What's Macroeconomics?

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Part 1

Introduction

Areas of economics

- Like the study of physical phenomena, the study of economic phenomena is divided into micro and macro analysis.
- It also faces a similar challenge: the difficulty of reconciling the micro level with the macro level.
- Unlike physics, the epistemological status of economics remains controversial, as the number of economists who question the dominant approach is anything but negligible.
- That said, there is general consensus on the broadly defined scope of microeconomics and macroeconomics, respectively:
  - Microeconomics focuses on the behaviour of individual agents.
  - Macroeconomics focuses on the behaviour of «aggregates».

Unit of analysis and the micro-macro link

- The main issue with defining microeconomics lies in the exact identification of individual agents:
  - Classical Political Economy focused on social classes as the primary unit of analysis.
  - Modern (neoclassical-like) approaches focus on individuals as consumers, savers, and/or entrepreneurs, thereby removing their socio-political identity.
- The controversies surrounding macroeconomics are arguably even greater:
  - Keynes founded modern macroeconomics as a methodology of aggregates.
  - Following the rational expectations counter-revolution, macroeconomics became secondary, as all aggregate behaviours must be explained in terms of the choices made by a representative individual agent who maximises a target function subject to a constraint (micro-foundations).
  - Modern dissenters either emphasise the need to develop a genuine «bottom-up» approach (complexity), or, like Keynes, advocate for macro-foundations of micro-behaviours.

