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Market Process-oriented Microfoundations for Global Macroeconomics – The Role of Capital and Interest

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100 YEARS
UNDERSTANDING
AND SHAPING
THE GLOBAL ECONOMY



Outline

- Motivation and classification
 - What microfoundations?
 - Why market process-oriented?
 - ⇒ Contribution to methodological diversity (paradigmatic talk)

- Capital and interest
 - Production: Capital-based and consumption-driven
 - Interest: Pure Time Preference and Loanable Funds
 - ⇒ Role of time in macroeconomics (intertemporal links)

- Applications and research
 - Linking financial/monetary sphere and real economy
 - Production possibilities, path-dependencies, and crises
 - Global perspective and top-down-approach
 - ⇒ Towards a coordinationist paradigm of macroeconomics



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Microfoundations for macroeconomics

- One economic process
 - Micro level: Economic mechanisms and individual decisions
 - Macro level
 - Mismatches on micro level show up as „imbalances“
 - Universal drivers (permeating into all micro markets)

⇒ Macroeconomics: Evidence for systematic misallocation of resources?

- Universal drivers
 - Money (medium of exchange)
 - Interest (price of time)
 - Capital (means for intertemporal coordination)
 - Labor
 - Policy

4

⇒ **Systematic micro disruptions as macro symptoms**



Market process view

- Disequilibrium approach
 - Menger/Hayek vs. Walras/Marshall tradition
 - “homo agens (HA)” vs. “homo oeconomicus (HO)”
- Role of entrepreneurs
 - Uncertainty: speculation, search, and discovery (HA as explorer)
 - Universal arbitrageurs: investment as intertemporal arbitrage
- Dynamics and time
 - Permanent adjustment process rather than sequence of equilibria
 - Market system as feedback mechanism (ex-ante and ex-post prices)
 - Time cannot pass without modifying knowledge (Hoppe, Lachmann)
- Value theory
 - Subjectivist perspective
 - Reverse value imputation (from ends to means)
- Prices as knowledge surrogates
 - Distorted price structures/monetary calculation vs. price level movements
 - Non-neutrality of money (Cantillon effects matter)



Macroeconomics and terminology

- Risks of macroeconomic misperceptions
 - Aggregating/averaging the problems away (e.g. aggregate production function approach)
 - Losing touch with microeconomic principles (e.g. key role of price mechanism)
 - Over-interpreting national accounts concepts (e.g. identities tell nothing about causality)
 - Ignoring production structures (netting out intermediate consumption)

- Language (terminology) and reasonings (theory)
 - Words can be misleading
 - Wording matters



