Introduction

Jesper Jespersen and Finn Olesen

ABOUT PROGRESSIVE POST-KEYNESIAN ECONOMICS: DEALING WITH REALITY

Today, more than a decade after the outbreak of the Great Recession, many economies are still struggling to get back on a prosperous track. Most countries were hit hard by the international crisis. The US, the EU and other countries have experienced low GDP growth rates and high levels of unemployment for a number of years. In the EU, and especially within the Eurozone, most member states have had to cope with the mainstream macroeconomic policy strategy of austerity (with Greece as the most significant recession case of the EU). As such, the neoclassical macroeconomics that became so dominant during the 1990s, and is still today by many seen as *the* only way to do macroeconomics, ruled the process of giving advice on economic policies to overcome the crisis. By using general equilibrium theory and models as the dominant analytical device, the focus point was at de-regulation, privatization and a balanced public sector budget to secure private sector optimization. No wonder that the vision of the beneficial welfare state and the egalitarian society was set on hold and in many cases rolled back on the political agenda. However, as we know as a fact today, prosperity did not come back to the many only to the few, already well off, in the US, in the EU and many other places. This misunderstood macroeconomics has taken a heavy political toll, because '[there is a] lack of correspondence between the results of their [the professional economists'] theory and the fact of observation; – a discrepancy which the ordinary man has not failed to observe' (Keynes, 1936, p. 33).

The Great Recession, initiated 10 years ago, began as an international financial crisis. It came as a surprise to mainstream macroeconomists. Accordingly, the policy recommendations were inconsistent and have been followed by stagnation, particularly of European economies, for a number of years. Consequently, many macroeconomic scholars have cast a critical eye on the content of the previously dominant new *Macroeconomic*

Moderation (Bernanke, 2012) and the related Dynamic Stochastic General Equilibrium (DSGE) models.

In addition, a number of ‘old’ mainstreamers have raised their concerns – ‘why did we not see it coming?’. Important contributions to this introspection are for instance those of Solow (2010), Romer (2016) and Stiglitz (2018). However, they all express doubts about what the substitute to the hitherto conventional macroeconomic methodology and modelling should be.

However, there are alternatives to this macroeconomic mainstream. One of them has for a long time been post-Keynesian economics. Unfortunately, this is still not fully recognized by the disillusioned ‘mainstreamers’, but that will change. Therefore, the intention of this collection of essays is to promote an agenda of cutting-edge views on the role of macroeconomic theory and models and to present an updated account of how post-Keynesian economics can contribute to an improved understanding of how to reduce imbalances in the future. There are many challenging issues, so we had to limit ourselves to a few vital themes: *Methodology, Financialization, Modelling and Teaching*.

Theme 1: Macroeconomic Methodology

In the opening chapter Sheila Dow addresses what could be considered as progression within macroeconomic thinking, the so-called cutting edge. The focus in her chapter is on two issues that arise when the question of how the real-world economic system could end up in the deepest and longest recession since the Second World War is asked: the lack of pluralism in macroeconomics and rigid mathematical modelling. There are, of course, no simple answers. Therefore, the solution regards understanding the functions of the financial sector, modelling strategies and teaching not a singular prescription, but pluralism. As she explains, this is the route to progress in macroeconomics. Sheila Dow argues persuasively that post-Keynesian economics is well situated to take up these challenges by its open-system approach, taking uncertainty seriously and arguing that macroeconomic theory goes far beyond simplistic aggregation of micro-economic agents’ rational behaviour coordinated through an equally simplistic, perfectly marked process modelled mathematically as a general equilibrium system. Finally, Dow expresses a deep concern towards any dual thinking in macroeconomics – the real world is much too complex to be understood in an ‘either/or way’. These areas are where progression in macroeconomics has to head in the future.

In the next chapter, Peter Skott stresses that the supply side has not yet received the attention that it deserves in post-Keynesian macroeconomics.

The labour market has to be considered in a much more pluralistic way, where incentives, institutions and regulations are explicitly represented in post-Keynesian growth theory. Although the empirical failings of the Lucas-type ‘microeconomic foundations’ is undisputable, the present theoretical disarray must not lead to a neglect of microeconomic behaviour in the future. Convincing macroeconomic theories have to recognize and address the connections between macroeconomic relations and the microeconomic behaviour whose aggregate manifestation these relations represent. Progressive macroeconomic theory must be in accordance with both behavioural and structuralist realities.

