

MAKING AND BREAKING RULES IN APPLIED ECONOMETRICS

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That is the question which has puzzled many an expert, and why? Because there were no reliable *rules*. Now we have the *Peter Kennedy rules*, and there will no longer be any difficulty. (Adapted from Sherlock Holmes to Dr Watson in *A Study in Scarlet*)

The lead article in Volume 1, Issue 1, *Journal of Economic Surveys*, 1987 was Adrian Pagan's 'Three Econometric Methodologies: A Critical Appraisal'. Reprinted in Oxley *et al.* (1995) *Surveys in Econometrics*, and updated in the same volume as 'Three Econometric Methodologies: An Update', the *Journal* quickly established an interest in papers that addressed the important issue of econometric methodology. Michael McAleer's 1994 *Journal* paper entitled 'Sherlock Holmes and the Search for Truth: A Diagnostic Tale' (also reprinted in Oxley *et al.*, 1995), and Dharma Dharmapala's 'On the History and Methodology of Econometrics', published in 1993, added to the *Journal's* growing portfolio of excellent papers published in this general area. It is fitting, therefore, that the current debate sparked by Peter Kennedy's 'Sinning in the Basement' paper be published in the *Journal*.

It is illuminating to re-read Pagan (1987, 1995) and see how far we have progressed. Adrian Pagan reminds us that although methodological debate in economics is almost as long-standing as the discipline itself (quoting John Stuart Mill, 1967): 'it was not until the Fifth World Congress of the Econometric Society in 1985 that a session was devoted to methodological issues' (p. 3). It is also interesting to note Adrian's highlighting of several of J. S. Mill's views on methodology. In particular: At the same time he (Mill) emphasized that, in many instances, it was easier to practice a science than to describe how one was doing it. He finally concluded that a better understanding of scope and method would facilitate the progress of economics as a science, but that sound methodology was not a necessary condition for the practice of sound methods. 'Get on with the job' seems the appropriate message. (p. 3).

This issue of the *Journal* contains contributions to the methodology of applied econometrics, and are presented in the Occasional Contributions section. The

catalyst for the initiative was Peter Kennedy's paper, which was submitted to the *Journal* in 2001. I encouraged several experts in the area to comment on his paper with a right of reply. These Comments from David Hendry, Jan Magnus and Ron Smith, and Peter Kennedy's Reply, are published below.

As will become apparent, Peter Kennedy's paper proposes a number of 'Rules of Sinning' (not surprisingly, 10 Rules) followed by '10 Commandments'. '[R]ules are made to be broken, as are Commandments' (see McAleer, 2001)), and the original set of divine rules (or Commandments) handed to Moses seems as though they had been worded so as to maximize their chances of demise. Michael McAleer and I know from personal experience that attempts to establish new sets of Commandments have a propensity to fall on barren ground — or is it ears? (The interested reader is directed to 'The Ten Commandments for Organising a Conference' (McAleer, 1997), 'The Ten Commandments for Attending a Conference' (McAleer and Oxley, 2001), and 'The Ten Commandments for Presenting a Conference Paper' (McAleer and Oxley, 2002)). Organisers of the 2001 Hawaii Conference on Business (see Oxley, 2001) appear not to have turned into 'pillars of salt', but will this fate befall econometricians if they ignore the latest set of Commandments proposed by Peter Kennedy?

The allusion to Commandments conjures divine associations. The issue in the case of econometrics is where this divine knowledge is held. Removing the biblical references and placing the issue in a modern context, we have the notion of experts, expert systems and codification of tacit knowledge. Such expert systems require the codification of operational rules extracted (somehow) from the experts. Oxley (1995) sketched-out a rudimentary system that might be used in econometrics, while Hendry and Krolzig (2001) and their PcGets software provide a working example.

The issue to be addressed is: Do rules lead to 'better' applied econometrics? Are Peter Kennedy's rules the way forward in a notoriously difficult discipline, or should we regard them as part of the quest for the econometrician's equivalent of the Holy Grail? Is sinning inevitable or even constructive?

Let the trial begin, with perhaps a reminder of a justifiably famous biblical quote: 'Let him who is without sin cast the first stone'. (John 8:7)

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