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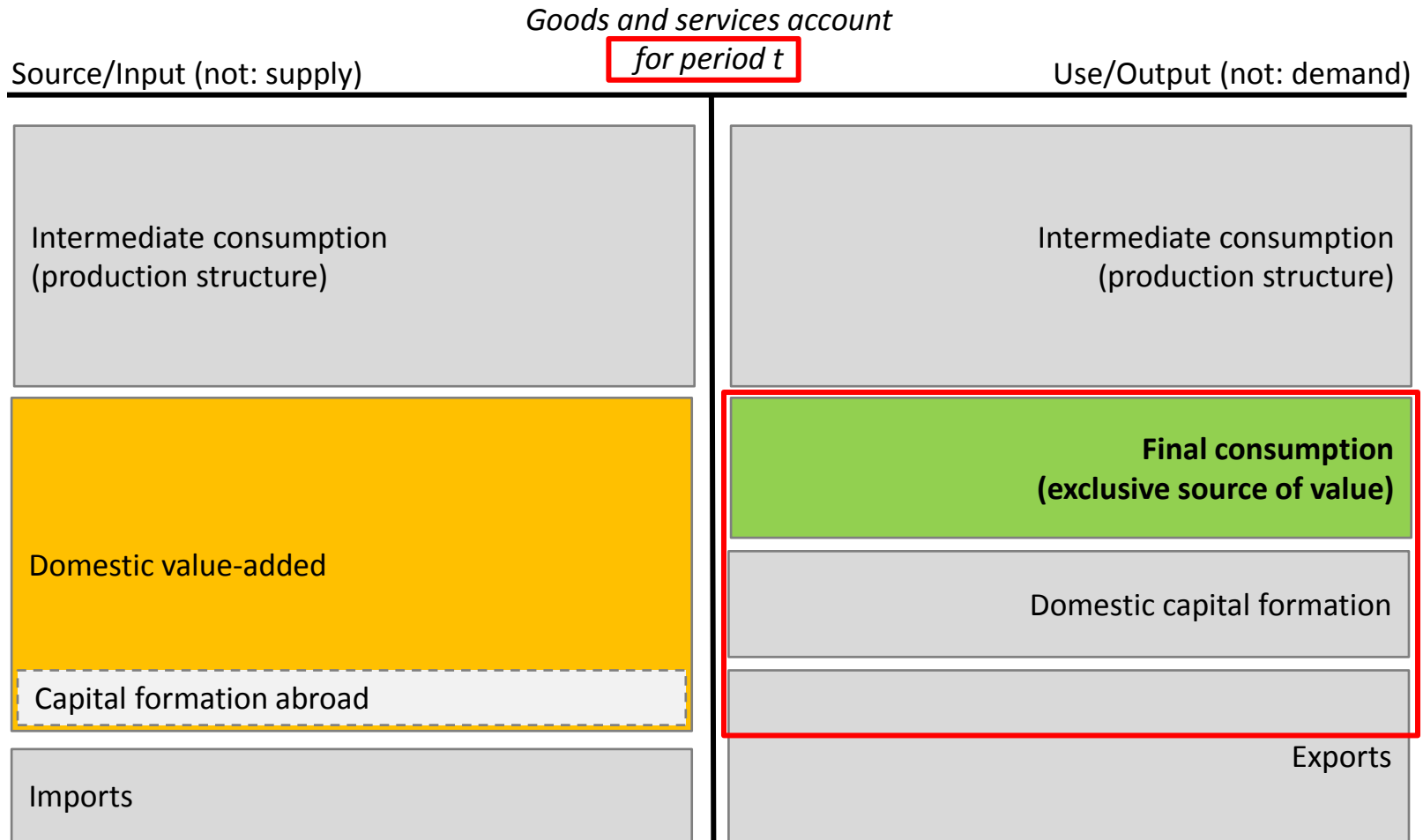
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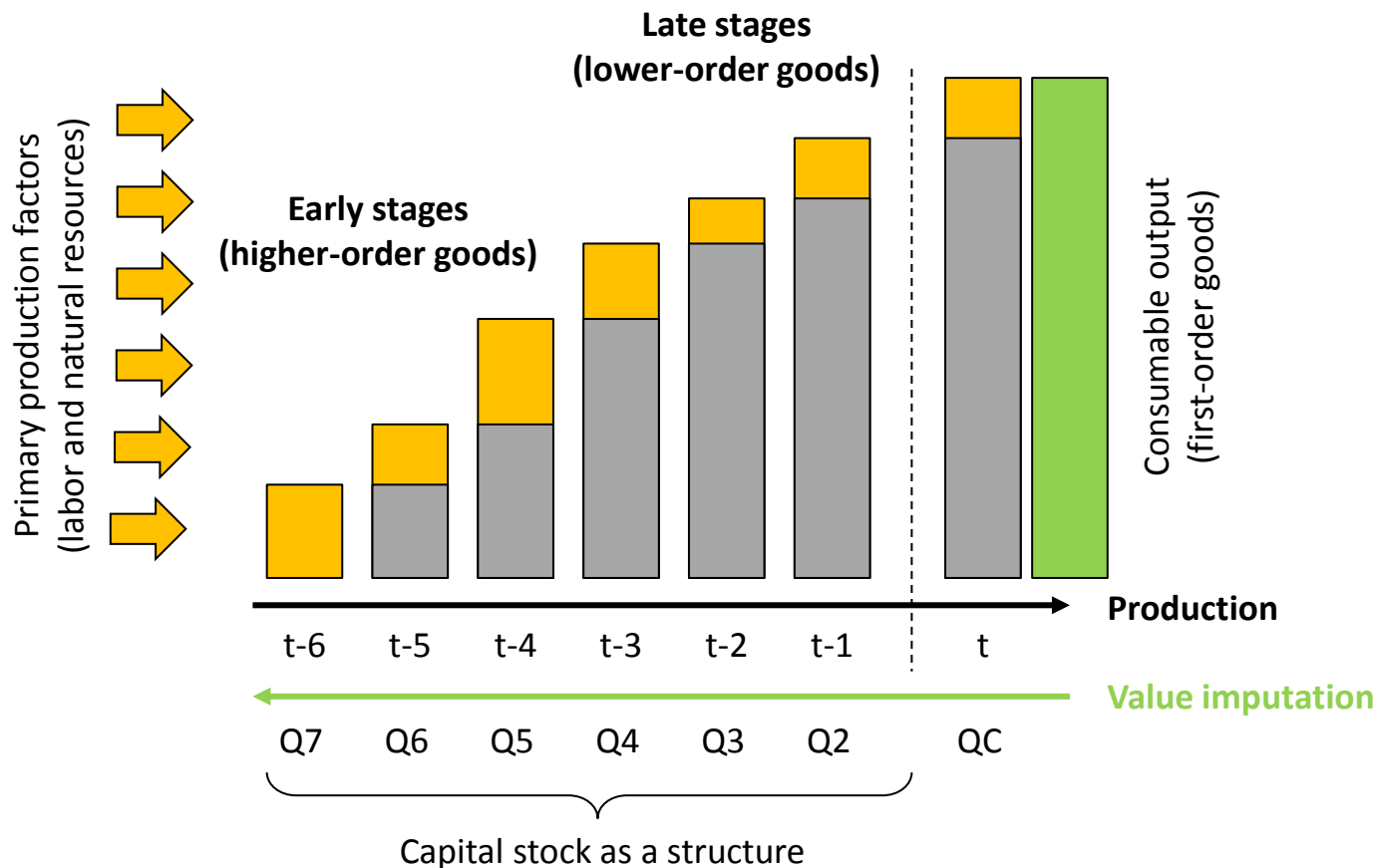


