





























		The Evolution of Macroeconomics: Between Phase II an	d Phase III
Тн	ЕL	UCAS CRITIQUE	
	Cru	cial inconsistency in Keynesian macroeconometric appro	bach
This "problem" was always		The estimated coefficients (the alpha's) themselves may chang policy (monetary and/or fiscal) changes!	ge if
present, but didn't reveal itself until the 1970's		In which case the macroeconometric approach <u>cannot</u> usefully policy advice – unless one "knows"/makes assumptions about alpha's themselves depend on policy	give how the
	Dis tur	covered in the 1970's amidst world-wide macroeconomi bulence induced (seemingly) by the two oil crises	c
		The usual Phillips relation "stopped working" even as policy-m tried harder than ever to exploit it	akers
		Led to breakdown of existing macroeconomic theory and open door for a complete re-thinking of the basic tenets of macroeco	ed the onomics
	Key	ynesian macroeconometric models are <u>not economic mod</u>	<u>dels</u>
		Merely a statistical description of historical events	
		Economics: the study of how incentives influence behavior of individuals/market participants	
		A damning criticism of the entire macroeconomics profession	
Sept	tember	1, 2011	16



	The Evolution of Macroeconomics: Phase I
Τн	E REBIRTH OF MACROECONOMICS
	"Macroeconomics" born as a field during and because of the Great Depression
	 Idea that government could/should regulate the periodic ups and downs of the economy rose to prominence
	John Maynard Keynes, <i>The General Theory of Employment,</i> Interest, and Money (1936)
	Basic tenet: various "rigidities" in many markets lead to "disequilibria that can last a long time
	Burns and Mitchell, Measuring Business Cycles (1946)
	 First systematic accounting of the co-movement of various aggregates i.e., GDP, consumption, employment, inflation, unemployment rate, etc
	How to "model" (i.e., conceptually/rigorously/mathematically think about) business cycles?
	Phase II: The large-scale macroeconometric models
	Death knell snelled by the devastating Lucas Critique

Kydland and Prescott (1982), Long and Plosser (1983)						
A dynamic general equilibrium (DGE) view of business cycles						
A "real" business cycle (RBC)						
TFP shocks the driving force, not policy shocks						
Business cycles are efficient and "natural"						
 so macroeconomic policy aimed at stabilizing cycles is unimportant/misguided 						
An economic theory, not a statistical theory						
Building blocks						
Consumer preferences (utility functions)						
Production technology (the microeconomics of how firms produce good						
Interactions through markets (goods, labor, and financial markets)						
The "alpha's" are functions of policy variables (if policy variables present in the model)						
thus immune to Lucas Critique (?)						
Foundation is the Solow neoclassical growth model						



					The Evolution of Macroeconomics: Phas	se III		
Pri		IPLES	of RI	BC M	ACROECONOMICS			
	Basic Tenets							
		Markets (operate p	erfectly c	ompetitively (a metaphor)			
		Price rigi from Key	dities/inf nesian pr	flexibilitie rinciples	s are <u>not</u> very important – conceptual br	eak		
		Model the relations	e econom hips – me	ic interac thodolog	tions, not merely the statistical ical break from Keynesian principles			
	Which types of events are important shifters of economic activity?							
		TFP shift	s (not pol	licy – ano	ther conceptual break from Keynesianisi What's "left over" after accounting for what we can account	n) nt for		
	How prod	w to measure TFP? As a residual, using the Cobb-Douglas oduction function $output = A f(k, n) = A k^{\alpha} n^{1-\alpha}$						
EXAMPLE	E			1 1	T (T) T (T) (T)			
<u> </u>	Period	Output	<u>Capital</u>	Labor	TFP			
pose alpha =	2006	12.0	16	9	1.0 Developitiety increased between 2005 and 2007			
for simplicity	2007	14.4	16	- 9	1.2 - Productivity improved between 2006 and 2007			
a ≈ 0.40)	2008	19.2	16	16	Productivity stagnated between 2007 and 2008			
	2009	17.6	16	16	1.1 Productivity declined between 2008 and 2009			



Key	nesian Macroeconomics
	Ideology: Price rigidities/"sticky prices"
	Policy stance: policy (fiscal and monetary) of crucial importance for macroeconomic performance
	Methodology: econometric/statistical modeling
RBC	Macroeconomics
	Ideology: Prices are not rigid or "sticky"
	Policy stance: policy (neither fiscal nor monetary) not important for macroeconomic performance
	Methodology: dynamic general equilibrium modeling
New	v Keynesian Macroeconomics
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