected by economic agents, in which case the economic consequences could not be foreseen on the basis of rational expectations. The proponents of the real business cycle school went one step further: For them, fluctuations in economic activity could only be explained by supply-side factors, such as a change in technology or in individual preferences.

The way out of this theoretical dead-end was provided by New Keynesianism which has arisen in Anglo-Saxon countries over the last two decades and provided the basis for the emergence of a ‘new consensus’. It shares the view of the new classical and real business cycle approaches that macroeconomic analysis should be based on a general equilibrium model founded on the principles of utility maximisation and rational expectations. However, the New Keynesians allow that markets might not always be in equilibrium. The basis for this is price or wage inflexibilities, which are backed by microeconomic foundation and which, consequently, imply that macroeconomic policies can have effects on real variables in the short run. For the new consensus, an active interest-rate policy is actually seen as necessary to stabilise the system. In the long term, however, monetary policy only has an influence on the price level. This approach is clearly at odds with Keynes’s plea for a ‘monetary theory of production’ in which money and monetary policy have an influence on output, growth and distribution, both in the short and the long term.

Dissatisfaction with these developments has been growing in parts of the academic community. There have even been criticisms from within the mainstream itself, i.e. in leading academic institutions, organisations and journals. For example, the notion of a rational individual, the *homo economicus*, is strongly questioned by experimental economics, which is currently enjoying an upswing in universities, while evolutionary economics, which has also won considerable respect, is challenging the notion of general equilibrium. Another group of critics, which includes amongst others the Post-Keynesians, attempts to develop the Keynesian research programme of a ‘monetary theory of production’. In this approach, money and monetary policy are seen to have short and long term impacts on output, growth and distribution. In fact, it could be said that, as far as macroeconomics it concerned, there is no homogenous mainstream any more. Despite these more recent developments, which have been most marked in Anglo-Saxon countries, there are several points which may be noted:

- The general equilibrium model with so-called rational expectations is still widely considered as the basic reference model and its role is not seriously questioned.
- Academic economics has become ever more specialised into narrow branches of knowledge; in this way it has lost contact with reality and is in danger of losing any political relevance. Larger, wider ranging questions are simply avoided.

- In other areas, empirical work is being carried out using statistical and econometric techniques but in a way that is devoid of any basis in economic theory.
- In Germany in particular, as a result of the weak and superficial impact of Keynes's ideas, economic research has neglected or at times ignored macroeconomic themes. The defence – whether open or veiled – of a purely supply-side approach has hindered the development of a methodological pluralism. Keynesian and other critical theoretical currents have been hindered or even blocked. Faith in the benefits of competition appears to recede when the dominant theoretical approach is itself subject to serious questioning.
- In the media and in policy debates, the range of views expressed by different currents is rarely reflected, and only proposals based on a simple supply-side approach are given serious coverage. Macroeconomic approaches to policy issues are marginalised. It is therefore not surprising that economic policy frequently lacks any conceptual basis and fails to meet up to the serious economic challenges which it faces. Economic policy and the recommendations of policy advisers are based on just one approach – supply-side economics – and do not take account of other approaches, let alone the extensive results of recent research.

Towards alternative theoretical and policy approaches

The FMM is concerned to develop theoretical and policy alternatives to the dominant approach. A major focus of the Network's theoretical interest lies in the writings of Keynes, and in the work of Post-Keynesians and New Keynesians which has mainly been developed in Anglo-Saxon countries. Institutional, evolutionary, game-theoretic and political economy approaches are also seen as valuable for developing macroeconomic research. In the search for theoretical alternatives, the following points seem important to us:

- Macroeconomic understanding does not arise from simply adding up microeconomic outcomes. The whole is more than the sum of the parts.
- Output and employment are macroeconomic phenomena which, in general, are determined by aggregate demand in the product market. In market economies the level of production and employment is usually constrained by a lack of demand rather than by persistent bottlenecks on the supply side.
- Money, and therefore monetary policy, is not neutral, neither in the short nor in the long term. Monetary and financial factors play a significant role in shaping the business cycle, distribution, growth and employment.
- Uncertainty, which is a structural feature of decentralised systems, plays a major role in how business decisions are reached. Institutions which can reduce uncertainty are of great macroeconomic importance.
- Macroeconomic policy involves exercising direct and indirect influence over a small number of key variables, in particular over interest rates, state expenditure and taxation, the exchange rate and nominal wages. Macroeconomic policy influences the real economy in the short term and long term through both the demand and the supply side.
- In market economies, there is no inherent tendency towards a stable general equilibrium in all markets, particularly as regards to full employment. Market economies are unstable and, therefore, require macroeconomic stabilisation policies.