“Final aggregate demand”: No demand and not all of it is final



**„Final“ use of domestic production
(only with respect to period t)**

Production: time consuming, multi-stage process



9

⇒ Capital formation: intertemporal intermediate consumption (higher-order goods transforming into first-order goods)



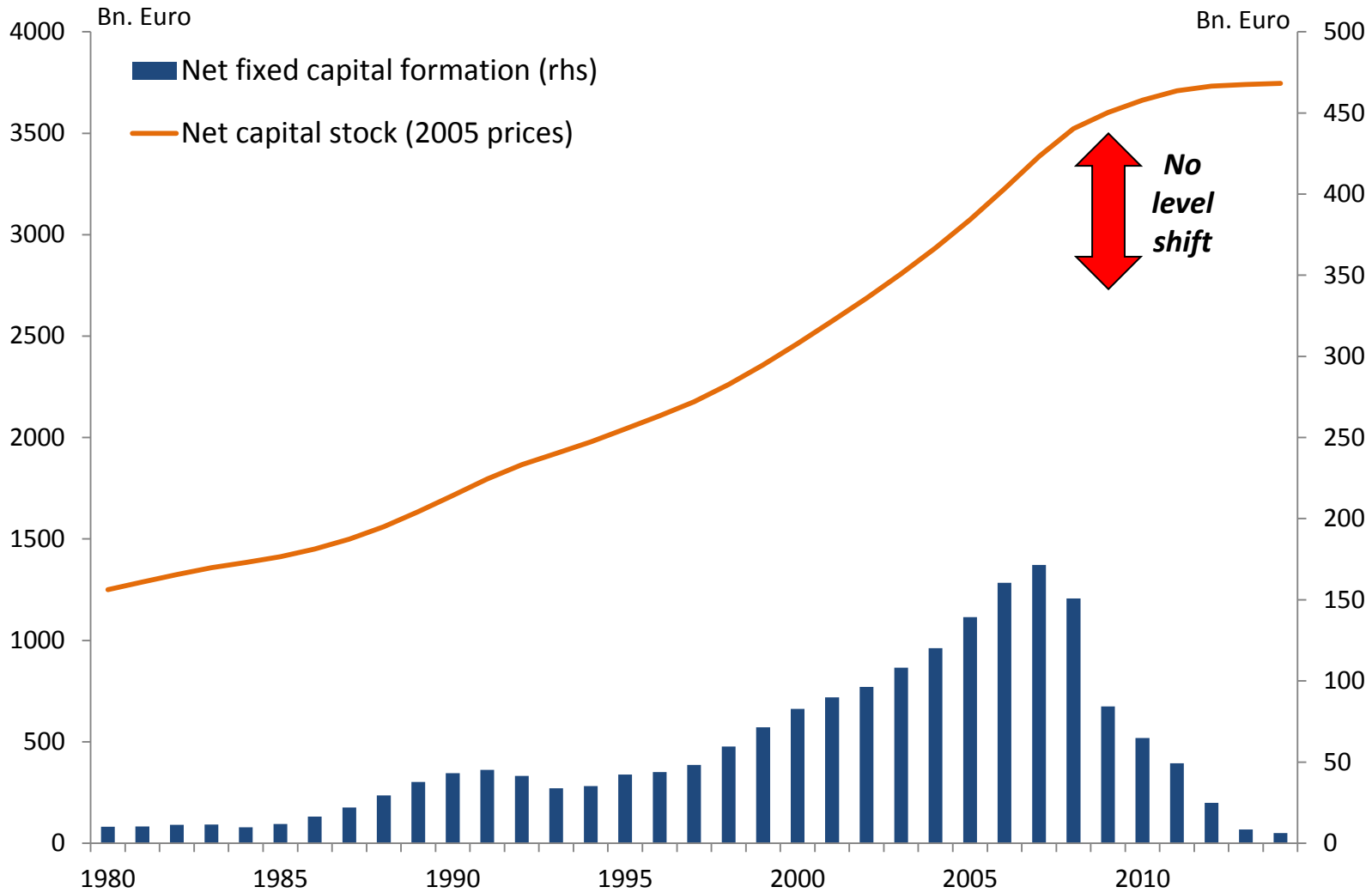
Capital

- Capital as intentionally produced productive means ...
 - ... not a disembodied abstraction or homogenous aggregate
 - ... nor a self-perpetuating (“Knightian”) fund
- Structure of heterogeneous goods
 - Limited convertibility and recombination losses (when reallocated to formerly second-best uses)
 - Capital as a structural pattern:
“The theory of capital is, in the last resort, the morphology of the forms which this pattern assumes in a changing world.” (Lachmann)
- Value dimension:
 - Ability to allow individuals to more readily realize their plans rather than physical characteristics or physical history
 - “Unfinished entrepreneurial plans” (Kirzner): Capital goods must be assessed in light of their usefulness to those plans

