A brief history of (macro) economic thought

from its origins to the present day

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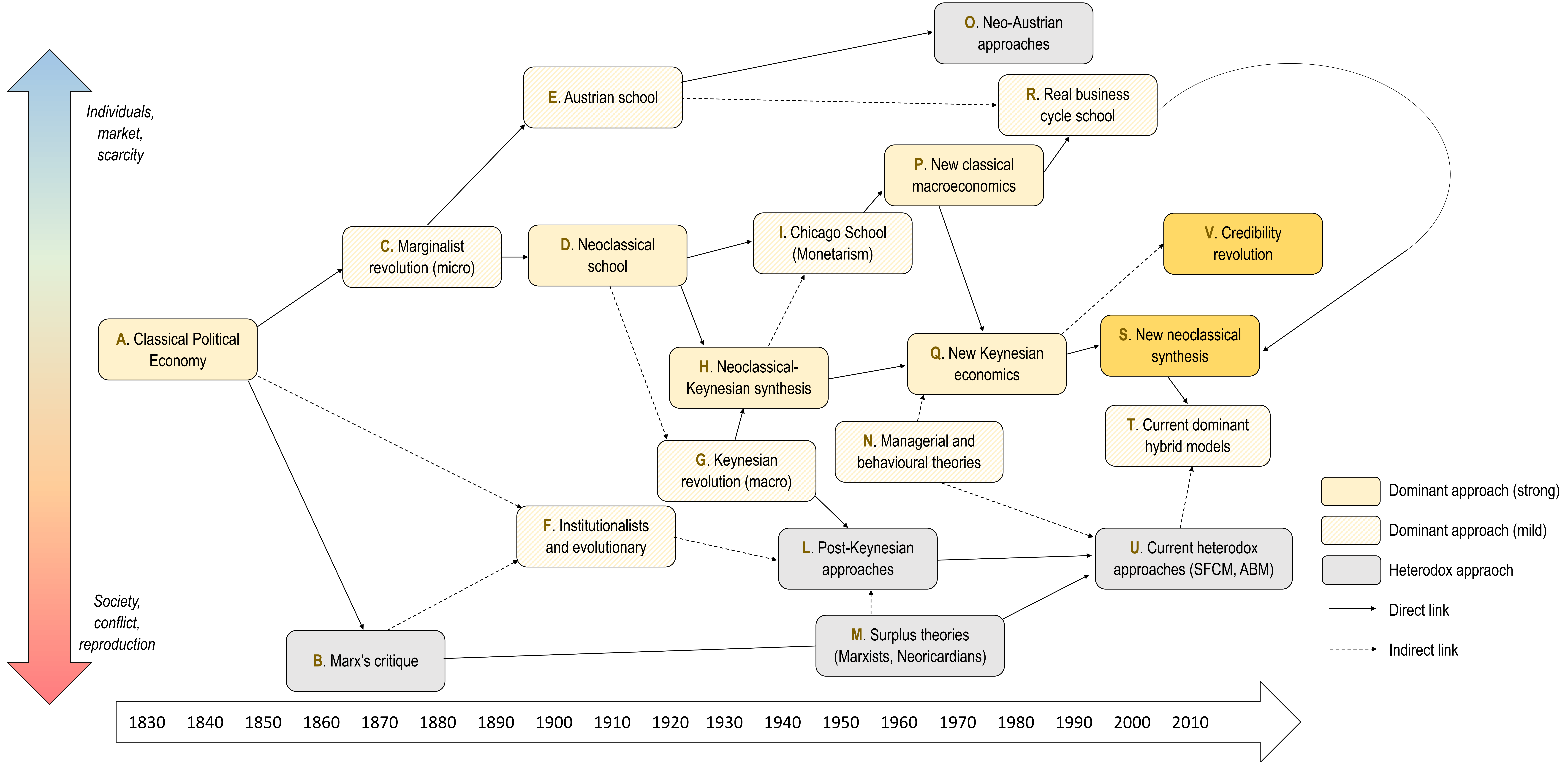
The macroeconomic tree



1 The two souls of Smith and the Classics

Two different views:

a) Micro (or individual) ► interaction between self-interested individuals, invisible hand, additive theory of value, division of labour, allocation

b) Macro (or social) ► social classes, market size (demand side), labour contents and value as cost of reproduction, development

Micro soul taken up and developed by neoclassical economists.

Macro soul taken up and developed by Classics (Ricardo) and Marx.

The former is at the basis of the marginalist revolution: economic system as a place of interaction among rational and maximizing individuals.

Equilibrium as a natural state in which everyone's plans are made mutually compatible through the movements of relative prices (indicators of scarcity). Efficient allocation.

