ONE-DAY CONFERENCE, MIDDLESEX UNIVERSITY,
RESEARCH AREA ON ECONOMIC POLICY FOR A CHANGING WORLD,
DEPARTMENT OF ECONOMICS AND STATISTICS

TITLE: ECONOMIC POLICY: IN SEARCH OF AN ALTERNATIVE PARADIGM
DATE: FRIDAY 03 DECEMBER 2010, 10:45-6:30
VENUE: MIDDLESEX UNIVERSITY, HENDON CAMPUS (Room: Barn, Middlesex University in London, The Burroughs, London NW4 4BT. Nearest Underground is Hendon Central)
ORGANISERS: Philip Arestis, University of Cambridge and Universidad del País Vasco; Ozlem Onaran, Middlesex University

PROGRAMME
10:45 Registration and Refreshments
11:15 Opening: Anna Kyprianou, Dean and Pro Vice-Chancellor, Middlesex University Business School

Session 1: 11.30-1.00pm
Chair: David Kernohan, Middlesex University

Nigel F.B. Allington, Ecole de Management, University of Cambridge, Cardiff University; John S.L. McCombie, University of Cambridge; Maureen Pike, Oxford Brookes University: The Failure of the New Macroeconomic Consensus: From Non-Ergodicity to the Efficient Markets Hypothesis and Back Again.

Philip Arestis, University of Cambridge and Universidad del País Vasco; Malcolm Sawyer, University of Leeds: A New Paradigm for Macroeconomic Policies

Jesus Ferreiro and Felipe Serrano, Universidad del País Vasco: The Institutional Dimension of the New Economic Policy

1.00– 2.00 Lunch

Session 2: 2.00-3.30pm
Chair: Philip Arestis

Giuseppe Fontana, University of Leeds: From Maestro to Villain of Modern Monetary Policy: A Critical Assessment of the "Greenspan Put" as the Main Cause of the Global Crisis

Engelbert Stockhammer, Kingston University: Greek debt and German wages. The role wage policy and economic policy coordination in Europe

Ozlem Onaran, Middlesex University: Who Pays for the Great Recession?

3.30–4.00: Coffee/Tea

Session 3: 4.00-5.30pm
Chair: Ozlem Onaran

Yiannis Kitromilides, Westminster University: Deficit Reduction Policies, Market 'Credibility' and Market Failure

Andrew Ross, Government Economic Service and HM Treasury: Does Economics Help Policy Makers?

John Grahl, Middlesex University: Financial Regulation in View of the Great Recession

5.30 – 6.30: Drinks

Registration: *Please register by* ***Monday 22nd November 2010*** *via sending an email with your name, affiliation, and position to Denise Arden, D.Arden@mdx.ac.uk, Middlesex University Research and Business Office. Places are limited and early booking is recommended.*

ABSTRACTS

The Failure of the New Macroeconomic Consensus: From Non-Ergodicity to the Efficient Markets Hypothesis and Back Again, **Nigel F.B. Allington, John S.L. McCombie, and Maureen Pike:** The 1990s saw the rise what many economists saw as a consensus in macroeconomics, with macroeconomic theory strongly related to, and affecting, policy. This led to the "Great Moderation" of low inflation and sustained growth. Based on the rational expectations hypothesis, asset markets were seen as efficient and the proliferation of financial instruments under "light regulation" were seen as the most efficient means of allocating risk, given agents diverse preferences for it. This paper considers the failure of efficient markets hypothesis from the collapse of Long-Term Capital Management in1997 to the subprime crisis ten years later. It presents a brief overview of the anatomy of the crises, its implications for the New Economics and the appropriate policy response.

