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News release

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Household behaviour and policy analysis – speech by Martin Weale

In a speech delivered at the New Zealand Economists' Network 2nd Annual Conference, Martin Weale – External Member of the Monetary Policy Committee (MPC) – discusses economic modelling and policy analysis with a particular reference to the limitations of analysis based round the concept of a representative agent.

Weale focuses on disaggregate models, which represent the economy as a collection of individual households in different circumstances, and their use to address important policy questions. In particular, Weale describes the way in which such models can be used to address a heterogeneous range of topics: the effects of credit constraints and fears about credit availability; tax structure; social security and pension arrangements; and influences on the take-up of education by mature students. Models of this type can also be used to explore the importance of myopia – one of the possible behavioural forms considered in behavioural economics.

Weale concedes that these analyses are all partial. They do not address the behaviour of firms and they have taken prices as fixed. Weale points out that for the approach outlined to be used more widely by macroeconomists it needs to be extended to describe in full the workings of the economy. He discusses recent work which merges a model of heterogeneous agents with a New Keynesian production and pricing structure, yielding insights into the distributional impacts of monetary policy. Weale relates this to the current debate in the UK about the distributional impact of asset purchases and low Bank rate.

Weale ends by reflecting that disaggregated models provide interesting ways of looking at the world. He warns against putting too much weight on findings from analysis based on a representative agent. Weale considers that the development of disaggregate models may help us to understand the nature of the shocks which have affected the international economy over the past five years: "Tightening of credit and fear of tight credit has affected both firms and households and, in the United Kingdom at least, this may be limiting the scope for recovery. Disaggregate modelling offers a coherent means of exploring this latter issue."

Key Resources

Household behaviour and policy analysis

Full speech by Martin Weale (170KB)