

Part III

Limitations

All too frequently in economics a new approach is advocated without an accompanying statement of the limitations of the approach. The limitations eventually emerge in the course of the public debate but the process is protracted. Here some of the limitations of the feedback approach are discussed in order to permit you to weigh carefully the pros and cons. These limitations are

- choice of criterion
- reactions to policy
- choice of model
- multiple decision makers.

The desired paths and weights discussed in Chapter 3 constitute a particular goal or choice of criterion. Many economists would prefer to use various other criteria for selecting among policies.

How people will react to policy is an old topic in economics — as old as public policy discussions. An example from the last fifty years is the debate that arose from Keynes' consumption function. Part of that debate concerned what proportion of increases in income that consumers would spend. More recently proponents of rational expectations have argued that feedback rules will be invalid as soon as they are announced because consumers and producers will change their behavior as soon as they know the feedback rule.

The choice of model is a difficult problem in economics since controlled experiments cannot be run. Many false models can be rejected with statistical procedures; however, sometimes two or more models fit the data equally well, so it is difficult or impossible to ascertain which competitor is

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indeed the correct model. Since the feedback rules reflect the choice of model, it is equally difficult to determine which is the correct feedback rule among those obtained from competing models.

Finally, one person does not control economic policy but rather the control extends to many people in the Administration, in Congress, and on the Federal Reserve Board. The simple approach to feedback that uses only a single decision maker is therefore incomplete.

Some of these limitations of the feedback approach can be mitigated within its framework with ease. Others can be mitigated only with considerable effort. Still others are limitations that are impossible to ease or to remove. The following chapters provide a guided tour of these four kinds of limitations.