Twitter Thread by David Andolfatto

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It's Sunday, Fed blackout, am recovering from soccer match, sipping on double espresso, so of course a perfect time to take on Tyler Cowen here. ■

> It is hardly phony, especially on social media, to refer to IS-LM models and the like as \u201cKeynesian.\u201d Krugman pushing it and, for better or worse, rising in popularity.
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> — tylercowen (@tylercowen) January 17, 2021

Like many people, I enjoy reading Tyler's blog. But there are times (alright, many times) I disagree with him. This is no big deal. I also disagree with myself sometimes (especially my past self). But his recent post left me puzzled. https://t.co/cie5SBKUly

What is he trying to say here? After thinking about it for a bit, I think he's critiquing the idea that "running the economy hot" leads to employment *and* real wage gains. Perhaps the former, but only at the expense of the latter. At least, this is what a textbook IS-LM model

tells us if one "runs the economy hot" through increased fiscal stimulus (on consumption and transfers, not public infrastructure investment). If this is what he meant, then he should have just said so, instead of labeling this a "Keynesian" proposition.

In fact, this property follows as a *neoclassical* proposition that is embedded in the IS-LM framework. (For non-economists, note that Keynes did not invent IS-LM; the framework was developed later by Hicks as an interpretation of *some* parts of the General Theory.)

For example, increasing G in a purely neoclassical model w/ standard labor/leisure trade-off typically increases output and employment. For a fixed capital stock, the increase in employment lower the marginal product of labor and, hence, the real wage.

It should come as no surprise even in that "basic" model, a number of assumptions are doing some heavy lifting. Those assumptions can be relaxed and, no surprise, the proposition can be reversed. It all depends. We need empirical evidence to make further progress here.

So, in my view, Tyler should not have associated that first proposition with "Keynesian" economics. And really, what's the point of doing so? Let's please stop this nonsense. Call it IS-LM if you want. And highlight the critical assumptions delivering the stated proposition.

I think the same thing holds for the "Lucasian economics" proposition. I understand (now) that what Tyler means by this is Lucas (1972) & not Lucas' view of how the economy operates. Professional economists can spot the difference. But is this not misleading for the lay person?

The final proposition seems related to the "supply-side" notion that the way to increase employment and real wages is to foster an environment that encourages innovation and investment.

Just to nitpick, this not likely to increase employment in the long-run (hours worked per capita have remained relatively stable over the past century). But wages and living standards increase. But this also holds true for "Keynesian" economics, especially at full employment.

My own view is that C-19 was a sectoral shock that depressed aggregate demand. To a first approximation, the U.S. fiscal response largely mitigated "insufficient demand" and provided the much needed insurance to the people disproportionately affected by the shock.

There's not much of an "output gap" left, in my view. The depressed levels of economic activity we're seeing are being driven largely by the virus (so, sectoral/supply considerations). Is fiscal stimulus really needed at this point? The answer to this question hinges very much

on one's view of whether the private sector can drive the recovery dynamic efficiently on its own. I'm not sure anyone really knows the answer to this question (and so, maybe we take out some insurance with an added fiscal push).

I suspect that Tyler may agree with this assessment. But whether one agrees or not, at least we won't be fighting like we're in a school cafeteria over whether "Keynesian" or "Lucasian" economics is better than the other.

And now time to soak in a tub.■