

## **Laudation for Olivier Blanchard**

Mr. President, Mr. Minister, Professor Sinn, Faculty and Students, Ladies and Gentlemen:

I am very grateful to the Center for Economic Studies for inviting me to deliver this laudation on the occasion of the award of your prestigious CES Distinguished Fellow Prize to Olivier Blanchard.

Olivier is an outstanding macroeconomist, among the very best of his generation. This is a statement with no standard error attached. He has made important contributions to a variety of fields within macroeconomics. The significance of those contributions has been widely recognized by his fellow economists, as reflected in the large number of citations that his publications have achieved. Some of those contributions are theoretical. Others are highly applied. Some are targeted to an academic audience. Others seek to influence the policy debate. All of them, however, are permeated by a strong drive to enhance our understanding of how modern economies work and how their workings can be improved.

Before I describe some of Olivier's scholarly contributions, let me give you some background. As an undergraduate, Olivier pursued studies in economics at the University of Paris. This is an unusual path among French academic economists, most of whom appear to share in their youthful years a puzzling attraction for the intricacies of road and bridge building. Being a

student in Paris in the late 60s surely left an idealist mark in Olivier, one that is discernible both in his work and his outlook.

But idealism doesn't go too far in the absence of solid foundations. So, in 1973 Olivier moved to Cambridge, MA to pursue a Ph.D in economics at MIT. With hindsight, the decision to go to MIT was a fateful one, starting a long-term relationship with its Economics Department that goes on to this date. The timing was also fateful: his arrival coincided with the first oil price shock, and the beginning of a long period of stagflation. Those developments were viewed by many as a strong challenge to the --back then mainstream-- Keynesian paradigm. That challenge would be compounded by the criticisms coming from the rational expectations school, which called into question both the methodology and some of the policy tenets of mainstream macro, including the existence of a Phillips curve tradeoff, and the effectiveness and desirability of stabilization policies.

Two of Olivier's professors at MIT, Stan Fischer and the late Rudi Dornbusch, started paving the way, through the combination of rational expectations with realistic nominal rigidities, for what would eventually come to be known as the New Keynesian approach to macroeconomics, and which currently constitutes the dominant paradigm. Olivier's dissertation, conducted under Stan Fischer's supervision, explored the consequences of learning and partial wage indexation for the effects of nominal disturbances on output, signaling the prominent role that Olivier would eventually have in that long but exciting and ultimately rewarding reconstruction effort.

After a spell at Harvard between 1977 and 1983, Olivier returned to MIT's Economics Department, where he has remained ever since, and where he served as a Department Chairman between 1998 and 2003. He holds the Class of 1941 Professorship there, from which he is currently on leave to serve as Economic Counselor and Director of the Research Department of the IMF.

Olivier's interests and contributions span many research areas within macroeconomics, from the quantitative estimation of the impact of fiscal policy shocks, to the economics of transition in Central and Eastern Europe. In fact, one could almost define the subject of macroeconomics as "anything Olivier has worked on." Yet, underneath the seeming diversity of topics and approaches, one can identify two themes that are central to economics and that have remained central to Olivier's research throughout his career. They can be stated in the form of two questions. Why do industrialized economies experience fluctuations? And, why do economies, some to a greater extent than others, experience such high and persistent levels of unemployment? In both cases, a natural question follows: What can and what should governments do about this?

Olivier's contributions to those two lines of research have been enormously influential. It would be impossible for me to do justice to them with the limited time I have. But let me mention two papers that I am particularly fond of.

My first choice is his 1989 AER paper with Danny Quah on “The Dynamic Effects of Aggregate Demand and Aggregate Supply Shocks.” Olivier had been interested for many years in the potential usefulness of structural VARs as a tool to estimate the effects of different shocks on aggregate variables, and to assess quantitatively their role in accounting for observed fluctuations. In fact, Olivier should be given credit for developing, jointly with Mark Watson in their contribution to the American Business Cycle volume, one of the first (if not the first) VAR that did not rely on the arbitrary recursivity assumptions that had been used up to that point. Yet, while the Blanchard-Watson approach was bringing explicit economic reasoning to bear on identification, it still relied on short run restrictions that were often hard to sell on theoretical grounds. Olivier’s paper with Danny Quah was the first to use instead long-run restrictions for identification purposes. One advantage of those restrictions was that they fit naturally the notion of long-run neutrality of certain shocks with respect to certain variables. Furthermore, certain long run neutrality propositions are likely to hold under a variety of models that have very different short-run properties, thus making identification based on long-run restrictions highly appealing in a variety of applications, as proved by the scores of papers that have adopted the Blanchard-Quah approach.

A second series of papers by Olivier that I and many others find particularly appealing are the ones that put forward the notion of “hysteresis in unemployment,” and which were jointly co-authored with Larry Summers. That work was motivated by the observed high persistence of unemployment in certain countries, especially those in continental Europe. The Blanchard-Summers papers argued that such outcome could be interpreted as the

natural consequence of insiders (i.e. those currently holding jobs) having a disproportionate weight in the process of wage bargaining. In that context, the natural or steady state level of unemployment is influenced by the evolution of actual unemployment itself (this is the property that the term “hysteresis” refers to). In the limiting case, when wage-setting reflects only the interests of insiders, even purely nominal disturbances may have permanent effects on employment and output. This is as dramatic a result as one can get in macroeconomics, and not surprisingly one that got plenty of attention and inspired much subsequent work.

In addition to his scholarly articles, Olivier is also the author, together with Stan Fischer, of the graduate textbook titled “Lectures on Macroeconomics.” Though written 20 years ago, the “Lectures” remain one of the few attempts to put together in a systematic and coherent fashion the body of knowledge that constitutes modern macroeconomics. I was Olivier’s research assistant at that time, and remember with great pleasure seeing the book grow out of the Monetary Economics sequence (I also remember helping put together the problem sets at the end of each chapter, clearly a modest contribution but one which at that time I viewed as a major honor). In addition, Olivier is the author of “Macroeconomics,” an excellent undergraduate textbook which is widely used in classrooms all over the world, having been translated into more than 10 languages.

Olivier’s academic contributions are, by themselves, worthy of the prize he is receiving today. But Olivier is clearly more than a highly productive, well cited academic: he has been and remains an intellectual leader, who has had an enormous influence on multiple cohorts of macroeconomists. As an

advisor, he has produced a large number of students, many of whom have become leading economists themselves. The impressive list includes Roland Bénabou, Ricardo Caballero, Chad Jones, Anil Kashyap, Athanasios Orphanides, Rob Shimer, and Gilles Saint-Paul just to name a few. As an editor, he served on the board of the *Quarterly Journal of Economics* for almost ten years, during which the journal consolidated its position among the top 5 general interest journals. More recently, he became the Founding Editor of the *American Economic Journal of Macroeconomics*, a new enterprise sponsored by the American Economic Association, and whose first issue will see the light in a few months.

Olivier's recent appointment as Economic Counselor and Director of Research at the IMF came as a surprise to many, but not to those who know him well: to Olivier economics is not an intellectual *divertimento* but a means to make the world a better place. Given the challenges of our time it is hard to think of many better bases than the IMF from where to make a contribution to that end. Even the idealistic French student of May 1968 might have agreed this is the right thing to do now.

Dear Olivier: Let me conclude this laudation by congratulating you for this important award and by thanking you for being such a great source of inspiration, to me and to an entire generation of macroeconomists. I am sure that the lecture you are about to deliver on one of the most dramatic episodes in modern economic history will be as enlightening as any of your contributions.

Thank you all for your attention.