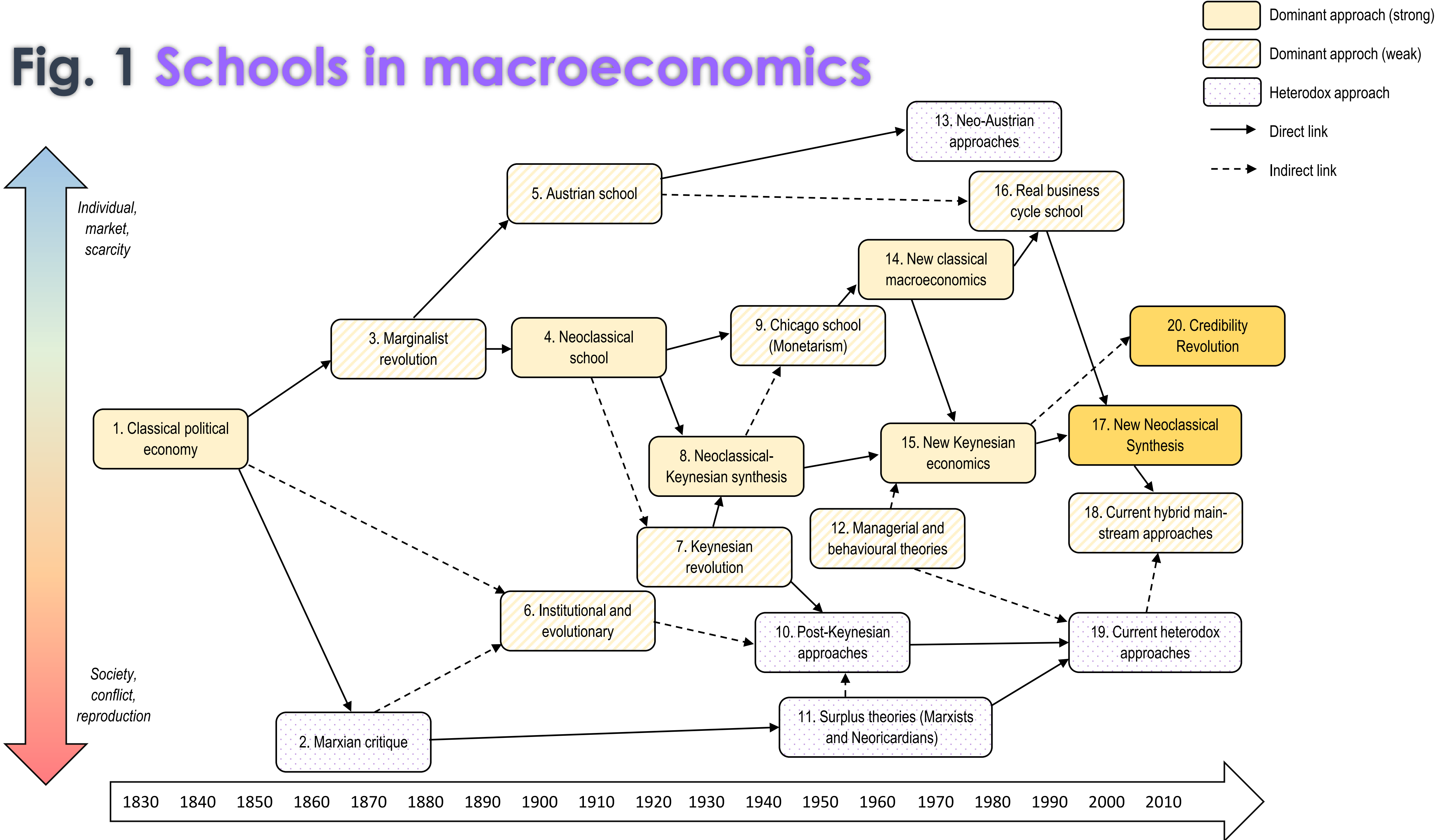


Fig. 1 Schools in macroeconomics

What do the macroeconomists do?

- Macroeconomists study the behaviour and structure of the economy as a whole, focusing on broad aggregate variables such as:
  - National income and output (GDP)
  - Employment
  - Inflation
  - Interest rates
- Key topics include the causes of inflation and unemployment, the determinants of business cycles, economic growth, and the effects of economic policies.
- Income distribution (the most important topic for CPEs!) has been neglected for decades, although recent signs suggest a reversal of this trend.

What do our students study?

- Most macroeconomics textbooks begin by introducing key macroeconomic variables, often accompanied by plots of recent time series.
- A distinction is typically made between the short, medium, and long run. However, no formal definition of «equilibrium» is usually provided.
- The «goods market» and a stylised «financial market» are then introduced, and the condition for their simultaneous short-run equilibrium is identified (IS-LM model).
- Inflation is incorporated into the model by adding the Phillips curve (and Okun's law). This brings the central bank's role into focus, allowing for the medium-run equilibrium.
- The discussion then shifts to the determinants of long-run growth (technical progress, education).
- The next step is to introduce complications to the basic model (e.g., expectations, open economy, mixed policies).

What’s missing?

- A brief overview of the history of macroeconomic ideas is sometimes offered, but it is usually disconnected from the main analysis.
- A sense of continuity is presented, overlooking important nuances and controversies within the mainstream view (e.g., the natural rate of unemployment vs NAIRU).
- Only capitalist economies are considered, although the term «capitalism» is never used.
- Examples of socialist-like economies may be included, but they often appear as «cherry-picked» cases to reinforce pre-existing ideas, rather than as part of a genuine comparative exercise.
- Some textbooks are now dedicating sections to global warming and (income and wealth) inequality, but these chapters remain separate from the core model.

