

Funding the Future

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I read with interest [an article that Simon Wren-Lewis has published this week](#). In it he says:

I want to talk about the latest Oxford Review of Economic issue on 'rebuilding macroeconomics', and particularly the first article by David Vines and Samuel Wills. The first thing I want to say is that the title is pretentious. Academic macroeconomics is reasonably happy doing what it is currently doing and in that sense there is nothing to rebuild. A better title is future directions for macroeconomics.

I suspect Simon is right: macroeconomics has always had a remarkable ability to be conceited despite its very obvious failings. But the next paragraph is the more important:

The Vines and Wills article suggests two major changes in direction. The first, following Blanchard, is to partly reverse the microfoundations hegemony, by allowing models or parts of models that don't include microfounded models routinely back into the top journals. The second is to focus on models that allow more than one long run equilibrium. I will take each in turn.

Simon then discusses these two issues and I recommend reading what he has to say. What I want to do is pull back further than he did and point out the absurdity of the claims that are being discussed. Simon remains too close to macro to do so, I think, and I stress I am not offering criticism when saying so.

The two claims being discussed are so absurd it is staggering that they need be considered. What is being said is not that the macroeconomy is, in fact, simply the aggregation of the microeconomy, although that, of course, would be wrong in itself. What is being said is that macroeconomics must be based on microeconomics or it is not considered suitable for discussion in peer-reviewed journals, whilst it also almost always assumes that there is one optimal solution to all economic problems.

Let me address the two issues, separately, and then together. Firstly, the presumption that there must be a microeconomic foundation to macroeconomic theory is simply to say that macro must be based on the critical assumptions that underpin micro that are

intended to ensure that it can deliver mathematical solutions to problems too complex in reality to be subject to sensible mathematical analysis.

So, macro must presume perfect knowledge of both the present and future, perfectly competitive markets where no one participant can influence prices, perfect access to capital that is available to all who want access to it, and of course an absence of externalities.

And before anyone says both macro and micro can manage deviance from these assumptions, of course I know that. But the point is it considers any situation where such things do not exist to be deviant. And that is wrong. In the real world none of these conditions even remotely exist. Something that even approximated to them would actually define deviance in reality.

But macro is built on these foundations. And the reason is linked to the second issue Simon challenges, which is the general requirement within macroeconomics that models be built where there is just one optimal or equilibrium scenario. That this is, by some odd fluke, one where the conditions that supposedly underpin microeconomics prevail in society, and pure markets meet all need with minimal government interference, with all consequences of all actions arising in the present point in time, is just one of those strange coincidences macro ignores as it pretends that this is not its pre-ordained outcome.

What, I suggest, Simon should have been saying is that macroeconomics is as rigged as recent government reports on policing and institutional racism were rigged to provide pre-ordained outcomes, because that is the reality of the current state of theoretical macroeconomics.

This is why what I do is, I suggest something else. I happened to touch on this theme in the introduction to 'Money for nothing and my Tweets for free', written this week, where I say, having discussed the weaknesses in macroeconomics:

My approach is, then, to look at the real world first, and to use the insights that theory provides to mould what I believe are pragmatic answers that can exist within the real constraints that society imposes (rightly or wrongly) to provide workable solutions to the actual problems that we face. If that tramples on any theoreticians' toes, so be it.

This conflict with pure theory is almost inevitable, anyway. That is because what I do is applied political economy, and not economic theory. In applied political economy, unlike economics, there is no assumption that there is an ideal form of economy. Market fundamentalists and hardcore socialists will, in that case, be disappointed by my approach. I believe in the private sector, whilst recognising that it is riddled with faults. I also think government is a fantastic tool for delivering many of the things that we need. It just so happens it can also fail to do that. I can live with the paradoxes and inconsistencies. Day-to-day we all do.

What that means is that instead of looking for perfect theoretical worlds, in applied political economy the question is, very often, why do we fail? The answer invariably comes down to the fact that we're human. We're not good at a number of really important things. Complexity is one of them. Pragmatism is another. Compromise is a third. Managing uncertainty is a fourth. We also suffer a number of self-limiting traits. Vanity, greed and belief in our own importance rank high amongst these, and I will acknowledge straightaway that I have been accused of all three before anyone does so for me. These things are the given truths of applied political economy for me. They mean that things will go wrong.

And the distribution of income and wealth and so power in society, which is a given in society at any point in time, has the marked propensity to make things worse, meaning it too is a significant factor to take into account in applied political economy.

My point in saying this is to suggest that economic theory is not always a great tool, by itself, to suggest a way out of the resulting mess. That mess is too complex in its nature and its extent to be captured within any one theory. Nor is any theory necessarily very enduring, because the reality is that the mess we humans create appears to be endlessly capable of adaptation. The emergence of the climate crisis is evidence of that, and changes pretty much every assumption we have made to date.

What I am suggesting, in that case, is that there is no perfect solution to an economics problem. I would have thought we should have learned that by now, but apparently not. Instead economics, on both the left and right, still pursues the idea that there is some 'ideal state' to which we are headed, whether it is the pure market economy or socialism, or some other 'ideal'. That though, is not true. Not only does no such ideal exist, as indicated by the fact that all of them have their opponents, but nor are they possible. And the idea that these mythical ideals represent some sort of economic nirvana is in any case just wrong: the propensity for human error will be just as strong in an ideal state as it is now, and without the moderating common sense that is essential if an economy is to work. That is why I look for practical answers to current questions, rather than seek to promote a theory. What I seek to do is mix an understanding of theory with a dose of experience to which I add a portion of ethics to suggest solutions.

The question is what is more useful? Is it macro, based in micro, that is rigged to always suggest pure marker solutions to problems, because that is all it is programmed to deliver, or applied political economy that is intended to find workable solutions to real world problems? I think you can guess my answer to that.