

Olivier Blanchard's maiden presentation to the Lisbon Academy of Science: an introduction

Mr President, Ms Secretary General, Eminent Fellows

It is a joy to welcome to this joint session of the two classes of the Lisbon Academy of Science, a foreign corresponding member of the L class proposed by the economics section, to give Olivier Blanchard a rather grand membership certificate, written in Latin, signed by President Artur Anselmo and Secretary General Maria Salomé Pais, and to introduce his maiden presentation on “where to from here?” I will first recall the process leading to his election, then offer a genealogy of his work on Portugal and close with some remarks about the person.

Process

As he enters this building for the first time, I would be remiss not to mention that Queen Maria I founded the Academy in 1779, upon a request from the duke of Lafões, just like King Louis XIII established the French Academy in 1636, upon a request from the Duke of Richelieu. Because the number of *immortels* is set at 40, the ritual of induction is far more elaborate there. To reflect French Republican identity I selected interdisciplinary snippets from three among the top 40 of over 700 [23, p. 22] with two eulogies, Condorcet in 1782 and Tocqueville in 1842, and Siegfried's 1947 reply. The mathematician's criticism of slavery brings together the US and our founding Queen: “*l'Américain, en rompant ses chaînes se mis en devoir de rompre celles de ses esclaves ; et, de tous les peuples libres, il a le premier appelé tout ce qui cultivait la même terre aux mêmes droits et à la même liberté. La Souveraine du Portugal, en gémissant de ne pouvoir imiter en tout ce grand exemple, a ordonné du moins que, dans ses vastes États, l'homme ne naîtrait plus esclave.*” (p. 40) The historian focuses on Bonaparte : “*Ces pouvoirs illimités qu'on avait avec raison refusés au prince, quand il ne représentait que lui-même et ses aïeux, on pouvait être amenés à les lui concéder lorsqu'il semblait représenter la souveraineté nationale.* ” (p. 527-8) The geographer reminds the eloquent lawyer who had just been received that “*il ne suffit pas d'avoir de grandes qualités, il faut en avoir l'économie* », thereby quoting an enemy of Richelieu, the Duke of La Rochefoucault, whom he discretely calls « le moraliste » (p. 498). It may not be the only time the word *économie* is used in the tome but it would not be economical to search any further...

Coming back to earth and our Academy, its class composition follows that of the Royal Society, established in 1660 by Charles II (the one who married a Portuguese Queen), where nowadays economics is a section in the class of Health and Human Sciences, an arrangement found at the American Academy of Arts and Sciences, established in 1780, where social science and humanities are two different classes (and Olivier has been a fellow since 1990). With 200 domestic and 100 foreign fellows, or *confrades*, we are twice as large as AAAS in per capita terms! Also, our founding Queen died in Brazil, the “foreign” category includes Brazilians and we hope to flag the Community of Portuguese-speaking Countries (CPLP), across which we have elected members, including four economists who visit whenever possible.

In early 2008, Jacinto Nunes (1926-2014), former President and dean of our section, agreed with Paulo de Pitta e Cunha, his deputy, José Luís Cardoso and myself to revitalize the section by asking all members for names to fill vacancies and topics of interest for conferences. When Jacinto finished his *Memoirs* [19] prefaced by Silva Lopes (1932-2015), the financial crisis led us to find a successor to James Tobin (1918-2002), granted an honorary Ph.D. by Nova University in 1981, on the same day as his certificate, and plan a meeting on “Economists and the crisis”.

Paul Krugman and Olivier Blanchard were thus proposed as foreign *confrades* in 2009 and we found support from the C class and CPLP to follow up on the initiative of the British Academy

(established in 1902 by Edward VII and with the same composition as our class L) to write to the Queen that the financial crisis was not the fault of economists [12].