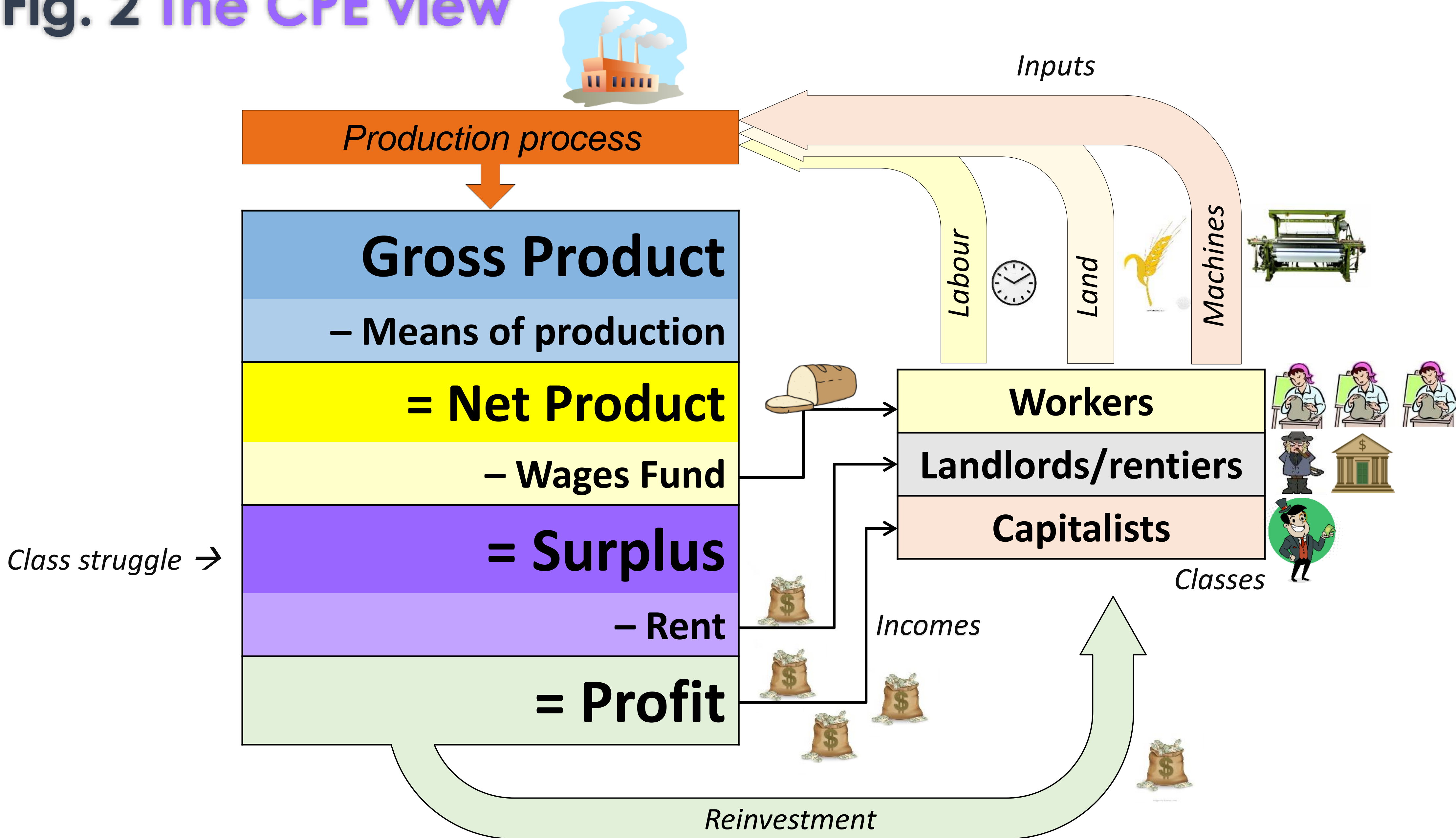
Part 2

Main controversies

Smith and the two «souls» of economics

- What are the controversies about? Where do they come from?
- There are two distinct economic perspectives in Smith's economic thought:
  - A microeconomic view: individual choices, competition, and efficient allocation.
  - A macroeconomic view: social interactions, surplus, and reproduction.
- The marginalist revolution aimed to liberate the first perspective from the second.
- Microeconomics was redefined as the (normative) science of efficiently allocating scarce real resources among alternative uses in a cooperative or trade-based economy.
- The Keynesian revolution (and 20th-century developments in Classical Political Economy) aimed to free the second perspective from the first.
- Macroeconomics was redefined as the positive science that studies growth and distribution in a monetary economy of production.

