

Lucas on “Rules, Discretion, and the Role of the Economic Advisor”

Lucas was asked to write a paper for a session on “Macroeconomic Policy, 1974/75: What Should Have Been Done?”

He begins by noting that this is not a useful question. Instead, he advocates a policy rule (generally he endorses Friedman’s “k-percent” money growth rule). He says that the Friedman rules are one answer to the question:

“Under what rules of the game, remaining predictably in force over long periods, can we expect satisfactory economic performance?” (p. 202) This, of course, was not the relevant question for policymakers, who must choose the setting for an instrument in an upcoming period.”

Lucas argues that theory based on rational expectations buttresses the case for thinking about policies in connection with the question posed in the preceding paragraph.

“... our ability as economists to predict the responses of agents rests, in situations where expectations about the future matter, on our understanding of the stochastic environment agents believe themselves to be operating in. In practice, this limits the class of policies the consequences of which we can hope to assess in advance to policies generated by fixed, well understood, relatively permanent rules (or functions relating policy actions taken to the state of the economy).” (p. 205)

“... analysis of policy which utilizes economics in a scientific way necessarily involves choice among alternative stable, predictable policy rules...” (p.206).

“I have been impressed both with how noncontroversial it [the above view] seems to be at a general level and with how widely ignored it continues to be at what some view as a “practical” level.” (p. 205) (For example, consider the title of today’s session ...)