

Comments on Banerjee, the Illusion of Macroeconomics

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Brookings

It is not clear to us that the best way to get growth is to do growth policy of any form. Perhaps making growth happen is ultimately beyond our control. Maybe all that happens is that something goes right for once (privatized agriculture raises incomes in rural China) and then that sparks growth somewhere else in economy, and so on. Perhaps, we will never learn where it will start or what will make it continue.

Banerjee

- (1) Macroeconomists have failed to find a reliable way to raise medium-run growth rates.
- (2) Should concentrate only on micro interventions that are shown to directly help people.
- I agree totally with (1), but that was an unrealistic expectation of macroeconomics.
- There's a big difference between (1) and "macroeconomics is useless", so (2) does not follow.

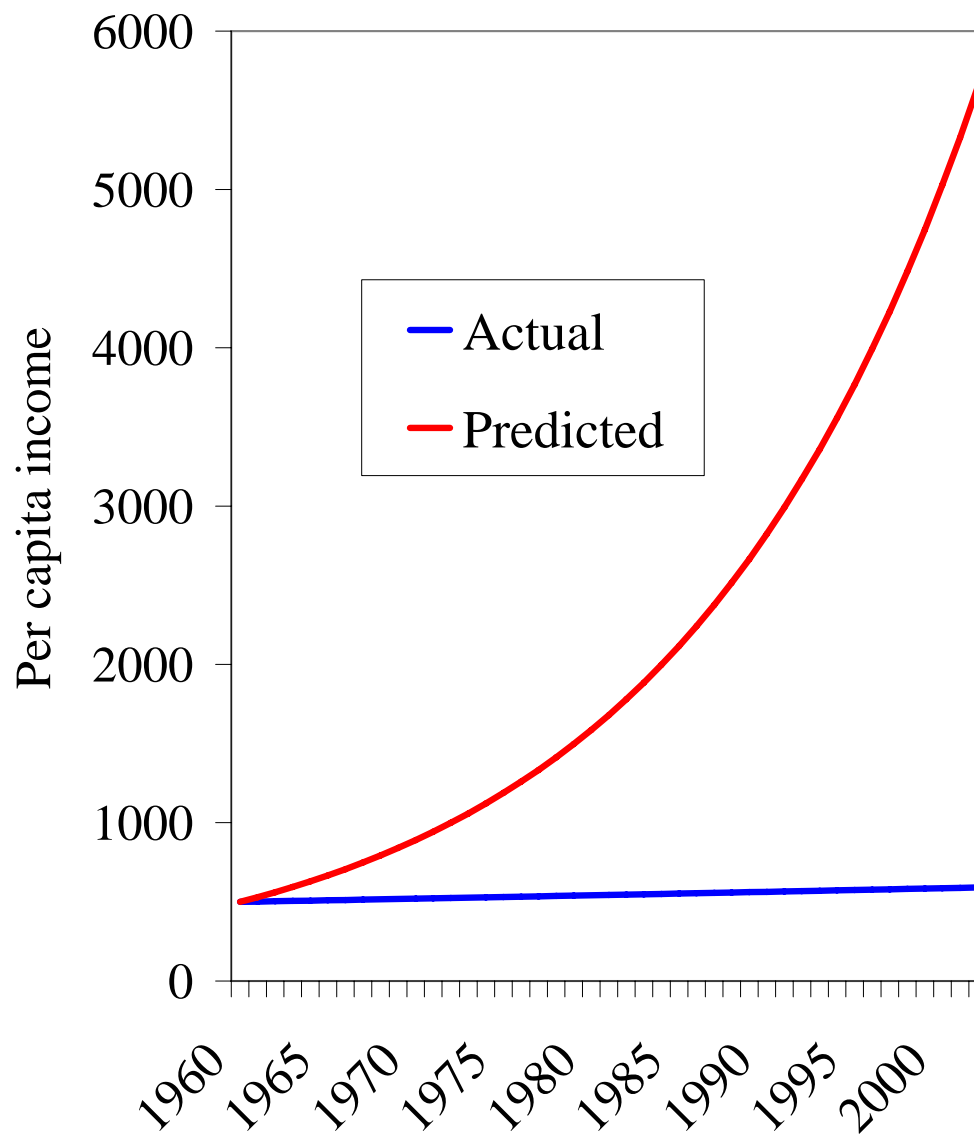
Macroeconomists themselves have made a case for point (1)

- (1) Failure of Big Push models of foreign aid to raise growth
- (2) Failure of structural adjustment/Washington Consensus to raise growth
- (3) Failure of shock therapy to promote smooth transition from Communism to capitalism

Evidence

- Evidence on big grandiose schemes to raise growth is not fully satisfactory, because it is intrinsically hard to evaluate them...
- ...which is another reason not to do them, since they may have large consequences that are either positive or negative
- What stylized evidence we do have raises alarm bells.

Actual growth in quarter of countries with highest foreign aid compared to predicted growth by "Big Push" model



Pointing out the failure of grandiose schemes to raise growth is...

- ...a constructive contribution of macroeconomists,
- because it would save a lot of wasted money and effort on futile and possibly counterproductive plans, like the Big Push of aid, structural adjustment and shock therapy.

Contributions of macroeconomics

- Specific advice on managing budget deficits and public debt, avoiding debt crises, controlling inflation, managing real exchange rates, deregulating banks, ...and many more.
- The insight that lack of knowledge on how to direct growth is a reason to design institutions that don't require such knowledge.