Nova's senior economics faculty agreed that Tobin's successors would combine the Academy with a doctorate *Honoris Causa*, but the 2009 choice innovated on two grounds. First the vote included the corresponding members of the section and was preceded by exchanges about where to take the section in light of the damage done to the profession by the financial crisis – which was deeply felt by the three former ministers of finance and, as Jacinto and Lopes had also been governors, led us to propose a conference on the subject to *Banco de Portugal*. Second, and related to the procedural innovation, we proposed two names rather than one. Though this showed to the other sections that economists could be part of the solution, it also delayed the formal vote until end May 2010. The section met again on September 16 and discussed the conference - where we would write a letter to a fictional Queen Lusophonia. Helena Garrido was briefed on the project and spread the news [16].

However, the funding crisis which led to the third Euro Zone bail-out in May 2011 made Olivier's presence in Portugal a matter of state and evidently postponed the conference. We waited patiently for his retirement from the IMF and also, of course, for the tenth anniversary of his celebrated paper on "the difficult case" [5]. Another twist was that the initiative for Krugman came from the last Rector of the old University of Lisbon, Sampaio da N6voa, also a *confrade*, and was endorsed by his Nova and Technical counterparts - the later now merged in the new ULisboa, so that he received a *TriDoc* in February 2012 [11]. The Academy was present in that he received his certificate from Jacinto but this took place at *Aula Magna* rather than here. The formal vote on Blanchard's honorary degree at Nova was delayed until last Fall and the March 2017 date set by the retiring Rector included recipients from other fields so that it could not be changed. Hence, Olivier must return to close this two-step Tobin succession!

As it turned out, Silva Lopes, who commented Krugman's doctoral speech, had taken a strong stand at the November 2009 meeting in favor of choosing two MIT economists hailing from both sides of the Atlantic. But he died one year after Jacinto, whom he had succeeded. As I welcome Olivier after having introduced Paul, let us remember the two *confrades* who, following Pinto Barbosa (1917-2016), did a lot for the introduction of the new economics in Portugal. Not surprisingly, it is here that they organized a *Symposium on Keynesian Studies* in 1977 [1] which the current governor of *Banco de Portugal* has agreed to follow up on, providing an interesting alternative to the conference "Economists and the crisis" that we were planning on seven long years ago.

Work

[6] is Olivier's fifth paper on Portugal this century. It is a sequel to [5], published ten years ago in the *Portuguese Economic Journal*. [24], also quoted in [6], is a contribution to a 2003 McKinsey report on increasing productivity growth: it appeared when Manuel Pinho, francophile and former IMF economist, was Economy Minister and I know he was very bullish on the exercise. But the genealogy includes two other co-authored papers: with Pedro Portugal, comparing unemployment in the US and Portugal [2], and with Francesco Giavazzi, taking a benign view of the current account deficits of Portugal and Greece [3]. Portugal also ran deficits in excess of 10 percent of GDP in the early 1980s, but the escudo was devalued by 60 percent between 1980 and 1987 and the deficit was eliminated. This time is different, however, because there are no large adverse shocks, budget deficits or financial market worries. When countries become more closely linked in goods and financial markets, they

should see an increase in investment and a decrease in saving because of higher expected rates of return and better growth prospects respectively.

In p. 186, after asserting that benign neglect appears to be a reasonable course of action, the paper concludes with the importance of collecting current account statistics in euro zone countries, as opposed to U.S. states. They should not stop because policymakers want to know 1) how much foreign debt a country is accumulating, 2) the potential output costs of adjusting relative prices given the level of foreign debt and 3) the effect of the budget deficit on the current account.

The discussants differed radically [13, 17 pp. 195-97]. Wilhelm Buitter, then at EBRD, was severe on the method but shared the result whereas Pierre-Olivier Gourinchas liked the paper but cautioned that globalization had not been smooth enough for greater cross-country dispersion in current accounts to be matched by lower income inequality. Therefore, large current account deficits may lead to situations of illiquidity, calling for some strictly positive amount of insurance, in the form of a government surplus.

