

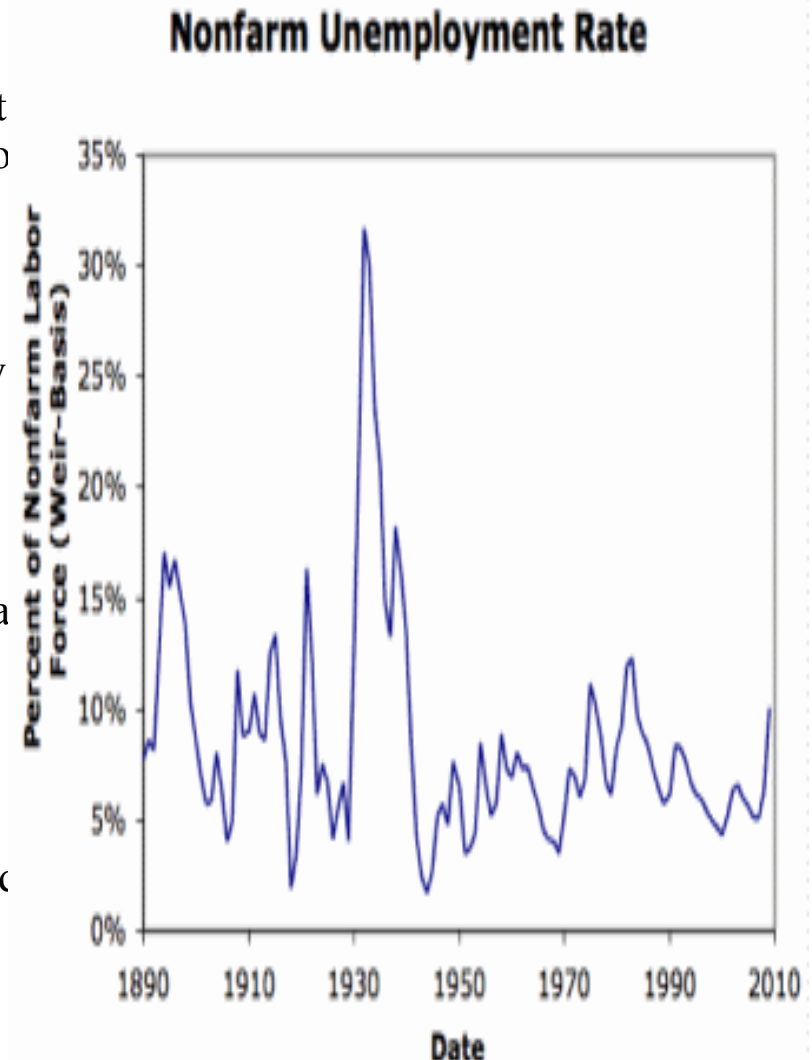
Lecture: 5.3.O.1 Macroeconomics for Beginners

The Polanyian Perplex:

- Market validates property rights—that is what a market economy is: the ownership, production, and exchange of commodities.
- “commodities” are properly pushed to their most valuable use by market forces, and it is right and proper that each use of them must pass a profitability test...
- But people want stable employment—and the flow of finance to guarantee that
- Why doesn't the market guarantee stable employment as a part of its normal functioning?

The “general glut”:

- What people used to talk about, instead of recession and depressions
- It focuses on what is going on: excess supply in pretty much all of the markets



Back Up to 1803

Jean-Baptiste Say:

- Argued back then that a “general glut” was a metaphysical impossibility
 - “If certain goods remain unsold, it is because other goods are not produced; and that it is production alone which opens markets to produce.... Whenever there is a glut, a superabundance, [an excess supply] of several sorts of merchandize, it is because other articles [in excess demand] are not produced in sufficient quantities...”
- By 1830 Say had changed his mind. Speaking of 1825:
 - “The Bank [of England]... forced the return of its banknotes, and ceased to put new notes into circulation.... Commerce found itself deprived at a stroke of the advances on which it had counted, be it to create new businesses, or to give a lease of life to the old. As the bills that businessmen had discounted came to maturity, they were obliged to meet them....
 - “They sold goods for half what they had cost. Business assets could not be sold at any price. As every type of merchandise had sunk below its costs of production, a multitude of workers were without work. Many bankruptcies were declared among merchants and among bankers...”

