Another AJE:M Article

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Last week's post illustrates why the mainstream New Keynesian journal, *American Economic Journal: Macroeconomics*, has since its debut in 2009 failed to explain the most important instability evidence. The core problem is that *AEJ:M* editors assign top priority to defending the "settled" New Keynesian market-centric general-equilibrium model class. That is a demanding task, especially since they must know their theory cannot rationally accommodate meaningful wage rigidity (MWR) or involuntary unemployment. But the gatekeepers, seemingly immune to shame, are persistent. Over time scholars have learned that publishable papers avoid the thorny New Keynesian ambition to microfound the suppression of wage recontracting.

It's apparently OK to do empirical analysis on macro phenomena that are rooted in MWR. But it is not acceptable to go outside the bounds of market centricity in the effort to rigorously model wage rigidity, which would enable sensible interpretation of empirical findings. Leading NK theorists believe in and impose a research agenda that rejects the New Neoclassical Synthesis mandate insisting macroeconomics be rooted in rational behavior. The NK academy is satisfied with keystone wage rigidity, e.g. the staggered Calvo Wage, that is obviously irrational.

As readers of this blog understand, that editorial judgement dooms NK macro theory to stabilization irrelevance. Readers also know that rational MWR results from optimizing employee-employer exchange that occurs in workplaces that are inherently restricted by costly, asymmetric information. *AEJ:M* editors don't want to hear that; they don't want, for whatever self-interest, to acknowledge that market-centric macroeconomics is not now, and since the Second Industrial Revolution has not been, settled theory. The GEM Project easily demonstrates that the price of the mainstream NK unwillingness to intuitively generalize rational exchange from the marketplace to the information-challenged workplace is the consequent inability to explain the most important instability evidence and, therefore, provide sensible policy advice.

The *AEJ:M* editorial satisfaction of with that sorry state of affairs is apparent with each publication of an article that involves, at least implicitly, unmentionable MWR and involuntary job loss. In other words, articles involving macro instability. There is a second telling example of the sorry state in the most recent issue, "Reconsidering the Consequences of Worker Displacements: Firm versus Worker Perspective," by Aaron Flaaen, Matthew D. Shapiro, and Isaac Sorkin (hereafter FSS). The authors summarize their article, which gets off to a promising start by recognizing that worker displacement produces involuntary job loss, as follows:

"Prior literature has established that displaced workers suffer persistent earnings losses by following workers in administrative data after mass layoffs. This literature assumes that these are involuntary separations owing to economic distress. This paper examines this assumption by matching survey data on worker-supplied reasons for separations with administrative data."

FSS use administrative and survey data to test this hypothesis:

"This literature assumes that when a firm is contracting by 30 percent or more, the workers who separate do so because of economic distress at the firm. It is not obvious, however, that all separations in these events are due to economic distress. For example, even when a firm is contracting by 30 percent or more, some workers might be quitting to better jobs. Such quits would lead to a downward bias in estimates of the earnings effects of displacements."

FSS find that: "Using a new methodology to account for the increased separation rates across all survey responses during a mass layoff, the paper finds earnings loss estimates that are surprisingly close to those using only administrative data." I don't know who, besides the authors, is surprised by that result; certainly there is no surprise here for friends of the GEM Project or anybody who has ever been involved with a large firm downsizing. They know that substantial contractions must produce joblessness that is overwhelmingly involuntary along with the loss of attendant wage rents and elongated search for replacement employment, which will pay significantly than the lost job. There, of course, may be a few voluntary quits in the mix reflect the spattering of employees who lined up another rent-paying, and therefore rationed, job.

It is a recurring pattern of the *AEJ:M* that any analysis of forced job separation, which is at the center of macro instability, is empirical. Authors avoid attempting to explain the phenomenon. As a result, *AEJ:M* articles such as the one by FSS are not very interesting. Nor are they policy useful. More generally, the limitations of mainstream market-centricity significantly compromises the ability of the academy to explain the behavior of modern highly specialized economies.

I cannot help it. I read something instability-related in the *AEJM* and I think through how it would be improved by application of generalized-exchange theory. The answer is always a lot. GEM modeling derives continues-equilibrium ILJ by microfounding MWR, which in information-challenged workplace rationally suppresses wage recontracting and motivates chronic wage rents. Given that context, the FSS article would come alive, illuminating macro phenomena that are important. The two-venue macro theory uniquely explains the nature of both involuntary permanent job loss and reduced wages in new employment. What policymakers can do about each is shown to be the product of rational behavior. Proper policy here is substantially different from effectively dealing with temporary job loss.

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