First presented at a *Banco de Portugal* conference in 2006, [5 p. 6] looks back at the argument, footnotes [3] saying that Pierre-Olivier was right to be worried about the required adjustment. Another footnote in [5] also questions the relevance of a DSGE model (co-authored by the moderator in that session, who became Portugal's finance minister and is now at the IMF, e.g. Fagan and Gaspar 2005): when wages adjust slowly to labor market conditions: even if the government can use fiscal policy to affect demand, it might maintain output at the natural level, and in the process eliminate the (partly desirable) current account deficit. Ten years after, [6] also assesses the macroeconomic state (boom, slump, two crises and a timid recovery) and clarifies the policy options, focusing on the treatment of nonperforming loans, product market reforms and labor market micro-flexibility, while avoiding wage and price deflation and faster fiscal consolidation. Euro exit is also undesirable on economic grounds.

The fact that new data showed the competitiveness problem to be less acute reminds me of course of Krugman's take on the April 25th Revolution [21], where we measured wages and output relative to their "warranted" level so as to take into account the effect of structural shocks (oil price rise, world recession, political instability) on the internal and external balance schedules defining the four "zones of economic unhappiness". As Jeff Frankel pointed out [15], devaluation remained the cure but the reason was the fall in the warranted real wage. Currently, treating non performing loans and reverting reform reversions in product and factor markets could bring output to its warranted level without threatening external balance.

Now, like forty years ago, the unfortunate consequences of a "politicized market economy" can be motivated by two quotes. The first: "*Les à-coups de l'accélération de l'histoire marquent la vie des peuples comme les sacrements celle du chrétien. Ces périodes extraordinaires sont aussi la bibliothèque où, qui en a compris la grammaire, peut lire à livre ouvert les lois du changement social profond*" [20] is from Serge Christophe Kolm, a French economist whose advice to devalue the escudo was rebuffed by the captains [9, note 9]. The second comes from Frank Graham, who founded Princeton's International Finance Section, and makes disorder the sole substitute for the controlled experiments of the natural sciences, cautioning that it may be excessive even for the most detached of scientists. [18].

Person

Everything has been said about our new *confrade*. Let me add that his demeanor reminds me more of *la vie en cool* than *la vie en rose* but, unlike Alberto Holly, a newfound friend from the

Lycée Français Charles Lepierre, we never shared an institution before this one. An Amienois like the current President of France, he studied at *École Supérieure de Commerce de Paris*, Nanterre University and MIT where he obtained his Ph.D. in 1977, the year Macron was born and Krugman also got his degree. With Mario Draghi, governor of the ECB, and Maury Obstfeld, his successor at the IMF, they were part of the golden age of open economy macroeconomics, led by the German-born economist Rudi Dornbusch (1942-2002), whom I called the mother of the Portuguese crawling peg [9, note 25].

Pentti Kouri (1949-2009) was also there and, when the Banks of Finland and Italy honored his memory in 2010, Olivier said “The Dornbusch approach, and its powerful implications, has dominated research...but imperfect substitutability seems central to the issues we face today”. This statement reflected his “rediscovery” of Kouri in another *Brookings Paper* with Francesco Giavazzi and a Portuguese student at MIT [4]. The quote, printed in the back cover of [10], links the genealogy above to Olivier’s many contributions to macroeconomic theory, where the Tobin tradition was to use M for money rather than for imports.

A profile written from Ile de Ré about “The smartest economist you’ve never heard of” [27] brings out Olivier’s maritime inclinations which we shared at the Beach of Apples in 2006. Krugman [22] waxes lyrical about his former classmate and the way he turned the IMF around to the point that I assigned the profile in a course on international macroeconomics to make Nova Law graduates believe that the Fund could be humane. The *WaPo* story starts with the advice our *confrade* gave to a Harvard student, when he was wondering about whether to take an offer from the Fund or UVA: “David, if you go to the IMF, you’ll be throwing your career away.” Now deputy MD at the IMF, he says that “Olivier is one of those rare academics who deserve to have a license to practice.” The evolution of Olivier’s thinking on Portugal over the last 15 years, evident from this visit, confirm the Lipton license!