A New Paradigm for Macroeconomic Policies, Philip Arestis and Malcolm Sawyer: In this paper we put forward a set of broad policies designed to secure full employment of labour with due regard paid to sustainable growth. We base these policies on the proposition that they arise out of and can only be understood by reference to the understandings (theoretical framework) of the ways in which the economy operates and works (or does not work). The general background to our theoretical framework is that the analysis is of a monetary production economy in which finance and credit plays a significant role. It relates to an economy, which has degrees of instability in the sense of being subject to the ups and downs of the business cycle and prone to crisis. There is often an inadequacy of aggregate demand (relative to what would be required for full employment of labour). The level and distribution of productive capacity can often be inadequate for underpinning the full employment of labour. Inflation is a non-monetary phenomenon with a complex of causes including conflicts of the distribution of income. A set of policies follows, which will be the focus of the contribution.

The Institutional Dimension of the New Economic Policy, Jesus Ferreiro and Felipe Serrano: From the perspective of the mainstream, the postulate of rational expectations led to downgrade the relevance of institutions in the economic analysis, both to understand the individuals' decision-making processes and the design and implementation of economic policies and public interventions. In this framework, markets are the only institution needed. Only when the assumption of rational expectations is relaxed to introduce possible problems of asymmetric information, it is justified to introduce institutions-policies in the analysis to solve this problem and to reach the market-clearing equilibrium outcome. Therefore, in a world of full information and rational expectations, aggregate demand is irrelevant in anything other than a strictly short-run context, and the only institutions that matter (apart from competitive markets) are those that bind the state to consistent (and therefore predictable) policy interventions. However once the existence of fundamental uncertainty is recognized, both the importance of aggregate demand and the role of institutions in the economy are radically revised. Institutions must be required and designed to reach a full employment level of economic activity. A well-designed institutional framework is a necessary condition to warrant the existence of that outcome and to help to implement macroeconomic policies that allow to reach and maintain this objective.

From Maestro to Villain of Modern Monetary Policy: A Critical Assessment of the "Greenspan Put" as the Main Cause of the Global Crisis, **Giuseppe Fontana:** This paper discusses the conventional view that the main cause of the current crisis is the accommodative monetary policy followed by Greenspan's Fed in the early 2000s. It assesses the merits and the drawbacks of this view by looking at the close relationship between the role of monetary policy in modern economies, and its theoretical frame of reference, namely the New Consensus Macroeconomics (NCM) model.

The paper concludes that there is little evidence that the monetary policies in the early 2000s are the cause of the credit and house bubbles, which have then led to the financial crisis.

Greek Debt and German Wages. The Role Wage Policy and Economic Policy Coordination in Europe, Engelbert Stockhammer: In spring 2010 a crisis of the Euro system was triggered by a sovereign debt crisis of Greece. In reaction to that the EU intends to tighten fiscal policy rules across the Euro zone. The basic idea behind this is that the Greek crisis was caused by lack of fiscal discipline. This paper argues that this is wrong analysis and gives wrong policy conclusions. Rather, German wage suppression is at root of the crisis of the Euro system. The paper explains why and draws policy conclusions. The Greek debt crisis is often presented as a result of lack of fiscal discipline. However, from a macroeconomic point of view, German export surpluses are a critical part of the story. Germany has pursued a policy of aggressive wage restraint resulting in large current account surpluses. Contrary to popular prejudice, German gains in competitiveness (since EMU) have not been founded on superior technological performance, but on more effective wage suppression. Germany's current account surpluses are some other countries' current account deficits (and capital inflows). In other words, in some countries (indeed most of this is going on within the Euro zone) some economic sectors have to increase their obligations to Germany: simply put, in Greece that was the public sector, whereas in Spain it was the household sector. Europe needs a set of economic institutions and policy rules that address such imbalances and their underlying mechanisms. The paper argues that the Greek sovereign debt crisis has laid bare fundamental flaws of the architecture of the Euro system. The present economic policy package of the Euro zone is consists of (1) a centralized and independent monetary policy aimed at price stability; (2) for practical purposes non-existing central fiscal policy; (3) national fiscal policies that are aimed balanced budgets (in the medium term) and are severely restricted by the SGP; (4) wage policy is hardly recognized as a policy area. This policy mix effectively institutionalizes the Monetarist vision of economic policy: a passive state aiming at price stability and an overwhelming trust in the market mechanism that presupposes, firstly, that wage are very flexible, and, secondly, that wage flexibility leads to full employment and to balanced current accounts. Neither long-lasting unemployment nor financial crises are supposed to occur in this view. In fact this policy setting has led to a medicore economic performance, a declining wage share, rising current account imbalances - and eventually a sovereign debt crisis. For the medium term, the Euro zone needs a policy setting that prevents long-lasting current account imbalances, guarantees full employment and an equitable distribution of income. This requires a re-writing of the Euro area rule book. We argue that an active coordiation of wage policy has to be at the center of a new policy mix. Wage policy has to ensure that wage grow with (national) productivity growth, that wage growth is consistent with (properly defined) price stability (on the European average), and with sustainable current account positions within the Euro zone. This implies that wages have to grow at substantially higher rates in Germany than in the deficit countries. If Greece, Spain and other countries are not to be pushed into severe deflation, this would imply inflation rates in the range of 5-8% (and according wage growth). Overall the Euo area inflation target will have to be revised upwards.

