

BUSINESS



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Mar 5 2009, 4:12 pm by [Paul Ormerod](#)

Have economists gone mad?

As everyone knows, the past six months or so have seem tremendous turmoil in the world economy. The most obvious example of this is in financial markets. But overall output is also now falling sharply; in countries like Japan and Germany it is [falling faster](#) than at any time since the 1930s.

It seems obvious that these economies are not in a state of equilibrium, where everything flows smoothly. We are a long, long way away from any sort of equilibrium. And in the build up to the crash, we were out of sync in the other directions, with huge asset price bubbles, and unsustainable build ups of debt.

What does mainstream economics have to say about all this? The answer, contrary to what most people might very well say when prompted is not "nothing". It is even worse.

The American academic economics establishment is by far the most prestigious in the world. Career-minded academics long to have an article accepted by one of its journals.

And the American Economic Association has just launched a new journal. Its title? 'Macroeconomics'. So this is exactly the place we should be looking if we want to know what academic economists are thinking about what is going on, how we got here.

Economists are notorious in the public mind for disagreeing with each other. But it turns out that, far from being riven by dissent, the academic profession believes it has reached a broad consensus. Indeed, the first issue carries an article by one of the world's leading macroeconomists, [Michael Woodford](#), entitled "Convergence in Macroeconomics: Elements of the New Synthesis".

The first and most important part of the new synthesis is that "it is now widely agreed that macroeconomic analysis should employ models with coherent intertemporal general equilibrium foundations". What does this mean in English?

It means (a) people and firms act in a rational, coherent manner; (b) they assess coolly and rationally the future consequences of decisions they take now; and (c) the key driving force underlying the economy is a tendency for it to revert to equilibrium.

Yes, rub your eyes. The evidence is now so overwhelming that none of these statements are true that it is hard to see how they could even have been written.

But this madness is not just confined to university seminar rooms. These sorts of models -- so-called 'dynamic stochastic general equilibrium models' -- have become more and more influential in recent years in central banks and treasuries around the world. No wonder the policymakers received such bad advice!

A distinguished friend of mine went to a seminar in the Bank of England at the very height of the crisis last autumn, where many of their brightest economists sat down calmly discussing the finer mathematical points of general equilibrium models. He felt rather like Banquo's Ghost, except no-one paid the slightest attention to him at all.

There is a strong tradition in economics which emphasises disequilibrium -- Schumpeter, Keynes, Hayek. It certainly doesn't mean that everything they wrote was correct, far from it. But exactly the time that the world economy is in massive turmoil, economists who work in their tradition, including some recent Nobel Laureates, are becoming increasingly marginalised by the hardline academic mainstream.

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I used Greg Mankiw's textbooks in college and read his blog every day. But in this Washington Post forum Mankiw makes two arguments against Obama's progressive tax plans that I find pretty puzzling. They are:CBO data show that the tax... [READ MORE](#)

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Denko asks:Virtually every government in the world is borrowing heavily in order to stimulate the economy. Who's lending?Governments have been borrowing heavily for centuries, so to some extent there's nothing new here. (See here for the CIA's ranking of nations... [READ MORE](#)

Duration, not rate

There are a lot of headlines screaming about how the U.S. unemployment rate is exploding, and has now reached levels not seen since 1983. The February unemployment numbers for February really are quite bad; unemployment increased 0.5%, from 7.6% to... [READ MORE](#)

Moral bankruptcy

Four weeks ago, I bought a grill on my credit card. It was not the best grill Home Depot had--indeed, because I am cheap, and also have never longed to rotisserie in my very

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Steve Koch

March 6, 2009 11:54 AM

Very thought provoking post.

Keynes and Hayek were academic adversaries. Keynes thought that a capitalistic economy tends to get stuck out of sync (insufficient demand) every now and then and needs governmental assistance (fiscal stimulus) to get it back on track.

Hayek thought that capitalistic economies work in cycles (the business cycle) and that government does more harm than good when it tries to fix the economy.

Hayek predicted the depression quite accurately while Keynes did not (losing the great bulk of his fortune during the depression).

