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Book Review: New Thinking in Macroeconomics: Social, Institutional, and Environmental Perspectives

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New Thinking in Macroeconomics: Social, Institutional, and Environmental Perspectives
Jonathan M. Harris and Neva R. Goodwin, eds.; Northampton, MA: Edward Elgar, 2003, 296 pp., $100 (hardback), $40 (paperback).
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For a long while macroeconomics was in a state of disarray as a result of the monetarist counter revolution and the rational expectations hypothesis that undermined the main tenets of the old Keynesian's neoclassical synthesis. However, in the 1990s a certain degree of consensus was reached within the mainstream and some authors started talking about a "new neoclassical synthesis" (e.g. Goodfriend and King 1997). The new synthesis can be seen as the consolidation of the conservative revolution—associated in the political realm to Ronald Reagan and Margaret Thatcher—in macroeconomics. In that view, the "great inflation" of the 1970s resulted from the excesses of liberal administrations in the 1960s, and it took a conservative administration committed to price stability to bring down inflation. Inflation, rather than unemployment, became the main concern of policy makers and macroeconomists.

The new synthesis revolves around the natural rate of unemployment notion, and can be summarized by three main propositions. First, the long-run Phillips curve is vertical at the natural rate of unemployment, and demand policies cannot affect the long-run equilibrium. Second, monetary policy should focus on acquiring and maintaining credibility for low inflation. Third, contractionary fiscal policy may be expansionary if fiscal consolidation leads to anticipated lower rates of interest and stimulates private spending. All in all the idea is that a minimal government committed to price stability would stimulate sustained output growth.

There are several limitations to the new synthesis. Jonathan Harris and Neva Goodwin have put together a volume that argues for a new approach to macroeconomics, which departs from conventional wisdom. They argue that on at least three fronts the new synthesis has been flawed. First, standard macro ignores problems that cannot be solved through market mechanisms. Second, it assumes that one model fits all situations, and can be applied in developed and developing countries alike. Finally, it ignores issues concerning the total scale of human economic activity, in particular those associated with the sustainability of economic activity. This critique, the authors argue, harks back to an earlier critique of mainstream Keynesian economics, based on the work of Joan Robinson and other radical Keynesians.

Beyond the notion of economic stabilization—defined as avoiding extreme inflation or recessions—the authors suggest that distributional equity; the achievement of broad social goals such as income security, education, and universal health care; and ecological sustainability should be part of macroeconomic policy concerns. In other words the new thinking on macroeconomics proposed by the authors would return to the old and more radical version of Keynes, one that emphasizes the inherent instability of capitalism; it would put distributional conflicts at the center of analysis, focus on the development of institutions, and more importantly it would recognize the link between macroeconomic and environmental policies.

The book is divided into four parts that are not altogether well defined, and the first one is a good example of that problem. Part one deals with national institutions and policies, and includes articles on how the American current account deficits threaten global stability, on the role of Federal Reserve Board in historical perspective, and finally a discussion of macroeconomic policies in transition economies. John Eatwell and Lance Taylor discuss the American stock-flow trap, that is, the accumulation of twin debts (domestic and foreign) as a result of the flow deficits (fiscal and current account). They build on the work by Wynne Godley at the Levy Economics Institute, and argue that the Clinton boom was heavily dependent on the accumulation of unprecedented private debt, and that a devaluation of the dollar would be necessary to correct foreign imbalances. Anne Mayhew argues that the Fed was not created to, and has been unable to, control the level of economic activity, even though the historical evidence presented does not support a categorical conclusion. The last paper in the first part, coauthored by David Ellerman and Joseph Stiglitz, discusses the causes of the different results in the transition from plan to market economies in Russia and China. They argue that in the Russian case the macroeconomic stance was excessively contractionary, and that shock therapy was unable to promote the development of market institutions in the postsocialist environment.

The second part of the book deals with the international context, even though some articles in the first part also did. Paul Streeten provides a broad, but not remarkably original, discussion of globalization. The main conclusion seems to be that the benefits and costs of globalization have been unevenly distributed, and arguably mainstream macroeconomics has been incapable of incorporating this result. That is one of the points raised by Nahid Aslanbeigui in his contribution that proposes a program of adjustment for macroeconomic textbooks. Beyond including globalization in macroeconomic textbooks, argues Aslanbeigui, alternative views of financial crises, which have become a recurrent feature of real world economies, should be discussed. Furthermore, Michele Naples argues convincingly that macroeconomic policies work better when an intuitional framework to manage conflicts over income distribution is in place.

The third part discusses employment and distribution questions. David Howell summarizes the main conclusions of a broader study (Howell 2003), which demolishes the so-called unified theory, that is the notion that high unemployment in several parts of Europe and high levels on inequality in the United States result from a skill mismatch caused by computerization in the workplace. The result of the skill mismatch is wage stagnation in the flexible Anglo labor markets, and employment stagnation in the European inflexible labor market. The thesis is simply not supported by empirical evidence. In particular, the notion that high unemployment is caused by labor rigidity does not account for the fact that countries with high unemployment in the 1980s and 1990s had low unemployment and essentially the same labor market institutions in the 1950s and 1960s. Randall Wray argues that traditional expansionary macroeconomic policies are insufficient to promote full employment, and that additional job creation programs are needed. In the last chapter of this section, Dorene Isenberg argues that homelessness in the United States results from a structural shift that led to a contraction of housing and welfare expenditure.

The last part of the book deals with the long-run consequences of macroeconomic growth on the environment. Peter Dorman shows that the debt crisis led to an acceleration of deforestation in the developing world, which suggests that a reform of the international financial system that reduces the burden of debt would be not just good macroeconomic policy, but also good ecological policy. Jonathan Harris and Neva Goodwin provide a long laundry list of the various environmental limitations of continuous macroeconomic expansion. Their main point is that current levels of growth are not sustainable, and that alternatives are necessary. The paper is thin on alternatives, suggesting taxes like the carbon tax to promote "greener" economic growth. They leave the question of what might be an intelligent macroeconomic policy, which bears on heterodox Keynesian principles and environmental awareness, open. The book concludes with a short article by John Kenneth Galbraith suggesting that Japan might find the answer for Harris and Goodwin's question. Galbraith hopes the Japanese, having solved the economic problem (as Keynes imagined his grandchildren's generation would do), may decide to dedicate their lives to higher purposes, and may live a more varied and civilized life. Hope springs eternal.

All in all, the book falls short of providing an alternative to the new consensus in macroeconomics, a task tackled in a more coherent way by Taylor (2004), for example. It also leaves open the question of how the notion of sustainable development can be reconciled with the need for accelerated growth in developing countries. However, the contributions in this volume constitute a valuable starting point for researchers and students of macroeconomics, extending the range of questions usually discussed by macroeconomists.

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