New Keynesian Teachers, Cornered

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Date : Feb 22, 2019

Mainstream macroeconomics professors' persistence in restricting rational exchange to the marketplace must make teaching a tough row to hoe. It must be obvious to their students that important transactions occurring in nonmarket venues are being ignored, casting doubt on the bona-fides of the neoclassical curriculum. The suppression is nowhere as consequential as in the case of large bureaucratic firms. Students are surely aware of decision-making inside such enterprises that is greatly at odds with textbook market-centric analysis. For example, highly-specialized profit-seeking firms layoff employees, rather than cut their nominal wages, in response to significant weakenings of demand. It is no secret that six million workers were laid-off in the 2008-09 Great Recession, an episode that arouses great interest in the classroom. In another important example, complex bureaucratic enterprises pay their workers chronic premiums above the market opportunity cost – a management choice that market-centric modelers misunderstand as irrational. The two examples illustrate an existential challenge to the stabilization relevance of New Keynesian macro theory.

Market-centricity substantially damages the capacity of mainstream macroeconomists to provide both useful advice to stabilization authorities and adequate instruction of students, especially in graduate schools where the NK neoclassical model class has a stranglehold on content. The GEM Blog has focused on the first problem; what follows looks at the second.

Implausible instruction. Teaching market-centric macroeconomics, consistent with the New Neoclassical Synthesis and falsely advertised to be stabilization-relevant, must strain instructors' sense of decency. Knowingly misleading students must be very difficult. NK teachers must either ignore involuntary job loss, the major cause of rising unemployment in recessions, or sneak in irrational assumptions to suppress wage recontracting. Chronic wage rents almost never come up. Unemployment persistence is explained with voluntary unemployment that occurs in job search, with little concern about the fundamental conflict with well-known evidence. Job downsizing, pure-profit expectations (and their impact on investment), and the role of the wage-price spiral in the 1970s stagflation are all out of bounds, as is the 1930s Great Depression. Discretionary management of total nominal demand is at best downplayed, implying no coherent discussion of the Fed's 2008-09 massive buyer-of-last-resort that shored up total spending and prevented the Great Recession from morphing into a cataclysmic depression. All in all, cornered NK teachers must attempt to sweep the most crucial characteristics of macro instability in highly specialized economies under the rug.

The great problem, besides ethics, of the cornered teaching plan is that students are not stupid. They have personal experience with macro events; they read news sites and newspapers; they get around. As a result, most know that the NK stabilization story is bunk. The results of David Colander's (2005, p.180) survey of and interviews with graduate students at seven top-ranked economics programs in North America do not surprise. Young scholars, even before the Great Recession and the associated attack by policymakers' on the uselessness of mainstream macro theory, has become disgusted with the macro product: "In the interviews, macro received highly negative marks across schools. A typical comment was the following: 'The general perspective of the micro students is that the macro courses are pretty worthless, and we do not see why we have to do it, because we don't see what is taught as a plausible description of the economy. It's not that macroeconomic questions are inherently uninteresting; it is just that the models presented in the courses are not up to the job of explaining what is happening. There's just a lot of math, and we can't see the purpose of it.'" Another student was more succinct: "Macro sucks." (Colander (2007), p.174).

Plausible instruction. Accepting the necessity of generalizing rational exchange from the marketplace to information-challenged workplaces, this is how – in outline – teaching stabilization macro theory could go. The rationale, rigorously derived from axiomatic assumptions in the GEM Project and reinforced by the best-practices management literature, for meaningful wage rigidity would be properly microfounded. MWR would be restored to its keystone status in stabilization-relevant macro theory by its capacity, for a substantial part of the labor force, to rationally suppress wage recontracting and support the profit-seeking payment of wage rents.

Given MWR, it is easy to produce involuntary job loss and evidence-consistent movement in employment, output, and income in response to adverse nominal-demand disturbances. Given chronic rents, it is easy to motivate unemployment persistence in business cycles; it is easy to motivate why significant share of laid-off workers eventually return to the employer who laid them off. It is easy to demonstrate why most employees persist in being out of labor-market equilibrium. It is easy to motivate firm downsizing, permanent job loss, and wage givebacks as a long-lagged result of chronic wage rents.

The MWR elucidation as the keystone concept in periodic macro instability easily leads into useful Keynesian analysis of consumption, investment (with a focus on pure profit), and net export spending as well as the demand-management roles of the central bank and the federal government. Instructors presenting this intuitive, useful story will be made confident by its consistency with the New Neoclassical Synthesis that mandates that macro modeling be rooted in rational price-mediated exchange organized by general decision-rule equilibrium. Of the three fundamental characteristics of economic theory, only market centricity is (and should be) violated; optimization and equilibrium continue to hold. It is not unreasonable to believe that students would become interested in macroeconomics again.

Blog Type: New Keynesians San Miguel de Allende, Mexico