

Hearing :: 7/20/2010 :: Building a Science of Economics for the Real World

## Opening Statement By Chairman Brad Miller

I know that economists must think politicians are impossible to please. Harry Truman complained that he wanted a one-handed economist. And now we're complaining that we got very confident economic advice in the last decade, but that one-handed advice proved to be wrong.

Unemployment is hovering at just under 10 percent – more than 16 percent when you include the folks who have given up looking for work or who are working part time when it's a full-time job they really want. Banks have cash but aren't lending, and the Federal Reserve can't lower interest rates any more without paying banks to take the money. There's worried talk of a deflationary spiral like the one that's dogged Japan for almost two decades. And arguments about whether it is better to stimulate the economy or cut the deficit appear backed more by ideology, gut feeling and election-year politics, than by honest evidence.

It would be great to have some reliable guidance to lead us out of this mess. But what we thought was authoritative guidance failed to see the mess coming and may actually have helped create the mess to begin with. Expert models of finance and the economy led to risk-taking at our largest financial firms and failed to warn our leading economic policy makers that doom lurked in the housing market.

Because our experts' way of looking at the economy left them blind to the crisis that was building, we were unprepared to deal with the crisis. A few weeks after Lehman Brothers went bust, Former Fed Chairman Alan Greenspan, the steward of our economy during the 20 years that culminated in the housing bubble's growth, told our colleagues on the House Oversight and Government Reform Committee that his reaction to the financial crisis was one of "shocked disbelief." He had "found a flaw," as he put it, "in the model that [he] perceived [to be] the critical functioning structure that defines how the world works."

Greenspan's fallen model of the market shares many assumptions with the model that's favored today, from academe to the world's central banks. The macroeconomic model is called the Dynamic Stochastic General Equilibrium model mercifully called DSGE for short. According to the model's most devoted acolytes, the model's insights rival the perfect knowledge Paul described in the First Letter to the Corinthians; but unlike the knowledge Paul described, DSGE's insights are available in the here and now.

To be fair, DSGE and similar macroeconomic models were first conceived as theorists' tools. But why, then, are they being relied on as the platform upon which so much practical policy advice is formulated? And what has caused them to become, and to stay, so firmly entrenched? And, finally, the most important question of all: What do we get when we apply the various tools at our disposal to the urgent economic problems we're facing today?

If this approach to economics is useless for the purposes of advising policy makers to lead to better economic outcomes, what are we getting out of the economic research funded through the NSF?

Besides raising these questions about the dominant model, we plan to have a look at the competition. What kinds of alternative models exist, and do we need to generate still others? Should we be using a variety of models in concert rather than relying on only one type? Should the Federal government use its funding of economic science to encourage the development of these alternative approaches?

We have a distinguished panel to help us delve into these issues. Dr. Robert Solow will tell us what is in the DSGE model, where it parts from the realities of the world, and what kind of advice it tends to deliver. Dr. Sidney Winter will talk about the economic realities that DSGE and its macroeconomic cousins fail to take into account and about how to look for policy advice when there are important features of the economy that don't lend themselves to modeling. Dr. Scott Page will provide a glimpse of a new form of model that advanced computing power has made possible, the agent-based model, and make a case for the use of many and varied models. Dr. David Colander will explain why DSGE has achieved such a monopoly and outline a plan designed to open the floor to a broader spectrum of ideas. And Dr. V.V. Chari will state that while DSGE models are definitely capable of improvement, many of the criticisms leveled against them are inaccurate and, in any case, "there is no other

game in town.”

So my advice to you is to prepare for a lively discussion, and with that I yield back my time and call on the Ranking Member, Dr. Broun, for his opening statement.

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