# Market Myopia

**Author :** James Annable

**Date :** May 4, 2018

Why doesn't the modern macro consensus organized around the market-centric, general-equilibrium model class simply self-destruct? Doesn't the embarrassment of having to having to push aside the most critical business-cycle facts, especially after experiencing a huge dose of involuntary job loss and other ignored evidence during the 2007-09 Great Recession, weigh heavily in the academy? Was anyone really surprised that stabilization-policymaker criticism of the usefulness of mainstream modeling in the aftermath of that extreme instability has been brutal? Vitriol is readily summoned when the cause is righteous and the target unmindful.

Karik Athreya, a stout defender of mainstream thinking, provides my personal favorite defense against the post-crisis condemnation. To paraphrase, critics do not appreciate how hard it is to do stabilization-relevant analysis within the mainstream dynamic stochastic general-market-equilibrium framework. From Athreya (2013, p.158): "Explaining macroeconomic method seems worthwhile, if only to communicate the difficulties that face anyone confronting macroeconomic questions. It is lack of appreciation for these difficulties, I think, that explains why we are taken to task for bad outcomes in ways that physicians, even when they can do nothing for patients, are not." From that timorous perspective, Athreya's *Big Ideas in Macroeconomics* (2013) reviews the limits to mainstream thinking, taking care not to take those boundaries as an indictment of the dominance of market-centric general equilibrium. "Instead, in each case, I will describe events through a narrative in which specific features arise somewhat naturally as a *compromise* (if an uneasy one) between expanding the 'reach' of a model [i.e., its capacity to explain the range of crucial evidence] and retaining its internal consistency. This, to my mind, is *the* central tension in macroeconomic model construction." (p.159)

Good for Athreya. He is, if only by example, getting at the nub of the failure of the stabilization-irrelevant edifice that is mainstream macroeconomics to collapse. The root cause, to coin a term, is *market-exchange myopia* (MEM). Athreya simply cannot imagine a coherent analytic framework other than the market-centric general-equilibrium model class pioneered by Walras, Arrow and Debreu. That breakdown in imagination does not mean that he or like-minded economists are not otherwise smart, well-trained, and well-intentioned. How they, with their many virtues, became convinced that market exchange is coterminous with all relevant economic exchange is a question that has been and will continue to be explored in the GEM Project.

Market myopia motivates Athreya's "central tension in macroeconomics" between explaining the range of critical instability evidence and maintaining the micro-coherence of mainstream macro theory. The GEM Project shows how to effectively resolve that dilemma by identifying the central mainstream failure to be the academy's non-intuitive insistence on restricting price-mediated exchange to the marketplace, pushing generalized-exchange macroeconomics and its capacity to be both coherent and stabilization-relevant outside the boundaries of "settled" theory. The substantial work needed to open up new frontiers in existing human capital is the critical roadblock. The GEM Project encourages macroeconomists to set personal ease aside, summon the courage to peak outside the mainstream market-centric box, and explore the more powerful generalized-exchange theory. When Athreya and his colleagues decide to become relevant, they will have good company. Kenneth Arrow (1974) and Sir John Hicks (1974) are examples of reputable theorists, deeply familiar with the general-market-equilibrium model class, who analyzed behavior inside large workplaces in order to solve problems outside the reach of the consensus market-centric framework. Absent that ambition, mainstream macroeconomists will continue to be stuck in a damaging stoicism that simply accepts being unable to explain the most critical instability evidence. If their stoicism is maintained, they should at least accept and acknowledge rejection as useful stabilization-policy advisors.

The better choice for dominant New Keynesian theorists is to accept the intuitive generalization of optimizing exchange from the marketplace to information-challenged workplaces. They would then no longer need to ignore crucial facts produced by modern, highly specialized economies, resolving the important difficulties that concern Athreya. The two-venue approach, given a chance, is easy to like. For example, it does not dismiss the Second Industrial Revolution, the obvious importance of large corporations, or the Nobel-honored work of Coase, Simon, and Williamson. Athreya acknowledges that missing literature: "… the [DSGME] model simplifies firms and thus gains tractability, but loses the ability to analyze any serious questions having to do with the nature of incentives within organizations." (p.38) His root problem, which he shares with almost everybody in the macro mainstream, is insufficient model-building curiosity. Market myopia prevents the New Keynesian mainstream from grasping the significance of optimizing activity occurring in large organizations. Relatively brief examination reveals the intra-firm "serious questions" to be profoundly consequential. The market-centric

training and practice of mainstream theorists has so dulled their instincts and ambition that an unexplored incentive class, the importance of which is obvious to everyone else, fails to excite interest.

Blog Type: New Keynesians Saint Joseph, Michigan