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I.

Makroökonomie, makroökonomische Politik-Regime und ‚guter Kapitalismus'

Macroeconomics, Macroeconomic Policy Regimes and 'Decent Capitalism'

Macroeconomic policy regime: A heuristic approach to grasping national policy space within global asymmetries*

Barbara Fritz

1. Introduction: between the global and the domestic: Missing analytical links

It is trivial to state that economic globalization severely limits the nation state's capacity to pursue policies of its own. However, the search for concepts and analytical tools to describe and evaluate this limited yet not inexistent policy space at the national level is much less self-evident.

On the one hand, standard economic theory and policy advice, at least for a long time, have assumed that there exists a standard set of policies to be pursued if a country is in crisis (e.g. Williamson 1990). This highly voluntarist approach of an optimal economic policy assumes that problems on the way to a sustainable growth path should be explained by domestic policy failures. From a purely orthodox perspective, the usual suspects of this failure would be an inadequate monetary policy, insufficient fiscal adjustment, or structural reforms which fail to reach deep enough.

It is true that more recently, relevant work even within the economic mainstream has started considering external factors as a severe constraint for standard domestic policies. Especially high and volatile international capital flows have been a topic of analysis for their destabilizing effects on the exchange rate and the financial sector of countries receiving inflows. Following

* Special thanks go to my colleagues Daniela Prates and Luiz Fernando de Paula for what I learned in our collective work on the challenges and limits for domestic policies which are imposed by global economic asymmetries on emerging market countries.

earlier critical work from a Keynesian or heterodox perspective (e.g. Flassbeck 2001; Herr 2008; Ocampo 2001), a series of authors, based on empirical assessment, recognize the problems imposed especially by financial globalization which cannot be addressed by standard economic policies (Rey 2015) and would require unconventional measures such as capital account controls (e.g. Ostry et al. 2010). Yet, a look at current adjustment programs both in the Euro zone and in developing countries and emerging markets shows that supranational institutions such as the IMF still seem to be rather far away from taking into account these interdependencies between global economic features and policy design and outcome at the domestic level. For instance, Euro zone countries such as Spain, which came into deep trouble without having suffered from a fiscal slip before, but rather from a mixture of dysfunctional wage competition by other currency union members and the relaxation of financial regulation, are being left alone with a dysfunctional deflationist adjustment burden as well.

On the other hand, when looking to relevant non-orthodox approaches, we have a series of rather determinist concepts, especially in the case of countries denominated as developing, emerging or peripheral. Here, globalization of the capitalist system rather condemns countries to remain in a peripheral position, due to colonial and post-colonial global interdependencies (e.g. Wallerstein 1979, 2011; Korzeniewicz et al. 2009). In contrast to conventional approaches, here the focus lies exclusively on global conditions and limits which create powerful path dependencies, while domestic policies aimed toward changing this position do not receive systematic attention.

So, what we are missing is an approach capable of intermediating between both perspectives: the asymmetric nature of the global economy, on the one side, and the chances and limits of domestic policies on the other. Yet, there is little to be found in the literature.

2. *The concept of the macroeconomic policy regime*

The concept of the macroeconomic policy regime, as brought forward by Hansjörg Herr in various publications, may serve as an analytical tool to bring these two perspectives together. Even if he seems not to be considering this concept as key within his own research when presenting his "selected current work" on his homepage,[1] I argue here that this is indeed useful as an intermediary concept between global structures and economic policies at the domestic level.

[1] See: http://www.hwr-berlin.de/fachbereich-wirtschaftswissenschaften/kontakt/personen/kontakt/hansjoerg-herr/

The term macroeconomic regime is understood as

> "the interaction between monetary policy, fiscal policy, wage policy and foreign economic policy within a framework of both: macroeconomic institutions which can be actively changed by policy-makers and become part of economic policy, and institutions which are beyond the control of policy-makers" (Herr/Kazandziska 2011: 2).

As this quote shows, one key characteristic of the concept of a macroeconomic regime[2] – or market constellation, as termed in an earlier publication (Herr 1995: 143ff.) – is that it encompasses a broad range of policy fields. Especially by including wage policies, it goes beyond standard analysis of the typical macroeconomic variables such as the fiscal budget, the monetary interest rate, and the exchange rate. This almost holistic perspective, similar to the French regulation school (e.g. Boyer 1990), also includes fields such as industrial policies and the form in which countries are integrated into the world market, the features of the financial sector, etc.

Second, the concept of the macroeconomic regime explicitly includes an institutional perspective, thus going beyond standard quantitative approaches which only focus on macro variables or quantifiable institutional features. Correspondingly, it is key that the concept analyzes policy options within their specific institutional context:

> "Institutions pave the way the policy instruments can be applied, and it is only when certain institutions are in place that certain types of policies become possible. Institutional changes can be induced by the decisions of the national governments, but they can also happen as a result of actions which are out of governments' reach" (Kazandziska 2013: 3, based on Heine/Herr/Kaiser 2006).