The late Greg Hill discusses, in Chapter 3, how the work of Shackle could give further inspiration to cope with reality for developing an alternative and, hence, a better macroeconomic understanding than the hitherto agent-based, but conventional mainstream DSGE models. According to Shackle’s arguments, human beings are autonomous in their behaviour and therefore very different in their rational behaviour. This is in some way the rationale behind the post-Keynesian scepticism towards the conventional microeconomic foundation of macroeconomics. It has to be so, owing to many obvious causes, one of which is the individual response to (fundamental and) unescapable uncertainty. Hence, autonomous agents cannot meaningfully be aggregated and represented by just one ‘representative agent’ (theory). Autonomous agents interact based on often incompatible beliefs. Hence, it is reasonable to argue that the interactions of these agents will take place under circumstances of general *disequilibrium*, where individual expectations in general will be disappointed. Such an understanding of individual behaviour with inspiration from Shackle could be an interesting point of departure for progression within post-Keynesian macroeconomics.

Next, in Chapter 4, Finn Olesen takes issue with the renewed discussion of the meaning of a non-ergodic system emphasized from an early stage by Paul Davidson (1971). In almost all of his writings, Davidson has argued that Keynes broke away from the classical (macro)economic theory of his time by rejecting three crucial classical methodological axioms of which one was the rejection of ergodicity in real-world macroeconomics. This rejection is explained by Keynes’s emphasis on the importance of fundamental uncertainty. Hence, to be a realist, or progressive post-Keynesian macroeconomist, one must accept non-determinism of the macroeconomic system and hence, non-ergodicity. However, recently a substantial critique of Davidson’s use of the concepts and of the divide between ergodicity/non-ergodicity has been presented by, among others, Rod O’Donnell. The essence and relevance of this critique is discussed by Olesen. In sum, Davidson’s original arguments seem still valid.

Stefan Voss's main concern in Chapter 5 is 'what comes after new neoclassical macroeconomics', which according to his reading has been demonstrated to be out of touch with reality, mainly exercised and supported by neoliberal politicians (and economists). He argues that the financial crisis has unveiled that the hitherto prevailing paradigm of neoclassical macroeconomics is struggling for its survival. His strong recommendation is to be more pluralistic in the choice of scholarly literature: not only Keynes, but also Schumpeter. Contributions by these two rather different macroeconomists could be bridged by drawing more explicit attention to Hyman Minsky and his financial instability hypothesis as a 'go between' among micro- and macroeconomic interpretations of the entrepreneurial 'animal spirit'. However, future scenarios present many challenges, among others, how to tackle the 'coming of robots' and how to establish 'sustainable development', which none of these three scholars really envisaged. Here is an open field for progression and pluralism in macroeconomics, which Voss recommends post-Keynesian macroeconomists to take seriously.

Theme 2: *Macroeconomic Financialisation*

As the trigger of the Great Recession most scholars point today to the developments in the financial system during the years leading up to 2008. Deregulation in combination with the 'efficient capital market hypothesis' prominently propagated by Eugene Fama (1991) (Nobel-laurate of 2013!) made macroeconomic theory blind to the potentially destabilising effects of a mushrooming financial sector. This development did not come as a big surprise to those post-Keynesian economists who have followed in the footsteps of Hyman Minsky; amongst others, Keen (1995) and Godley and Lavoie (2007) could be mentioned as well-known examples.

The following three chapters focus on the role, origin and some consequences of *Macroeconomic Financialisation*. This section is opened with a chapter written by Malcolm Sawyer, who discusses various macroeconomic aspects of the process of financialisation. He points out that financialisation as such is not a new phenomenon. It has been with us ever since economies turned to the capitalistic structure of production. Further, he points to historical periods where the size of financial transactions out-paced real sector activities as hotbeds for macroeconomic instability. The macroeconomic disruption following the years of financial super-expansion leading up to 2008 should have come as no surprise to scholars knowing the history of financial crises, see for instance Kindleberger (1978). In this chapter Sawyer elaborates on the nature of financialisation and the expansion of the financial sector in the past four decades. He gives

a review of the relationships between finance and real economic growth. He is concerned with the empirical coincidence of this mushrooming financial sector and contemporary slowing of growth in the real economy. This empirical observation leads Sawyer to consider whether this coincidence can be given a post-Keynesian causal explanation, and what, in this case, the implications for future theoretical development (and policies) might be.

