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Sashay past Zuccotti Park and the signs bob up and down like puppets. All Debt Is Evil followed by Where's My Bailout? next to End the Fed. A little confused? And the rest of world's not? Several weeks ago, as Occupy Wall Street was hitting prime time, the Royal Swedish Academy of Sciences announced the Nobel Prize for economics. Two American economists, Thomas Sargent at New York University (lured from Stanford in 2002) and Christopher Sims of Princeton University (recruited from Yale in 1999 by pre-Federal Reserve Ben Bernanke) bagged the prize "for their empirical research on cause and effect in the macroeconomy." The pair employed the rational expectations hypothesis to rewrite economic models, The Wall Street Journal noted, "that central bankers and other economic policy makers use to analyze the likely effects of measures from tax increases to interest-rate cuts. Earlier models had proved simplistic, failing to account for the ways that policies and individual behavior affect one another." The tone assumed a reverence for economic authority the protesters, if they cared, would have denounced. Still, economists applauded politely, and the media that cares about such things, after reciting accomplishments, seemed more fixated on the national triumph: We're still No. 1, baby! The fact that the economy still flounders, rendering Sims' and Sargent's models (among others) suspect, was apparently not relevant. The Swedes had spoken.

For a brief moment, it was the '80s and '90s again, a period in which Sims and Sargent did much of their prizewinning work and when rational expectations soared like a butterfly over a gathering Great Moderation economy. Rational expectations emerged from a broader political context that featured a Reaganite distrust of state action. Markets anticipated, and often undercut, state actions. Government intervention, whether fiscal, monetary or regulatory, "distorted" the natural unfolding of markets toward equilibrium; the belief in market efficiency was thus a doppelgänger to rational expectations. But for all its identification with free markets and a reduced role for government, "Freshwater" rational expectations shared some underlying fundamentals with its rival, "Saltwater" New Keynesians. Both define markets as "rational," based on a set of hypothetical relations of their choosing. As Roman Frydman and Michael Goldberg argue in their recent book, "Beyond Mechanical Markets," both construct mechanical models that in theory provide, like physics, predictability. These models are "predetermined," encompassing causal relations that drive outcomes for individuals and markets. Any divergence from those rational outcomes becomes "irrational," from mispriced stocks to so-called bubbles.

Frydman and Goldberg are deeply skeptical of those mechanical models (though they accept mathematical models based on different premises). Their skepticism is both empirical -- if they work so well, why can't we predict outcomes more effectively? -- and conceptual: They don't believe markets are predetermined. Instead, markets are arbiters of what they call "non-routine change" and "imperfect knowledge," from technological dynamism to Zeitgeistian mood swings to a thousand factors that elude foreknowledge. Investors are not irrational; in fact, they

are, they argue, quite rational in coping with uncertainties that can't simply be talked away. This position has less to do with politics and more to do with the market phenomenon strapped upon the gurney. The rational expectations crowd, the New Keynesian formalizations of the great man's "General Theory" – Keynes himself accepted the ineradicability of uncertainty, which makes you wonder if he would ever have subscribed to the full New Keynesian faith – and even some behavioral economists, who blame market woes on human waywardness, go wrong, they insist, when they embrace mechanical models of reality. The pair even claim Friedrich Hayek, who attacked a tendency in economics to scientism or universal rules, as a ghostly supporter.

Who's right? Well, markets prone to nonroutine change feel more intuitively true than predetermined markets driven by the mechanical unfolding of cause and effect. Intuition isn't exactly rigorous, of course. Prediction does seem a reach for earthbound souls, even those with tenure, a chair or a Nobel; and the future, historically or financially, seems just as uncertain as it was to the Greeks, ancient and modern. To steal from Irving Kristol, rational expectations has been mugged by reality. Is rational expectations, as represented by Sims' and Sargent's models, progressing toward perfection, or, as Frydman and Goldberg suggest, is the entire enterprise as fundamentally flawed as Alan Greenspan's regulatory model? This is a big question for an age saturated, despite the yearnings of the Occupy crowd, in economic thinking and pervasive markets. In short, this debate over the nature of markets is fundamental, although the great mass of economists and practitioners, the trophy-giving Swedes and much of the media may not fully realize it. What is a market? When you see that on a sign, you'll know we're getting somewhere.