2 The Keynesian revolution and the inception of modern macroeconomics

Critique of the pillars of neoclassical economic thought:

a) Say's law ▸ supply (does not) create its own demand

b) Natural interest rate ▸ the interest rate (is not) the price of saving

c) Labour supply curve ▸ (does not) show an increasing relationship between units of labour supplied and real wage

Theoretical implications: analysis of macroeconomic equilibrium.

Economic policy implications:

a) anti-cyclical fiscal policy supported by monetary policy

b) socialization of investment and credit

3 Bastard” Keynesians: the Neoclassical-Keynesian Synthesis

The IS-LM model = general economic equilibrium with Keynesian features in the short term and neoclassical in the long term.

Keynes’s “General Theory” as a special case:

a) Liquidity trap ▸ flat LM curve

b) Investment insensitive to interest rate ▸ vertical IS curve

c) Wage rigidity ▸ which prevents readjustment via “wealth effects”

Third leg of the theory: Phillips curve as a trade-off between unemployment and inflation.

Economic policy implications: anti-cyclical monetary and fiscal policies of the 50-60s.

4 The Monetarist counter-revolution and the School of Rational Expectations

Double oil shock, social conflict and stagflation in the 70s. Attack on Keynes:

a) Return of the quantity theory of money ▸ low and unstable fiscal multiplier, while high and stable “monetary multiplier” (but not usable)

b) Adaptive expectations ▸ the Phillips curve becomes vertical in the long term (Friedman and Phelps), when the monetary illusion disappears

c) Rational expectations ▸ there is only one unemployment rate that stabilizes inflation (NAIRU). The economy is always at its natural equilibrium, except for stochastic shocks

Policy implications: public spending crowds out private spending, due to increasing interest rates (monetarists) and because it is anticipated (neo-monetarists and Lucas critique).

Economic cycle as an effect of unanticipated (erroneous) monetary policies.

Necessary supply-side policies + independent central bank

5 Growth models: from Harrod-Domar to Solow

Starting from the late 1930s, a new line of research opens up with the development of the first growth models:

a) Harrod-Domar model ▸ the impossibility of stable and efficient growth without state intervention

b) Solow model ▸ stability issue is set aside, efficiency is guaranteed by the possibility for firms to choose the optimal combination of factors

However, long-term growth remains unexplained: total factor productivity or the Solow residual as the *mano de dios*.

Furthermore, constant saving propensity...

6 From Ramsey to “New Keynesian” DSGE models (via RBCS)

Original model: Ramsey ▶ optimal allocation of consumption/saving for the planner. Then: Cass-Malinvaud-Koopmans ▶ application to decentralized market

Methodological innovation: explicit introduction of micro-foundations as a choice problem, which is then reduced to a constrained maximization problem.

At the foundation of Real Business Cycle models: not monetary policy, but (rational individual reactions to) technological shocks as the basis of the business cycle.

New Neoclassical Synthesis and emergence of (New Keynesian) DSGE models:

a) IS curve ← consumer utility maximization, subject to budget constraint

b) Phillips curve ← firm profit maximization, subject to production function and sticky prices

c) Central banker’s rule ← central bank loss minimization, subject to Phillips curve

Implications: Keynesian in the short term, neoclassical in the long term.

7 Looking for alternatives: new empirical methods and non-neoclassical models

Growing dissatisfaction with traditional models, fuelled by the crises of the 2000s.

In the last 15 years, two alternative paths have emerged:

a) Credibility revolution ▸ light theoretical structure and emphasis on data (SVAR, DID, SCM, RCT)

b) Non-neoclassical modelling ▸ multiple equilibria, path dependence, complexity, procedural rationality:

- “Keynesian” input-output models
- heterogeneous agents models and other complex systems techniques
- rediscovery of structural macroeconometric models
- stock-flow consistent dynamic models

To wrap up: main schools in macroeconomics

Dominant approaches	Mildly dominant approaches	Heterodox or critical approaches
A Classical Political Economy	E Early Austrian School	B Marx’s critique
D Neoclassical School	C Marginalist Revolution	L Cambridge Keynesians and other post-Keynesian approaches
H Neoclasical-Keynesian Synthesis (IS-LM model and Phillips Curve)	F Institutional and evolutionary economics	M Suplus theories and reproduction paradigm (Marxists and Neoricardians)
P New Classical Macroeconomics (or Neo-Monetarism or School of Rational Expectations)	G Keynesian revolution	O Neo-Austrian Approaches
Q New Keynesian Economics	I Chicago School (or Monetarism)	U Current heterodox approaches (e.g. SFCMs, ABMs, Keynesian IOMs)
S New Neoclassical Synthesis (New Keynesian DSGE models)	N Managerial and behavioural theories	
V Credibility Revolution (new empirical methods: e.g. SVAR, DID, SCM, RCT)	R Real Business Cycle School (Classical DSGE models)	
	T Current dominant hybrid approaches (e.g. HANK models)	

Thank you

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