Who Pays for the Great Recession?, Özlem Onaran: The crisis laid bare the historical divergences within Europe, and transformed the global recession into a European crisis. In the European context, the mirror image of the wage suppression strategy and current account surpluses in the neo-mercantilist countries like Germany were imbalances within Europe in the form of current account deficits, public or private sector debt in the periphery of the Euro Zone, in particular Greece, Portugal, Spain, and Ireland or in Eastern Europe, in particular in Hungary, Baltic States, Romania, Bulgaria. The paper discusses the diverging outcomes of the crisis and policy response in Europe with a particular focus on the distribution of the costs of the crisis and labor market outcomes. What we are going through is a crisis of extreme inequality in distribution, which unfolded as a financial

crisis, and was tamed via major banking rescue packages and fiscal stimuli. The hegemonic narrative is now relabeling crisis as a "fiscal crisis". However the push for public debt reduction as the major target of macroeconomic policy is the biggest threat to a continuous recovery. The financial crisis is likely to turn into a further distribution and jobs crisis.

Deficit Reduction Policies, Market 'Credibility' and Market Failure, Yiannis Kitromilides: The formation in May 2010 of the first coalition government in the UK for seventy years was followed by the pronouncement that public deficit reduction was the coalition government's top policy priority. The outgoing labour government also had a deficit reduction plan which, however, was rejected by the coalition partners on the ground that it lacked market 'credibility'. The coalition government claimed that the establishment of market 'credibility' can only be achieved through the implementation of *immediate* and *unpalatable* fiscal austerity measures and that without market 'credibility' the country would face a disastrous 'Greek-style' adverse market reaction. The paper examines in detail these claims and considers two further questions. First, is there is any justification for this subordination of public policy-making to market sentiment. Do financial markets strengthen or subvert democracies? Second, are markets 'rational' in the way they define policy 'credibility', or is there a 'market failure'? An example of market failure is when there is 'synchronized' fiscal austerity in a number of interconnected economies: if only one country adopts fiscal austerity measures the markets may consider this a 'credible' policy of deficit reduction; if a number of indebted countries adopt simultaneously fiscal austerity measures the markets may no longer consider fiscal austerity as a 'credible' deficit reduction policy. The recent experience with fiscal austerity in PIIGS countries tends to provide empirical support for the existence of this type of 'market failure'. The adoption of deficit reduction policies in order to 'appease' the financial markets may in fact be counterproductive.

