Jeff Frankel, Jan. 8 & Feb. 4, 2008

Ten classic IsoM papers

In a field where conferences and journals proliferate exponentially, a unique attraction of the NBER International Seminar on Macroeconomics is its 30-year pedigree and worldwide reputation. It is not hard to think of some classic and highly influential papers.

In 1980, William Branson and Julio Rotemberg published "International adjustment with wage rigidity." This, the quintessential ISoM paper, established that while frictions in US labor markets were best thought of as temporary rigidities in nominal wage levels, frictions in European labor markets were best thought of as temporary rigidities in *real* wage levels. This model explained many puzzles, such as the much slower adjustment of the unemployment rate in Europe in the aftermath of the 1970s oil shocks, and the German skepticism for the locomotive theory of coordinated macroeconomic expansion that the US pushed at the famous Bonn Summit of 1978. The asymmetrich characterization of European and American labor markets was adopted by Jeff Sachs and others, and became virtually conventional wisdom.

In 1983, Martin Feldstein published "Domestic saving and international capital movements in the long run and the short run." The so-called Feldstein-Horioka finding – that countries rates of saving and investment are more highly correlated than you might think if they were able to borrow and lend freely on world capital markets – is one of the most widely discussed empirical propositions in all of international macroeconomics. Many of the refinements made by later imitators and critics, such as noting the need for instrumental variables to correct for endogeneity and the failure of the coefficient to decline over time, were actually present in the original research.

In 1988 Francesco Giavazzi and Marco Pagano published "The Advantage of Tying One's Hands: EMS Discipline and Central Bank Credibility." This influential article developed what economists considered the strongest "pro" argument throughout the 1990s process of European monetary integration that culminated in the adoption of the euro in 1999 . This is the argument that, like Odysseus tying himself to the mast in the Greek myth, small European countries that fix their exchange rates and thereby give up the ability to undertake monetary expansion in the future even if they want to, can achieve lower inflation rates.

In 1992, Chris Sims published "Interpreting the Macroeconomic Time Series Facts: The Effects of Monetary Policy," perhaps the most widely cited papers during the Gordon-deMenil era, i.e., during the first half of ISoM's life. Vector AutoRegressions across five major countries produced some commonalities, such as the result that monetary contractions, as measured by positive innovations in interest rates, tended to be followed by falls in output. This was a result traditionally expected by macroeconomists while not, Sims suggested, by proponents of Real Business Cycle theory. But the paper came up with one finding that was considered surprising because hard to reconcile with effective monetary policy: a tendency of interest rate increases to predict increases in price levels. This empirical regularity became known in the literature as the "price puzzle."

In 1994, Jose de Gregorio, Alberto Giovannini and Holger Wolf published "International evidence on tradables and nontradables inflation." This has proved to be one of the most useful empirical papers on the famous Balassa-Samuelson effect (countries with rapid productivity growth experience real appreciation), in that it directly confirmed the intermediating variable that others had merely hypothesized: rapid increase in the relative price of non-traded goods.

In 1996, Peter Boone published "Politics and the effectiveness of foreign aid." This was one of the first papers to analyze foreign aid econometrically, and has been followed by many others.

In 1998, Richard Clarida, Jordi Gali and Mark Gertler published "Monetary Policy Rules in Practice: Some International Evidence," probably the most widely cited IsoM paper of all time. By comparing performance across countries, the authors built support for central banks to switch from targeting exchange rates to targeting inflation. Sure enough, inflation targeting subsequently became the new reigning champion among monetary regimes, both in theory and in practice, replacing such past champions as monetarism and exchange rate targeting.

In 1999, Giancarlo Corsetti, Paolo Pesenti and Nouriel Roubini published "Paper Tigers? A Model of the Asian Crisis." This influential paper was an unusually timely response to the East Asian Currency Crisis, which was still underway when it was written. It helped establish the view that the Asian problems originated in what economists call moral hazard, which everyone else began at this time to call "crony capitalism."

In 2000, John Taylor published "Low inflation, pass-through, and the pricing power of firms." This paper has been highly influential in the burgeoning literature on "pass-through," which refers to the coefficients that tell what percent of a given devaluation of the domestic currency is reflected in the domestic price of imports, and then in the CPI. Taylor was perhaps the first to discover that the pass-through coefficient had declined strongly in the 1990s, which he attributed to a reduction in price instability relative the high-inflation 1970s and 1980s.

In 2002, Reuven Glick and Andy Rose published "Does a currency union affect trade? The time-series evidence," one of the most widely cited IsoM papers of recent years. In a world-renowned paper two years earlier, Rose had made the remarkable discovery that members of a currency union apparently trade three times as much with each other as non-members. One of many critiques of this finding held that one could not reason from such cross-section comparative statics evidence to conclude that countries undertaking a real-time experiment, such as the new European Monetary Union, would experience such increases in trade. Glick and Rose looked at the time series evidence in post-war history, and found that, indeed, in cases where countries had joined or (more often) left currency unions, their intra-union trade was far higher in the union years than in the non-union years.