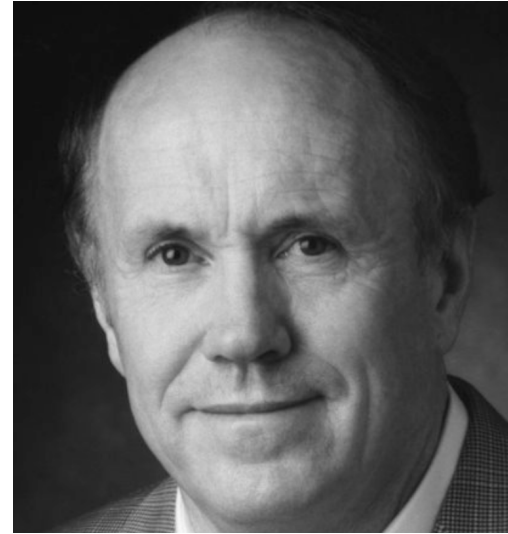


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Garbage Economics

Unfortunately, some intellectual trash collection needed here...

- A large number of economists—like Edward Prescott and Robert Lucas, both of whom were awarded the Nobel Prize (yes, it is strange)—argue that there are no “general gluts”: that when unemployment is high, it is invariably the case that:
 - The unemployed have decided that they don’t want to work right now—that a large chunk of the workers in the economy have decided to take a “Great Vacation”
 - There has been a loss of knowledge about how to produce, and so unemployed workers cannot add more value than the wages firms would have to pay to induce them to work—that there has been a “Great Forgetting”
 - That the rate of depreciation of the capital stock is now so high that it is not worth putting the machines in operation—that there is an ongoing “Great Rusting”
 - Cf. Narayana Kocherlakota, whose classification this is <<http://web.archive.org/web/20090925174330/http://www.econ.umn.edu/%7Enkocher/stuff.pdf>>
- Now back in 2009, when Narayana wrote this, he went on immediately to say:
 - “None of these disturbances seem compelling, to put it mildly.... This... group of... scholars has worked... on the consequences of... disturbances... [not] on uncovering their true sources...”
- Unfortunately, Lucas and Prescott and company believe that these are the true sources
- & thus that nothing can (or perhaps should) be done to stabilize employment
- For them, it is as though all large fluctuations in unemployment are like that of the spring of 2020, when non-socially-distanced jobs disappeared and unemployment rose as countries tried to suppress the coronavirus



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This Is a Long Tradition...

That nothing can, or perhaps should be done, to stabilize employment near full employment...

- What is best, in the long run at least, is “austerity”...
- & the unemployed should simply take the hit and wait for the market to cure itself...
- “The market giveth, the market taketh away: blessed be the name of the market...”
- For example, Joseph Schumpeter in the depths of the Great Depression of the 1930s:
 - “The chief difficulty... depressions are not simply evils, which we might attempt to suppress, but... adjustment to previous economic change. Most of what would be effective in remedying a depression would be equally effective in preventing this adjustment. This is especially true of inflation....
 - “In all cases... recovery is sound only if it does com of itself. For any revival which is merely due to artificial stimulus leaves part of the work of depressions undone and adds... new maladjustment of its own which has to be liquidated in turn..... Our story provides a presumption against remedial measures which work through money and credit.... Policies of this class are particularly apt to keep up, and add to, maladjustment, and to produce additional trouble in the future...”



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My Advice:

**IGNORE ALL SUCH
“LIQUIDATIONIST” AND
“AUSTERIAN” AND “REAL-
CYCLE” ECONOMISTS:
THEY ARE PROFOUNDLY
UNHELPFUL!!!!**

A Word from the Other Side of the Hill...