Fig. 2 The CPE view



Scarcity view vs reproduction view

- If one accepts the neoclassical-marginalist view, then our societies are seen as «village fairs», where the impersonal forces of competition transform the uncoordinated behaviours of a plurality of self-interested individuals into a mechanism for achieving maximum social wellbeing.
- Money is merely a «thing» that serves as a lubricant to facilitate individual transactions. Competition ensures that each factor of production (whether labour or «capital ») is remunerated according to its contribution to the production process.
- If one accepts the Keynes + CPE view, then our societies are systems of production of commodities by means of commodities and labour, where a surplus is generated and distributed according to various social, institutional, and political factors.
- Money is a (triangular) social relation. It is essential for initiating the production process (where it functions as «capital»), as production firms require it to purchase the only commodity external to their sector: the labour force.

From the «Classics» to Keynes

- The 3 pillars of what Keynes improperly named the «Classics» were:
  - Employment (hence output) is determined in the labour market.
  - Aggregate supply creates its own demand («Say's law»).
  - The real interest rate is the variable that allows matching the supply of funds (saving) with the demand for funds (investment).
- Implications: market forces allow achieving a unique and stable optimal equilibrium.
- Keynes questioned all of them:
  - There is no upward-sloping supply curve. Employment is determined in the goods market (multiplier).
  - Aggregate demand constrains supply (hence production). Saving adjusts *ex post* to investment.
  - Money is endogenous. Loans create deposits. The interest rate is a monetary variable.
- Implications: multiplicity of equilibria.

Back to the (New) Classics

- The monetarist and neo-monetarist (new classical) response in the 1970s was:
  - Employment is determined in the labour market if the model is properly micro-founded. The fiscal multiplier is smaller than previously acknowledged due to rational expectations (permanent income hypothesis, Barro-Ricardo equivalence) and model misspecifications (Lucas critique).
  - For the same reason, current values of real variables can only deviate from supply-side determined values due to stochastic shocks (Monetarists and New Classics: monetary policy errors; RBC: technological innovations; New Keynesians: market imperfections).
  - Money is exogenous (early Monetarists) or weakly endogenous (subsequent developments), but it is still possible to identify a unique natural interest rate that balances investment and saving in the medium to long run.
- Implications: a return to a unique and stable equilibrium (although there is room for short-run monetary policy if New Keynesian imperfections are considered).

