FRIEDMAN'S PRESIDENTIAL ADDRESS IN THE EVOLUTION OF MACROECONOMIC THOUGHT

N. Gregory Mankiw
Harvard University

Ricardo Reis
LSE

American Economic Association
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TWO DIMENSIONS

Phillips curve / business cycles	The long and the short run	Role of expectations
Monetary policy	Cannot do	Can do

BEFORE THE ADDRESS

PROBLEM OF ACHIEVING AND MAINTAINING A STABLE PRICE LEVEL

ANALYTICAL ASPECTS OF ANTI-INFLATION POLICY

By Paul A. Samuelson *and* Robert M. Solow
Massachusetts Institute of Technology

I

Just as generals are said to be always fighting the wrong war, economists have been accused of fighting the wrong inflation. Thus, at the time of the 1946-48 rise in American prices, much attention was focused on the successive rounds of wage increases resulting from collective bargaining. Yet probably most economists are now agreed that this first postwar rise in prices was primarily attributable to the pull of demand that resulted from wartime accumulations of liquid assets and deferred needs.

This emphasis on demand-pull was somewhat reinforced by the Korean war run-up of prices after mid-1950. But just by the time that cost-push was becoming discredited as a theory of inflation, we ran into the rather puzzling phenomenon of the 1955-58 upward creep of prices, which seemed to take place in the last part of the period despite growing overcapacity, slack labor markets, slow real growth, and no apparent great buoyancy in over-all demand.

It is no wonder then that economists have been debating the possible causations involved in inflation: demand-pull versus cost-push; wage-push versus more general Lerner "seller's inflation"; and the new Charles Schultze theory of "demand-shift" inflation. We propose to give a brief survey of the issues. Rather than pronounce on the terribly difficult question as to exactly which is the best model to use in explaining the recent past and predicting the likely future, we shall try to emphasize the types of evidence which can help decide between the conflicting theories. And we shall be concerned with some policy implications that arise from the different analytical hypotheses.

History of the Debate: The Quantity Theory and Demand-Pull. The preclassical economists grew up in an environment of secularly rising prices. And even prior to Adam Smith there had grown up the belief in at least a simplified quantity theory. But it was in the neoclassical thought of Walras, Marshall, Fisher, and others that this special version of demand determination of the absolute level of money prices and costs reached its most developed form.

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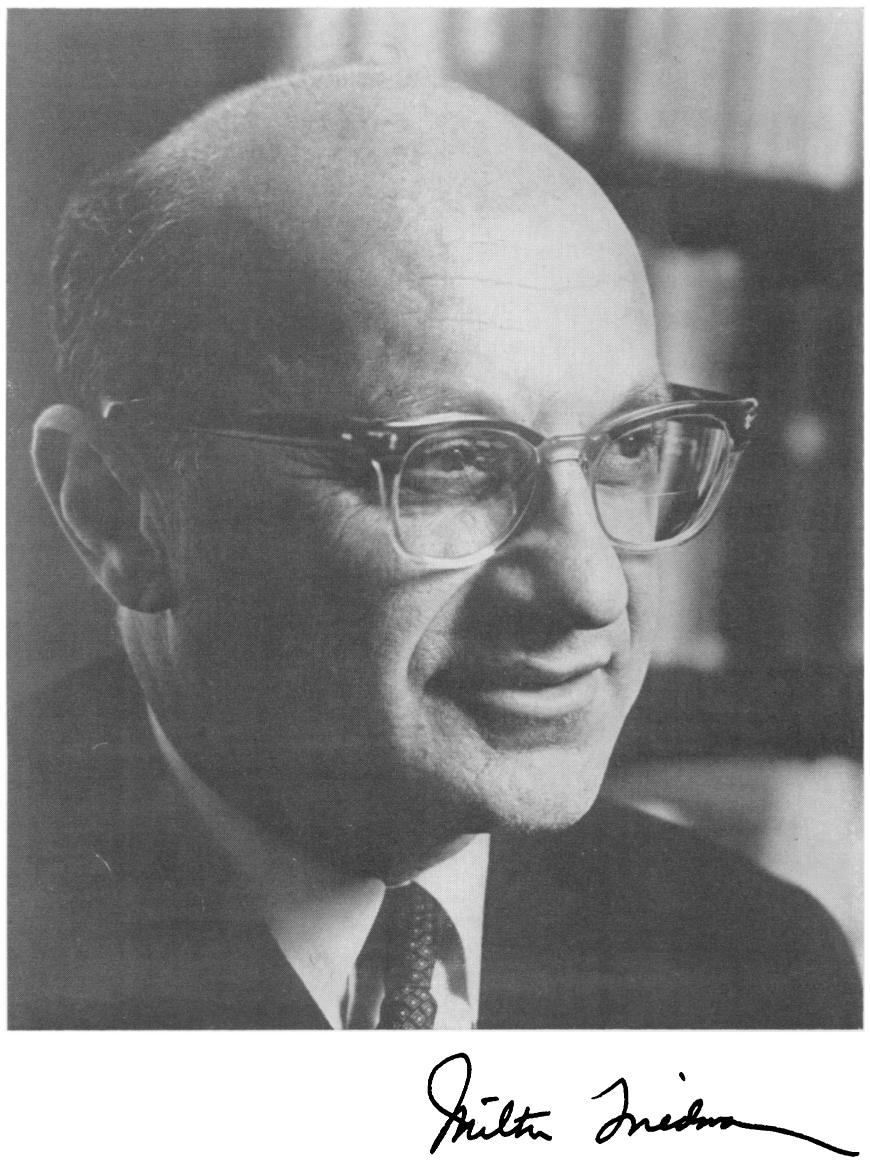
BEFORE THE ADDRESS