David Andolfatto, formerly of the FRBSL:

- He writes <<http://andolfatto.blogspot.com/2009/09/kocherlakota-on-state-of-macro.html>>:
 - “This is exactly how I would expect a first-year undergraduate to interpret a model that they've seen for the first time. And DeLong claims that he has a PhD in economics. Let me help the poor lad along...”
 - “There is no need to appeal to DeLong's childish ‘great forgetting’” interpretation of a negative technology shock. A negative technology shock occurs when the realized return on investment is lower than expected... think of all the fibre optic cable planted across the world's oceans in anticipation of a demand that never materialized.... Recessions may be explained, in part, by collective mistakes on investments made in the past...
- This is just not professional: a fall in the value of new investment that is the result of excess investment made in the past because of mistaken expectations

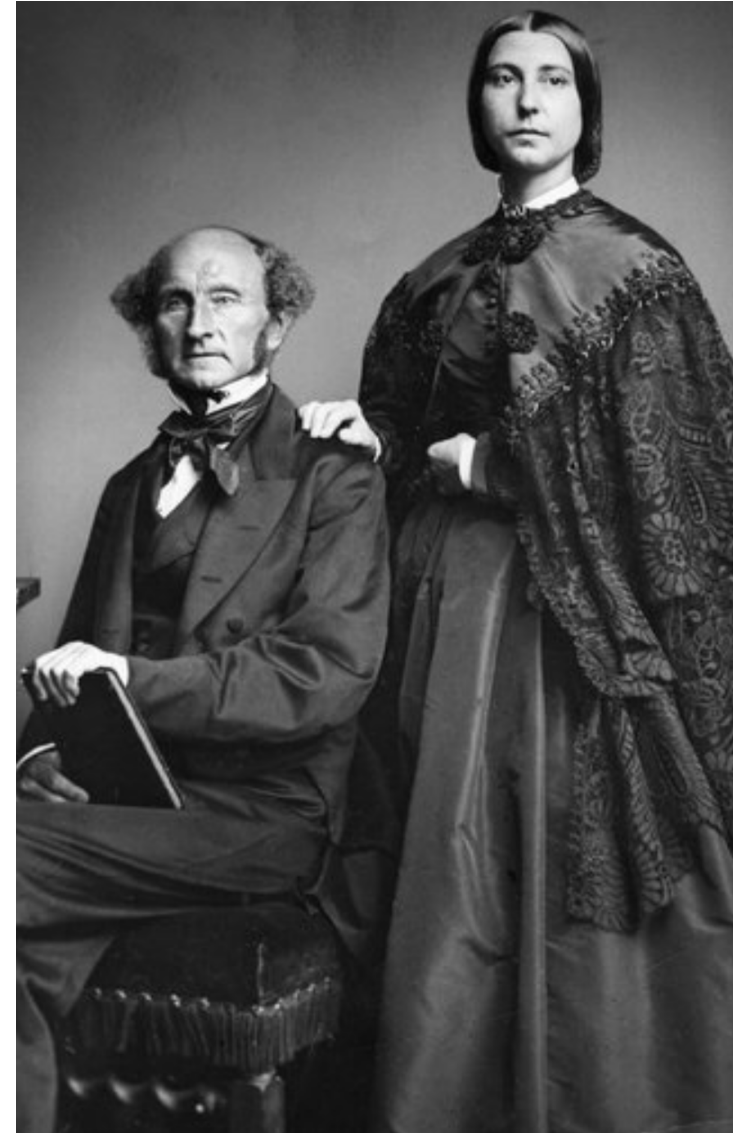


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Curing a General Glut

John Stuart Mill in 1829

- “Those who have... affirmed... [the possibility of] an excess [supply] of all commodities, never pretended that money was one.... Persons in general, at that particular time... liked better to possess money than any other commodity. Money, consequently, was in request, and all other commodities were in comparative disrepute.... There would seem... no particular impropriety in saying that there is a superabundance of all or most commodities, when all or most of them are in this same predicament...
- A general glut, a general excess supply of other goods and commodities is an excess demand for cash money—for possession of stable immediate purchasing power
- Money is liquid trust, and when general trust in counterparties has been eroded, people want more in the way of tangible, liquid trust
- How then to cure a “general glut”?
 - A fall in prices and values so that the amount of money in the system matches demand
 - But this produces lots of bankruptcies, which further erode trust
 - Have an organization that can create money—the central bank—do so in large enough quantities
 - Have the government put people to work directly by paying them or buying stuff they market



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Yoga Lessons and Lattes

A two-good economy: yoga lessons & lattes:

- (This is what economists do: stripped-down thought experiments that we hope capture the essence, and then generalize)
- Excess demand for yoga lessons is deficient demand for lattes
 - Yoga teachers are overworked
 - Latte-pullers stand idle
 - Latte-pullers retrain to teach yoga
 - System rebalances at a higher level of human satisfaction
- Not a process we want to interfere with...



