

Famous Recanting of Barro and Grossman

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Last week's post praised the 1970s fixed-wage general-equilibrium (FWGE) model of Keynesian consumption constructed by Robert Barro and Hershel Grossman. That model class, however, assumed wage rigidity and was eventually, and fiercely, recanted by both authors, capturing the uncompromising mood of the times. By the publication of their *Money, Employment, and Inflation* (1976, p.6), the authors were feeling the heat of increasing New-Classical insistence that all macro models be explicitly constructed on optimizing market exchange organized by general-market-equilibrium. No free parameters allowed. From the Introduction to their insightful book: "One other omission from our discussion is especially embarrassing and should be explicitly noted. Although the discussion stresses the implications of exchange at prices which are inconsistent with general market clearing, we provide no choice-theoretic analysis of the market-clearing process itself. In other words, we do not analyze the adjustment of wages and prices as part of the maximizing behavior of firms and households. Consequently, we do not really explain the failure of markets to clear, and our analyses of wage and price dynamics are based on *ad hoc* adjustment equations."

The famous recanting sent out several messages. First, it was remarkably quick – just five years after their path-breaking article. The influence of the ascendant new neoclassical insurgents must have been immense as early as the mid-1970s. Second, microfounding meaningful wage rigidity, defined by its capacity to rationally suppress wage recontracting, must have been viewed by that time by the best macro theorists as too tough a nut to crack. Third, and most instructive, forcing the recanting of a fine piece of economic research that helped explain important evidence indicates that there was no damage to stabilization-relevance that the neoclassical insurgents were unwilling to pay. Keynesian consumption, primarily driven by income and a pillar of macro modeling organized around aggregate demand, was hereafter generally thought to be inconsistent with micro-coherent analysis. The postwar anti-Keynesian revolution in the academy was conducted by dangerously ambitious people.

Perhaps the greatest personal cost was to Barro. He is the surviving author of the FWGE Keynesian consumption model that represented a powerful advance in macroeconomics. It demonstrated the elegance and relevance that, given the eventual microfounding of meaningful wage rigidity, would have moved him into the all-time top rank of macro theorists.

It is an instructive question why he does not resurrect his signature contribution to macroeconomics now that the GEM Project has definitively derived MWR from axiomatic assumptions rooted in optimizing exchange organized by general decision-rule equilibrium. His Nobel Prize is waiting.

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