Helping Great Economists: Sir John Hicks

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John Hicks was a giant of 20th-century economics. Like a number of other great economists, he began his studies specializing in mathematics, later switching to economics.

Hicks was knighted in 1964 and shared the Nobel Prize with Kenneth Arrow in 1972. In the aftermath of the publication of my 1984 book (*The Price of Industrial Labor*), I corresponded with Sir John who had a lifelong interest in labor pricing. He was a kind and insightful scholar, who understood the necessity of microfounding meaningful wage rigidity (MWR) if macro theory is to be stabilization-relevant.

Original Great Idea

In his 1937 *Econometrica* article, Hicks famously reformulated the goods and money markets in Keynes's *The General Theory* to be consistent with a general-market-equilibrium framework that he generally (and casually) restricted by assumed price rigidities – his famous IS-LM model. That paper ("Mr. Keynes and the 'Classics'") became one of the most cited papers in the literature. A few years later, in his 1944 *Econometrica* article, Franco Modigliani demonstrated that Keynes's signature labor-market failure centrally required wage rigidity. Early Keynesian analysis was constructed on IS-LM equilibrium restricted by assumed labor-price stickiness.

GEM Helping Hand

Some context. In their influential *Lectures on Macroeconomics* (1989), Stanley Fischer and Olivier Blanchard concluded that Early Keynesian thinking, especially the Neoclassical Synthesis, was "in theoretical crisis". In response, they organized their text around a benchmark neoclassical model featuring "optimizing individuals and competitive markets" with an important caveat. While research on microfounding wage and price rigidities evident in the data was on-going, B&F argued EK shortcut assumptions remained necessary to inform policymakers, the alternative being "a harmful utopia that leaves the real world to charlatans". (pp.27-28) *Lectures* includes irrational models that are "the workhorses of applied macroeconomics", notably featuring Hicks's IS-LM interpretation of *The General Theory* that assumed non-microfounded price rigidity. B&F position their text to occupy a difficult middle ground in an increasingly contentious debate.

New Keynesian criticism. The "charlatans", however, won. Given that Hicks's IS-LM analysis was constructed on the assumption of nominal price rigidity, it was therefore rejected in macro mainstream once it was organized by the New Neoclassical Synthesis, a revolution led by New Keynesians, New Classical, and Real Business Cycle theorists. The reassertion of neoclassical macroeconomics moved Hicks's theoretical infrastructure to the dustbin.

How GEM modeling helps. Microfounded MWR rescues the IS-LM great idea, restoring its acceptability in aggregate-demand analysis. More interesting to me, it also powerfully informs Hicks's attempt late in his career to model nominal wage rigidities. Hicks came close to the GEM Project's description of modern labor pricing without actually microfounding MWR.

Melding the Project's large- and small-establishment wage determination provides a powerful, integrated version of the flex- and fix-price aggregate-supply modeling of John Hicks. Using the great 20th-century theorist's macro analysis to provide literature roots for generalized-exchange theory is more than a presentational convenience. Hicks (in his *Crisis in Keynesian Economics* (1974), p.66) explicitly motivated his fix-price sector with an intuitive workplace exchange relation (WER): "Employers were reluctant to raise wages, simply because of labor scarcity; for to offer higher wages to particular grades of labor that had become scarce would upset established differentials. They were reluctant to cut wages, simply because of unemployment; for if they did so they would alienate those whom they continued to employ. The 'stickiness' is not a matter of money illusion; it is a matter of continuity."

Is the Game Worth the Candle?

Yes. It is not every day that you get to rescue Sir John Hicks from the dustbin. Cumulative score: Worth it: 9 (Lewis, Solow, Harris-Todaro, Bernanke, Lucas, Samuelson, Kerr *et al*, Okun, Hicks). Not worth it: 0. As the score builds, keep in mind the major objection of mainstream theorists to generalized-exchange macroeconomics:

Adding a second (workplace) venue of rational exchange is too much work. Its benefits are not worth the effort.

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