Research questions

The FMM would like to promote research and discussion in a number of key areas. In each, the interrelationship between economic theory, institutional structures, and policy conclusions is considered to be especially important. The Network conceives of macroeconomics in a broad sense, and wishes to include interchanges with other areas in its discussions (for example microeconomics, mesoeconomics and political economy). It also attaches great importance to strengthening international networks between researchers involved in developing critical approaches. The specific areas which it plans to focus on include the following:

- **Macroeconomic theory:** For the reasons outlined above, macroeconomic theory is in need of renewal. It cannot return to the neoclassical synthesis of the 1960s. Research interest concerns the link between Post-Keynesianism and New Keynesianism, in particular as regards the determinants of macroeconomic activity in the short and the long term, and to the need or possibilities for conducting stabilisation policy.
- **Unemployment:** Seventy years after Keynes's *General Theory*, the various explanations and remedies for unemployment diverge strongly. Approaches which view unemployment, not in terms of equilibrium, but rather in terms of inadequate aggregate demand, inappropriate institutional structures, and misconceived policies should therefore be developed further on.
- **The distribution of income:** In most OECD countries, there has been a tendency for the share of wages in national income to decline, for the distribution of income to become more unequal, and for poverty to rise. This raises numerous questions about the causes of these trends, the extent to which they have a macroeconomic explanation, and whether it is possible to develop policies to reverse them. It also raises questions about the role of the wage bargaining process in determining the distribution of income, and the factors which affect the size of the profit mark-up adopted by companies.
- **Monetary theory and policy:** By further developing the theory of endogenous money, there is a need to deepen our understanding about the short- and long-term effects of monetary policy on output and employment, and the implications of this for central bank policy, especially as regards the European Central Bank. Further on, also the relationships between monetary policies, exchange rates and international currency systems have to be explored.
- **Macroeconomics and the financial sector:** The rapid growth of national and international financial markets, together with the increasing orientation of non-financial companies towards financial markets raises the question of the extent to which this affects macroeconomic variables such output, distribution and growth, together with the implications it might have for financial stability. There is also a question of whether asset markets and non-bank financial institutions are subject to adequate regulation.
- **European integration:** Economic growth in the EU has generally been too low to reduce high unemployment remarkably. But there have also been significant divergences between the member states, and this has been strengthened as a result of the expansion into Eastern Europe. The reasons for this, and the problems to which it gives rise, need to be analysed, as do the implications for economic policy and for any further expansion of the EU ('deepening vs. widening').
- **Globalisation:** Since the break-down of the Bretton Woods System, the liberalisation of currency markets and the growth of international trade and capital flows have led to a host

of problems for developed countries. The situation has been even more difficult for so-called emerging markets and, above all, poor developing countries. Globalisation has been accompanied by large exchange-rate fluctuations, enormous current-account imbalances, the sudden outbreak of financial crises, tax competition and by massive tax evasion, while the supposed benefits of free trade for growth and employment have often failed to materialise. All these aspects need to be analysed more intensively.

- International comparisons: Despite the process of globalisation, national economies frequently develop very differently. Comparative macroeconomic studies that examine different institutional and policy constellations ('macroeconomic constellations'), together with analyses of the different types of developed market economies ('varieties of capitalism') are valuable in understanding the determinants of output, growth and distribution.
- Macroeconomic aspects of underdevelopment: Explanations for the causes of underdevelopment and proposals for viable development strategies require a stronger macroeconomic basis. Key issues include the exchange-rate regime, the international financial architecture, the impact of capital flows, the development of the domestic financial sector, regional monetary cooperation, debt-reduction strategies and the prevention of financial crises.
- Macroeconomics of ecological problems: The issue of climate change, one of the central problems of the 21st century, involves a whole series of macroeconomic issues, including the connection between climate change, economic growth and income distribution; the macroeconomic implications of energy pricing and of tradable emissions certificates; the relation between resource allocation and capital accumulation; the ways in which the atmosphere might be managed as a collective good by a supranational authority; and how to deal with ecological uncertainty and the methodological difficulties involved in making long-term economic analyses.

Activities

The FMM is intended to provide a pluralist forum where the various themes outlined above can be discussed. It seeks to strengthen networking between those involved in research at universities and research institutes, especially in Germany and Austria, but also more widely in Europe. It also seeks to encourage new research and to promote a discussion of the results of research with people who are involved in politics, unions or other associations. To this end, the Coordinating Committee of the Network organises an annual international conference, the main theme of which varies from year to year. After being reviewed by referees, a selection of the conference papers is published in books or in special issues of academic journals. The Network also has a strong commitment to supporting the development of young economists. For this purpose, it includes graduate student sessions at the annual conference, and it organises summer schools for master and PhD students and young researchers.

The Coordinating Committee of the FMM