Opening Remarks

Frank E. Morris

It is probably fair to say that economic policy is now being made in at least a partial vacuum of economic theory. Unlike earlier periods, no one body of theory seems to have a very broad acceptance. If Keynesianism is not bankrupt, as Messrs. Lucas and Sargent suggest, it is at least in disarray. Certainly, the confidence that I felt as a member of the Kennedy Treasury in our ability to use the Keynesian system to generate outcomes for the economy which were highly predictable has been shaken, and I believe a great many other people have also lost that confidence. I look back with nostalgia on those years in the early sixties when we used, with remarkable success, small econometric models to make fairly exact estimates of what we needed to produce a given result in the economy. Now we have much more elaborate econometric models that are coming up with estimates in which we have much less confidence.

Since the early sixties another school of theory, the Monetarist school, has flowered and most of us have learned a very great deal from it; however, at the same time, few of us are willing to accept the entire Monetarist body of theory. I have a feeling that the high water mark of Monetarism is already behind us. So with Keynesianism in disarray and Monetarism ebbing (if that is the case), we see a new school of theory evolving around the label of rational expectations. It is not clear just what this new school will generate that will be operational for policy-makers. Certainly, much of what it has generated as far as monetary policy is concerned is pretty much what we have already learned from the Monetarists – that the market is not a blank sheet of paper on which we can write with some confidence whatever we want. I think we have all learned that market feedback is something we must consider in formulating policy and we have seen such remarkable feedbacks recently in a sharp rise in the stock market after short-term interest rates rose by 3/4 of 1 percent.

My only problem with the rational expectations school and the Lucas-Sargent paper is that they promise us a complete system ready for policy-makers in ten years. Obviously, ten years is a rather long time to wait; particularly for me, since ten years from now I will be on the verge of retirement. I am afraid that it will be a long time before we again have the complete confidence which we had in the early 1960s – that we knew exactly what we were doing. I await the return of such confidence. I think we are all looking for a new synthesis in economic theory. Historically we all know that such a new synthesis does not

Frank Morris is President, Federal Reserve Bank of Boston.

arise out of the brain of one man in a moment of great inspiration. We know from the history of Keynes' general theory that it reflected the work of a great many people during the decade preceding his writing. Many people put together building blocks and pieces that contributed to the formation of the new synthesis. We are not expecting this meeting will generate the new synthesis that we are all seeking but perhaps it will generate one building block or two upon which a new synthesis will be based. Or perhaps a building block is already in place and will be revealed to us so that we can spread the gospel. That is the background upon which we can begin this investigation.