Part 3

Policy implications

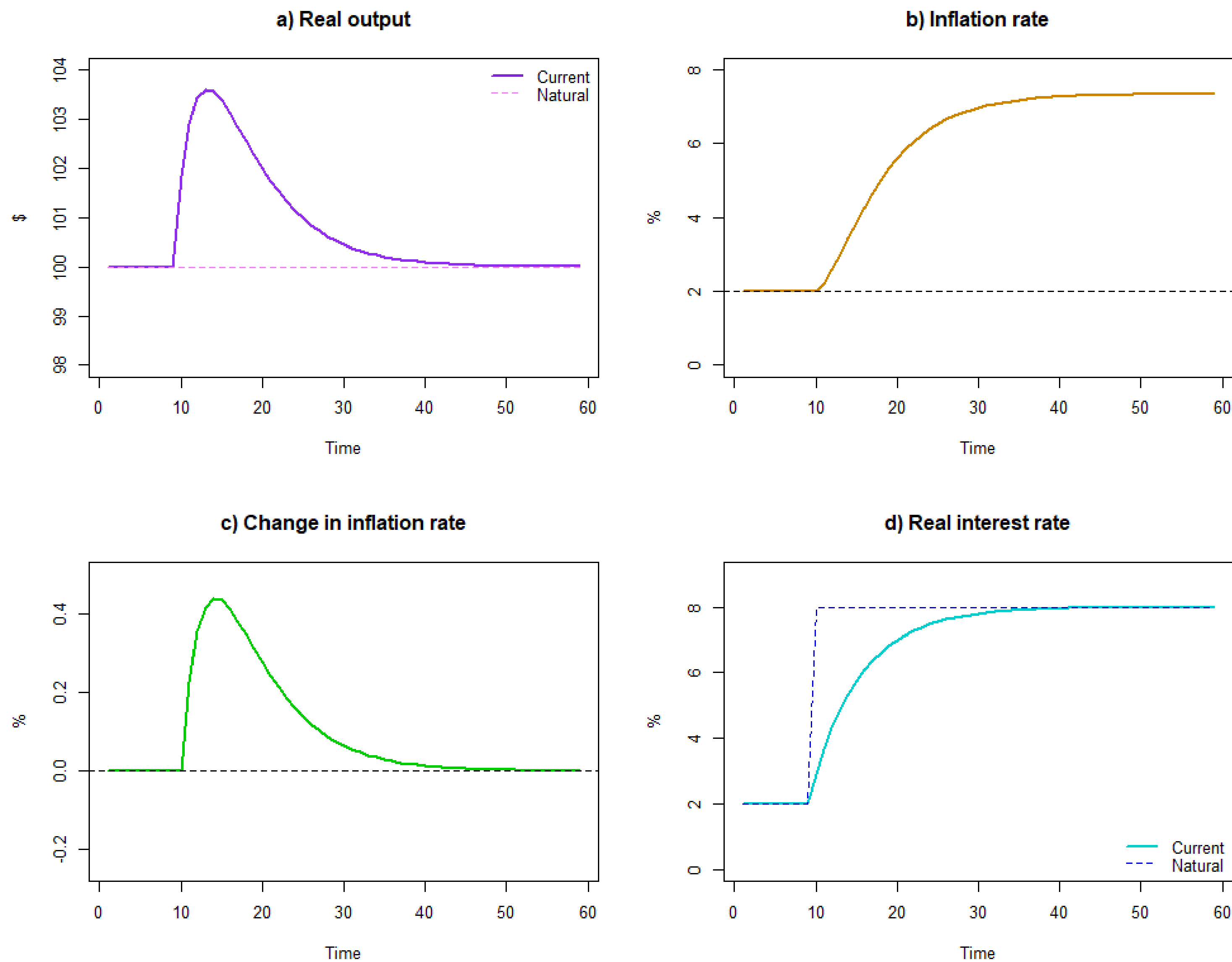
The «standard» macroeconomic model

- The mainstream macroeconomic model can be reduced to 3 fundamental equations:
  1) Real output (gap) is a decreasing function of the real interest rate [IS curve]
  2) Inflation is an increasing function of real output (gap)[Phillips curve]
  3) The interest rate is an increasing function of the inflation rate (difference with target rate) [monetary rule]
- Shocks can produce «real» effects in the short run due to price stickiness.
- However, inflationary effects trigger the central bank response in the medium run.
- Real variables (output, employment) return to their natural levels in the medium run, determined by initial endowments and available technology. Money is neutral.
- Long-run growth is driven solely by technical progress (and education).

The normative side: policy implications

- Government intervention is permitted in the short run as long as it helps the economy converge to its «natural» (= supply-side determined) equilibrium.
- Monetary policy - The primary policy tool, typically implemented by adjusting the policy rate. However, unconventional measures such as quantitative easing (QE) and credit easing (CE) may be necessary when near the zero lower bound (liquidity trap).
- Fiscal policy - A secondary tool, primarily implemented through automatic stabilisers (e.g., unemployment benefits). Discretionary fiscal policy can interfere with monetary policy by influencing inflation expectations, though it may be required when near the zero lower bound.
- Planning - Seldom discussed in macroeconomics textbooks…