10

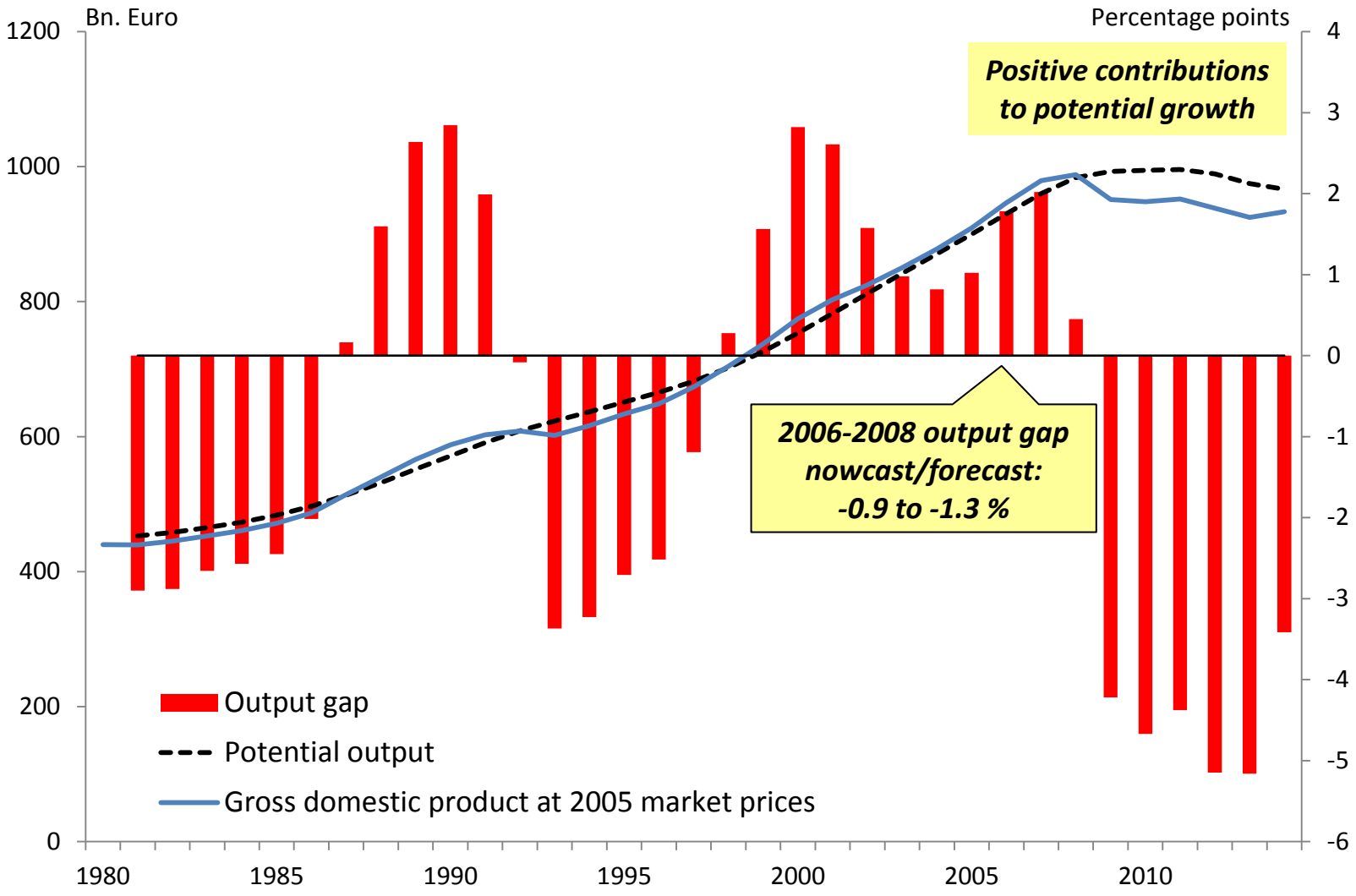
⇒ **Missing link between micro and macro level (Skousen)**

Value of the Spanish capital stock?



