

Taylor Conference
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One of the most important and welcome developments in government over the last 50 years or so has been what I would call the “professionalization of economic policy.” If I had to date the beginning of this development I would choose 1961, when the Kennedy administration was formed. I was just beginning graduate work then, and all of a sudden people on my reading lists—Walter Heller, James Tobin, Robert Solow, Kenneth Arrow, W.W. Rostow—were headed to Washington. Robert McNamara brought a group of economists to the Department of Defense to apply the cost-benefit analysis that Arnold Harberger was teaching us about in class.

The Vietnam years were a setback to this growth in the influence of economists, but only a temporary one. Increasingly, first-rate economists have been centrally involved in the formulation and execution of economic policy. This is obvious in the governance and staffing of the Federal Reserve System, where the Chairman, most of the Board, and now many of the Bank presidents are economists with international research reputations. The CEA has generally maintained the high standards of the Kennedy years, and many of its members and staffers have gone on to important roles elsewhere in the executive branch.

This progress—and I mean progress for our society, not just for our profession—has been built on the research of several generations. But this tradition of research would not have been translated into concrete policy the way it has been in the last few decades without the contribution of a new generation, a generation of people who can move comfortably back and forth between the technical research frontier and policy roles at the highest level. For me, John Taylor’s career is a leading example of this kind of intellectual flexibility and effectiveness. When I first met John he was a new assistant professor at Columbia, a student of T.W. Anderson’s. He was on top of control theory and time-series methods back in those days before Sims and Sargent had made these topics part of the core curriculum, and he and Ned Phelps were applying these methods to the then-novel rational expectations models of monetary economies. John was quick to see that policy discussion in such models would have to be conducted in terms of the properties of policy *rules*. He also insisted from the beginning that a useful monetary model would have to incorporate, in some form, the inflexibilities that can make bad monetary policy so dangerous. Since those years, John’s modeling efforts and thinking on policy have evolved in many ways, but as far as I know he has never moved away from these two principles.

I could see then that John was a first-class technician, but I wondered how much economics he knew, and I was surprised when I learned that he had gone to work at the CEA. It did not seem a good match. But talking with him after he left the Council, I could see that he had thrived on the huge variety of different problems that had come across his desk there, and seemed to have something interesting and knowledgeable to say about every current problem in economic policy. You can see this same ability to switch from one problem to the next without missing a beat in his new book, *Global Financial Warriors*.

After his Council days in the 1970s, John plunged back into the hard technical problems of econometric model-building, now incorporating international interactions. Over the years since then, he has moved back and forth between government and academia, thriving and contributing in both environments. I think that each of these two career paths has contributed to the astonishing success of the Taylor rule.

The academic origins of monetary rules can be traced back to Henry Simon's advocacy of 100% reserves, adopted by Milton Friedman in Friedman (1948). Somehow, this idea of eliminating the banking industry never caught on with bankers, and Friedman moved on to a 4% growth rule for M1 or M2 in his writing in the 1950s. But why commit ourselves to a single number for all time, and even if we wanted to, how would we do it? Robert Gordon and Ben McCallum proposed more flexible but, I think, equally well-motivated and effective rules for targeting nominal income. For my taste, the McCallum rule is as good as it gets in the monetary rule business: It tells us when to put more reserves into the system and when to take them out, and if it doesn't work the first time we can keep doing it until we get it right. The problem is that everyone in the business and banking worlds wants to talk about monetary policy in terms of a short term interest rate. John saw that the way the Fed was behaving in the Volcker and Greenspan years corresponded pretty well to what any decent rule for reserves, like McCallum's, would do in any given situation. By capturing this highly successful monetary policy behavior in a coherent and easily interpreted formula, he gave us a specific rule that can be imitated, even committed to, by future open market committees. This is real economic and political progress.

There is a passage in Lawrence Klein's Yrjo Jahnsson Lectures that has stayed in my mind. I'm sorry I did not think to bring the exact quote with me to Dallas, but as I remember it he is trying to explain to a non-technical audience why we value mathematically-explicit macroeconomic models. There have been brilliant policymakers in the past, he says, and there will be more in the future. They do not seem to need our models and yet we cannot deny their successes. But when they leave office, they do not leave behind knowledge that might enable others to replicate their successes. We have to start over, again and again. Our task as quantitative economists, he wrote, was to incorporate the main features of these successes into cumulative science so that future generations might repeat them. Except for the fact that Klein's Lectures were given in 1968, you might think he was writing with Paul Volcker, Alan Greenspan, and John Taylor in mind.

References

Friedman, M. 1948. "A Monetary and Fiscal Framework for Economic Stability." *American Economic Review*, 38(3): 245-264.