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

![Chart showing the Phillips Curve with data points for 1948-1957.](chart.png)
The early days

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

\[ \sum \alpha(.) < 1 \]

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 $\pi$ by $\frac{1}{2}$ 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

- 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!