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DOI
10.1080/08911916.2021.1945249

Publication date
2021

Document Version
Final published version

Published in
International Journal of Political Economy

International Journal of Political Economy

ISSN: (Print) (Online) Journal homepage: https://www.tandfonline.com/loi/mijp20

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To cite this article: Servaas Storm (2021) A Rejoinder, International Journal of Political Economy, 50:2, 111-115, DOI: 10.1080/08911916.2021.1945249

To link to this article: https://doi.org/10.1080/08911916.2021.1945249

INTERNATIONAL JOURNAL OF POLITICAL ECONOMY
2021, VOL. 50, NO. 2, 111–115
https://doi.org/10.1080/08911916.2021.1945249

A Rejoinder

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ABSTRACT
This is a rejoinder to the stimulating comments by David Colander, Drucilla Barker and Jeronim Capaldo on my critique of the non-progressive macroeconomic DSGE research paradigm. The three comments expand my arguments and underscore the need for a drastic change in the mainstream approach to macroeconomics.

KEYWORDS
New Keynesian DSGE models; CGE models; empirical fidelity; macroeconomics

I wish to begin by thanking David Colander, Drucilla Barker and Jeronim Capaldo for taking the time to write such thoughtful responses to my critique of the non-progressive macroeconomic DSGE research paradigm. Each one of their reflections usefully expands and amplifies the message of my critique and I hope that the three comments will be made available to all visitors of the *Museum of Implausible Economic Models*, who have come to learn more about why our society allows Serious Economists to work on useless models applied to mostly irrelevant problems.

Professor Colander makes two points. The first one is that "recognition of DSGE fallacies will change little in macroeconomics", because "standard mainstream DSGE macroeconomics is not in crisis, and will likely be unaffected by outside-the-mainstream criticisms". This is true. The smug response to my critique by Simon Wren-Lewis (2021) illustrates the point rather well:

> Many people *outside the mainstream*, such as Servaas Storm here, want a revolution that removes the many things about the mainstream *they don't like*. But revolutions happen because mainstream economists see that one is needed. [....] Because the micro-foundations hegemony is *progressive*, there will be no revolution. Neither financial crises or pandemics are impossible to model using standard tools.

The refusal by Wren-Lewis to engage with the substance of the critique reflects his wish to continue to live in a state of denial. In this state, people *outside the mainstream* are by definition disqualified from making useful criticism, while the micro-foundations hegemony is considered "progressive", because it is *not impossible* to recalibrate and tweak DSGE models to "describe" financial crises or pandemics. This, clearly, is a ridiculous measure of "scientific progress", devoid of any empirical content, immune to empirical falsification, and reduced to the mere ability of the DSGE modeler to tell Just-So stories in a policy-making context. Never mind that the auxiliary hypotheses needed to make the model outcomes resemble the real world are logically inconsistent with the (Lakatosian) hard core of the DSGE research programme. And please don't bother about the deep methodological problems of model parameter calibration and/or estimation!

The simple point is, as Colander argues, that mainstream economists do not have to see the problem, as long as their careers progress, inside academia and in central banks (with their splendid canteens), and as long as they manage to maintain the monopoly on what counts as the

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"right way to do" macroeconomics and what not. It is impossible to make DSGE modelers understand the problems, because their careers, blogger status, mortgage payments and pensions depend on them not understanding. The obvious inability of mainstream macroeconomics to make progress – which requires discarding the defunct DSGE approach – raises major sociological questions concerning power structures within the profession, the influence of funding agencies, the systems of journal ratings (which are used to inform hiring decisions, promotions and research funding; see Heckman and Moktan 2020), and the revolving door between universities and central banks, finance ministries, and the IMF. I must confess that I did not hold the expectation, or faint hope, that my critique would 'revolutionize' the field. My more limited ambition was to stimulate debate, where possible, and to encourage critical thinking, by offering a complete catalogue of DSGE failings to undergraduate and graduate students and all others instructed in error by the mainstream of the economics profession.

Colander's second point concerns my call for "a neutral economics". Colander has important things to say about "truth" and "neutrality" from a methodology-of-science and a history-of-thought perspective, with which I do agree. However, my call for "a neutral economics" which was based on Galbraith (1973), has been somewhat misunderstood. First, my call did not concern the "neutrality" or "objectivity" of macroeconomic *policy choices*, but rather the "neutrality" of the description of how the macroeconomy works. Does income distribution matter for long-term growth? What is the role of money and finance in a monetary production economy? How do we measure potential output? These are all hard-core theoretical issues (distinct from policy advocacy) which need open and serious debate. Of course, there will always be differences in prior assumptions (Myrdal) and 'pre-analytic Vision' (Schumpeter). But when explicated, made transparent and openly debated, such "non-neutrality" need not diminish the value of economics in understanding social phenomena.

