

© Keen, S, 2016. The definitive, peer reviewed and edited version of this article is published in Review of Keynesian Economics, 5, 1, pages, 2017.

The WHO warns of outbreak of virulent new “Economic Reality” virus

Steve Keen, Kingston University London

JEL Codes: B41, B50, E30, E44, E47

Abstract

A new virus, known as ‘Reality’, has started to afflict Mainstream Economists, causing them to reject the “as if” arguments they used to use to justify their models. There is no known cure for the virus, and complete avoidance of ‘Reality’ is the only effective strategy to avoid infection.

PRESS RELEASE FROM THE WHO

The WHO today warned of a virulent new virus affecting vulnerable groups in the Mid-West and Eastern USA. The outbreak, which began in the Mid-West’s extensive Great Lakes “Freshwater” river system, has recently jumped the “Saltwater” barrier, meaning that the entire population of its target species—“Mainstream” economists—is now at risk.

Speaking on behalf of the WHO, Dr Cahuc explained that the virus works by turning off the one genetic marker that distinguishes this species from the rest of its genus, the Human Race. This is the so-called “Milton” gene (Friedman, 1953), which goes dormant in other Humans as they pass through puberty. Its inactivity reduces their imaginative capacity, making it impossible for them to continue believing in such endearing infantile fantasies as the Tooth Fairy and Santa Claus. While regrettable, this drop in imagination is necessary to prepare Humans for the adult phase of their existence.

“Professor Milton Friedman found a way to re-activate this gene during PhD training, using his ‘as if’ gene splicing technique”, Dr Zylberberg elaborated. “This enabled a wonderful outpouring of imaginative beliefs by Mainstream Economists, which gave birth to concepts like NAIRU, Money Neutrality, Rational Expectations, and eventually even DSGE models. This wealth of imagination was regarded by Mainstream Economists as a more than sufficient compensation for returning to the child-like phase of the Human species.”

The Milton gene conferred other advantages on Mainstream Economists, which have been highly important to their success in competition against their rival species, the Heterodox Economists. “Being endowed with a child-like nature, the arguments of Mainstream Economists were treated with the low level of critical evaluation that adult humans normally reserve for conversations with their infant stage”, said Dr Cahuc. “This made their policy recommendations much more likely to be adopted, instead of the more complicated proposals put forward by their niche rivals”, he said.

The new virus—named ‘Reality’—de-activates the Milton gene once more. “Consequently”, Dr Cahuc warned, “the very beliefs that define this unique species are at risk. Unless we are very careful, it may become extinct!”.

Unfortunately, there is as yet no known cure to this virus. “WHO therefore recommends complete avoidance of ‘Reality’ as the only effective strategy for those wishing to remain as Mainstream Economists”, Dr Cahuc concluded.

However, this strategy is made extremely difficult by one cunning characteristic of the Reality virus: after an initial phase of disorientation and distress, its sufferers begin to experience pleasure, and actually *want* to pass the virus on to others. “Its transmission mechanism is a particularly insidious aspect of this disease”, Dr Cahuc lamented.

The first confirmed victim and carrier of the Reality virus was the ex-Federal Reserve of Minneapolis President Narayana Kocherlokota, who wrote a brief note promisingly entitled “Toy Models” in July 2016. It now appears that the very title of the paper was a disguised manifestation of the disease, since Mainstream Economists enjoy playing with both Toys and Models. This enabled it to bond with the recipients’ Milton gene. Having penetrated the gene’s defences, the virus struck!

The paper began innocuously enough, by restating the conventional Mainstream belief that “macroeconomic research can and should be grounded in an established body of theory”. But then, Kocherlokota continued that:

“My own view is that, after the highly surprising nature of the data flow over the past ten years, this basic premise of “serious” modelling is wrong: we simply do not have a settled successful theory of the macroeconomy. The choices made 25-40 years ago—made then for a number of excellent reasons—should not be treated as written in stone or even in pen. By doing so, we are choking off paths for understanding the macroeconomy.” (Kocherlokota, “[Toy Models](#)”, July 14 2016)

The WHO’s hopes that this outbreak was confined to the USA’s Freshwater system were dashed just a month later, when the previously highly resistant Saltwater economist Olivier Blanchard showed signs of infection. Under the cover of a respected Mainstream outlet, Blanchard released a paper with the worrying title of “[Do DSGE Models have a future?](#)”. Though the paper thankfully concluded that they do, it made a number of potentially virally-influenced statements, such as:

“There are many reasons to dislike current DSGE models.

