

Overview

Alan S. Blinder

I am here today in a very new role for me. While I am not young by any reasonable criterion, I am very young as a central banker. I've been here at the Kansas City Fed conferences in Jackson Hole several times before, but always as an academic speaker, where my role was clearly to say something and maybe even to say something interesting. It is quite clear that, in my new job, my new role is to say nothing and certainly not to say anything interesting.

Mindful of that dictum, I'd like to take us back to the perspective of a central banker, which is to say back to macroeconomics — a subject we haven't talked about very much in the symposium in general, but especially not this morning. (That is not criticism at all; I feel it was quite appropriate to discuss the things we have discussed this morning.) In particular, I was very glad to see, when I received the program, that this is a conference about reducing, not *increasing*, unemployment. Charts 1 and 2 (eight panels in all) illustrate what a woman from Mars who landed here in Jackson Hole to look at the unemployment history of the world since 1970 would have seen: the standardized Organization for Economic Cooperation and Development (OECD) unemployment rates of a nonrandomly selected sample. The eight panels cover every country represented on the program—including the OECD and the European Union (EU) as countries—except, I'm sorry to say, New Zealand. That's because the OECD does not have a standardized unemployment rate for New Zealand that goes back this far. So this is the entire available sample. The hypothetical woman from Mars could be forgiven for wondering if the governments

Chart 1 Standardized Unemployment Rates

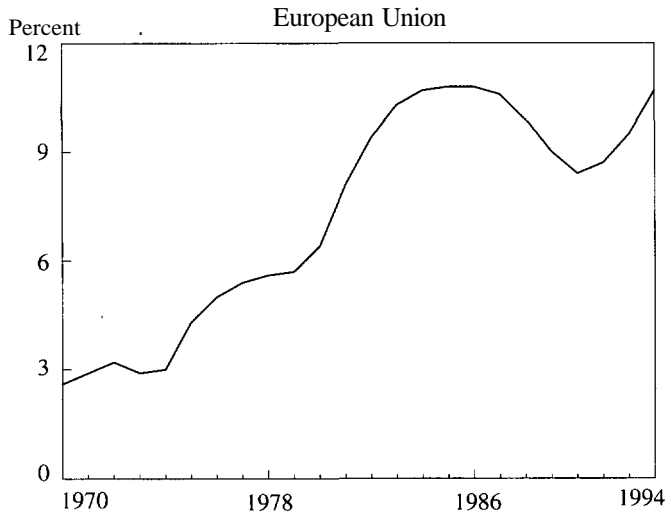
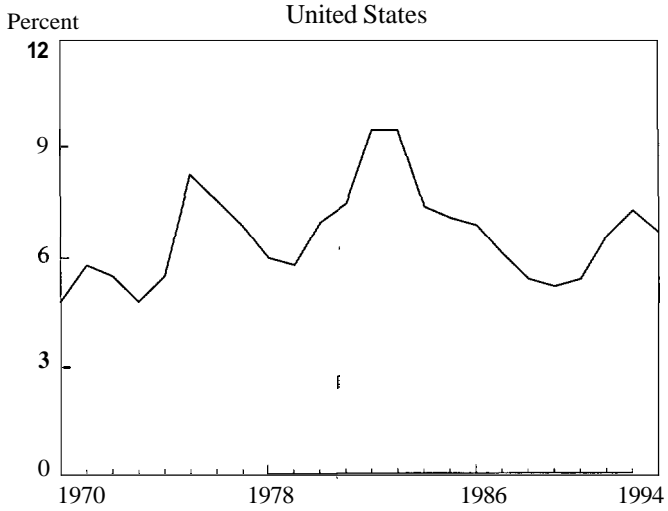
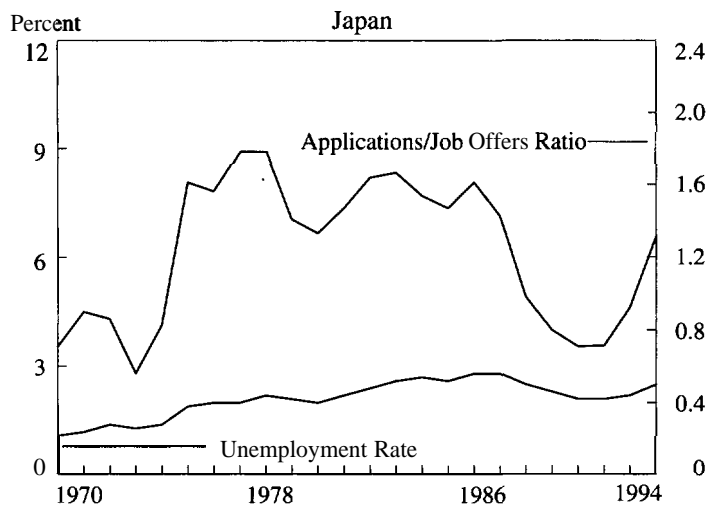
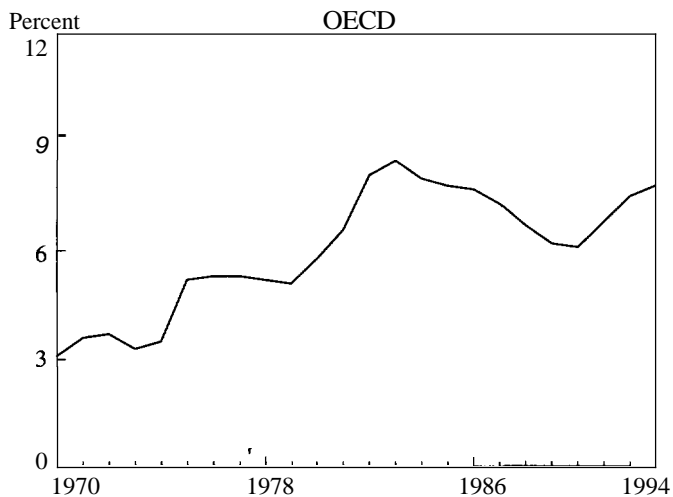