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Yoga Lessons, Lattes, and Cash

Deficient demand for yoga lessons and lattes is excess demand for cash:

- Yoga teachers stand idle
- Latte-pullers stand idle
- Can't retrain to produce cash
- In normal times bankers can produce cash
 - But what if times are not normal?
- The central bank can produce cash—it is still a trusted counterparty...
- The government can buy stuff—it is still a trusted counterparty...

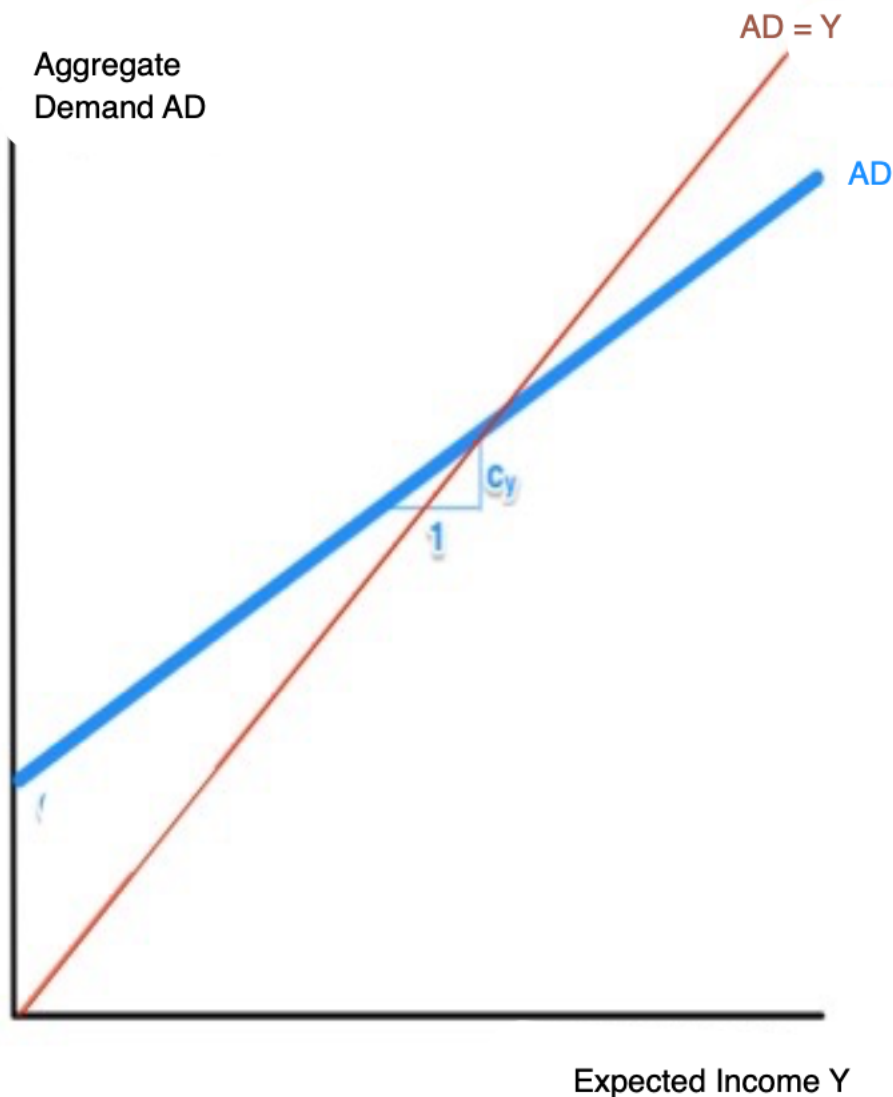


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When Does the Government Have to Step in?

