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Diane Coyle is a professor of economics at the [University of Manchester](http://www.manchester.ac.uk/research/Diane.coyle/) and runs the consultancy [Enlightenment Economics](http://www.enlightenmenteconomics.com/). Her latest book is [GDP: A Brief but Affectionate History](http://www.amazon.co.uk/GDP-Brief-but-Affectionate-History/dp/0691156794/ref=sr_1_1?s=books&ie=UTF8&qid=1392737076&sr=1-1&keywords=diane+coyle+GDp)

[**Macroeconomics without the blinkers**](http://www.enlightenmenteconomics.com/blog/index.php/2015/01/macroeconomics-without-the-blinkers/)

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Why was the 2008 Global Financial Crisis such a surprise to a surprising number of economists? A new book, [amazon\_link id=”026202859X” target=”\_blank” ]Understanding Global Crises: An Emerging Paradigm[/amazon\_link] by Assaf Razin, suggests one reason is the mental blinkers imposed by the real business cycle worldview, whereby productivity shocks and nominal wage stickiness accounted for most cyclical fluctuations – as long as monetary policy was sensibly guided by a rule that avoided policy shocks. That complacency (as it turned out) has of course evaporated, leaving instead agreement about some aspects of the macroeconomic problem – the zero lower bound problem and role of “unconventional” QE – and wild disagreement about fiscal policy.

[amazon\_image id=”026202859X” link=”true” target=”\_blank” size=”medium” ]Understanding Global Crises: An Emerging Paradigm[/amazon\_image]

The book starts with a history of the financial crises of the 1990s and 2000s – and you only have to see that history (the Asian crisis, LTCM, the dot com bubble) to be puzzled anew by the widespread belief in permanent stability by the mid-2000s. The second part looks at the various sources of financial fragility: asymmetric information, risk-shifting and risk-taking, excessive optimism, and co-ordination failures. This section presents a model of the optimal amount of insurance against risk-taking financial institutions, taking account of the moral hazard and adverse selection problems. The third section turns to currency and balance of payments crises, and the Eurozone’s unpalatable choices. It is a relatively short book covering in a very elegant way a lot of theoretical and historical territory.

The book concludes that some vital questions remain unanswered by the latest dynamic general equilbrium models it presents – including the most bitterly-disputed policy questions: when should fiscal austerity be implemented to reduce debt levels and unfunded demographic liabilities; when should monetary policy start to be tightened; when does the need to stabilise the financial system outweigh the risks of moral hazard.; and how should monetary policy take account of asset price bubbles during the zero/low interest rate period? These seem pretty fundamental, which I suppose will keep macroeconomists busy for some time.

The book is based on courses Prof Azin has taught since the crisis, and is geared towards a graduate student audience, so it is not one for the general reader interested in the sorry state of the global economy and financial markets, post-2008. It looks like a must-read for relevant courses, however. To me – with a foot in the academic camp but not remotely expert in global macro or finance – it also looks like it’s retrofitting economic theory to events. It is good to have it demonstrated so clearly, as many macroeconomists have assured me, that macro models can accommodate the kinds of event we have experienced in life. But it leaves unanswered the original puzzle – why did so many macroeconomists wear the real business cycle blinkers in the first place?