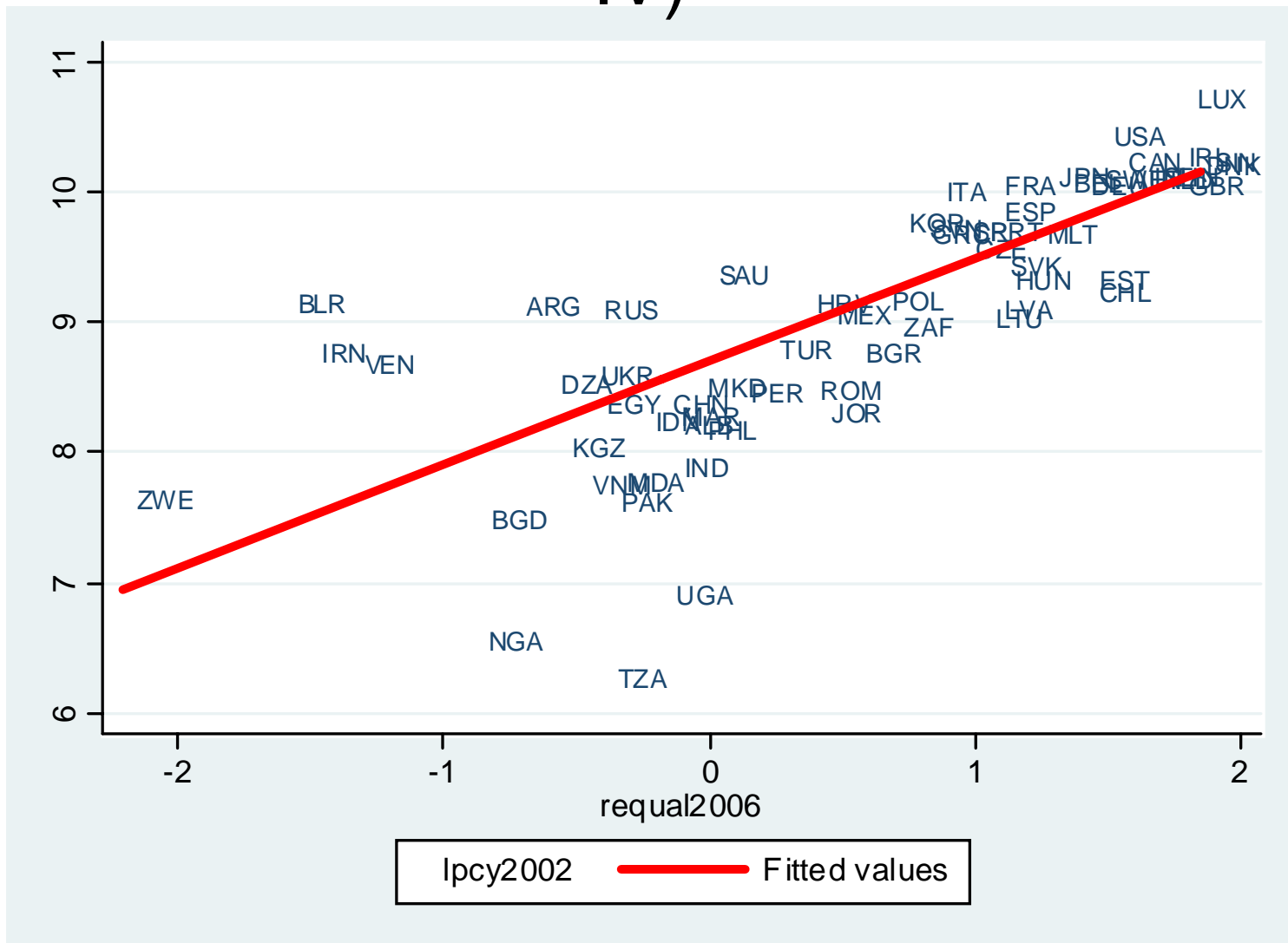
Although we don't know how to raise growth, societies still do have to choose economic systems

- Since knowledge on how to direct the whole economy is missing, maybe want a system that takes advantage of decentralized knowledge.
- Since it is hard to identify effects of programs and products on individuals, maybe just let individuals choose programs and products
- Maybe want a system with consumer choice, entry and exit, competition, decentralized and competitive innovation, entrepreneurs, decentralized financing system for entrepreneurs, freedom to complain to politicians who have to take complaints seriously, voter feedback

Systems

- Sounds a lot like markets and democracy
- Evidence is supportive of these systems in LEVELS, not in growth rates.
- We don't know much on how to make transition to have more market and democratic freedoms (recall failure of shock therapy)...
- ...but evidence supportive that attaining something like these systems will pay off in the long run.
- Macroeconomists like Friedman and Hayek predicted failure of central planning, and then this prediction was confirmed by events.
- This evidence was convincing enough to cause Ex-Communist countries to switch to Capitalism.

Market institutions correlated with per capita income (holds up with somewhat dubious IV)



Role of macroeconomists

- Advice on macroeconomic stabilization – fairly successful track record (but NOT because of World Bank/IMF structural adjustment, which is not supported by evidence)
- Macroeconomists still have a “Big Ideas” role in discussing alternative long-run systems for development – markets vs. central planning, African/ Arab/ Latin/ Hindu/ Maoist/ Leninist socialism vs. democratic capitalism, not as ideologues but as evidence-based pragmatists.