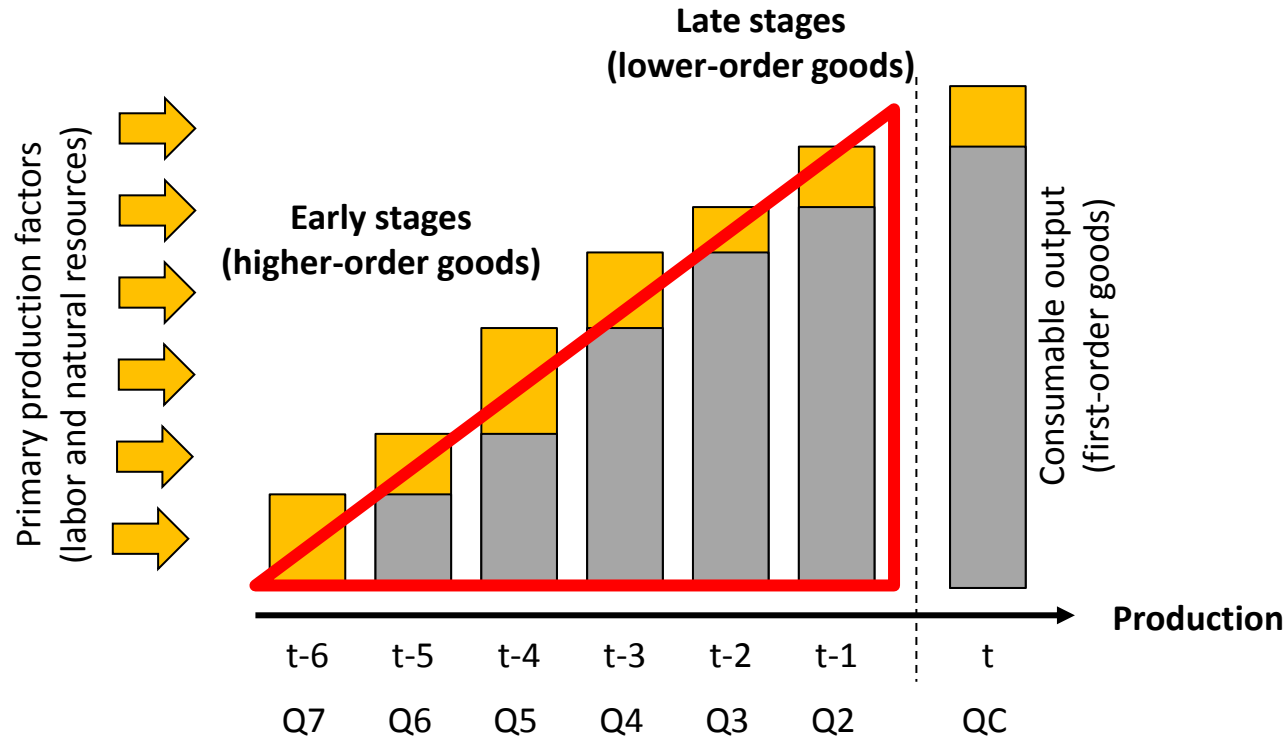


Spain: No negative impact of capital stock distortion ("ghost estates") on potential output?



Source: European Commission, AMECO and CIRCA databases.

Production: The Hayekian triangle



13

⇒ What determines the number of production stages/shape of the Hayekian triangle?