This focus on the interaction between policies and institutions allows for a specific insight: policy outcomes may differ from their intended aims for a variety of reasons, and failures in terms of policy implementation may be

[2] When using the concept of regime, Herr makes a cursory reference to its origins within social science, for example by hinting at its use within the field of International Relations (Krasner 1983). Yet, others using the concept of macroeconomic regimes within economics, such as Baele et al. (2011), also focus exclusively on the usage of the concept in terms of policy fields, simply defining it as the monetary policy with its implications on aggregate demand and supply.

only one among a series of reasons. With this perspective, (more or less) unsuccessful reform processes to foster sustainable growth can be assessed taking into account the specific conditions of a country which are not easy to be changed, at least in the short run. The way wage formation occurs according to country specific features represents one example. There might be strong labor unions which demonstrate a certain degree of politicization, pushing inflation with nominal wage increases which even counteract contractive monetary or fiscal policies. Or wage formation occurs in a highly decentralized manner, which makes the wage level pro-cyclical, thus fostering boom-bust cycles.

The encompassing perspective on the interaction of a broad set of policies and institutions is especially helpful in explaining why countries, despite significant policy efforts, may not experience a takeoff in terms of investment and growth. We see that macroeconomic policy regimes, or market constellations, show a high degree of inertia, or path dependency, due to the rigidity of institutions.

This gives us a powerful explanation of why economic actors may adjust to policy shifts only at the margin, but not fundamentally change their attitude. Instead, there is a high risk that investors remain in a sit-and-wait position, or procrastinate in their investment decisions, as long as they are not strongly convinced that the future will significantly differ from the past. Generally speaking, it is necessary to achieve strong structural breaks with a significant impact on expectations. At the same time, policies should be designed towards preventing negative feedback, and clearly embedded within he specific institutional setting.

Based on this broad definition, Herr applies the concept of the macroeconomic regime to all sorts of countries: advanced economies (e.g. Heine/Herr/Kaiser 2006; Herr/Kazandziska 2011); transformation countries (Herr 1995; Herr/Tober 1999); accession candidates to currency unions (Herr/Kazandziska 2007), and developing economies (e.g. Priewe/Herr 2005).

The aim is to classify, both in general and for specific cases or types or countries, regime types according to their effect on growth and stagnation. A regime deemed optimal would be comprised of some sort of a regulated financial system and labor market, together with active government policies aimed at reducing uncertainty and maintaining demand bringing about high investment, growth, employment, and low inequality. As this runs along the lines of the post-Keynesian literature, it will not be further described here.

A relevant part of the concept is the typology of regimes of growth or stagnation. When looking at developing and transformation economies specifically, as in Priewe/Herr (2005: 58ff.), growth regimes are classified as "growth without external debt", "growth with sustainable external debt", or "growth with unsustainable external debt", while stagnation regimes are characterized as "stagflation", "austerity", "structural non-competitiveness", or "social instability". This typology is rather flexible, offering somewhat different taxonomies in other publications, thus being adjustable to specific country case studies, and especially helpful for a comparative research design.

3. *A methodologically open heuristic approach*

I argue that from both an area studies and a methodological perspective, the macroeconomic policy regime approach is highly welcome as it highlights the relevance of deep and systematic knowledge of specific features of a certain economy, in contrast to purely econometric knowledge, the dominant requirement for economists at the moment.

This goes against standard economic wisdom, which is dominated by formalized models. Yet the implications of a purely formal and econometric approach are severe for several reasons. First, research inescapably has to be driven by data availability. Consequently, where data are missing, research is not possible. This is similar to searching for a lost key only where the light is shining and all the space outside the lamp's ray remains in the dark.

A second implication of the formalization of the economics discipline is that economic contexts, such as institutions and their complex interactions with policies, have to be translated into quantifiable variables, e.g. for describing institutional variety such as the form and degree of independence of a central bank. Instead of describing and analyzing this variety, which might include the multidimensional relationship between a central bank and fiscal institutions on primary and secondary markets for public bonds, or regulation of international capital flows, among other aspects, a formal model has to create proxy variables which translate this institutional richness into quantifiable indicators. In employing such a strategy, empirical content and context are downgraded to "anecdotal evidence", that is to say they are considered inferior in comparison to statistical evidence. For one institution or policy it still may be possible to elaborate on quantifiable variables, based on careful comparative analysis of institutional features, including their changes over time. Yet, this becomes impossible when trying to analyze the interdependency between a whole set of policies and institutions on the expectations of economic agents. Here, econometric models remain blunt, as the complexity

of the interdependence of variables and related problems of endogeneity are left insolvable by formal models.

> "What is generally left of possible relevance in macroeconomics are cross-country regressions a la Barro which, in their more sophisticated manifestations, include relatively crude institutional and geographic variables which, at best, can be called the beginning but not the end of wisdom, i.e., something intermediate is needed beyond such regressions and old-fashioned country studies. (…) While there have been increasing challenges to the universalism of the machinery of neoclassical economics, emanating from an enhanced interest in institutions, behavioral and experimental economics, much of this remains something of a black box, reminiscent of Solow's technology 'residual' and requiring more convincing theoretical and empirical meat on the bones. It should, therefore, be no surprise that there has been increased questioning of the usefulness of economics in the public policy arena" (Ranis 2009: 3).