Schumpeter also was an academic enemy of Keynes and always maintained that the Depression should be allowed to run its course (i.e. the government should not try to fix things via deficit spending or inflation). Schumpeter felt that recessions could actually strengthen the economy in the long run (creative destruction, for example).

REPLY

Greg Feirman

March 6, 2009 3:52 PM

These guys are such jokers!

REPLY

Diversity

March 7, 2009 1:28 PM

Which leads on to the question of why Wynne Godley's modelling, which is still online [here](#) at the Bard Institute, is so stalwartly ignored by the academic mainstream? In an appropriately Keynesian way, Godley has been roughly right about the situation of the US economy for a long time.

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own back yard, it was the... [READ MORE](#)

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DeLong/Boldrin stimulus smackdown

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Should Geithner go?

Henry Blodget thinks it is time for Timothy Geithner to go. So far, Geithner's performance has been shockingly unimpressive. It's not as if he's walking into the crisis anew; he's been the head of the New York Fed for years...

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Americans Are Angry

Sen. John McCain takes President Obama and Congress to task on the "pork-barrel" earmarks in a \$410 billion spending bill. ...



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CNBC's Rick Santelli is back, saying it was unusual for the White House Press Secretary single him out in a presser last week...

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The (Non)State Of The Union



Pres. Obama addresses a joint session of Congress and the nation in a speech focusing on the economy, promising that we will "rebuild stronger than before." ...



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During the Fiscal Responsibility Summit, Pres. Obama asks Sen. John McCain for his thoughts, and the two agree that the new WH helicopter is an "example of the procurement process gone amok." ...

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Centrists Worry About Budget's Impact On Small Businesses

Centrist lawmakers from both parties are expressing unease over the impact of

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President Obama's budget plan on small business, a politically sacrosanct group that appears to have no easy definition. Beginning in 2011, Obama's budget would raise about \$1 trillion...

What Role Have Sticky Wages And Prices Played?

Question from the National Journal's Expert's Blog: How much of a factor in the

NationalJournal.com

downturn have been sticky wages and prices? Can you point to sticky wages affecting the level of employment in particular industries, or sticky prices further...

Geithner Outlines Support For Crackdown

The Obama administration will back legislation to force wealthy individuals and

CongressDaily

corporations sheltering money in offshore accounts to pay more in taxes, Treasury Secretary Geithner told the House Ways and Means Committee Tuesday. "We fully support your efforts," Geithner said...

Banks Work To Kill FTC Omnibus Provision

Banks are protesting a provision tucked into the omnibus appropriations bill

CongressDaily

that would allow the FTC to issue rules on cracking down on predatory mortgages and allow state attorneys general to enforce the language and all consumer lending covered under...

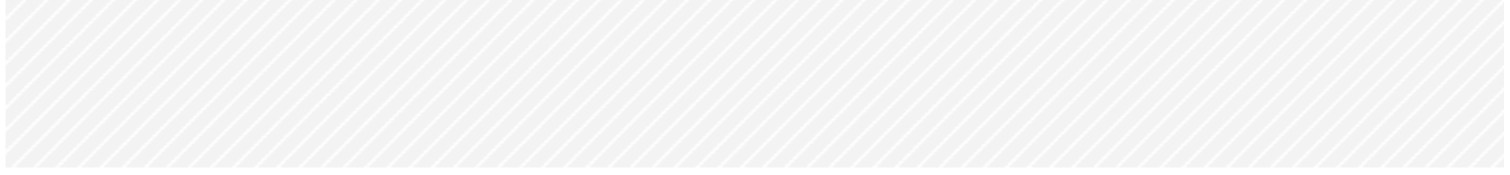
Advisers Say Obama Ready To Sign Omnibus Bill

Top advisers for President Obama Sunday said he will sign an omnibus spending bill

CongressDaily

still percolating on Capitol Hill despite its inclusion of billions in earmarks. White House Chief of Staff Emanuel and OMB Director Orszag appearing separately on Sunday...

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