Foreword

The New School For Social Research has played an important role, contributing to many fields of advanced study in the United States – for example, a recent conference on the work of Franco Modigliani in relation to the prevailing economic situation. This book starts from much earlier work at the New School, the early 1940s Seminar of Marschak and Haavelmo on econometrics, which laid the foundations for the work at Cowles.

Nell and Errouaki have written a very welcome book, coming at a good time. Its message is one of support for the original Cowles approach, agreeing that our work then was on the right track. They correctly understand the intention of the founders, which was to bring mathematics together with economic theory, so as to develop precise hypotheses that could be confronted with data, using methods of statistical inference. The idea was to expand and develop economic theory, making it more realistic, so that it could be put to use to solve some of the world’s problems. We felt we had all the answers from a statistical point of view and from the point of view of econometric methodology and economic content; we could make it easy to have a well-organized, well-run economy after the war. It was generally expected that econometric investigations would build up a large body of agreed-upon findings, and that different investigators would normally replicate – or improve on – each other’s results.

In fact agreement has been hard to come by; what Jacob Marschak very early on called the ‘model selection’ problem has stood in the way. Statistical inference alone will not do the job; but it is not necessarily a step forward to try to solve the difficulties by introducing hard-to-justify assumptions – normality in probability distributions, ergodicity in time series. What is needed is greater realism, closer and more systematic attention to what economic agents are actually thinking, planning and doing. I have advocated the use of survey data; the authors here call for fieldwork and drawing on vernacular knowledge.

When the big models, along with every other form of economic investigation, ran into trouble in the 1970s, many investigators turned against the approach. Nell and Errouaki rightly deplore this; structural econometrics got a lot of things right, and presented a reasonable picture of
the macroeconomy. People have said that the models failed to predict the effects of supply shocks on the inflation of the 1970s, and that they didn’t predict the changes in structure. I believe the economy didn’t change in structure; instead, exogenous inputs changed a great deal within a largely unchanged structure. And the large-scale models did a good job of predicting recession and inflation.

This book is massive; it covers a great deal of ground, starting from philosophy of science, extending to methodology, and foundations of probability and statistical inference. It then goes on to the basics of structural econometrics and the Cowles approach, especially Keynesian econometric models, and finally covering the critiques of the Cowles approach and Keynesian econometrics, including the critiques of those critiques. The book also presents a number of the authors’ own contributions. These include their proposal to overcome the problem of induction and establish the existence of lawlike regularities in economics, justifying the assumption of a ‘data generating mechanism’; this leads them to their methodological triangle-circle (MTC) diagram, which summarizes their methodology. In addition to methodology they propose some specific modelling—for example, in regard to wage-price spirals, the analysis of money supply and demand, Keynesian uncertainty, and Minskyian financial instability. These ideas may seem unorthodox in today’s context; but they would not have seemed out of place to many of the early econometricians, for example at the Oxford Institute of Statistics. In developing econometric models some people became slaves of the neo-Classical behavioural formulations; in their fear of being ‘ad hoc’ they chose theoretical lines which were not always well conceived. Many have forgotten, if they ever knew, the lessons of Keynes. Our authors propose to correct this, drawing on their program of fieldwork and conceptual analysis, and suggest some concrete steps along the path to reconceptualizing difficult and controversial areas of macro theory. The authors have succeeded in orchestrating a lively debate over the scientific foundations of structural econometrics. Their book deserves a broad readership.

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