Second, I did call for a "neutral economics" precisely to critique the supposed "neutrality" of DSGE models. DSGE modelers have "shaken the heavens and the earth and the sea and the dry land" to create the image that these models are "scientific", "technical", "de-politicized" and therefore "neutral" – and under cover of their (self-professed) neutral technocratic expertise, they have managed to influence macro policies in distinctly non-neutral ways and wield considerable political power, at great social cost, without being accountable for the outcomes.

But as Galbraith (1973) writes, such an economics in which economic life has no content of power and politics, is not neutral – it is the accomplice and ally of those who exercise power. "Economics, so long as it is thus taught, becomes, however unconsciously, a part of an arrangement by which the citizen or student is kept from seeing how he is, or will be, governed" (Galbraith 1973, 6). A "neutral economics" is an economics in which power is admitted into our calculus – one in which economists analyze the power of corporations over the state, of shareholders and finance over corporations, of big corporations over workers, of monied interests over the environment, and of the monetized economy over the non-monetized sphere of social reproduction. DSGE macro modelers are "useful fools" who are amply rewarded for their work which is instrumental in neutralizing any suspicion that this is the reality.

For Drucilla Barker, the key question is why economists, including feminist economists, are forced to conform to a paradigm that is incapable of addressing crucial real-world problems (e.g., the crises of care and social reproduction) and that simply ignores the substantial costs of wrong-headed macro policies (including structural adjustment policies and fiscal austerity), particularly for the non-monetized sector of the household (Seguino and Braunstein 2019). Professor Barker rightly attributes this fundamental disinterest in "empirical fidelity" to the incentive and power structures within the academy which reward the worshiping at the altar of "model consistency", "selfish optimizing behavior", "deep parameters" and all the other embellishments of the DSGE totem.

This is a crucial observation indeed. The New-Classical counter-revolution, which eventually gave birth to the New Keynesian DSGE mainstream, was never about "empirical fidelity", even if

Lucas and Sargent (1979, 1) claimed that the stagflation of the 1970s had falsified Keynesian macroeconomics, because "the predictions [of Keynesian models] were wildly incorrect". To Robert Lucas (1981, 560), the failure was "as clear-cut an experimental discrimination as macroeconomics is ever likely to see". But right from the start, the stagflation-based falsification of Keynesian macro models has been just a convenient myth: standard Keynesian macro-econometric models of the Tinbergen-Klein variety could well explain the stagflation (Goutsmedt et al. 2016). Instead, "the ascendancy of new classicism in academia was […] a triumph of a priori theorizing over empiricism, of intellectual esthetics over observation and, in some measure, of conservative ideology over liberalism". As Alan Blinder (1988, 278) wrote. I would put much more emphasis on the last factor than Blinder did.

Professor Barker points to the fundamental change in the (pre-analytic) "values" driving macroeconomic thinking – from a (Keynesian) belief in the superiority of deliberate macroeconomic coordination of aggregate demand with the aim to stabilize unemployment over the unruly business cycle, to a (New-Keynesian) belief in the superiority of selfish individual behavior which, aggregated through markets, will generate equilibrium growth, driven by technology and demography. Macro policy is needed only because the economy is constantly prone to exogenous (technological and/or demographic) shocks and suffers from some (idiosyncratic) inertia in wages, prices and interest rates which, when left unattended, make the adjustment back to the equilibrium state slow and therefore costly. All real-world problems of coordination and conflict (over values and interests), between workers and firms, finance and the real economy, women and men, and rich and poor, are conveniently defined away by the assumption of the representative agent. (The introduction of a few heterogeneous robotic agents in a DSGE model is just another strategy to hide a lack of meaning behind the smokescreen of additional "complexity".)

Barker calls for a drastic change in (pre-analytic) values for choosing among theories – emphasizing empirical adequacy, novelty, ontological heterogeneity, mutuality of interaction, applicability to human needs, and decentralization of power. I agree: why not consider models based on social norms such as reciprocity and responsibility? Reciprocity and responsibility are important mechanisms to coordinate and stabilize the macroeconomy, which are often superior to "market coordination", precisely because markets constantly fail and capitalism is inherently unstable. One specific, formal illustration of reciprocity and responsibility in a macro context is the German system of *Kurzarbeit*, which was instrumental in keeping employment relatively stable during the Great Financial Crisis of 2008 as well as during the COVID-19 recession, by protecting workers and their jobs and demand.

