Krugman Apologises!

Sorry, that was a belated April Fool's joke. He hasn't, of course—though there has been an apology of sorts from Nick Rowe, which is duly noted and accepted.

The best Krugman could manage is the following update to his original diatribe "Oh My, Steve Keen Edition":

> **Update update**: Ah, so Keen didn't mean DSGE — a term that refers *only* to New Keynesian models — when he said DSGE; he meant New Classical, which he somehow regards as the underlying principles for models that aren't New Classical at all. OK. Anyway, enough of that. I'm all for listening to heretics when they offer insights I can use, but I'm not finding that at all in this conversation, just word games and continual insistence that the members of the sect have insights denied to us lesser mortals. Time to move on.

Gee, thanks Paul. So I'm playing word games, am I—and you're not? Let's take a closer look.

Marking Krugman

Paul, your comprehension of my piece failed on at least two counts.

Figure 1: Krugman's Last Word

Oh My, Steve Keen Edition

Update: OK, I'm done with this conversation. I've had enough back and forth, including off-the-record stuff, to confirm for myself that there's no there there. And there are more important battles to fight.

Oh dear. Nick Rowe sends me to Keen's latest, which asserts the following ***about New Keynesian models***:

> "Firstly, there are similar ***underlying principles to the DSGE models*** that now dominate Neoclassical macroeconomics, and as with Ptolemaic Astronomy, these underlying principles clearly fail to describe the real world. They are:
>
> -All markets are barter systems which are in equilibrium at all times in the absence of exogenous shocks—even during recessions—and after a shock they will rapidly return to equilibrium via instantaneous adjustments to relative prices;
>
> -The preferences of consumers and the technology employed by firms are the "deep parameters" of the economy, which are unaltered by any policies set by economic policy makers; and
>
> -Perfect competition is universal, ensuring that the equilibrium described in (1) is socially optimal…"

What on earth? Point 1 is all wrong — NK models are all about sticky prices, so what's that about "instantaneous adjustments"? (And who said anything about rapid return to equilibrium?) Point 3 is also completely wrong: NK models almost always assume imperfect competition, so that we can talk about price-setting agents.

This is all in Eggertsson and Krugman, by the way.

Nick uses a four-letter word to describe this; I can't, because this is the Times.

Firstly, in the excerpt you quote, I refer to "***underlying principles to the DSGE models*** that now dominate Neoclassical macroeconomics". Somehow you read that as being a statement about "***about New Keynesian models***".

No it wasn't Paul: I was referring to the general class of post-IS-LM neoclassical models, which includes the "Freshwater" New Classical models about which you have made such a song and dance in the past—contrasting their unreality and conservatism with your realistic progressiveness. Remember "Freshwater Rage", "How did Economists get it so wrong?" or "Disagreement among economists"? You might dislike them Paul, but they're your Neoclassical cousins, and it was their "pure" theory, which forms the foundation for your NK models, to which I referred in that excerpt.

Yes, I know that Mark Thoma claimed in a Tweet that New Classical models weren't DSGE models—and that by implication, DSGE was reserved for NK models exclusively and therefore my Fail grade was wrong. I'll get to that later.

Secondly, directly below the section you quote, I continued as follows:

> If that were actually the real world, then not only would there not be a crisis now, there would never have been a Great Depression either—and recessions would simply be minor statistically unpredictable but inevitable events when the majority of shocks hitting the economy were negative, and they would rapidly be resolved by adjustments to relative prices (wages included, of course).
>
> So economists like Krugman—who describe themselves as "New Keynesians"—have tweaked the base case to derive models that "ape" real-world data, with "sticky" prices rather than perfectly flexible ones, "frictions" that slow down quantity adjustments, and imperfect competition to generate less-than-optimal social outcomes.
>
> This is Ptolemaic Economics: take a model that is utterly unlike the real world, and which in its pure form can't possibly fit real world data, and then add "imperfections" so that it can appear to do so.

So Paul, not only did I distinguish between NC models and NK ones, I even mentioned you by name in that section as someone who has added imperfect competition, sticky prices and so on to that base NC model. And yet you implied that I was a moron who didn't even know that NK models include imperfect competition, sticky prices and so on—and you wonder why you got a Fail?

Oh all right, yes I'll consider Thoma's argument. I see that's what you're claiming in your attempt to weasel out of an apology:

> so Keen didn't mean DSGE — a term that refers *only* to New Keynesian models — when he said DSGE…

Figure 2: Thoma's Tweet

So you and Thoma believe that DSGE models ***exclusively*** refer to NK models? Frankly I think that's like a wrinkled pea claiming that it's unrelated to a smooth one: they're still both peas. And the [Wikipedia entry on DSGE models]—which I'm sure has been checked over pretty carefully by fans of Neoclassical economics—makes no such distinction. In fact, it treats RBC/NC and NK as schools of DSGE modelling, precisely as I do:

"**Schools of DSGE modeling**

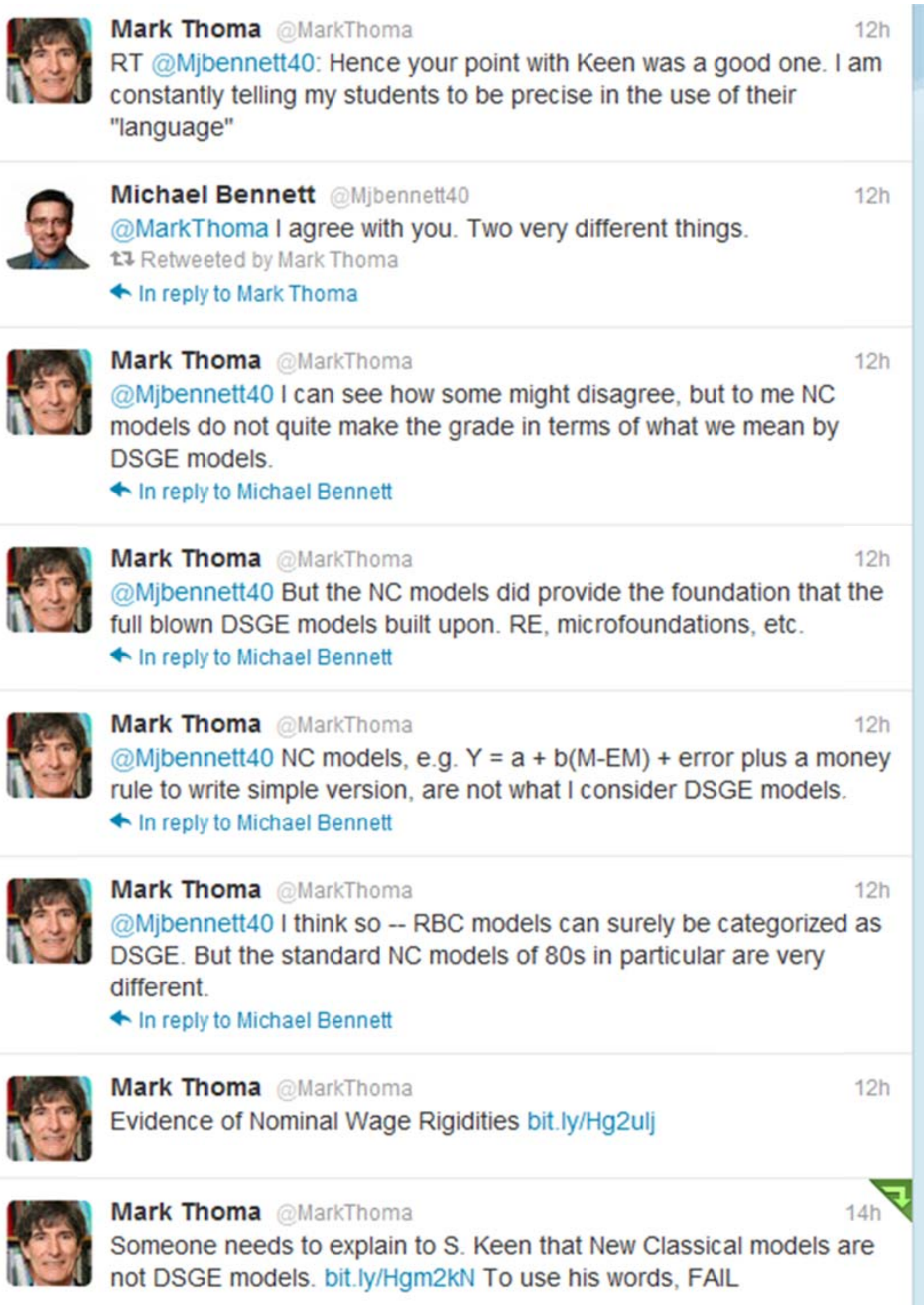
At present two competing schools of thought form the bulk of DSGE modeling.[1]

Real business cycle (RBC) theory builds on the neoclassical growth model, under the assumption of flexible prices, to study how real shocks to the economy might cause business cycle fluctuations. The paper of Kydland and Prescott (1982) is often considered the starting point of RBC theory and of DSGE modeling in general.[2] The RBC point of view is surveyed in Cooley (1995).

New-Keynesian DSGE models build on a structure similar to RBC models, but instead assume that prices are set by monopolistically competitive firms, and cannot be instantaneously and costlessly adjusted. The paper that first introduced this framework was Rotemberg and Woodford (1997). Introductory and advanced textbook presentations are given by Galí (2008) and Woodford (2003). Monetary policy implications are surveyed byClarida, Galí, and Gertler (1999)." (Wikipedia Entry)

So I won't accept Thoma's excuse for your behaviour—and nor do some of his own followers, judging by his subsequent Tweets.

