

Foreword to John and Wendy Cornwall's book

Modeling Capitalist Development

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### **Modelling Capitalist Development**

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True macroeconomists are hard to find these days. They seem to have dug themselves into the woodwork in response to the new classical, and their new Keynesian clone, population explosion. When you find a true Keynesian, you have found a treasure, and the Cornwalls are true, unrepentant Keynesians.

I call their analysis “true New Keynesian.” (I can’t simply call it New Keynesian, because that term has been hijacked by a set of writing that often has little to do with either Keynes or macro, but is actually a combination of partial equilibrium analysis and new monetarism going under a Keynesian label.) It is Keynesian because it retains a framework within which aggregate demand can play a role in affecting the long run performance of the economy. It is new because it incorporates new ideas that are relevant for the exposition. The Cornwalls have carefully followed the modern developments in macroeconomics, adapted those aspects of it they consider advances, and eliminated those aspects of it that they find fads.

In this well-structured book they present, in a wonderfully clear style, a framework that “explains” the stylized facts of macroeconomic development of the industrial nations during the last 100 years. They consider these stylized facts in historical sequence, arguing that the facts trace out a pattern of alternating episodes of poor and superior macroeconomic performance. The framework they use is evolutionary; it is

neither completely self-regulating nor knife-edge. The system adapts, but adapts slowly, to events and disturbances. Using their updated, evolutionary model, they explain the past and give us insight into the future.

The Cornwall's work is an example of the direction the macro profession would likely have gone had it not become lost in overly formal rational expectations models. It blends elements of three traditions: Schumpeterian, Swennilsonian, and Keynesian. The big change from the early Keynesian work is a switch from a focus only on the short run to a focus on the intermediate run. In this intermediate run there are many possible directions the economy might take. Which it takes is not a priori determined

This intermediate run approach replaces the sterile concept of a unique long run equilibrium with multiple equilibria. Agents are forward looking, but not so forward looking as to push our credulity over the limit. This intermediate run approach directs us to think of the economy as a path-dependent process, where hysteresis rules. There's no predetermined future. Which way the economy goes depends on how institutions and government policy deal with our problems.

The Cornwall's Keynesian macroeconomics admits to its deductive limitations. It recognizes the macroeconomy as a complex system from which one cannot build up from first principles to a complete understanding. Instead, one must build down, developing a contextual macroeconomic analysis through an understanding and appreciation of the economy's institutions. It is an analysis in time. The Cornwalls call it "appreciative theorizing." Another name for it would be Charles Peirce's term, abduction. Abduction is not deduction, not induction, but a sensible blend of the two. In abduction the role of

theory is to create a reasonable story that “explains” the facts. Using abduction one is careful not claim a model is more than what it is—a reasonable story.

The Cornwall’s overriding policy interest is in keeping unemployment as low as possible. That interest guides their analysis. They argue that a defining feature of the golden age was full employment. They contrast that golden age with the latest episode of neoliberalism where there has been much more unemployment. Drawing on their historical analysis they argue that, to achieve high employment government, capital, and labour must create and sustain an institutional environment that makes social bargains possible, and relieves the economy of constraints on aggregate demand. The golden age achieved this through an activist government. It worked because of a willingness by labour to abandon unrestricted collective bargaining and accept moderate wage demands in exchange for full employment, an expanded welfare state, and “fair” treatment in the workplace.

The political forces that led society to create such golden age institutions have changed in the last 30 years, leading to a breakdown of those institutions and the establishment of a neoliberal regime. The defining characteristics of this modern neoliberal regime are a focus on price stability and an elimination of the institutions necessary for full employment. The Cornwalls argue that the neoliberal institutions place too strong a constraint on aggregate demand, and are therefore inconsistent with the full employment goal. Whether institutions can change to become consistent with full employment is an open question. Based on history, they argue that some kind of big push—a precipitating event—is necessary for institutions to change, and that this is unlikely in the near future.

I don't agree with everything in this book but I agree with much of it, and I can highly recommend it to all. It is a sensible blend of institutional knowledge and analytic understanding. It is insightful, instructive, and will give the reader an excellent sense of what the real issues in macro are.