

SOME SKEPTICAL OBSERVATIONS ON REAL BUSINESS CYCLE THEORY

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REVIEW ON PRESCOTT'S PAPER:

- Standard RBC Model
- Fluctuations in output from the trend accounted for variations in employment and virtually all the rest by the stochastic technology parameter.
- Investment will be three or more times as volatile as output and consumption half as volatile
- Key deviation: empirical labor elasticity of output is less than predicted

"An important part of this deviation will disappear if the economic variables were measured more in conformity with theory"

⇒ Theory ahead of measurement

SUMMER'S MAIN POINTS

"Many theories can approximately mimic any given set of facts; that one theory can does not mean that it is even close to right."

According Prescott: model economy is parameterized on the basis of microeconomics information and long run properties

- Are the Parameter Right?
- Where are the Shocks
- What about Prices?
- Exchange Failures

SUMMER'S MAIN POINTS

- Gross overstatement on the parameters
 - The Share of HH time devoted to market activities $\rightarrow \frac{1}{3}$
- Intertemporal elasticity of substitution in labor supply (no micro evidence)
- Existence of Technological shocks is hard to find, while there is other potential explanation
- A price-free economy
- Partial breakdowns in the exchange mechanism are almost dominant factors in cyclical fluctuations

SUMMER'S MAIN CONCLUSIONS

1. Analyzing diverse agents interact under the equilibrium is harder than analyzing the optimal action of a single agent
2. Improvement should focus on why sometime exchange works and sometimes fails
3. Rather than detour to a stochastic analysis of Robinson Crusoes

COMMENTS

The use of competitive theory under the neoclassical growth environment should not be attacked - Prescott.

As Summer mentioned, "Extremely bad theories can predict remarkably well. Ptolemaic astronomy guided ships and scheduled harvests for two centuries."