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BOOK REVIEW

RETHINKING MACROECONOMICS: AN INTRODUCTION

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When Paul Romer of the New York University's Stern School of Business presented a paper explaining *"The Trouble with Macroeconomics"* at the Commons Memorial Lecture in January 2016, he resented the fact that macroeconomics had gone backwards over the last three decades. Likewise, when Krugman wrote "What went wrong with economics and how the discipline should change to avoid the past mistakes" in the Economist in 2009, he concluded that the discipline had gone astray. Steve Keen (2009) attributed that and the failure of macroeconomic theory to explain current economic phenomena (the 2008 economic crisis) to how macroeconomics is taught. Keen explains that despite the failure of neoclassical macroeconomics theory to explain current real economy changes, academics and economists have the ideological contentment and thus continue to teach and recite economic theory from the same textbooks they used in the pre-crisis even after the crisis.

Like most, McDonald defines macroeconomics as a study of the aggregate behavior of the whole economy and regards the main objective of macroeconomics as understanding the determinants of aggregate economic activity. Therefore, teaching introductory macroeconomics is about imparting students with the basic knowledge required for identifying policies to improve economic performance. According to Taylor (2000), macroeconomics taught at principles level should be easily understandable, memorable and consistent with both the modern economy and relevant with macroeconomic models used in practice.

The objective of McDonald's "Rethinking Macroeconomics" is to introduce different heterodox macroeconomic schools of thought to students aimed at equipping them with the basic knowledge

required for designing and understanding macroeconomic policies and real economic phenomena of the current modern macro economy. This is not due to pedagogical pressure from students or the economics society, but there is a need for adopting alternatives to neoclassical economics to widen the scope of the taught introductory macroeconomics. Several existing schools of thought should be included in the traditional introductory macroeconomics textbooks such that students get to know about them, distinguish them and apply them for analysis.

John F. McDonald is Emeritus Professor of Economics and Finance at the University of Illinois at Chicago where he joined shortly after earning his PhD in economics from Yale University in 1971. He has widely published in macroeconomics, urban economics and, real estate economics besides serving as editor of the *Journal of Real Estate Literature*. This vast teaching and working experience under macroeconomics provides him with sufficient knowledge to criticize the content and teaching of macroeconomics.

McDonald's objective is to expose introductory level students to the different schools of thought. Rather than analyzing these, he prefers to only present the main ideas given by proponents of each school, notably the Keynesian school, monetarist school, new classical school and lastly the Austrian School. According to McDonald, the Keynesian school is rooted in the economic works of the British economist John Maynard Keynes (1883–1946) widely regarded as the most important economist of the twentieth century. His 1936 book, "The General Theory of Employment, Interest and Money" revolutionized economics from just "political economy" into two major divisions; microeconomics and macroeconomics. Written during the 1930s Great Depression, Keynes's General Theory disregarded Say's Law "supply creates its own demand" on assumption that rigidities and imperfections exist in markets. To Keynes, even with flexible prices and wages, chronic unemployment during the Great Depression happened due to the fall in aggregate demand which is why the economy could not achieve close to full employment. Government must intervene with an effective monetary policy to reduce interest rates so that effective demand rises. Similarly, in his 1940 short pamphlet "How to Pay for the War", Keynes proposed an "inflation tax" rather than printing more money, to finance the 1939 massive military expenditure. This effective fiscal policy influences aggregate demand and generates economic stability. Keynes believed that economics is a product of its time and his ability to adapt his economic thinking in that time was illustrated by

providing a theory to help capitalist economies achieve close to full employment during recessions. Thus we should not be static with macroeconomic theories even when they do not explain the current situations.

McDonald associates "Monetarist School" to Milton Friedman who in the 1960s attacked the Keynesian school by re-establishing the quantity theory of money at times when economies experienced high inflation rates. Their debate was focused on two specific points: (1) the relationship between the money, interest rate, prices and levels of output, (2) on the role and conduct of macroeconomic policy. Monetarists hold the view that money is so important in macroeconomics because not only does it temporarily affect the output and employment levels, but, in the long run, changes in money supply affect the price level. Therefore, monetarists see changes in the money supply as a principal effect on effective demand and business cycles.

When classical economics underwent its own "revolution" in the 1970s led by Robert Lucas to make the New Classical school, it presented an alternative to the Keynesian school especially on real business cycle and economic growth theory. It concentrates on supply side economics which posits economic fluctuations as a result of supply side shocks. It focuses on alternative sources of economic growth. Its major effect on public policy was "income tax" cuts proposed by Arthur Laffer while explaining the Laffer curve. This view dominated Ronald Reagan's administration (Reaganomics) between 1981 and 1986 but has been deemed more political than economic.