Such an emphasis on reciprocity and responsibility also means that we must give more attention to the non-monetized economy (including the non-transactional care economy, social reproduction and unpaid domestic labor). The coronavirus crisis has shown, with brutal clarity, which activities we can – and cannot – live without. Services by nurses, cleaners, school teachers, garbage removal workers, and food production workers are essential, but are all disastrously underrewarded. Capitalist profit-making is completely dependent on the essential work of caring for people, of keeping them alive and healthy, but markets nevertheless prioritize profits over care and social reproduction, which in our patriarchal capitalism remain mostly the responsibility of women (Folbre 2021). Worse, markets actively exploit and often even destroy the non-monetized economy. Macroeconomics, in general, has been incapable of addressing the (often predatory) interactions between monetized production and non-monetized social reproduction – and Professor Barker rightly suggests that macroeconomists ought to open up their discipline to analyzing these empirically critical issues, rather than continuing going down the dead-end street of the umpteenth irrelevant DSGE model innovation or tweak. Again, this requires a clinical look at capitalism and the non-market institutions sustaining it, a renewed focus on "empirical fidelity" and a sound detachment from personal economic interest.

Jeronim Capaldo usefully expands my critique of DSGE models to their "evil twin": Computable General Equilibrium (CGE) models, which are the workhorse of (global) trade policy analysis. Like DSGE models, neoclassical CGE models generate implausible outcomes. For instance, according to a CGE model analysis by the South African Treasury, an increase in the (low) minimum wage by 29% would depress real GDP of South Africa in the long run by 7.5% (compared to the base run with unchanged minimum wages). If one were to take this prediction seriously (but please don't), it would mean that the economic damage of higher minimum wages would be larger than the damage to the South African economy of the COVID-19 crisis (due to which South Africa's real GDP declined by 7%, according to IMF data). The implausible CGE model results are completely caused by the neoclassical model assumptions built into the model – which are at odds with South African reality (Storm and Isaacs 2016), but serve a useful ideological purpose of obfuscating that reality to the benefit of the powers that be. Similarly biased (full-employment) CGE models of the global economy are the power elite's favorite instrument to propagate "free capital movement" agreements, dressed up as "free trade" agreements, including the TTIP (Capaldo 2014), the TPP (Capaldo and Izurieta 2018) and CETA (Kohler and Storm 2016).

However, the main message of Jeronim Capaldo's important contribution is that the monopoly of DSGE and/or CGE models in macroeconomics not just crowds out sensible policy discussions, but (reflexively) changes reality in ways which do constrain actual macro policy space. The best example is the use of mechanical fiscal policy rules, biased toward austerity and based on a narrow supply-side interpretation of output gaps, which have *de facto* led to the destruction of production capacity and a decline in potential growth. Capaldo uses the Italian macroeconomic experience to illustrate this point – with which I am, of course, in strong agreement (Storm 2019). His discussion of the fiscal multipliers used in two recent DSGE model studies for the Italian economy offers a stark illustration of the disconnect between the pompous rhetoric, emphasizing micro-foundations and deep parameters, and the *praxis* of deliberately choosing lower fiscal multipliers (from a budget-neutral exercise) to assess the macro impacts of a fiscal stimulus involving years of budget deficits. This is another instance in which conservative priors triumph over a neutral policy approach. It is finally quite ironical, as Capaldo points out, that the predicted time-paths of the two micro-founded DSGE models used (the European Commission's QUEST and the Italian Treasury's MACGEM-IT) do not match and lead to differing policy recommendations. What to be done?

In his conclusion, Jeronim Capaldo argues that the influence of bad models on policy can only be broken if we manage to break their influence on prevailing expert opinion. I agree. But the task is tough, and, as Drucilla Barker asks, who will step up? Tearing down the monopoly of DSGE orthodoxy will be possible only if macroeconomists continue to build and maintain alternative models to inform and encourage policy discussions outside the path beaten by the macro-mainstream. In all this, there is a silver lining, however. The DSGE modeling project is programmed to continue going down the path toward irrelevance and, being unable of self-correction, it must at some point crash into this wall called "economic reality". This could take decades, but once the crash will have happened, there will be a demand for alternative, sensible, and more humane modeling approaches. It is vital, therefore, to maintain these initiatives in the meantime. And in all instances, responsible macroeconomists should be able to do better than just "muddling through".

Notes on contributor

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