Fig. 3 The standard model: a fiscal policy shock



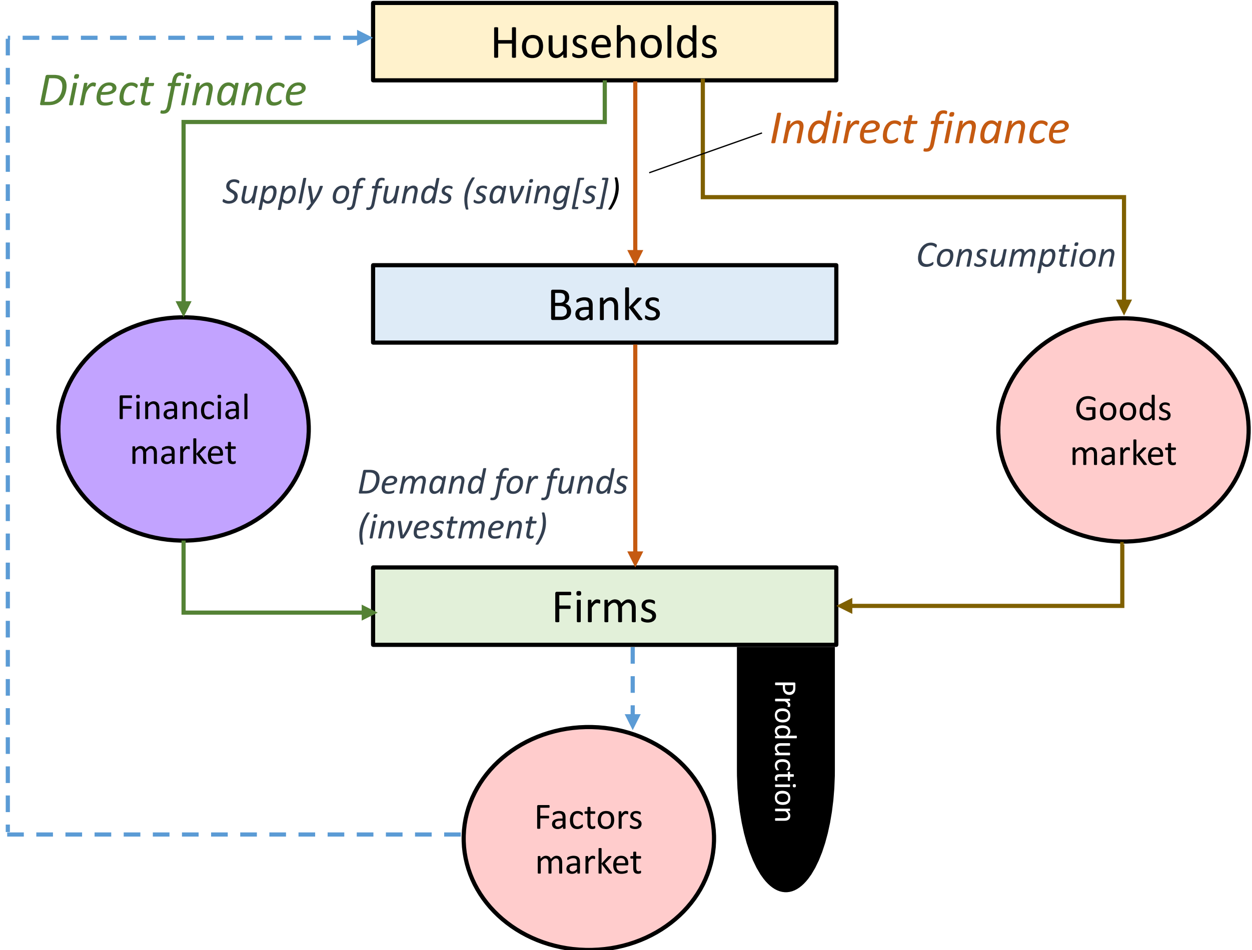
Part 4

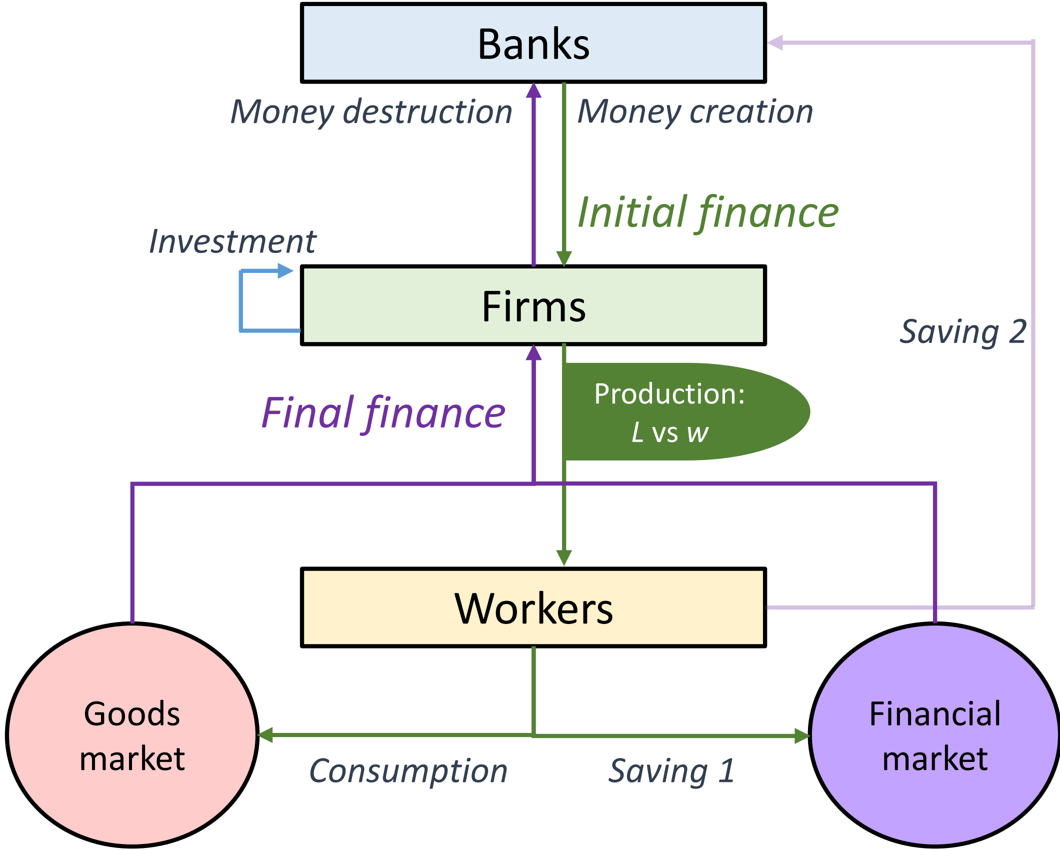
Ancient macroeconomics: preliminary thoughts

Modern methods for ancient economies?

- Is contemporary economics useful for analysing ancient societies?
- Scarcity View (Neoclassical, Monetarist, New Classical, New Keynesian, and 2 Syntheses):
  - Pros: focuses on trade (cooperation among factors of production), relies on universal principles (e.g., Pareto efficiency), and offers a simple and flexible analytical framework.
  - Cons: lacks historical context, relies on hypothetical markets, and tends to underestimate the significance of monetary relations.
- Reproduction View (Neo-Ricardian, Marxian, Post-Keynesian, and other heterodox):
  - Pros: emphasises the role of money and demand, identifies the origin of surplus, and is overtly historically grounded.
  - Cons: rooted in capitalist societies, lacks universal principles, brings about complexity.
- Focusing on money, the best way to understand the differences between these two views is by examining the distinct monetary circuits they propose...

Fig. 4 Monetary circuits: scarcity vs reproduction view





Thank you

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