Harald Uhlig “Economics and Reality”
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• Examines 4 points of view:

1. Economics is a science.
2. Economics is an art.
3. Economics is a competition.
4. Economics is politics.

• Examines specific cases for illustration and debate:

1. Is there a Phillips curve?
2. Are prices sticky?
3. Does contractionary monetary policy lead to a contraction in output?
4. What causes business cycles?
1. Economics is a Science

Theory-led deductive approach
Derive falsifiable predictions from a prior hypothesis
(Popper (1934))

Vs.

Empirically-grounded inductive approach
Derive theoretical principles from careful observation

Uhlig conclusion: Reality does guide economics. Empirical evidence influences and should influence economics, as in any scientific discipline, but there is not a single successful approach to do so.
2. Economics is an Art.

- Economists should not try to construct a “Theory of Everything.”

  Occam’s razor: The hypothesis with the fewest assumptions able to explain a given set of facts must be the correct one.

- “Beware of theorists bearing free parameters.” (Goldberger and Lucas)

- A good theory is false by design. The key is to summarize key facts that a good – and therefore minimalistic – theory is meant to capture.

- Uhlig conclusion: Reality influences economic thinking by guiding theorists to design beautiful, minimalistic theories that connect to a select set of key facts.
3. Economics is a Competition of Ideas

- How do economists decide which direction of research is correct, which line of inquiry is fruitful, which argument is convincing?

- McCloskey: Economics is rhetoric.

- Old theories are never really discarded. Economists love to hang on to beliefs once formed.

- Uhlig conclusion: New theories predict or explain new facts. Nonetheless, old theories stay around, whether they explain existing new and old facts or not.
4. Economics is Politics

• “Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.” (Keynes, 1936, Ch. 24)

• There is a competition of ideas in practical politics as well.

• Uhlig concludes that “economic thinking at the practical level of economic policy is thick-skinned and conservative. It is rarely influenced by fresh economic theory or by fresh empirical evidence, unless it fits well with an agenda that had been established elsewhere already.”
1. Is there a Phillips Curve?
Phillips (1958)
Curve fitted to 1861-1913 data

Fig. 10. 1948-1957
Fig. 1. The US Phillips curve 1948–2008. Data: Civilian Unemployment Rate, BLS, monthly, seasonally adjusted. 12-months log-change in the Consumer Price Index for all urban consumers, BLS, monthly data.
Fig. 2. The US Phillips curve 1948–2008. Adjacent data points have been connected.
Fig. 3. The changing Phillips curve over time.
2. Are prices sticky?
Nabisco Premium Saltines 16oz.
3. Does contractionary monetary policy lead to a contraction in output?
Effect of a positive shock to the fed funds rate (sign restrictions constrain the price response to be non-negative.)

Fig. 5. This figure shows the possible range of impulse response functions when imposing the sign restrictions for $K = 5$ at the OLS point estimate for the VAR.
4. What causes business cycles?
Fig. 7. Comparing the cyclical (HP-filtered) component of labor productivity and real GNP.