In Chapter 7, Diego Guevara, Apostolos Fasianos and Christos Pierros search within the early writings of John Maynard Keynes (i.e. before 1936) for traces of a theory of financialisation. The chapter associates Keynes's methodological insights with the analysis of the process of financialisation. First, they underline the relevance of his analyses for studying the present period of financialisation, i.e. the neoliberal era leading up to 2008. Second, they use his analytical framework to demonstrate that the period between 1900 and 1933 corresponded to a phase of (early) financialisation, since similar conditions, before and after the crash of 1929, prevailed then and have again repeated themselves. They place particular emphasis on how financial sector interests and profit motives influenced the policy decisions of deregulation before the crash and public rescue packages after it. It is puzzling that Keynes's thorough analysis of financial instability, elaborated in *Treatise on Money*, was totally overlooked in the period of academic retrospection following the 2008 crash.

Ulaş Şener argues in the following chapter that the policy recommendation derived during the *Great Macroeconomic Moderation*, that central banks should be made independent of the government, has its roots in the neoclassical doctrine of neutral money. On the contrary, Şener shows with reference to several heterodox macroeconomic theories that monetary neutrality is entirely out of touch with reality. Hence, the theoretical foundations and conceptual roots of central bank independence are controversial for several reasons: (a) monetary policy has an impact on the real economy and (b) even if money was neutral, there is no reason – and especially not from a neoclassical perspective of optimizing individuals – to assume the governors of the central bank to be excepted from the general assumption of self-interest. Hence, the political economic narrative of 'independent' central banks is shaky. To overcome and to understand these contradictions within neoclassical economics, pluralism in economics teaching is necessary and the curriculum of monetary theory and policy should incorporate heterodox macroeconomic approaches to money.

Theme 3: Macroeconomic Modelling

In Chapter 9, written by Hamid Raza, Mikael Randrup Byrialsen, Bjorn Gudmundsson and Gylfi Zoega, a stock-flow consistent modelling

approach is used to present a post-Keynesian-inspired analysis of a balance of payments crisis. They develop a theoretical framework with the main purpose of explaining the role, which capital inflows might have played in causing economic disruption in a small open economy with sovereign currency, like for instance Iceland. They conclude that large inflows might generate a debt-led boom that is not financially sustainable. An episode of financial excess eventually followed by a financial crash, which usually has stronger negative impact on the real economy than the preceding boom. In particular, it is shown that smaller, but sovereign monetary regimes are easily destabilized owing to currency risk premiums and large balance-of-payments effects; however, countries with a sovereign currency also have the potential to adjust more rapidly owing to exchange rate flexibility, capital controls and autonomous restructuring of the financial sector. This development is illustrated by a stock-flow consistent model simulation of the Icelandic economy during the severe financial and economic crises of 2008–2015.

In Chapter 10 Eckhard Hein demonstrates empirically that the macroeconomic institutions and the macroeconomic policy approach in the Eurozone have failed badly in the sense of not protecting and shielding the Eurozone countries from the global financial crisis. On the contrary, a number of Eurozone countries have been hit harder than non-euro countries. In this Chapter Hein argues that the dominant macroeconomic policy regime in the Eurozone is designed according to New Consensus Macroeconomics, which dominated the macroeconomic discourse for more than 20 years leading up to the crises of 2008. The policy regime has many similarities to a model that Steindl (1979) called the ‘stagnation policy’ model. A post-Keynesian/Steindlian/neo-Kaleckian inspired macro-model is subsequently used to demonstrate what alternative policies could have prevented the prolonged stagnation and unequal development within the Eurozone. Against this theoretical background Hein examines the specific macroeconomic institutions and the macroeconomic policy undertaken in the Eurozone, all based on the New Consensus Macroeconomics, as different to the alternative ‘effective demand’ model. A number of crucial deficiencies related to the New Consensus Macroeconomics model with regard to real sector growth are highlighted. This comparison of the two models provides the grounds for an outline of a progressive macroeconomic policy approach with specific recommendations of how to transform the institutional setup and how to coordinate macroeconomic policies within the Eurozone, based on this post-Keynesian/Steindlian/neo-Kaleckian approach, in order to prevent the next economic crisis from developing into a new and prolonged period of stagnation.