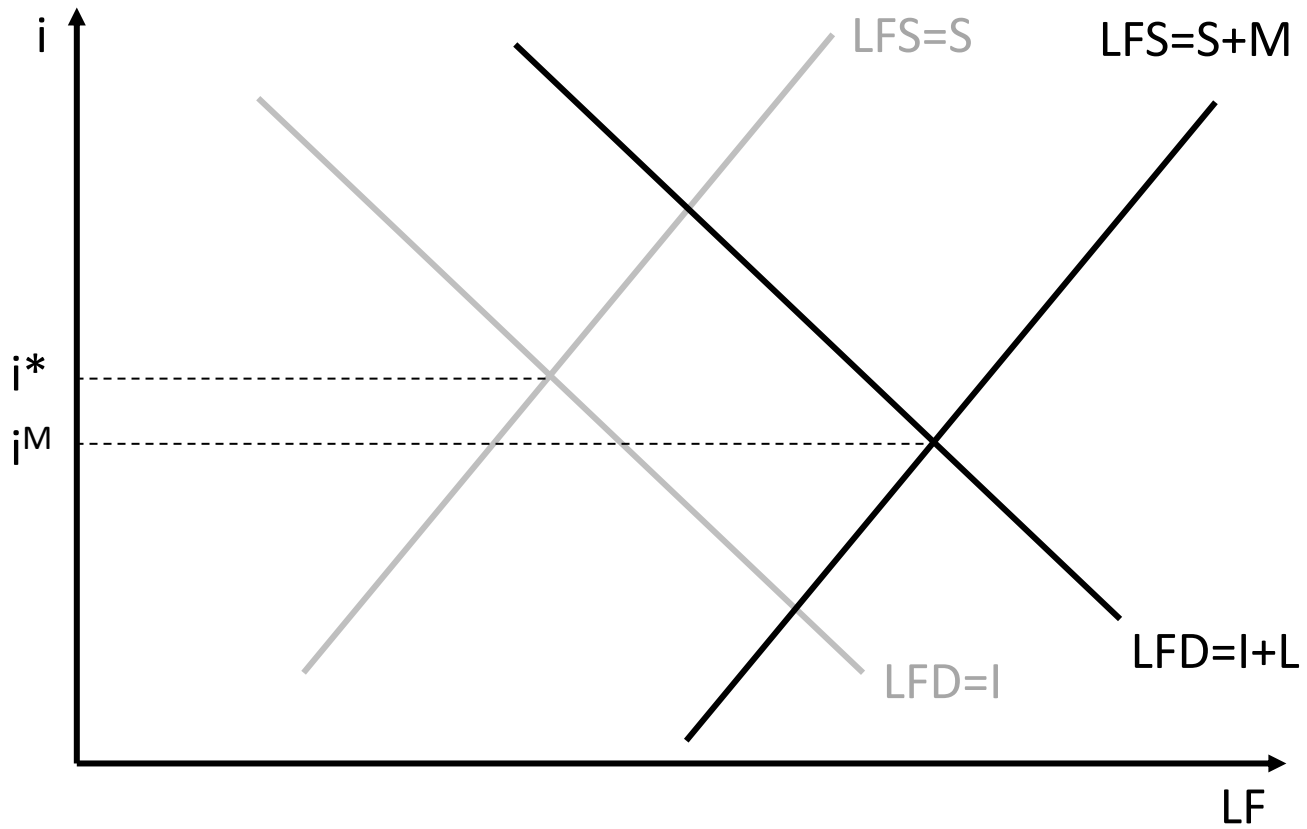
Interest

- Interest as a value phenomenon
 - Expression of time preference
 - Price of future goods relative to present goods
 - Discount rate interwoven in the entire price system
- Capitalization theory (Fetter): Interest vs. price of capital
 - Productivity of capital reflects in price of capital goods, not in interest rate
 - Valuation of reproducible capital pushed backward to primary factors (durability matters, not reproducibility)
 - Price of capital = present value of future income streams
- Interest and “roundaboutness of production”
 - Capital-intensity increases productivity of labor
 - Choice of more roundabout production schemes depends on time preference

⇒ Pure time preference = market rate of interest?



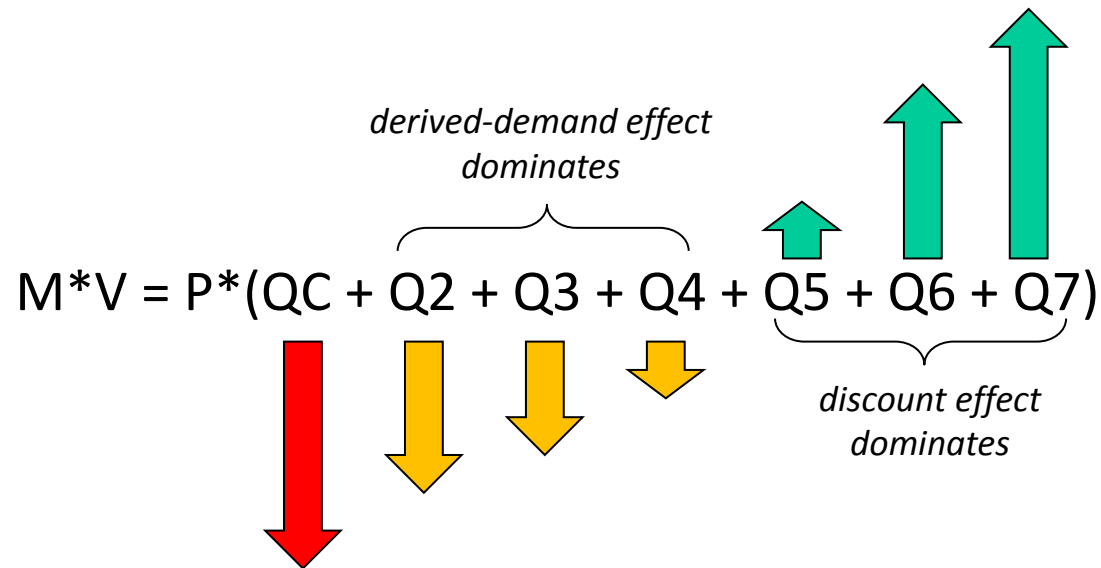
Interest rate and market for loanable funds



Coordinating saving and investment

- Saving

- Saving up for something: Future demand, not a leakage
- Derived-demand and discount effect

