

# At Last, A Coherent Theory of Involuntary Unemployment

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Mainstream macro theorists reasonably insist on coherence with mainstream microeconomics. The early Keynesian separation of macro and micro into incompatible systems has long been unacceptable in the academy. In pursuit of coherence, modern model-builders work within the common framework of dynamic stochastic general-market-equilibrium (DSGE). We know, however, that the general practice has a fundamental problem. The consensus model class cannot coherently accommodate involuntary job loss, especially in response to nominal demand disturbances, and consequently cannot be stabilization relevant. The inability of modern theorists to convincingly conjoin coherence and stabilization-relevance has marginalized their thinking, notably forcing it to the policymaking sidelines during the perilous Great Recession. This paper shows how to restore stabilization relevance without giving up model coherence. The key to that happy outcome is the intuitive generalization of rational labor-related exchange from the marketplace to the large-establishment workplace. Two-venue general equilibrium modeling is an important, sensible innovation, introducing a powerful new frontier to macro analysis and opening up an extensive research agenda – an overview of which is provided.

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