BPEA and Monetary Policy over 50 Years

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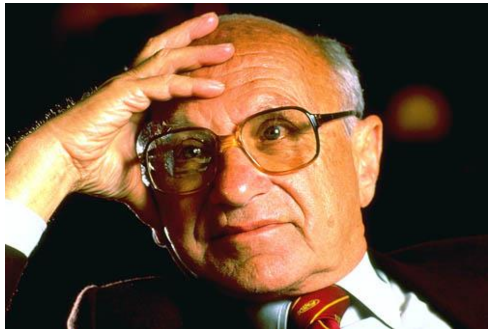
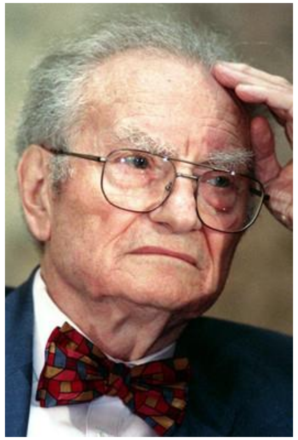
Macroeconomics circa 1970

- Loose “theory” was tolerated.
- Giant macroeconometric models roamed the earth.
- The Keynesian-monetarist wars were raging.





Okun and Perry assembled the whiz kids

- Bill Poole (1937)
- Bill Branson (1938)
- Bob Gordon (1940)
- Barry Bosworth (1942)
- Bob Hall (1943)

Important Note: I’m younger than all of them!

I limit myself to three topics

1. Phillips curves
2. Money growth and monetarism
3. Ideas for and evaluations of monetary policy

1. BPEA and the Phillips Curve

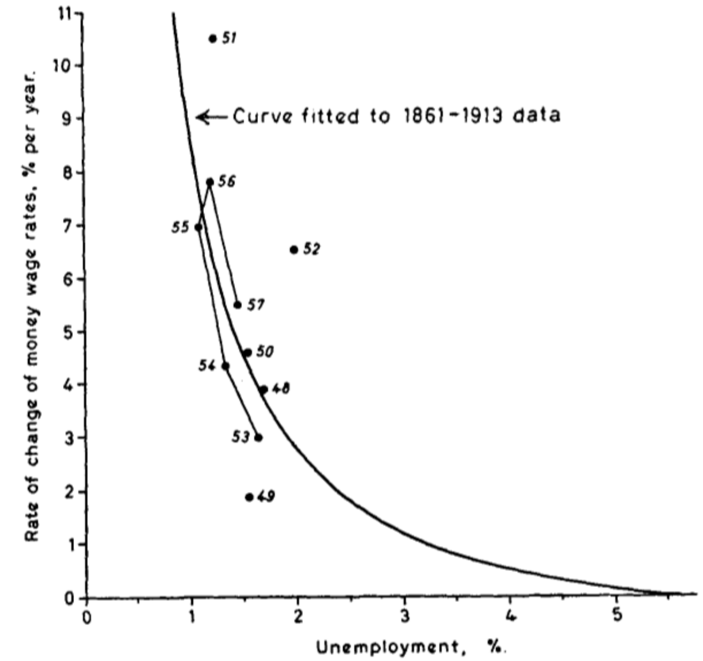


Fig. 10. 1948-1957

The early days

$$w_t = \alpha(L)\pi_t + f(U_t) + \varepsilon_t$$

$$\Sigma\alpha(.) < 1$$

Phillips (1958): $\alpha = 0$

Lipsey (1960): $\alpha = 0.76$

Gordon (BPEA, 1970): $\alpha = 0.45$

But the Friedman-Phelps critique hung over these estimates. $\Sigma\alpha$ should be 1.

The next generation

- Gordon (BPEA, 1972): a nonlinear $\alpha(\pi)$, rising to 1 at about 7% inflation.
- Then supply shocks started to hit, throwing first-generation Phillips curves off.
- BPEA published multiple papers about supply shocks in 1973-74
- Gordon's (1975) Phillips curve had *both* supply shocks *and* $\alpha \approx 1$.

