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

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September 20, 2017

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.


Fabio Ghironi
@FabioGhironi

Very much looking forward to seeing the new macro framework @kocherlakota009 is working on: sites.google.com/site/kocherlak ...

RETWEET 1 LIKES 9

10:14 AM - 20 May 2017

1 1 9

Tweet your reply

NRKocherlakota @kocherlakota009 · 23h
Replying to @FabioGhironi
A tiny step forward here: docs.google.com/viewer?a=v&pid.... And there are other much better steps by Comin and Gertler ... and by (1)

1 2 11

NRKocherlakota @kocherlakota009 · 23h
Brunnermeier and Sannikov. And Khaw, Stevens, and Woodford: columbia.edu/~mw2230/KSW.pdf is great. There's definitely good stuff going on! (2)

1 1 13

NRKocherlakota @kocherlakota009 · 23h
But my post was aimed at something different: fostering a general recognition of the magnitude of the empirical deficiency of (3)

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[*] 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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NRKocherlakota @kocherlakota009 · 23h
core elements of what's called "modern" macro (but is showing its age after 40 years!). (end)

1 · 2

Roger E. A. Farmer @farmerrf · 22h
I'm not sure why you gave up on this line of research minneapolisfed.org/~/media/files/... which builds on my work?

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Fabio Ghironi @FabioGhironi · 17h
1/ Your work and all the other pieces you mentioned are fascinating. However, without any intent to offend anyone, it is not clear to me

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Fabio Ghironi @FabioGhironi · 17h
2/ where the revolutionary modeling innovations are at this point.

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Fabio Ghironi @FabioGhironi · 17h
3/ True, some of the models are significant departures from "standard" DSGE framework,

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Fabio Ghironi @FabioGhironi · 17h
4/ but I definitely wouldn't say so of the things Comin & Gertler have been doing.

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Fabio Ghironi @FabioGhironi · 17h
5/ (In that vein, I would recommend also this Benigno-Fornaro paper personal.lse.ac.uk/benigno/stagtr...)

2 · 1 · 2

Fabio Ghironi @FabioGhironi · 17h
6/ And I don't see revolutionary new modeling tools being developed or introduced in the other papers.

(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 @farmerrf · 17h

So a continuum of steady state equilibrium unemployment rates is 'business as usual'?

Roger E. A. Farmer @farmerrf · 17h

And making beliefs both fundamental and rational is 'business as usual'?

Roger E. A. Farmer @farmerrf · 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 @farmerrf · 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 @farmerrf · 17h

... selecting the equilibrium that is locally unique makes no sense as a selection criterion. Beliefs must be modeled as fundamentals

Roger E. A. Farmer @farmerrf · 17h

Here is a link to a paper that shows how to do that static1.squarespace.com /static/573b5f2...

1 1

Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

6/ Sadly, some out there would still consider it badly wrong because—horror—it includes Euler equations. But I digress.)

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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,

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Fabio Ghironi @FabioGhironi · 16h

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

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Fabio Ghironi @FabioGhironi · 16h

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

2

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

2

NRKocherlakota @kocherlakota009 · 16h

But step 1 can't be solving a very hard problem - it's got to be recognizing the problem. end

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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.

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NRKocherlakota @kocherlakota009 · 15h

To me, the mismatch between data and theory calls out for a change that is more than incremental.

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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, >

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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.

Fabio Ghironi @FabioGhironi · 16h

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

2

Roger E. A. Farmer
@farmerrf

Following

Replying to @FabioGhironi @kocherlakota009

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

2

Tweet your reply

Fabio Ghironi @FabioGhironi · 15h

Replying to @farmerrf @kocherlakota009

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

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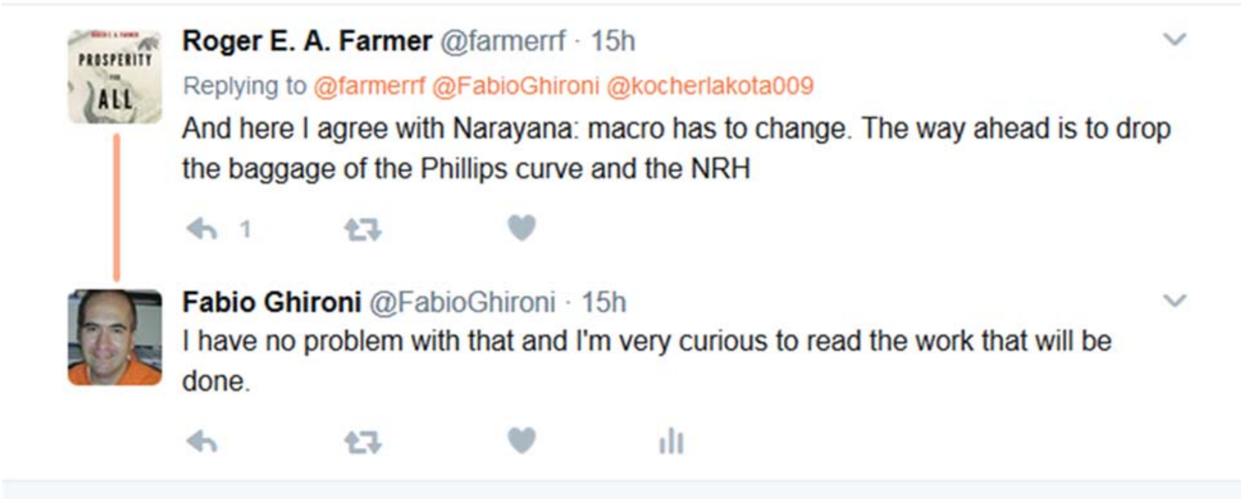
Fabio Ghironi @FabioGhironi · 15h

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?

My own perspective on what macro needs is here: http://faculty.washington.edu/ghiro/GhiroFuture.pdf. It is forthcoming in an issue of the *Oxford Review of Economic Policy* on "Rebuilding Macro Theory" edited by David Vines and Samuel Wills. I strongly recommend reading the entire issue.