Phillips curve / business cycles	The long and the short run	Role of expectations
Before the address	Series of short runs	Shifts of curve, caveats

Monetary policy	Cannot do	Can do
Before the address	Stand idle in depression	Choose point in menu

THE ROLE OF MONETARY POLICY



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THE ROLE OF MONETARY POLICY*

By MILTON FRIEDMAN**

There is wide agreement about the major goals of economic policy: high employment, stable prices, and rapid growth. There is less agreement that these goals are mutually compatible or, among those who regard them as incompatible, about the terms at which they can and should be substituted for one another. There is least agreement about the role that various instruments of policy can and should play in achieving the several goals.

My topic for tonight is the role of one such instrument—monetary policy. What can it contribute? And how should it be conducted to contribute the most? Opinion on these questions has fluctuated widely. In the first flush of enthusiasm about the newly created Federal Reserve System, many observers attributed the relative stability of the 1920s to the System's capacity for fine tuning—to apply an apt modern term. It came to be widely believed that a new era had arrived in which business cycles had been rendered obsolete by advances in monetary technology. This opinion was shared by economist and layman alike, though, of course, there were some dissonant voices. The Great Contraction destroyed this naive attitude. Opinion swung to the other extreme. Monetary policy was a string. You could pull on it to stop inflation but you could not push on it to halt recession. You could lead a horse to water but you could not make him drink. Such theory by aphorism was soon replaced by Keynes' rigorous and sophisticated analysis.

Keynes offered simultaneously an explanation for the presumed impotence of monetary policy to stem the depression, a nonmonetary interpretation of the depression, and an alternative to monetary policy

* Presidential address delivered at the Eightieth Annual Meeting of the American Economic Association, Washington, D.C., December 29, 1967.

** I am indebted for helpful criticisms of earlier drafts to Armen Alchian, Gary Becker, Martin Bronfenbrenner, Arthur F. Burns, Phillip Cagan, David D. Friedman, Lawrence Harris, Harry G. Johnson, Homer Jones, Jerry Jordan, David Meiselman, Allan H. Meltzer, Theodore W. Schultz, Anna J. Schwartz, Herbert Stein, George J. Stigler, and James Tobin.

PRESIDENTIAL ADDRESS

Phillips curve / business cycles	The long and the short run	Role of expectations
Before the address	Series of short runs	Shifts of curve, caveats
Milton Friedman	Long run the classical anchor	Central, what creates and defines the "short run"

Monetary policy:	Cannot do	Can do
Before the address	Stand idle in depression	Choose point in menu
Milton Friedman	Peg unemployment or interest rates	Don't be a shock, respond if can, target M

THE CURRENT STATE OF PLAY

Much changed, but Friedman remained untouched: long-run time frame and centrality of expectations.

CURRENT STATE OF PLAY

Phillips curve / business cycles	**The long and the short run**	**Role of expectations**
Teaching	Long run comes first	Intertemporal tradeoffs and beliefs dominate
Theoretical research	DSGE synthesis	Plethora of models, RE is the exception in the research frontier
Empirical research	Collapse of the hybrid NKPC in last decade	Use of survey data, heterogeneity and disagreement

CURRENT STATE OF PLAY

Monetary policy	Friedman	Academics	Policymakers
Real variables, inequality	Can't	Can't	Can talk
Policy instruments and targets	Only M	Interest rates and inflation, not money	Can and have, successfully
Discretion	Can't	Can't, but rules with feedback to "natural"	Can if transparent, forecast targeting
Prevent Depression	Can't	Can	Did

THE ROAD AHEAD

- The long run
- Expectations
- Phillips curve
- Monetary policy
- Recessions depression

All still central today

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THE ROAD AHEAD

- Expectations: a new canonical benchmark.
- New wave of monetary policy can and cant's:

  1. Fiscal dimensions of monetary policies
  2. "Reservism" focus on reserves, not currency
  3. Near-zero interest rates
  4. Financial stability