The simplest Keynesian macro model:

- Divide the relevant population into three:
 - Consumers buying consumption goods and services C
 - Businesses expanding their capacity through investment spending I
 - Foreigners buying our exports EX
 - Private expenditure: $C+I+(GX-IM)$
- Government purchases G and taxes T
- Central bank sets real interest rate r
- Wants to set aggregate demand AD equal to potential output Y^* :
 - $C+I+(GX-IM)+G = AD = Y^*$
 - Lower T raises C consumption spending
 - (Higher AD also raises C by amount c_y)
 - Lower r raises I investment spending
 - (Lower r also reduces the value of the currency and so raises EX)
 - Higher G raises AD directly

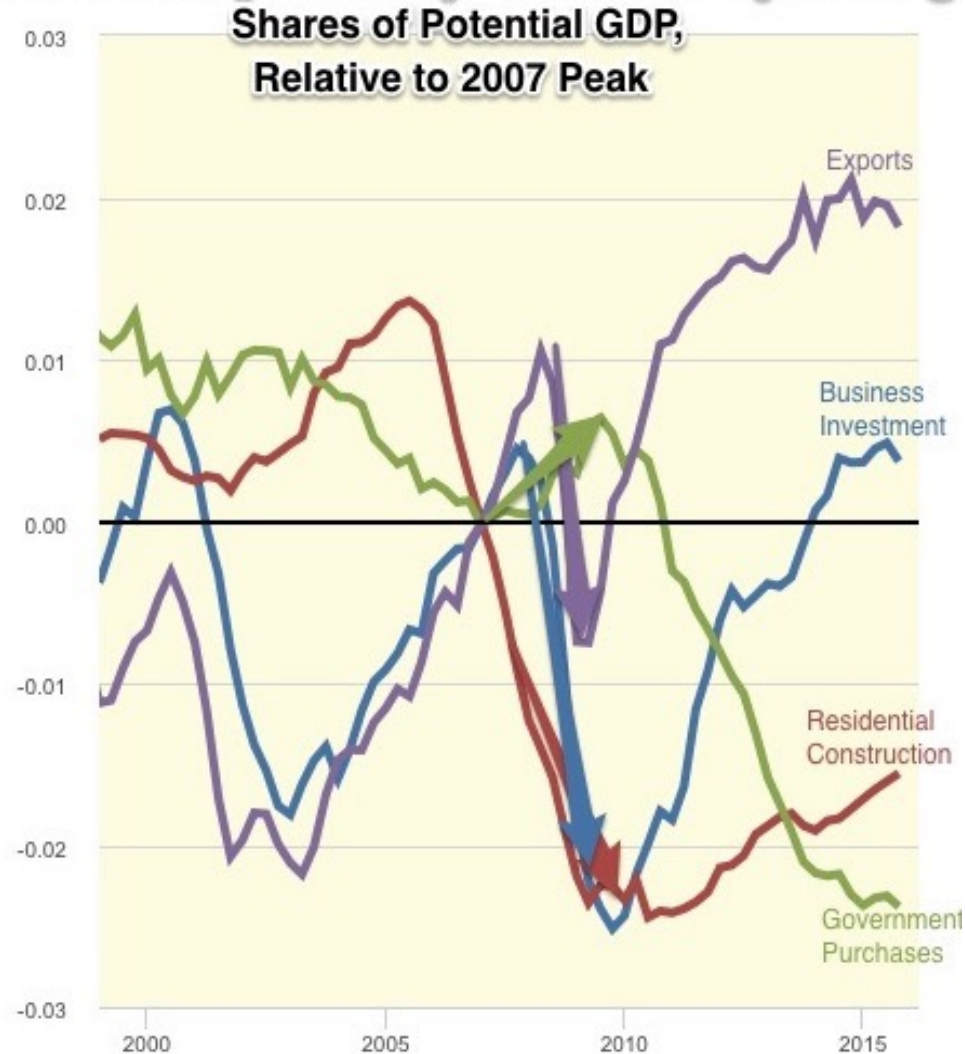


An Example of a General Glut

2008-2009:

- Collapse of trust due to subprime derivatives leverage debacle
- Enormous jump up in demand for “cash”
- The components of investment spending I collapse:
 - Business investment (blue)
 - Residential investment (red)
 - Plus exports (purple)
- Federal Reserve does not add enough cash to the system (because of its operating procedures)
- Obama stimulus (green arrow) grossly inadequate to keep the spending flow high enough for full employment
- Compare to 2005-2008:
 - Collapse of residential investment with collapse of housing bubble
 - But no depression, no “general glut”\y
 - In absence of excess demand for cash, business investment and exports take up the slack

Four Principal Components of Spending



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