Theme 4: *Teaching macroeconomics*

How to teach (macro)economics in a pluralistic and realistic way is addressed in Chapters 11 and 12. Jan Holm Ingemann and Poul Thojs Madsen are, in Chapter 11, concerned with the low success ratio of an ordinary teaching of economics: students often find courses to be very abstract and out of touch with the economic realities experienced by ordinary people. Ingemann and Madsen recommend a major change of the pedagogical practice away from mainly solving mathematical optimizing problems and instead recommend problem-based learning (PBL), which has real-life problems as its point of departure. According to this approach, theory and methodology need to be tailor-made to the specific problem under investigation. Students doing problem-based projects need to construct their own theoretical framework, often by combining different economic paradigms, linking to other social sciences and consulting previous, often interdisciplinary, research concerned with the problem at hand. These requirements constitute a challenge for mainstream economics, where theories are built on assumptions that are often very remote from real-life economics. Theoretical models that face real-world economics, like post-Keynesian economics, are far better suited to problem-based work, because they employ open-system analysis, which can be supplemented by other schools of thought and social sciences. PBL-trained students often analyse problems that require them to relate their project to previous studies of the problem at hand as well as mainstream and heterodox economic theory. This complexity makes students dependent on the advice and guidance of their supervisor, who needs to be open-minded, pluralistic and familiar with different economic paradigms. Hence, this pedagogical procedure is demanding for the supervisor, but when he/she is successful, it is so much more rewarding for the students, who learn how to conduct research by identifying and using a relevant method.

In Chapter 12, Mogens Ove Madsen and Finn Olesen provide a real case study of how PBL could be employed, and how this method is in fact practised at Aalborg University, Denmark. Teaching of economics at most economics departments focuses almost exclusively on mainstream economics. However, because of years of economic recession, many economists seem to have become more and more critical of the modern mainstream macroeconomics – the New Neoclassical Synthesis – and their use of the DSGE modelling approach. As such, there seems to be a bit of a gap between the mainstream textbook story and real-life phenomena. Furthermore, the teaching approach is also rather uniform among departments with an almost exclusive focus on formalised economic models. One is, however, able to teach economics from a non-mainstream perspective,

as has been done for many years at Aalborg University. Here economics is taught pluralistically, incorporating both the mainstream orthodoxy and a range of heterodox approaches. Furthermore, our pedagogy emphasises the approach of PBL in good accordance with the guidelines given by different research methodologies.

Concluding chapter: Looking into the future: realism in macroeconomics is needed

The former minister of finance of the Danish government, 1993–2000, Mogens Lykketoft, was asked to give an account on his experiences working with and advised by the (macro)economists of the Treasury. His spontaneous reaction was: ‘Do not blindly trust economists’.

In this final chapter he provides strong arguments as to why he did not trust economists blindly, while in retrospect he is considered by most Danish economists to be the most successful minister of finance since the 1960s. One reason for this outcome was, according to himself, that he had consistently preserved a healthy scepticism regarding mainstream economics based on his own economic studies in combination with his life-long experiences from practical policy. This attitude protected him from being caught in the web of (sometimes) very theoretical policy conclusions derived from mathematical models, which were often fundamentally detached from reality. His experiences were that economic models are partial and often biased by ideology. For the time being, the Treasury models have a neoclassical free-market twist, which gives neoliberal policies priority with regard to growth and employment. This result is contrary to reality, where the Scandinavian welfare model has been very successful. If the New Macroeconomic Consensus model had ruled back in the 1960s and 1970s, the welfare state would never have been realized and the Scandinavian countries would have done much more poorly during the present crisis. So, his recommendation to his fellow politicians is not to lose their common sense and not to trust the outcome of ‘ideal’ models of either a perfect market or a perfectly planned economy. They are out of touch with the aspirations of ordinary people and therefore detached from reality.

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