Does Economics Help Policy Makers?, Andrew Ross: The UK Government Economic Service is briefly described and the day-to day work of its members is contrasted with that of academic researchers. It is observed that in government economics is about 'dilemmas rather than lemmas' and that a close watch and good judgement, informed by history as well as the latest in economics, is more important than any particular model. A humorous metaphor is used to illustrate how academic advice can often feel to policy makers. The conclusion is a call for the discipline to give more emphasis to equipping 'professional practitioners' and to confess with humility and tolerance the limits of our knowledge.

Financial Regulation in View of the Great Recession, John Grahl: The main lines of regulatory reform for the financial sector are now becoming clear in the US and the EU, in terms of the content of regulations as well as the new institutional arrangements. In general these changes are minimalist; they have been welcomed by the large banks and their shareholders. However, it seems unlikely that the new regime will be tested for some time because the lessons of the crisis are still fresh in the memory. Three points will be argued about re-regulation. Firstly that a radical agenda of structural change (separation of deposit and investment banking or break-up of the biggest banks) is misconceived because the measures concerned would threaten the integrity of the global banking system. Secondly that one effective path of reform would be a vigorous defence of the interests of the households and small businesses which use the financial system - many of the malfunctions of the system have been at their expense. Thirdly, that the main policy objective after the crisis should not be regulatory, but rather to require a more efficient and less costly system. The most important aspect of the new system should be a lower cost of capital for producers.

BIOGRAPHICAL NOTES

Nigel F.B Allington is Professor of International Finance at the Ecole de Management, Grenoble, France; Director of Studies in Economics at Downing College, Cambridge; and is in the Julian Hodge Research Centre for Applied Macroeconomics, Cardiff University. He is also a Member of the Cambridge Centre for Economics and Public Policy at the University of Cambridge.

Philip Arestis is Honorary Senior Departmental Fellow, Cambridge Centre for Economics and Public Policy, Department of Land Economy, University of Cambridge, UK; Professor of Economics, Department of Applied Economics V, University of the Basque Country, Spain; Distinguished Adjunct Professor of Economics, Department of Economics, University of Utah, US; Senior Scholar, Levy Economics Institute, New York, US; Visiting Professor, Leeds Business School, University of Leeds, UK; Professorial Research Associate, Department of Finance and Management Studies, School of Oriental and African Studies (SOAS), University of London, UK; and current holder of the British Hispanic Foundation 'Queen Victoria Eugenia' British Hispanic Chair of Doctoral Studies. He is Chief Academic Adviser to the UK Government Economic Service (GES) on Professional Developments in Economics. He has published as sole author or editor, as well as co-author and co-editor, a number of books, contributed in the form of invited chapters to numerous books, produced research reports for research institutes, and has published widely in academic journals.

Jesus Ferreiro is Associate Professor in Economics at the University of the Basque Country, in Bilbao, Spain, and an Associate Member of the Centre for Economic and Public Policy, University of Cambridge. His research interests are in the areas of macroeconomic policy, labour market and international financial flows. He has published a number of articles on those topics in edited books and in refereed journals such as American Journal of Economics and Sociology, Economic and Industrial Democracy, Économie Appliquée, Ekonomia, European Planning Studies, International Journal of Political Economy, International Labour Review, International Review of Applied Economics, and the Journal of Post Keynesian Economics.

Giuseppe Fontana is Professor of Monetary Economics at the University of Leeds (UK) and Associate Professor at the Università del Sannio (Italy). He has recently been awarded the 2008 L.S. Shackle Prize, St Edmunds' College, Cambridge (UK). He is a Life Member Fellow at Clare Hall (University of Cambridge, UK), and a Visiting Research Professor at the Centre for Full Employment and Price Stability (University of Missouri Kansas City, USA), and the Cambridge Centre for Economic and Public Policy (University of Cambridge, UK). He has published several journal articles and edited few books with international publishers. He has recently published Money, Time, and Uncertainty with Routledge.