  -- "Chateau Gordon 1975"
- The Brookings Rule of Thumb (one point year of U lowers π by ½ point)

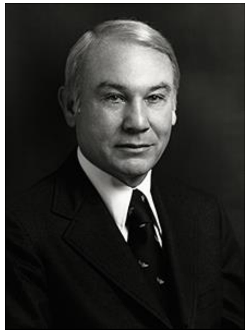
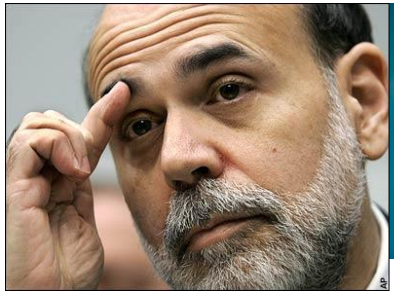
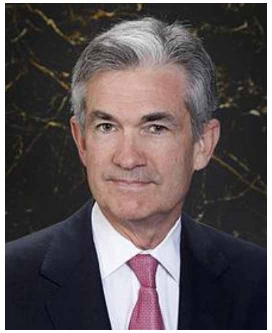
The Phillips curve vanishes

- Q1: Why didn't the low unemployment rates of the late 1990s raise inflation more (Gordon 1998)?
- Q2: Why didn't the Great Recession reduce inflation more (Krueger, Cramer, and Cho 2014)?
- Q3: Why has the Phillips relationship disappeared?
- I eagerly await Chateau Gordon 2022.

2. Money growth and monetarism

- Mission Possible: Okun and Perry; but Poole in defense (despite *QJE* 1970)
- Historical irony: Monetarism *rose* on the back of rising inflation. But then it *fell* because high inflation spurred financial innovation.
- Many papers on money demand and financial innovation (Goldfeld 1976)
- Blinder as discussant for Simpson (1984): "an intelligent brief about why the Federal Reserve should not have done what it did between October 1979 and October 1982."
- Bill Poole was overworked, but never convinced.

3. Advice for monetary policymakers

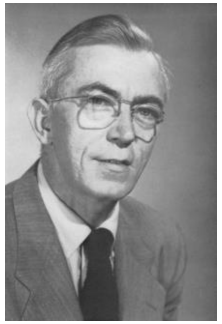
       

The early days

- First BPEA issue, Kareken (1970): “the economy may take one course if the FOMC uses the [Treasury] bill rate and money market variables in specifying policy… and another if it uses one or more of the monetary aggregates”
- Second BPEA issue, Poole (1970): “politicians and the informed public now clearly recognize that excessive zeal in fighting inflation will produce excessive unemployment”
- Okun (1972) on rules-versus-discretion. (This was long before Kydland and Prescott (1977), but long after Friedman (1948).)
- A notable disconnect between theory and reality: The Kydland-Prescott (1977) and Barro-Gordon (1983) models basically predicted that inflation would always be *too high*, not that it would *rise* (as it had from 1965 to 1980 in the U.S.) and then *fall* (as it did after 1980).

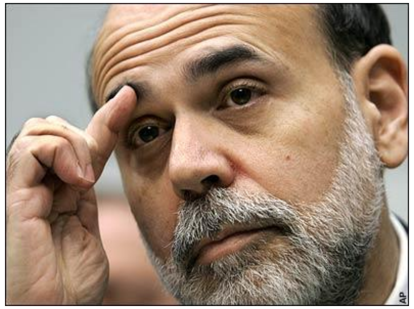
The early days (continued)

- 1974: Notable BPEA debate between Tobin and Poole. (Guess who the two discussants were!)



- 1975: Modigliani and Papademos estimated the NIRU (NAIRU) at 5.1-5.8%, and said that “monetary policy should be aimed at explicitly stated targets for real output and employment” (Nominal anchors were not yet in vogue!)

The Bernanke oeuvre



- 1991 (with Lown): on the credit crunch
- 1997 (with Gertler and Watson): on oil shocks and monetary policy
- 2004 (with Reinhart and Sack): “Monetary Policy Alternatives at the Zero Bound”
- 2018: on the real effects of “disrupted credit” during the financial crisis. (He should know!)

A few other notable highlights

- Krugman (1998) on the liquidity trap coming "baaack."
- Eggertsson and Woodford (2003) on optimal monetary policy at the zero lower bound (led to "lower for longer")
- John Williams (2009) on why the 2% inflation target might be too low (Or was that his evil twin?) 
- A host of papers between 2010 and 2018 on unconventional monetary policy—including one by Janet Yellen (2018)
- Eric Rosengren and others (2018) called for a Fed review of its strategy, tools, and communications.

Summing up: BPEA’s greatest hits

1. Development of empirical Phillips curves
2. The demise of monetarism
3. Sensible thinking and writing about supply shocks
4. Keeping the Keynesian flame burning through *several* Dark Ages

Thank you, BPEA!