First: They are based on unappealing assumptions. Not just simplifying assumptions, as any model must, but assumptions profoundly at odds with what we know about consumers and firms.” (Blanchard, 2016, p. 1)

“This is a very troubling assertion”, Dr Zylberberg stated, “since in the past Blanchard had no difficulty in making ‘as if’ assumptions about things that were really ‘as isn’t.’”

Initially the WHO thought that Blanchard may have acquired the virus from Kocherlokota, but further research implies that Blanchard could himself have been the original source of the virus.

Dr Zylberberg noted that Blanchard clearly had a strong immune system, given such superbly imaginative papers as “[The State of Macro](#)” (Blanchard, August 2008), in which he remarked, one year after the start of the Global Financial Crisis, that “The state of macro is good” (Blanchard, 2009, p. 210). However, epidemiological research by Dr Cahuc revealed that there were signs of infection as long ago as 2010, when Blanchard wrote that:

“IT WAS TEMPTING FOR macroeconomists and policymakers alike to take much of the credit for the steady decrease in cyclical fluctuations from the early 1980s on and to conclude that we knew how to conduct macroeconomic policy. We did not resist temptation. The crisis clearly forces us to question our earlier assessment.” (Blanchard et al., 2010, p. 199)

This was followed up by a 2014 paper in which the disorientation stage of the virus was evident. Entitled “Where Danger Lurks” (Blanchard, 2014), this paper asserted that:

UNTIL the 2008 global financial crisis, mainstream U.S. macroeconomics had taken an increasingly benign view of economic fluctuations in output and employment. The crisis has made it clear that this view was wrong and that there is a need for a deep reassessment. (Blanchard, 2014, p. 28)

The WHO would have raised an alarm about Blanchard case earlier, were it not for the soothing conclusion to this paper, which was that:

The crisis has been immensely painful. But one of its silver linings has been to jolt macroeconomics and macroeconomic policy. The main policy lesson is a simple one: Stay away from dark corners. (Blanchard, 2014, p. 31)

It was clear from this that Blanchard’s Milton gene was still active, Dr Cahuc noted, since Mainstream Economics actually provides no way to identify where the dark corners are.

The WHO now deeply regrets its early complacency, since almost immediately after Blanchard’s 2016 outbreak, an even more virulent strain of the virus appeared: the “RR” or “Romer Reality” variant. This aggressive virus broke into the wild on September 14 2016, when [a paper was accidentally released](#) from the isolation ward at Yale University. This strain of the virus apparently has no need to conceal its purpose, since the paper was entitled “The Trouble with Macroeconomics” and it made many assertions that indicate that the sufferer’s Milton gene has been completely silenced.

“Not only does it bluntly assert in its abstract that ‘For more than three decades, macroeconomics has gone backwards’”, Dr Zylberberg noted, “it even parodies Mainstream Economics in a way that we thought was previously confined to the ‘KK’ (‘Keen at Kingston’; Keen, 2011) virus, to which Mainstream Economists had previously been completely resistant”.

Mainstream Economists are advised to completely avoid contact with carriers of the RR strain, since it makes a frontal assault on the Milton gene itself—seeking not merely to de-activate it, but to remove it entirely from the genome with outrageous statements like the following:

In response to the observation that the shocks are imaginary, a standard defense invokes Milton Friedman’s (1953) methodological assertion from unnamed authority that “the more significant the theory, the more unrealistic the assumptions (p.14).” More recently, “all models are false” seems to have become the universal hand-wave for dismissing any fact that does not conform to the model that is the current favourite. The noncommittal relationship with the truth revealed by these methodological evasions and the “less than totally convinced ...” dismissal of fact goes so far beyond post-modern irony that it deserves its own label. I suggest “post-real.” (Romer, 2016, p. 5)

“Worse still”, noted Dr Cahuc, “it identifies Mainstream Economic beliefs—which adult humans believe are scientific concepts, and therefore to be taken seriously—with other beliefs that adults themselves once had in their youth, and which they therefore know are fantasies.”

“This could mean that adult humans—and in particular, Politicians—might start to reject Mainstream Economic advice,” Dr Zylberberg interjected. “This could be fatal to the continued existence of Mainstream Economists. The threat is that serious.”