Figure 3: Thoma's subsequent Tweets



You should also read that Wikipedia entry, by the way—it includes some criticisms of DSGE modelling by your senior Robert Solow that you clearly haven't paid attention to (Robert M. Solow, 2003, 2001, 2008). I know you don't like reading what other people write—"I Don't Care" I think you said—but that's why you make mistakes like the one you've made here. Since I know from your past form that my advice here is probably falling on deaf ears, here's Solow as quoted in the critical section of the Wikipedia entry. At least read that; I'll wait:

> **Controvers**y
>
> The United States Congress hosted hearings on macroeconomic modeling methods on July 20, 2010, to investigate why macroeconomists failed to foresee the Financial crisis of 2007-2010. Robert Solow blasted DSGE models currently in use:
>
> 'I do not think that the currently popular DSGE models pass the smell test. They take it for granted that the whole economy can be thought about as if it were a single, consistent person or dynasty carrying out a rationally designed, long-term plan, occasionally disturbed by unexpected shocks, but adapting to them in a rational, consistent way... The protagonists of this idea make a claim to respectability by asserting that it is founded on what we know about microeconomic behavior, but I think that this claim is generally phony. The advocates no doubt believe what they say, but they seem to have stopped sniffing or to have lost their sense of smell altogether.' (Solow's statement to Congress, July 2010)

Now stop complaining about the mark: frankly, getting a fail for this essay is the least of your worries. You seem to have alienated a large part of your peer group by this behaviour—who are you going to have lunch with after this performance? Buttafuccinwho (yes, his nickname sounds rude, but at present you're in no position to accuse somebody else of rudeness), for example, seems unlikely to ever want to play ball with you again:

> I'm certainly not in a position to determine who's right and wrong, and frankly don't really care, but did you even read Keen's post? Two paragraphs below the part you excerpted: "So economists like Krugman—who describe themselves as "New Keynesians"—have tweaked the base case to derive models that "ape" real-world data, with "sticky" prices rather than perfectly flexible ones, "frictions" that slow down quantity adjustments, and imperfect competition to generate less-than-optimal social outcomes."
>
> **Is there a four-letter word for someone criticizes another person in a very public forum without reading what they've written? Or would a seven-letter word fit better**? (Buttafuccinwho)

No, that isn't all. I believe your gang calls itself "New Keynesian", doesn't it?

Well I am going to ban you from using that term in future: find another one.

Why? Well, for starters, the Post Keynesian gang claims that you're denigrating their gang by claiming to be related to them, when you're not. And I've done a bit of Talmudic research and found that they're right: the SLIME model you use—what? Oh, sorry, yes I meant IS-LM, my apologies—anyway, the IS-LM model wasn't developed by Keynes at all.

Yes, I know you know it was developed by Hicks, but it wasn't as an interpretation of Keynes—it was a "Walrasian" model developed before Hicks had read Keynes at all. Look, Hicks says so right here:

> *that model was already in my mind before I wrote even the first of my papers on Keynes.'* (John Hicks, 1981, p. 140; emphasis added)

And he also traces the model to Walras, not Keynes

> 'the idea of the IS-LM diagram came to me as a result of the work I had been doing on three-way exchange, conceived in a Walrasian manner. I had already found a way of representing three-way exchange on a two-dimensional diagram (to appear in due course in chapter 5 of Value and Capital). As it appears there, it is a piece of statics; but it was essential to my approach (as already appears in "Wages and Interest: the Dynamic Problem") that static analysis of this sort could be carried over to "dynamics" by redefinition of terms. So it was natural for me to think that a similar device could be used for the Keynes theory.' (Hicks 1981, p. 141-142)

So at best,you're a Hicksian economist. But actually, even that won't do, because Hicks disowned IS-LM in that same paper, on the basis that macroeconomics can't be modelled as an equilibrium process:

> 'I accordingly conclude that the only way in which IS-LM analysis usefully survives—as anything more than a classroom gadget, to be superseded, later on, by something better—is in application to a particular kind of causal analysis, where the use of equilibrium methods, even a drastic use of equilibrium methods, is not inappropriate…
>
> When one turns to questions of policy … the use of equilibrium methods is still more suspect. … There can be no change of policy if everything is to go on as expected—if the economy is to remain in what (however approximately) may be regarded as its existing equilibrium. It may be hoped that, after the change in policy, the economy will somehow, at some time in the future, settle into what may be regarded, in the same sense, as a new equilibrium; but there must necessarily be a stage before that equilibrium is reached. There must always be a problem of traverse. For the study of a traverse, one has to have recourse to sequential methods of one kind or another.' (Hicks 1981, p. 152-153)

So I think you could call yourself something like "Old Hicksians"; that would be OK. Or maybe "New Walrasians" when you do that DSGE thing.

Yes, I know you don't like either of those names. But, to coin a phrase, "I Don't Care".

Hicks, John. 1981. "Is-Lm: An Explanation." *Journal of Post Keynesian Economics*, 3(2), 139-54.

Solow, Robert M. 2003. "Dumb and Dumber in Macroeconomics," *Festschrift for Joe Stiglitz.* Columbia University:
____. 2001. "From Neoclassical Growth Theory to New Classical Macroeconomics," J. H. Drèze, *Advances in Macroeconomic Theory.* New York: Palgrave,
____. 2008. "The State of Macroeconomics." *The Journal of Economic Perspectives*, 22(1), 243-46.