Chart 1
Standardized Unemployment Rates
continued



Source: OECD Main Economic Indicators.

Chart 2 Standardized Unemployment Rates

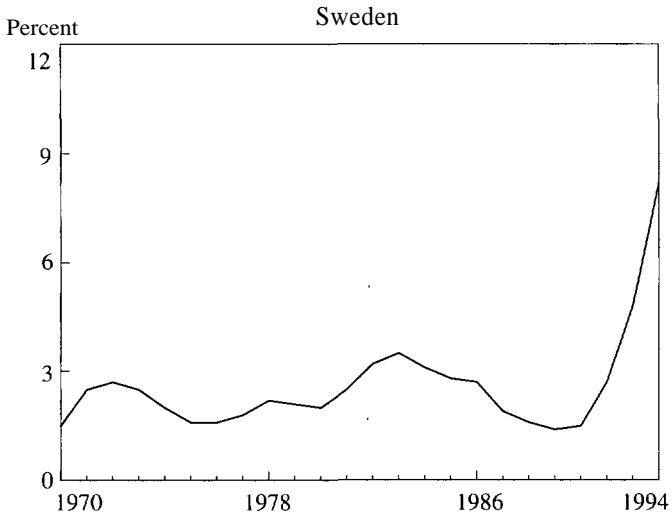
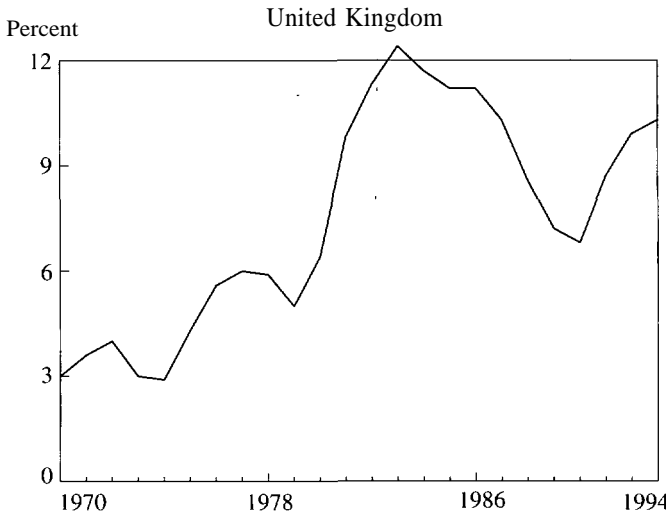
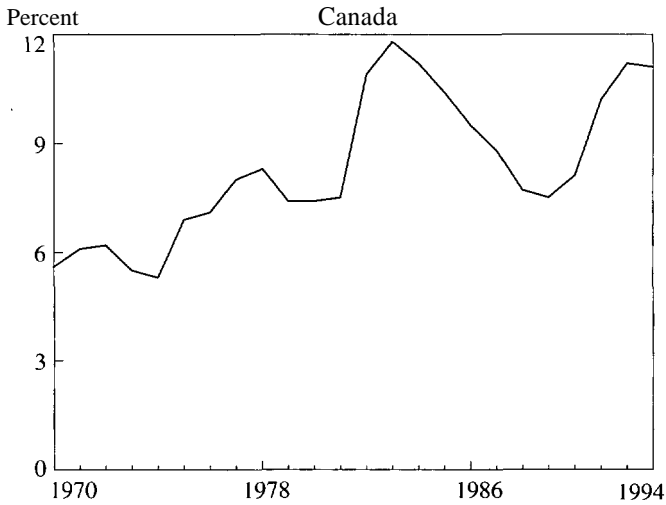
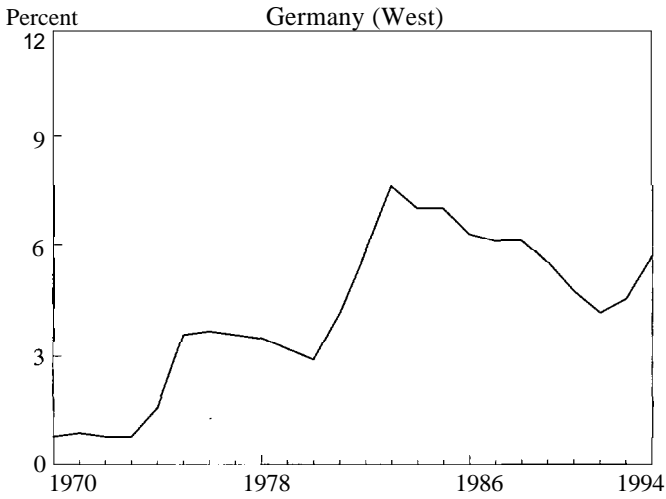


Chart 2 Standardized Unemployment Rates continued



Source: OECD Main Economic Indicators.

of these countries were really worrying about *reducing* unemployment during this period rather than *increasing* unemployment. If they were worrying about reducing it, they weren't doing too well—except perhaps for Japan and the United States.

Now, in my view, central banks, or more generally macroeconomic policies, do indeed have a role in reducing unemployment as well as, not incidentally, in reducing inflation. Before I pursue that point further, there is a preliminary point—actually a hurdle which, if not jumped, leaves nothing more to say on the subject. That hurdle is this: for a central bank to have any role in either raising or reducing unemployment, you have to believe in Keynesianism. If you don't, changes in aggregate demand are all dissipated in prices right away—up or down—and you just don't have any ability to affect the unemployment rate.

The *Fortune Encyclopedia of Economics* has a definition of Keynesian economics. I wrote it, so I know what's in it. I am only going to summarize the first half of it, which is the definition of *positive* Keynesianism, forgetting about any *normative* considerations. This definition has three pieces, and I'll just read them briefly. First, it says: "A Keynesian believes that aggregate demand is influenced by a host of economic decisions—both public and private—and sometimes behaves erratically. The public decisions include, most prominently, those on monetary and fiscal (that is, spending and tax) policy."