McDonald also discussed the Austrian school developed by Ludwig von Mises, and Friedrich von Hayek in the 1930s. Although monetarists and Keynesians have disregarded the Austrian school, it gained prominence because of its ability to align with many of the facts of the 2008 financial crisis and recession. The Austrian business cycle theory is embedded in classical free-market economics as applied to real investment. It requires foregoing current consumption for future production and further opposes interest rate determination by the monetary authority (central banks). It suggests that a free market economy will recover quickly from a downturn, provided that the government intervenes.

McDonald also delves deeper to explain how the above schools can be applied to different economic phenomena dating back to World War I and its aftermath, the Great Depression, World War II, the 1950s global economic growth period, and the 2008 financial

crisis. Interestingly, all four schools discussed by McDonald have different views on the 2008 financial crisis. The Austrians blamed the monetary authority, Keynesians blamed the fall in aggregate demand, monetarists blamed the Federal Reserve interest rate policy while Lucas and his new school proponents blamed aggregate demand that affected prices. Students will fail to understand the exact cause of the crisis.

I, therefore, suggest that the author should have discussed other heterodox schools of macroeconomics thought such as Institutionalist, Post-Keynesians, Resource-based, behavioral, and Religious economics with focus on Islamic economics which I think better explains the current real economic phenomena. An unbiased look at Islamic economics offers basic understanding of causes of the crisis. Chapra (2008) explains that taking interest (*ribā*), separating the financial sector from the real sector, greed and moral hazard are among the causes Islamic economics will offer for the crisis. Even when some schools of thought may somehow offer similar reasons the exclusivity and consistency of Islamic economics is incomparable.

Behavioral economics is promising a better understanding of decision making theory and can give rise to new economic theories. The 2017 Nobel Prize in Economics awarded to Professor Richard H. Thaler, of the University of Chicago Booth School of Business comes as proof for acceptance of unorthodox economics. Thaler's contribution to the literature of economics has been constant, massive, and extremely original since the 1970s. His work on integrating economics with psychology incorporated psychologically realistic assumptions into the analysis of economic decision making by exploring how human traits such as consequences of limited rationality, social preferences, and lack of self-control systematically affect individual decisions as well as market outcomes. The decision to award a behavioral economist followed a Nobel Prize in economics award to Oliver Hart and Bengt Holmstrom in 2016 for their work on contract theory. This is further proof that some of the best work in economics is being done so far by those following unorthodox economics to tackle, explain and understand the complex problems in economics.

Because economics students have over relied on unrealistic assumptions embedded in neoclassical economic theory in forecasting and explaining several other big glitches of macroeconomics even when economists have to accept them as essential, the failure by neo-classical wonder-models to predict the Wall Street crash of 2008 and the resulting economic recession was a clear indication that a better

economic theory on which to build a better and newer economic model was required. What was unclear was where we were going to find such a model. Such promising and core ideas remain stunted if they are not introduced to universities and faculties as well as research and focus groups to explore them and this is what McDonald advocates.

The strength of the book lies in the way he explains the different schools of thought. He prefers to use a few graphs and macroeconomic data where necessary to explain the key issues of each school and this helps to relate the theoretical explanations to real life observations, hence making it easy to see the application. Likewise is the organization of the book. He first presents the Keynesians, then he follows with the monetarists who criticised them. He then follows it with the new classical school who criticised both the former and then the Austrian school who criticised the past three schools. This presentation style explains the interrelatedness of the schools hence facilitating understanding. Despite having contesting schools, these contradictions give macroeconomics its strength. Introducing students to such unorthodox views aids their understanding and appreciation of macroeconomics. The author is not inclined to any school and therefore does not create bias for the reader. He rather leaves it to the reader to understand the schools and decide on which views to take in explaining economic phenomena.

In a nutshell, "Rethinking Macroeconomics" serves its objective. It offers a context non-existent in traditional introductory macroeconomics textbooks. Thus, it is an ideal accompaniment and suitable for undergraduate students who have done at least an introductory course in macroeconomics. The flow of discussions in this book and the uncomplicated analytical methods used guide the readers throughout and the background discussions on topics, the macroeconomic data accompanied by graphical illustrations make the book ideal for teaching undergraduate macroeconomics students.

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