John Grahl is Professor of Economics at Middlesex University Business School. His main interests are European Integration and Financial Services. He is a founder member of the Euromemorandum Group which argues for a change in EU policies. His most recent book is *Global Finance and Social Europe* (Edward Elgar, 2009).

Yiannis Kitromilides is a Senior Lecturer in Economics, Westminster Business School, University of Westminster. He has also taught at the University of Greenwich, at the University of Middlesex and at the School of Oriental and African Studies, University of London.

John S.L. McCombie is Director of the Cambridge Centre for Economic and Public Policy at the University of Cambridge and Fellow in Economics at Downing College, Cambridge. He holds an MA and PhD from the University of Cambridge and an MA from McMaster University Canada. He has previously been a member of the Department of Economics at the University of Hull and the University of Melbourne, Australia.

Ozlem Onaran is Senior Lecturer at Middlesex University, Britain. She is a research fellow of the Research Program "International Tax Coordination" at the Vienna University of Economics and Business, a member of the Coordinating Committee of the Research Network Macroeconomics and Macroeconomic Policies, a research associate at the Political Economy Research Institute of University of Massachusetts, Amherst, and a member of Research Group on Money and Finance. She has articles in journals and books on globalization, crisis, distribution, employment, investment, development, and gender.

Maureen Pike is at the Department of Economics and International Business, Oxford Brooks University and is an Associated Member of the Cambridge Centre for Economics and Public Policy at the University of Cambridge. She has a PhD from the London School of Economics and has previously been a member of the Department of Economics at the University of Hull and Queen Mary College, University of London.

Andy Ross left school at 15 as a telecoms apprentice. He studied, mainly part-time, for degrees from the LSE, Birkbeck College, Roehamption Institute and Nottingham Trent. He is a member of the Committee of Heads of University Departments of Economics, the Economics Network Advisory Board, the RES Conference Committee and a non-executive Director and Fellow of the Institute of CPD. He is ex-visiting Erasmus professor, ex-textbook author, ex-polytechnic head of economics, ex-university dean, ex-college director, ex-university inspector, ex-local government councillor, ex-failed dot com Director and ex-Investors in People reviewer. He joined Office of National Statistics as a civil service in 2000 and jointly founded, with Professor Haskel, the ONS micro-lab, now the OECD's leading micro-lab. He worked at the Office of Fair Trading before joining the GES Team at HM Treasury in 2005. Andy is currently Deputy Director and Head of Professional Development for the GES.

Malcolm Sawyer is Professor of Economics, Leeds University Business School, University of Leeds, UK. He was until recently Pro-Dean for Learning and Teaching for the Faculty of Business, University of Leeds, UK. He is managing editor of International Review of Applied Economics, on the editorial board of a range of journals and editor of the series New Directions in Modern Economics. He has published widely in the areas of post Keynesian and Kaleckian economics, industrial economics and the UK and European economies. He has authored 11 books and edited 18, has published over 70 papers in refereed journals and contributed chapters over 100 books.

Felipe Serrano is Professor in Economics at the University of the Basque Country, in Bilbao, Spain He is the head of the Department of Applied Economics V at the University of the Basque Country. His research interests are in the areas of social security, the welfare state, labour market, innovation and economic policy. He is the author of a number of articles on those topics in edited books and in refereed journals such as Economies et Sociétés, Ekonomia, European Planning Studies, Industrial and Labor Relations Review, International Labour Review, International Review of Applied Economics, and the Journal of Post Keynesian Economics

Engelbert Stockhammer is Professor at Kingston University. His research areas include macroeconomics, unemployment, financialization, and Political Economy. He has published widely in academic journals on the demand effects of changes in functional income distribution, economic policy in Europe and the macroeconomic effects of financialization. He has authored the book “The rise of unemployment in Europe” (Edward Elgar, 2004) and is co-editor of Heterodoxe Ökonomie (Metropolis 2009) and a forthcoming Modern Guide to Keynesian Economics and Economic Policies (Edward Elgar).