Dare To Be Silly by Paul Krugman

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The title above was one of the four rules for research I laid out many years ago; it seems worth recalling when reading Lars Syll's diatribe against IS-LM. I would respectfully submit that Syll doesn't get what economic modeling is for. And his piece offers an occasion to talk about what it actually is for.

Syll complains that IS-LM is a "brilliantly silly gadget" that "doesn't adequately reflect the width and depth of Keynes's insights on the workings of modern market economies." Well, of course it doesn't. It's a model – a simplification of reality designed to provide useful insight into particular questions. And since 2008 it has done that job, yes, brilliantly.

Before I turn to Syll's critique, let me summarize my understanding of one of the great turning points in the practice of economics – the turn away from institutional economics in the 1940s and 1950s. Until that time, institutional economics – generally taking the form of long, discursive books rich in historical detail – had been a strong presence in U.S. thought. But then came Samuelson and associates, and models took over.

Why did this happen? It wasn't, as some might imagine, about free-market ideology: Samuelson started with Keynesian macro (or "Keynesian" macro, if you feel the urge to claim that the master meant something different), and in fact faced a fierce campaign by right-wingers to keep his work out of the schools. No, what happened was the Great Depression.

Think about it. Here we had an utter catastrophe, and people wanted answers: how could this happen, what can we do? Institutional economics replied, in effect, by saying "Clearly what is happening is a complex process with deep historical roots. We need to address those complexities. It would be foolish to expect easy answers." Meanwhile, American Keynesians said, "We have inadequate demand. Increase government spending!"

And the Keynesians were right, confirming the sense that they had something useful to offer, while the institutional tradition came up short.

So now we come into another great crisis, and again we want answers. What will reduce unemployment, and what will make it worse? What effects can we expect from a huge expansion of the Fed's balance sheet? What about unprecedented peacetime budget deficits? What about austerity programs?

I read Syll's paean to Minsky, and I have no idea how he would answer any of these questions. What I suspect, however, is that he would talk about complexity and nuance, and then propose answers without basing them on any model at all – which would in fact mean engaging in implicit theorizing, and probably fairly crude implicit theorizing at that. You see that a lot among people who reject IS-LM as too simple and unsubtle: what they have ended up doing in practice, for the most part, is predicting soaring inflation and interest rates, because whether they know it or not they have effectively reverted to crude quantity-theory and loanable-funds models.

Meanwhile, those of us working with IS-LM, and arguing that we had entered **a liquidity trap**, predicted little effect from the Fed's balance sheet expansion, certainly not an explosion of inflation; low interest rates despite government borrowing; severe adverse effects from austerity. And we were right – because in reality, using a "silly" little model is a lot more sophisticated than talking grandly about complexity, and then trying to make diagnoses with no explicit model at all.

IS-LM isn't a model of life, the universe, and everything. **It's a minimalist gadget** designed to let you think coherently about the interactions among money, bond markets, and the real economy. **And it has performed extremely well in our time of need.**

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