Preface

Mainstream macroeconomics is under attack, professionally and in the popular press, as rarely before. The professional attack centers on the adhoccery of a field in which the existence of institutions may be assumed rather than derived from first principles, in which markets may not clear and individuals may not maximize. The public attacks on macroeconomics stem in part from the desire of the nonmainstream critics for public recognition, in part from the errors of professional forecasters.

The papers on inflation, indexation, and policy collected in this book reflect, and I think justify, the view that mainstream macroeconomics can contribute much to the analysis of policy issues and controversies. The book is divided into four parts, each with its own introduction. I take the opportunity here to argue that mainstream macroeconomics is both scientifically and socially useful.

Macroeconomists to be useful have to operate at several levels. For example, at some fundamental level we do not understand why monetary policy has the real effects it does. It is entirely appropriate and necessary that research on this issue continue. At a less fundamental level we know that tight money produces a recession, and that the major cause is the slow adjustment of wages and prices. It is entirely appropriate when we analyze the process of disinflation that we use models with sticky wages and prices, recognizing that some assumptions are ad hoc, making explicit the qualifications that could change the answers—for instance, contract structure may change—but not refusing to analyze the question until we have agreed-upon microfoundations.

I am told, usually by friends, that the best thing macroeconomists could do is to stop giving the profession a bad name by talking about policy. Macroeconomics receives so much attention because it is serious economics, about the real world, and not primarily a series of intellectual exercises. It would be easy to avoid controversy and retain our purity by

leaving the real world to handle its own problems. But that would be a mistake. The main reason for doing the best we can to analyze current problems, despite the imperfections of our understanding, is that the problems are important and that answers will be given anyway. Either we bring our knowledge and research to bear on problems, or we leave the field to those who know less or nothing but will not admit it. Economic policy is far too important to be left to the hucksters.

We do have knowledge to offer. Consider, for instance, the period since 1980. Macroeconomists said in 1980 that it would take a recession to reduce the inflation rate. It did. Nor were their estimates of the sacrifice ratio seriously incorrect. Mainstream textbooks and standard models say that the combination of a large full employment fiscal deficit and tight money will produce high real interest rates. They did. Augmented to include the foreign sector, these same models predict that deficit-induced high interest rates will be accompanied by an exchange rate appreciation and balance of trade deficit. They are.

The models that produce these conclusions, the IS-LM model, and its international extension, the Mundell-Flemming model on the demand side plus Phillips curve type models on the supply side, are mainly descriptive. Maximizing behavior underlies some of the behavioral functions but is not the centerpiece of the analysis. Such economics is not currently fashionable, and empirical work in this tradition is now carried out mainly by commercial forecasters. The Lucas critique of econometric policy analysis, which succeeded almost entirely by the force of a priori argument with practically no evidence of its empirical importance, swept away old-fashioned macroeconometrics. However, both descriptive macroeconomic models, like those of chapters 5 through 8 and chapter 13, and descriptive macroeconometrics are too useful to be kept down.

We should exaggerate neither the failures nor the successes of mainstream macroeconomics. There have certainly been surprises in the last five years. Forecasters did make systematic mistakes about the strength of the recovery in 1983 and 1984. The dollar has stayed strong longer than expected. Short-term forecasting is not the ultimate test of the insights contributed by macroeconomics, for it is more important to get the trends resulting from particular policy actions right than the precise timing.

Despite this complacent tone I know, as does every macroeconomist, that the field needs continuing improvement at both the fundamental and the more applied levels. I agree with most of the criticisms of theoretical adhoccery and empirical inadequacies offered by critics—for instance, the equilibrium school—who understand the field. I feel better when a model is

derived from first principles than when it is purely descriptive. I differ only in believing firmly that there is a usable, useful core of macroeconomics that should be retained and improved rather than thrown away.

The professional debate that runs through this preface and several of the chapters is part of the dialectic process of improvement. Ours is a remarkably civilized profession, in which differences can be clearly stated and important issues debated without either exaggeration of the controversy or personal attacks. The importance of the issues, the intellectual fascination of the arguments, and the tough civility of the debate are what makes macroeconomics exhilarating.

I have been fortunate indeed in my intellectual and personal friendships. My young teachers, Laurence Harris at the London School of Economics and Miguel Sidrauski at MIT, were also close friends. I learned much from them in each capacity. Frank Fisher, Franco Modigliani, and Paul Samuelson were mentors and examples. It is a continuing pleasure to be a colleague of theirs, and the rest of the MIT Economics Department. Rather than name them all, let me acknowledge the role of E. Cary Brown in genially presiding over and invisibly guiding this multitalented group for so many years. And as the generations change at MIT, I am lucky to be able to work with Olivier Blanchard.

I was at the University of Chicago for four years. There could be no better complement to an MIT graduate education than being a member of Milton Friedman's Money Workshop. That Jacob Frenkel was a student in my first class at Chicago, and soon a friend, was a further bonus.

My second home is the Economics Department at the Hebrew University. That contact began when I met and worked for Don Patinkin at MIT in the summer of 1968. It is a source of great satisfaction that I have been able to maintain close ties with the members of the Jerusalem department and that part of my recent research has been on the Israeli economy.

Writing *Macroeconomics* with Rudi Dornbusch was and continues to be an invaluable intellectual experience, mainly because a textbook owes the students a believable account of how the world works. Our confidence that mainstream macroeconomics provides such an account has strengthened as we have written successive editions. Even beyond *Macroeconomics* my collaboration with Rudi has been extraordinary, enhanced by his generosity, optimism, and friendship.

Finally, I would like to thank David Wilcox and Carol McIntire for their assistance in the editing of this volume.