Robert Lucas: Figuring It Out

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Robert Lucas was a towering figure in the anti-Keynesian revolution that eventually installed market-centric general-equilibrium as the mainstream macro model class. He insisted that acceptable models be rooted in rational behavior. In particular, he forcefully argued that inconsistent foundations for macro and micro cannot be sustained. Most economists, including New Keynesians and most recently the theorists associated with the GEM Project, agree. Everybody began taking microfoundations very seriously.

Lucas, however, differs from mainstream dogma by refusing to accept modern macroeconomics as settled theory. Lucas's intellectual honesty is front and center in his public recognition that stabilization irrelevancy is the price paid for the success of the anti-Keynesian revolution. He has clearly thought hard about that outcome, as illustrated by some musings in a 2004 speech: "The problem is that the new theories, the theories embedded in general equilibrium dynamics of the sort that we know how to use pretty well now – there's a residue of things they don't let us think about. They don't let us think about the U.S. experience in the 1930s or about financial crises and their real consequences in Asia and Latin America. They don't let us think, I don't think, very well about Japan in the 1990s."

Perhaps his most critical recognition is: "We may be disillusioned with the Keynesian apparatus for thinking about these things, but it doesn't mean that this replacement apparatus can do it either. It can't. In terms of the theory that researchers are developing as a cumulative body of knowledge – no one has figured out how to take that theory to successful answers to the real effects of monetary instability. Some people just deny that there are real effects of monetary instability, but I think that is just a mistake. I don't think that argument can be sustained." Well, it's my blog; my assessment is more blunt. His "some people" must have encountered the widely available nominal-to-real instability evidence that periodically features millions of involuntary lost jobs and decided, given that the phenomenon cannot be accommodated in their "settled" mainstream model class, to simply ignore it . How can they not be among today's most intellectually dishonest macro theorists. Mainstream research is at its core Ptolemaic.

The GEM Project is developing a macro theory that is a more general cumulative body of knowledge, one that does not exclude the estimable contributions of the Early Keynesians as well as the powerful information readily available from corporations' best practices. The Project has figured out how to derive, from axiomatic model primitives, recognizably-sized real effects from disturbances in nominal demand. The Early Keynesians, beginning with Modigliani and Patinkin, insightfully identified the necessary analytic keystone for useful research: meaningful wage rigidity rooted in rational behavior. The Project rigorously refines MWR, properly defining and microfounding MWR, forcefully arguing what competent macro theorists already, at least deep down, know. Absent MWR, stabilization-relevant macroeconomics is not possible. Unfettered wage recontracting, a pillar of market-centric modeling, will always subvert the capacity of adverse nominal demand disturbances to induce involuntary job loss.

Why couldn't Lucas, a smart guy, figure that out? In retrospect, the problem seems pretty obvious. He, and almost everybody else, never grasped the debilitating nature of restricting rational exchange to the marketplace. Mainstream macro theorists debate micro-coherence, they debate dynamics, they debate stochastic, they debate multi-market equilibrium, they debate equilibrium. They debate everything but what really matters when it comes to stabilization-relevance. Nobody considers market centricity to be a choice. But it is simply not true that all interesting price-mediated exchange occurs in the marketplace. The GEM Project, featuring the generalization of rational price-mediated exchange from the marketplace to information-restricted workplaces, makes clear that market centricity has been progressively damaging macro stabilization relevancy for more than 100 years.

More from Lucas: "Keynes's first objective is to say, 'Look, there's got to be a way to respond to depressions that's consistent with capitalist democracy.' What he hits on is that the government should take some new responsibilities, but the responsibilities are for stabilizing overall spending flows. You don't have to plan the economy in detail in order to meet this objective. And in that sense, I think for everybody in the postwar period – I'm talking about Keynesians and monetarists both – that's the agreed-upon view: We should stabilize spending flows, and the question is really one of details about how to best do it." Bravo. That is a pretty good summary of the modern context for doing stabilization-relevant macroeconomics. Of course, I would add something pretty important. The GEM Project has figured out how, by generalizing rational price-mediated exchange, to embed that practical context in optimizing dynamic stochastic general-decision-rule-equilibrium theory. That rational-behavior model uniquely provides powerful guidelines for model-building that is simultaneously micro-coherent and stabilization relevant. Isn’t that too good a deal for macroeconomists to pass up?

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