Commentary for Session “Looking Back: Historical Perspective on Policy Rules”
including discussion of Asso, Kahn, and Leeson (2007)

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Scope of AKL paper

• Coverage of my commentary is subset of AKL subject matter: pairwise comparison of Taylor’s view of rules with that of Friedman.
• I consider Simons & Phillips along the way.
Friedman and Taylor on monetary policy rules: a comparison
Policymaker objective function

- Taylor 79: intertemporal sum of $\lambda(\pi_t - \pi^*)^2 + (1 - \lambda)(gap_t)^2$
- Friedman (e.g., 1982): basic agreement with this obj. fn.
- Common ground: for monetary policy, stabilization means centering output on its exogenous natural rate—targeting positive gap both infeasible and undesirable (e.g. Taylor, 1987).
Policy objectives & price stickiness

• Cost of inflation (given natural rate & M/P) comes from price-stickiness-induced fluctuations.

• Of the RE formalizations of NRH, Taylor’s work on nominal contracts matches Friedman’s views best.

• Also consistent with Simons.

• Relative price dispersion emphasis vindicated by NK literature (e.g. R&W, 1997).
From objectives to rules

• Common ground on objectives & model.
• Different philosophy about incorporating these into rules.
• Taylor: pursue final objectives directly and make use of structural model in rules.
• Friedman: don’t.
Incorporating structure in rules

- Taylor: respond to gap, inflation (or forecast).
- Friedman: feedback on inflation is fighting last war; while inflation forecasts & gap estimates too fragile.
- $\Delta m$ rule rationale: model uncertainty plus QT property common to different models.
Features of simple rules

• Taylor move to simple rules 1981 informed by 1979 control analysis.
• Less model-dependent but with continuing firm view of basic model structure.
• Activist rule for Δm with stabilization but no accommodation role.
• Taylor 2007: 1979/81 rule “essentially a ‘Taylor rule’” for Δm.
Interest-rate vs. money growth rules

• Taylor has emphasized similarities between $R$, $\Delta m$ rules.
• CMG a way of automatically generating activist $R$ rule.
• Friedman critique of $R$ rules applied most to pegs; good $R$ rules seemed hard to find.
• Difference across Friedman & Taylor on feasibility of offsetting money demand shocks.
Postwar business cycles

- Similar views on cycle: potential output generally smooth; pre-1984 output volatile because of price stickiness interacting with destabilizing policy response to real shocks.
AKL on Taylor/Phillips/Friedman

• AKL: important discussion of influence of Phillips on Taylor’s work.
• They argue that Phillips accepted that expectations appear in Phillips curve.
• But let’s leave aside expectational issue; I argue: still a fundamental difference between Phillips and Friedman/Taylor on PC.
The power and duty of monetary policy

“…whilst an ‘appropriate’ quantity of money is a necessary condition of stable prices, it is not a sufficient condition.”
John Maynard Keynes (1943, p. 185).

“…monetary restraint is a sufficient condition for controlling inflation…”
Milton Friedman (1980a).

- Phillips subscribed to Keynesian position.
- Brought out in treatment of relative price shocks.