A Conversation on the Future of Macroeconomics with Narayana Kocherlakota and Roger Farmer*

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On May 21, 2017, I had a Twitter conversation on macroeconomics with Narayana Kocherlakota and Roger Farmer. I found the conversation interesting and valuable. I copy it below with some additional comments.

* The views I express in this document are personal and do not reflect the views or policies of the CEPR, NBER, and the Central Bank Research Association.
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(Clarifying note: My tweet numbered 1 above was responding to Narayana—though I find Roger’s work just as fascinating. 😊)
Fabio Ghironi @FabioGhironi  ·  17h
7/ Don’t get me wrong: I think this is all very important work that I and everyone else will learn much from.

Fabio Ghironi @FabioGhironi  ·  17h
8/ But I don’t see huge modeling discontinuity relative to the past—with “past” including macro (or just econ) *before&other* than DGSE. End

Roger E. A. Farmer @farmerf  ·  17h
So a continuum of steady state equilibrium unemployment rates is ‘business as usual’?

Roger E. A. Farmer @farmerf  ·  17h
And making beliefs both fundamental and rational is ‘business as usual’?

Roger E. A. Farmer @farmerf  ·  17h
I like the Benigno Fornaro paper. I discussed it two years ago. But what selects the equilibrium and what determines money wages?

Roger E. A. Farmer @farmerf  ·  17h
Everybody needs to wake up to the fact that 1. There are always multiple equilibria in monetary DSGE models and

Roger E. A. Farmer @farmerf  ·  17h
... selecting the equilibrium that is locally unique makes no sense as a selection criterion. Beliefs must be modeled as fundamentals
Here is a link to a paper that shows how to do that static1.squarespace.com/static/573b5f2...

1/ Thank you Roger! I'm not sure the point I was trying to make was clear enough, so I will try again.

2/ Anyone who did not read only the "standard-fare" DSGE macro should have known your work and that of others

3/ who departed from that standard fare in their modeling strategies and assumptions.

4/ (I've been a fan of your work since reading the first edition of your macro of self-fulfilling prophecies way back then.

5/ So, I of course am a big fan of what you did in that EJ paper.

6/ Sadly, some out there would still consider it badly wrong because—horror—it includes Euler equations. But I digress.)
7/ My point is that, as of 2017, I don't view using your approach as revolutionary. I view it as part of what should be the broad toolkit.

8/ of every macroeconomist who is not dogmatically tied to one or another modeling and solution approach.

9/ I think the same about the modeling strategy that Narayana used in his slides.

10/ Then again, I am guilty of using those ugly nominal rigidities and the standard DSGE strategy in my own papers.

11/ But I learned stuff I found interesting from what I did, I keep learning as I take the strategy in other directions I believe relevant,

12/ and I guess I am happy with that and with continuing to learn from the work of others using different approaches.

13/ I just don't think of them as revolutionary if they are rooted in work every serious macroeconomist should know & appreciate by now. End
NRKocherlakota @kocherlakota009 · 16h
I agree. None of this work addresses the core problem in my post: the models would have assigned near 0 prob to macro events of past decade

NRKocherlakota @kocherlakota009 · 16h
But step 1 can't be solving a very hard problem - it's got to be recognizing the problem. end

Fabio Ghironi @FabioGhironi · 15h
I was not making a point about the core problem, but I definitely agree that we should pursue an incremental approach.

NRKocherlakota @kocherlakota009 · 15h
To me, the mismatch between data and theory calls out for a change that is more than incremental.

Fabio Ghironi @FabioGhironi · 15h
I used incremental to mean what you were saying: cannot start from the hardest thing first. As for what you are saying now, >

Fabio Ghironi @FabioGhironi · 15h
the work I am seeing so far is incremental. May not be so vs standard DSGE, but I view it as so relative to broader macro over longer span.
13/ I just don't think of them as revolutionary if they are rooted in work every serious macroeconomist should know & appreciate by now. End

Glad you like the EJ paper. But what part of 'animal spirits permanently change the steady state U-rate' is part of the standard paradigm?

6:33 PM - 20 May 2017

You are missing my point. It may not be in the "standard paradigm" of those who pay/paid attention only to standard DSGE.

It should be/is in the standard paradigm (or toolkit) of non-dogmatic macroeconomists (whether or not they choose to use your approach).
This is where the conversation ended. But here is what this conversation and many other “signals” have me worried about: Some very smart people will use models, tools, or solution approaches that have been around for a *long* time, but which are different from the basic DSGE paradigm (or from what *they* view that paradigm to be). Those models, tools, or solution approaches are well known to every macroeconomist who did not read only the standard DSGE stuff. (In some cases, they even build on the same toolkit of dynamic optimization as standard DSGE.) The above-mentioned smart people will use those models, tools, or solution approaches to explain 2006-today. A subset of that work will be published in the top-5 economics journals. (Prediction: That subset will come from the “usual suspects” at the usual schools.) It will receive the blessing of the appropriate set of bloggers and be mentioned in The Economist, FT, and WSJ. And it will be called (at least by some) the revolution that macroeconomics so badly needed.

But is it really? Or is it just re-discovering stuff that every reasonable macroeconomist should have known and be prepared to use for a long time?

It seems to me that a lot of people out there simply do not read enough and/or choose to be blind (or dogmatically opposed) to a lot of work they decided long ago that they consider wrong.

Is this good for (macro)economics?