Roundtable: Implications for further research and cooperation

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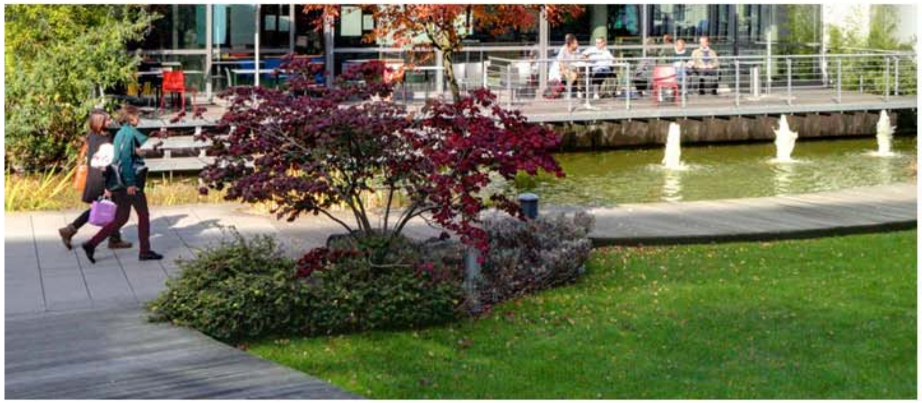
Workshop: Real analysis versus monetary analysis: Does it matter and what are its main implications for macroeconomic theory and policy?

March 14, Oesterreichische Nationalbank, Vienna



Comment by

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Outline

- Real versus monetary analysis
- Why real analysis will continue to dominate economics
- Why the financial crisis has not led to a revival of Keynesian economics (monetary analysis)

Real versus monetary analysis

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- Distinction between real and monetary analysis useful (even though – in my view – it is simply: Neoclassical versus Keynesian economics)

- Monetary analysis (Keynes) captures key features of the real world:

- credit (not savings) fund investment, savings follow investment
- credit is created by commercial banks (making them special)
- commercial banks create credit not by intermediating funds from savers but by creating money on their own (with access to base money provided by the central bank – the term "credit creation *ex nihilo*" does more harm than good)

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Why real analysis will continue to dominate economics

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- The microeconomic foundation paradigm has a strong narrative: how can something be wrong (dismissed) in the aggregate that holds for the individual? (fallacy of composition problems raised by Keynes with regard to the labor and capital market have neither been understood nor taken seriously)
- Real analysis is able to build complex models that are in line with key features of real world economies and hence provide rationales for standard Keynesian policies

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- Price / wage stickiness assumption is key to ensure that neoclassical (real) analysis is able to derive outcomes and policy conclu-sions that match real world observations on economic outcomes and policies

- Stickiness assumption not needed to build reasonable Keynesian (monetary) models, but reasonable neoclassical (real) models

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Why real analysis will continue to dominate economics

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- There is no elaborated and accepted Keynesian (monetary) model beyond IS/LM which (seems to) suffer from ignoring the real / monetary distinction (which is why it was discarded in the inflationary 1970s / early 1980s)

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Why the financial crisis has not led to a revival of Keynesian economics (monetary analysis)

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- Neither real nor monetary analysis "explains" financial crisis.
- Financial crises are explained by models of finance (Goodhart (1987) / Calomiris/Gorton (1991))
- It is the combination of the nominal convertibility guarantee of deposits into cash (Diamond/Dybvig 1983), together with the uncertainty about the true value of bank assets (Diamond 1984), that leads to the possibility of runs and systemic financial crises.

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Thank you very much for your attention

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