

# A Macro Annus Mirabilis?

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The GEM Project's generalization of rational exchange from the marketplace to workplaces restricted by costly, asymmetric workplace information is exceptionally consequential. That core theory simultaneously microfounds three separate models that, taken together, fundamentally reorganize textbook macro theory:

- Labor pricing that is chronically in excess of market opportunity costs;
- Nominal labor pricing that is downward rigid over stationary business cycles; and
- Employee on-the-job behavior in information-challenged workplaces.

Those models are needed to adequately explain the rational existence of involuntary job loss, the persistence of cyclical unemployment, the existence of good and bad jobs, the distribution of firm revenues among its production inputs, the behavior of pure profit, the determinants of capital spending, the primacy of income among the determinants of consumption, and more.

Chronic wage rent, downward-rigid labor pricing, and worker on-the-job behavior were derived simultaneously in the Project's close analysis of the optimizing and equilibrium properties of information-challenged workplace exchange. Their concurrent appearance is reminiscent of Albert Einstein's *annus mirabilis* that beautifully opened up research frontiers that greatly improved physicists' capacity to explain relevant evidence. In 1905, the great theorist reconstructed physics with a quick succession of papers on the special theory of relativity, the quantum explanation of the photoelectric effect, and the wondrous  $E=MC^2$ .

A huge difference between today and the 1905 *annus mirabilis* is that Einstein's breakout was rooted in individual genius that today remains a source of wonder. By contrast, the Project's fundamental reconstruction of labor, and ultimately macro, theory is the product of cumulating insights by many economists. Indeed, I can attest that the generalized-exchange theory was almost wholly anticipated by work done well before the founding of the GEM Project. Examples of the nearly forgotten research include:

- Kerr, Dunlop, Reynolds, Harbison, Myers, Lester, *et al.*, who in the middle 20<sup>th</sup> century pioneered labor economics that focused on modeling rational employee/employer behavior inside information-challenged workplaces. Unfortunately, their collective analysis never microfounded their descriptions of chronic wage rent, downward-rigid labor pricing, and worker on-the-job behavior.
- Dual-economy theorists, especially the underappreciated *Internal Labor Markets and Manpower Analysis* (Lexington, MA: D.C. Heath, 1971) by Doeringer and Piore that carefully summarized what was known about what goes on, and why, in highly specialized workplaces;
- Fixed-Wage General-Equilibrium theorists who elegantly explored the consequences of fixed nominal labor pricing in otherwise general market equilibrium, a line of thought inspired by Clower and Patinkin and associated with Barro, Grossman, Malinvaud, Drèze, Bénassy, *et al.* The FWGE school, constructed on the assumption of wage rigidity, was relatively quickly put out of business by the mainstream academy's insistence on market-centric general-equilibrium analysis absent assumptions of convenience.
- Efficiency Wage theorists, especially Solow and Annable's pioneering morale-centric version that was the most promising of that now moribund literature. Taken together, EW theory was an ambitious effort of macro theorists to model employer-employee interaction in information-challenged workplaces. Its persisting failure to microfound target on-the-job behavior, however, produced mounting disinterest in the nonmarket approach.
- The estimable Arthur Okun, who before his untimely death in 1980 got closest to putting the nonmarket pieces together in the posthumously published *Prices and Quantities* (Washington, DC: Brookings Institution, 1981);
- Behavioral economists whose carefully constructed experiments continue to yield results that improve our understanding of preferences that guide workplace behavior.

Taken together, that research collection provided the necessary ingredients to reconstruct macro theory that is much more closely aligned with available evidence and provides much improved support to policymakers. The puzzle pieces just had to be put together. The most important remaining question is how long it will take macroeconomists to get on with the hard work of incorporating the workplace venue into mainstream thinking.

