

Aki Lehtinen

Model selection in macroeconomics: DSGE and ad hocness

Abstract:

In this paper we investigate the applicability of Rodrik's account of model selection to the dominant modelling platform in macroeconomics, viz., Dynamic Stochastic General Equilibrium (DSGE) models. Although Rodrik outlines the recent twists and turns in macroeconomics at the level of general theory and outlook, he does not really examine the practice of applied macroeconomic modelling and only suggests that his account of model selection (and possibly of diagnostics) ought to be applicable also to macroeconomics. In Rodrik's account, economic knowledge accumulates 'horizontally' in producing ever more partial, context-sensitive, and even mutually inconsistent models of new aspects of economic phenomena, and the crucial skill in applying this knowledge to explain or influence the real world is in the judicious selection of the right model(s).

We examine how the key step of identifying critical assumptions is complicated by the interconnectedness of the common structural core of the DSGE models, and the myriad of more or less ad hoc modifications introduced to model various rigidities and other market imperfections. We also examine the implications these difficulties have for the applicability of Rodrik's diagnostic scheme to model selection in macro-economics.