Second, it says that a Keynesian believes that: "... changes in aggregate demand, whether anticipated or unanticipated, have their greatest short-run impact on real output and employment, not on prices."

And third: "Keynesians believe that prices and, especially, wages respond slowly to changes in supply and demand, resulting in shortages and surpluses, especially of labor."

That is at least one person's definition of what it means to be Keynesian, in a positive sense. Now, by this definition, I submit that President Nixon had it right when he said, "We are all Keynesians now." (I think he said this in the 1970s.) Money is not neutral, and I

don't think I have to take any time to defend that proposition any longer — although I must say that, if this were a conference of academics, I probably would. If you accept this proposition, then I can go on. If you don't, of course, I can sit down right now. (I suppose I shouldn't put that to a vote!)

If you accept this proposition and you accept the natural rate hypothesis, which has been thoroughly discussed at this meeting, they lead to what I like to call "the approximate dichotomy." I'll come at the end to why it is only "approximate"^w—or at least one reason why—but this is what I mean by the approximate dichotomy: where employment is concerned, in the short run macroeconomics is everything and in the long run macroeconomics is nothing.

Let me elaborate slightly on what I mean by that. In the short run, changes in aggregate demand can and do easily change the unemployment rate by, say, plus or minus two percentage points. Such events happen frequently in business cycles. There is nothing, I submit, that we know in the way of microeconomic interventions that could have an effect remotely close to that in the United States—certainly not in the short run, and maybe not even in the long run. So that's one-half of the dichotomy.

However, in the long run the meaning of the natural rate hypothesis, as Dale Mortensen stated clearly this morning, is that the unemployment rate will converge to the natural rate *regardless of macroeconomic policy*. And that means, roughly speaking, that the employment rate of five to ten years from now has nothing to do with today's macroeconomic policy. The latter is totally irrelevant. Today's macroeconomic policy will, however, have something to do with the price level of five to ten years from now.

I emphasize this dichotomy because, while it is mother's milk to economists, it is almost totally unknown outside the economics profession — indeed it is a totally foreign doctrine. Very few people have in their heads the notion that the effects of aggregate demand on jobs are temporary, which is not to say ephemeral — I don't mean they are gone in three to six months, they are certainly not—but temporary. Nor do most people realize that a very big microeconomic achieve-

ment, at least in the United States, might be reducing the natural rate of unemployment by 0.25 percent. That would be a major, major achievement. But I think that very few people outside the economics profession understand either part of this dichotomy, which is a shame.

In view of this approximate dichotomy, what is a poor central banker to do? My view is that we should remember a television quiz show that I occasionally watched in my wasted youth called *The Price Is Right*. You may remember that on *The Price Is Right* an object would appear, and contestants were supposed to guess the price. You won if you came as close to the actual price as possible *without going over*. That was the name of the game. Similarly, in my view, the job of a central bank, in this regard, is to guide the employment rate up to its natural rate, but not higher than that. By that criterion, I think the United States is extremely close to being "on target," but the European Union, I believe, is quite far from being on target.

I have stated quite clearly, I think, that I believe the central bank does have a role in reducing unemployment, or raising employment. But, as we know, not all central banks explicitly recognize an employment objective of that sort. We heard very eloquently at lunch yesterday, from Donald Brash, the virtues of single-minded concentration on an inflation, or a price level, objective. The charge given by the Congress to the Federal Reserve is quite different, as many of you know. It calls upon us to pursue *both* maximum employment *and* stable prices. Since these two objectives conflict in the short run, the Federal Reserve Act calls upon us to strike a balance. That has always seemed very appropriate to me.

In thinking about the fact that different central banks have quite different stated objectives, I started to wonder whether the objectives actually matter. And, while I was wondering about that, I stumbled upon something which some of you have seen before: a ranking of central banks by Alex Cukierman and two co-authors. (See Chart 3.) Cukierman and others rated twenty-one industrial countries by what they called "central bank independence." Actually, I think this was quite a big misnomer because, if you notice, the United States is ranked pretty low. And I can tell you we feel fairly independent at the Fed, at least inside the building. In fact, the rankings really rate central