In this sense, the macroeconomic policy regime approach allows for methodological and disciplinary broadening.

> "While other social sciences have traditionally tried to imitate the methodology of economics, if with a substantial lag, non-economists, especially those in political science, are now ahead of economists in terms of their willingness to move into that no-man's-land between the disciplines and in recognizing that cross-area convergence is but a convenient illusion" (Ranis 2009: 4).

Political science offers important methodological tools for the combination of quantitative and qualitative methods (see e.g. Lieberman 2005). Some of the variables and their interdependence may be grasped by more or less sophisticated statistical instruments, for instance a monetary policy reaction function, which seeks to isolate the impact of monetary policy changes on specific variables such as the exchange rate, inflation and even short term output. Yet, the analytical quality of quantitative analysis will significantly improve if properly combined with a more comprehensive analysis of this interdependence with specific institutions and other policies.

4. Embedded in a Keynesian perspective

However, the macroeconomic regime approach certainly is no eclectic concept driven by nothing but the empirical assessment of institutions and policy outcomes. Here, three features are key. First, the concept departs from the Keynesian axiomatic assumption that uncertainty, and the attempt to reduce uncertainty, drive the behavior of economic actors and the results of their interaction.

This point is intrinsically linked to the Keynesian assumption that economic actors assume future development resembles the past, unless there are structural breaks.

> "In practice we have tacitly agreed, as a rule, to fall back on what is, in truth, a convention. The essence of this convention – though it does not, of course, work out quite so simple – lies in assuming that the existing state of affairs will continue indefinitely, except in so far as we have specific reasons to expect a change" (Keynes 1936: 152).

Second, the approach explicitly covers the interaction of the real and the monetary sphere.

> "The strength of the economy (say, in terms of real GDP per capita) depends to a large extend on a functioning monetary and financial system based in well-accepted local money" (Priewe/Herr 2005: 46).

Thus, the approach is especially capable of addressing problems as they emerged in the Great Financial Crisis, a situation which is not covered by most of standard economic models which focus on the real sphere.

Third, the concept of a macroeconomic policy regime assumes that the establishment of monetary stability is far from being sufficient to assure growth, as uncertainty undermines market coordination towards equilibrium with full employment. Thus, the state should take an active role in several kinds of economic policies. Specifically, monetary, exchange rate, fiscal, labor and sectoral policies should be coordinated to assure monetary and financial stability as well as sustainable growth and employment.

5. *Relevance of highlighting interdependence of domestic and global regimes*

As stated at the outset, I interpret the macroeconomic policy regime as (being) an analytical tool to intermediate between the global and the national perspective.

In most of the work related to this concept, Herr focuses on national policies. This may be explained by his engaged interest in policy advice for optimal policies. For this purpose, the scale for analysis unavoidably has to be the domestic sphere, as the nation state is the main actor being addressed.

Yet, it is possible to integrate the global perspective into this approach so as to elaborate on how global conditions concretely shape and delimit policy space and specific policy regimes at the national level. When looking at the above mentioned classification of growth and stagnation regimes for developing and transformation countries, avoiding unsustainable external debt, denominated in foreign currency, turns out to be the key variable for a growth regime. Behind this is the understanding of a hierarchical and asymmetric global monetary order where the competition between currencies results in a pattern where only a small number of countries are able to contract debt at the global level in their own money. The majority on the other hand, especially emerging market and developing economies, are forced to contract debt in other countries' currency. This hierarchical nature of the global monetary system and its changes over time have not only been analyzed by Herr (e.g. 1992). Eichengreen and Hausmann for instance, based on an empirical assessment of currency denomination of international financial contracts, have introduced into the economic mainstream the label of 'original sin' (Eichengreen/Hausmann 2005); in the field of International Political Economy, Cohen (1998, 2004) has established the concept of a 'currency pyramid'.

The fundamental implications of this global currency hierarchy on domestic policies, which depend on the position of a country's currency, have received some formalization by Riese (2004/1993). He offers a similar approach for developing a typology of growth and stagnation regimes against the backdrop of the hierarchical global monetary order, enriched by a simple yet convincing formalization of the equilibria condition for the foreign exchange market for the case of currencies at the lower stratum of this hierarchy. Departing from a difference in the liquidity premium among currencies, he deduces the necessity for a difference in terms of interest rates and profit rates. A similar approach, with links to the Latin American structuralist literature, is offered by Paula et al. (2015). Fritz et al. (2016), for their part, seek to organize concepts of developmentalist strategies combined with redistribution under the policy space constraints for emerging markets imposed by an international monetary asymmetry. In a similar vein, literature on the asymmetric patterns of global trade between center and periphery countries could be included in the analysis.

This perspective opens a promising research field. Bringing together in a more systematic manner the strands of literature on the hierarchical nature of the global monetary regime and related issues, and those on the interdependence between a broad set of policies and institutions at the domestic level, e.g. the macroeconomic policy regime, will certainly help to increase our understanding of the puzzle of stagnation and underdevelopment. And it can enhance our understanding of the limits and specific challenges for the design of adequate policies at the nation state level by concurrently taking into account the interdependence of global limitations and domestic policy space.

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