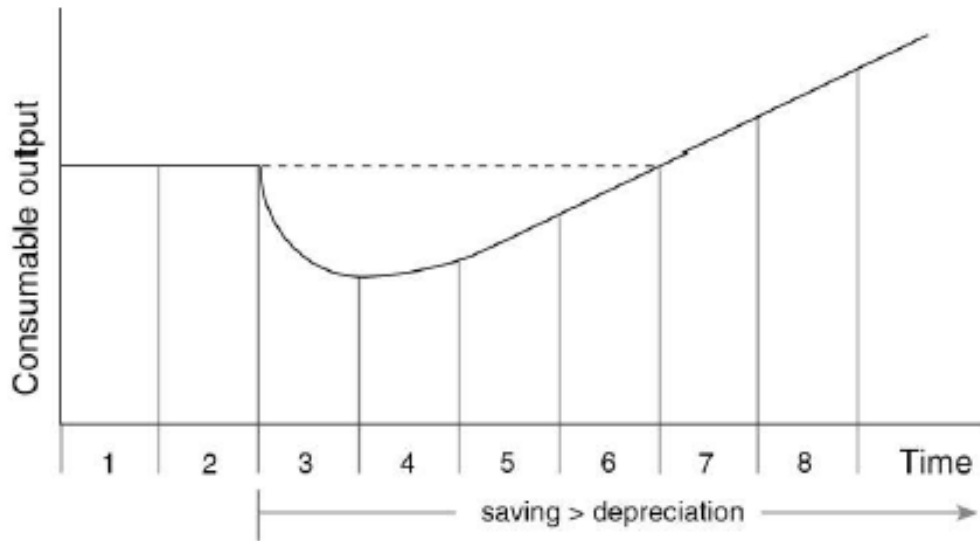
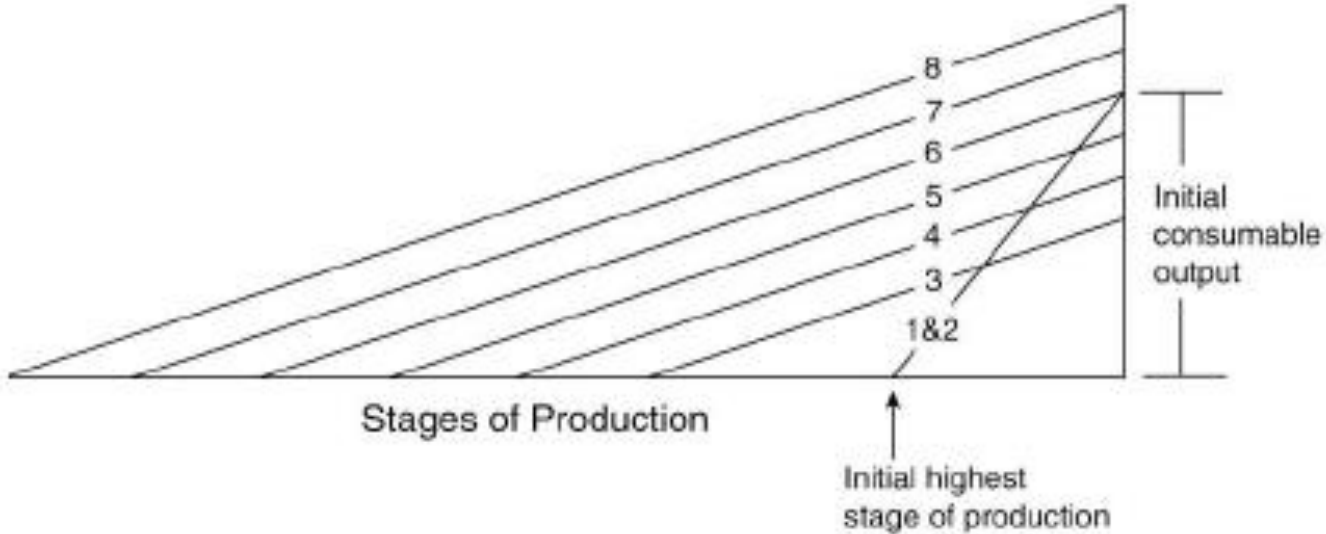


- Investment: Stage pattern matters (not volume alone)