Indeed, the concerns of Drs Cahuc and Zylberberg do seem warranted. Romer's paper abounds with troubling analogies like these:

Once macroeconomists concluded that it was reasonable to invoke an imaginary forcing variables, they added more. The resulting menagerie, together with my suggested names now includes:

- A general type of phlogiston that increases the quantity of consumption goods produced by given inputs
- An "investment-specific" type of phlogiston that increases the quantity of capital goods produced by given inputs
- A troll who makes random changes to the wages paid to all workers
- A gremlin who makes random changes to the price of output
- Aether, which increases the risk preference of investors
- Caloric, which makes people want less leisure (Romer, 2016, p. 6)

It also parodies great Mainstream Economics works of imagination like "Shocks and Frictions in US Business Cycles: A Bayesian DSGE Approach" by the renowned Smets and Wouters (Smets and Wouters, 2007):

What matters in the model is not money but the imaginary forces. Here is what the authors say about them, modified only with insertions in bold and the abbreviation "AKA" as a stand in for "also known as."

While "demand" shocks such as the **aether AKA** risk premium, exogenous spending, and investment-specific **phlogiston AKA** technology shocks explain a significant fraction of the short-run forecast variance in output, both **the troll's** wage mark-up (or **caloric AKA** labor supply) and, to a lesser extent, output-specific **phlogiston AKA** technology shocks explain most of its variation in the medium to long run. ... Third, inflation developments are mostly driven by the **gremlin's** price mark-up shocks in the short run and the **troll's** wage mark-up shocks in the long run (p. 587).

A comment in a subsequent paper (Linde, Smets, Wouters 2016, footnote 16) underlines the flexibility that imaginary driving forces bring to post-real macroeconomics (once again with my additions in bold):

The prominent role of the **gremlin's** price and the **troll's** wage markup for explaining inflation and behaviour of real wages in the SW-model have been criticized by Chari, Kehoe and McGrattan (2009) as implausibly large. Galí, Smets and Wouters (2011), however, shows that the size of the markup shocks can be reduced substantially by allowing for **caloric AKA** preference shocks to household preferences. (Romer, 2016, p. 7-8)

The dangers to Mainstream Economists are therefore clear: avoid 'Reality' at all costs, if you want to remain Mainstream Economists.

Though very concerned, Drs Cahuc and Zylberberg do take solace that the RR strain of the virus has recently been moved from Yale University, where it could easily come in contact with many academic Mainstream Economists, to the World Bank. “Thankfully, this will isolate the ‘Romer Reality’ strand from academic economics departments, where Mainstream Economists breed. There is therefore still hope for the survival of this species,” Dr Cahuc concluded.

Catalog of Viral Symptoms

- BLANCHARD, O. 2009. The State of Macro. *Annual Review of Economics*, 1, 209-228.
- BLANCHARD, O. 2014. Where Danger Lurks. *Finance & Development*, 51.
- BLANCHARD, O. 2016. *Do DSGE Models Have a Future?* [Online]. Peterson Institute for International Economics. Available: <https://piie.com/system/files/documents/pb16-11.pdf>.
- BLANCHARD, O., DELL'ARICCIA, G. & MAURO, P. 2010. Rethinking Macroeconomic Policy. *Journal of Money, Credit, and Banking*, 42, 199-215.
- KEEN, S. 2011. *Debunking economics: The naked emperor dethroned?*, London, Zed Books.
- KOCHERLAKOTA, N. 2016. *Toy Models* [Online]. Available: <https://docs.google.com/viewer?a=v&pid=sites&srcid=ZGVmYXVsdGRvbWFpbmNrb2NoZXJsYWtvdGEwMDI8Z3g6MTAyZmIzODcxNGZiOGY4Yg>.
- ROMER, P. 2016. The Trouble with Macroeconomics.

Bibliography

- CAHUC, P. & ZYLBERBERG, A. 2016. *Le négationnisme économique et comment s'en débarrasser*, Paris, Flammarion.
- FRIEDMAN, M. 1953. The Methodology of Positive Economics. *Essays in positive economics*. Chicago: University of Chicago Press.
- SMETS, F. & WOUTERS, R. 2007. Shocks and Frictions in US Business Cycles: A Bayesian DSGE Approach. *American Economic Review*, 97, 586-606.