Willi Semmler's Macroeconomics: An Appreciation

By Edward J. Nell

The 25 years from 1948 to 1973 were pretty good for middle class and even poor households in the advanced world. Employment was high, inflation low, productivity grew faster than ever and real wages grew along with it. Innovation was strong and new sectors opened up everywhere, and the public sector was more fully funded than ever before. This was the Keynesian era. Governments – even so-called conservative ones, as in the UK - explicitly adopted Keynesian policies, and supported the development of econometric models that could help to design their interventionist policies. (Roy Harrod was an advisor to Harold Macmillan)

Since then there has been a move away from interventionist policy, and from econometric modeling. The models could not deal with the oil shocks, nor could they handle or explain 'stagflation'. And the political climate changed, first following the oil shocks, then with the election of Reagan and Thatcher. In the resulting confusion the simplicities of Friedmanesque Monetarism took flight and lit up the skies. By the time Keynesians had got their act together to shoot down Monetarism, it had been replaced, or supplemented, by New Classical thinking, together with Real Business Cycles, all draped in Rational Expectations.

What followed was an era that might best be described as ideological argument over how an idealized (and therefore unrealistic) economy should work. New Classicals, New Keynesians, and Real Business Cycle theorists – all taking Rational Expectations seriously – offered accounts of how an economy based on unrealistic, sometimes impossible, assumptions would move towards an equilibrium or end up cycling in an equilibrium path – in spite of the all-too-evident fact that actual economies – the US or the UK – were regularly exhibiting features wholly inconsistent with equilibrium, and behaving in ways contrary to the models. Post Keynesians and the various schools of Marxian and other heterodox economists, however, were simply ignored.

Keynes, however, was not ignored; he was vilified. He was not a real economist, according to Lucas. No real economist under the age of 40 takes Keynes seriously anymore, it was said. As for 'involuntary unemployment', Lucas intoned, speaking *ex cathedra,* 'it was not

a fact to be explained, it was a hypothesis, offered to explain a real phenomenon, the variation in actual levels of employment'. There wasn't even a Keynesian problem anymore[1]

So from about 1980 to the Crash of 2007-8 there was a general atmosphere unfriendly to new research in macroeconomics – unless it was designed to show that macro policies were ineffective or damaging. Showing that interventionist policies were 'ineffective' was a particularly common argument, and it was often based on a demonstration that the multiplier was miniscule, or non-existent or offset by monetary developments. And of course, there was the crowding out story, and the effect of an expansionist intervention on interest rates, undermining the expansion.

These issues go back to the beginning of Keynesian analysis, but work on them had largely stagnated, or become repetitive. Willi Semmler and his associates have now developed new methods and new techniques to carry forward the work that had begun early in the Keynesian era, but had become stagnant and unimaginative. For example, they show not only that multipliers are different when the economy is expanding and when it is contracting, they have worked out how to calculate different but related multipliers for different states of the economy generally, and they examine how the multiplier interacts in these different states with monetary and financial variables[2].

This is pretty advanced, but it deals with issues that go back a long way right to the beginning. The story of the Keynesian multiplier can be dated to May 1929; Keynes gave two talks, one in London on May 28, another in Leceister the next day. Both were talks supporting Liberal candidates in the ongoing General Election, and in both cases Keynes was supporting the program of Lloyd George (a program he was largely responsible for writing). This program called for the creation of large scale public works to offer employment, putting the unemployed to work and getting them off the dole. But the Government with the support of the Treasury objected. First, the only way to pay for such a program would be to take away money now financing other projects, so there would be essentially no net gain (crowding out). And secondly, any such effort to expand would

---

[1] Lucas at the time of his Nobel Prize, was the only economist to have the word 'macroeconomics' appear in his citation. The great macroeconomists, Hicks, Samuelson, Solow, Tobin and many others, were all cited for other accomplishments, not for their work in macro. For the mainstream establishment real economics is about scarcity, and how can there be scarcity if there is involuntary unemployment? Macro is the wrong way to go.

[2] See Stefan Mittnik and Willi Semmler (2012): "Regime Dependence of the Multiplier , *Journal of Economic Behavior and Organisation*, vol. 83, no 3: 502-522

certainly drive up interest rates. All too familiar … For the liberals to win, these arguments had to be overcome (and essentially the same arguments are out there today…)

Keynes's notes for the talks those two days cover the different ways money can be found or created, so that nothing has to be diverted from financing ongoing projects, and he seeks to show that interest rates do not have to come under pressure to rise. We would certainly rephase or refine his arguments today, but there can be no doubt that he opened the way. Willi and his colleagues offer us not only models, but also empirical methods to demonstrate these points.

Even more remarkable is the fact that Keynes sought to calculate the precise, numerical extent of the expansion in employment as the result of 'secondary' spending: this is the multiplier and it is the first time that we have it as the sum of an infinite series. In his notebook, he wrote out an arithmetical formula for an infinite series that summed to a finite amount. This was the secondary employment that would result from removing an unemployed worker from the dole and putting him to work – thus doubling his spending and setting up the series of respending. Moreover he then calculated the savings from the dole, as secondary workers were taken off it and put to work– this savings could be part of the financing of the public works.

Keynes considers several different possibilites of leakages, essentially different states of the economy. In other writings, and in a letter to Harrod he suggests that these conditions might be stable for long enough to study, but that over time they would most likely change, though slowly. He recommended empirical studies of the multiplier in marked contrast to his reaction to Jan Tinbergen's early econometric modeling, which he criticized very strongly at about the same time.

Keynes's views on the likelihood that the multiplier might vary in value with the state of the economy seems to be an early version of the argument that James Duesenberry presented in the 1950s and 60s. He proposed that the multiplier / accelerator mechanism in the upswing of the cycle would be different from that in the downswing, and every cycle would very likely differ in some ways from every other. Duesenberry asserts this but doesn't demonstrate it, nor does he present much evidence. But he makes a plausible case for looking into it.

This is what Willi and his co-authors have done. They have not only studied and answered these questions, but they have developed empirical methods of analysis to make their studies precise and workable. They have moved the Keynesian project forward after decades of stagnation.