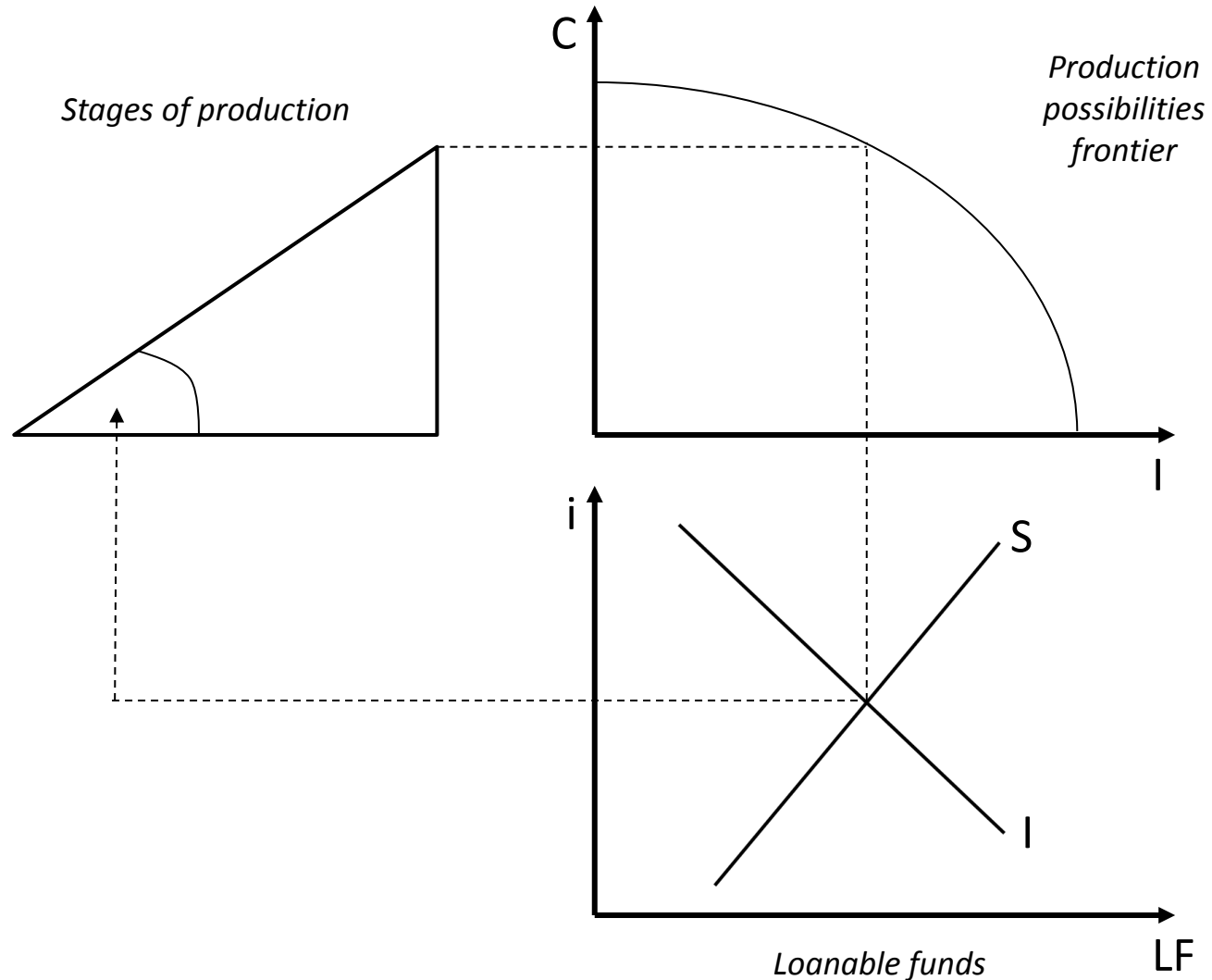
⇒ Entrepreneurial challenge: bringing capital structure in line with pure time preference (intertemporal arbitrage)



Saving and growth



Capital-based macroeconomic framework





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 - ⇒ **Towards a coordinationist paradigm of macroeconomics**



Applications (1/2)

- Potential production/output gap estimations
 - Disaggregated approaches (marketable production possibilities)
 - Market revaluations compared to national accounting data

- Capital stock distortions as flipside of financial crisis
 - Repairing intertemporal discoordination problems
 - New light on “austerity” debate

- Non-neutrality of money/monetary policy
 - Monetary theory of the business cycle (systematic investment failures due to excessive credit creation)
 - “Capital gives money time to cause trouble” (Garrison)
 - Scenario of globalizing monetary policy (multilateral swap agreements)



Applications (2/2)

- International macroeconomic imbalances
 - Current account vs. financial account (capital vs. trade flows)

- Global macroeconomic imbalances: The savings glut debate
 - Negative natural interest rates ahead?
 - Need for more public debt to fill the global “investment gap”?

- Global business cycle and regional/national impact
 - Top/down view:
Economic activity within countries derived from global dynamics
 - National specialization and impact of capital restructuring



A coordinationist macroeconomic paradigm

- Key research and policy question:
Evidence for hampered market coordination processes?
 - Coordination efficiency vs. macroeconomic management
 - Important role of intertemporal coordination (capital and interest)
 - Path-dependency of economic activity via capital allocation

- Beyond the demand-side vs. supply-side controversy
 - Coordinationist macroeconomics is not a cheerleader for growth
 - Intermediary step to linking macroeconomics and well-being
 - Overcoming the production-biased view
(production serves consumption, not vice versa)
 - Putting consumers/households back in the center
 - Value theory remains key pillar
(whether preferences are exogenous or endogenous)

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