The other-wordly philosophers **The Economist** 16 July 2009

The purists, known as “freshwater” economists because of the lakeside universities where they happened to congregate, blamed stagflation on restless central bankers trying to do too much. They started from the classical assumption that markets cleared, leaving no unsold goods or unemployed workers. Efforts by policymakers to smooth the economy’s natural ups and downs did more harm than good.

America’s coastal universities housed most of the other lot, “saltwater” pragmatists. To them, the double-digit unemployment that accompanied Mr Volcker’s assault on inflation was proof enough that markets could malfunction. Wages might fail to adjust, and prices might stick. This grit in the economic machine justified some meddling by policymakers.

Mr Volcker’s recession bottomed out in 1982. Nothing like it was seen again until last year. In the intervening quarter-century of tranquillity, macroeconomics also recovered its composure. The opposing schools of thought converged. The freshwater economists accepted a saltier view of policymaking. Their opponents adopted a more freshwater style of modelmaking. You might call the new synthesis brackish macroeconomics.

Pinches of salt

Brackish macroeconomics flowed from universities into central banks. It underlay the doctrine of inflation-targeting embraced in New Zealand, Canada, Britain, Sweden and several emerging markets, such as Turkey. Ben Bernanke, chairman of the Fed since 2006, is a renowned contributor to brackish economics.

For about a decade before the crisis, macroeconomists once again appeared to know what they were doing. Their thinking was embodied in a new genre of working models of the economy, called “dynamic stochastic general equilibrium” (DSGE) models. These helped guide deliberations at several central banks.