We look forward to his maiden presentation today and to his future contribution to the conference held over from 2011 on economists and the crises. His recent blog calling for several classes of macro models besides the real business cycles based DSGE workhorse [7] was favorably contrasted with the most cited author in [6], Ricardo Reis - who managed to write two *Brookings Papers* on Portugal in two years [28, 29]. While Reis challenges claims from Kevin O’ Rourke [26] that Portugal is a bit boring, he may not convince us that DSGEs are the only way to go [30]. Instead of what *Eurointelligence* called “denial” [14], *confrades* from C class involved in the Letter to Queen Lusophonia project have joined the crusade against silos [31] and would support greater use of agent based or adaptive models [8, 25].

My last word on this occasion is in memory of Rudi, to whom we Portuguese owe a lot. He always said we were like Scotts and only Brazilians were “true Latins”. How would our *confrades* react to this – especially our Luso-German Treasurer?

Thank you.

Revised, 18 May 2017 (longer draft version [here](#))

Jorge Braga de Macedo

References

1. Academia das Ciências de Lisboa 1977, *Simpósio de Estudos Keynesianos*.
2. Blanchard, Olivier and Pedro Portugal. 2001. "What Hides Behind an Unemployment Rate: Comparing Portuguese and U.S. Labor Markets." *The American Economic Review*, 91(1):187-207.
3. Blanchard, Olivier and Francesco Giavazzi, 2002 “Current Account Deficits in the Euro Area: The End of the Feldstein-Horioka Puzzle?”, *Brookings Papers on Economic Activity* Fall

4. Blanchard, Olivier, Francesco Giavazzi and Paula Sá 2005, "International Investors, the U.S. Current Account, and the Dollar" *Brookings Papers on Economic Activity* .
5. Blanchard, Olivier 2007 "Adjustment within the euro: The difficult case of Portugal" *Portuguese Economic Journal* 6 (1), 1-22, May
6. Blanchard, Olivier and Pedro Portugal 2017a "How to strengthen the Portuguese recovery", draft May
7. Blanchard, Olivier 2017b, "On the Need for (At Least) Five Classes of Macro Models", Peterson Institute of International Economics, Apr 10
8. Bookstaber, Richard 2017 *The End of Theory: Financial Crises, the Failure of Economics, and the Sweep of Human Interaction*, Princeton University Press
9. Braga de Macedo, Jorge 2008 "Economic Advice and Regime Change in Portugal", in Francesco Franco (editor) *Challenges Ahead for the Portuguese Economy*, , Lisbon: ICS, pp. 201-229.
10. Braga de Macedo, Jorge and Urho Lempinen (editors) 2010 *Open Economy Dynamics, Selected Papers by Pentti Kouri*, Helsinki: Taliesto
11. Braga de Macedo, Jorge 2013 "Krugman's TriDoc", *Notas Económicas*, Revista da Faculdade de Economia da Universidade de Coimbra, nº 37, June, pp. 7-22
12. Braga de Macedo, Jorge (editor) 2015 *Writing to Queens while Crises Proceed Expanded edition In Memory of Manuel Jacinto Nunes*, IICT and CG&G also <https://run.unl.pt/handle/10362/14560>
13. Buiter, Wilhelm comment on [3]
14. *Eurointelligence* 2017 "Macro in a state of denial", Apr 12,
15. Frankel, Jeffrey comment on [20]
16. Garrido, Helena 2010 "Krugman e Blanchard integram Academia das Ciências de Lisboa", *Jornal de Negócios*, 16 Sep
17. Gourinchas, Pierre-Olivier comment on [3]
18. Graham, Frank 1930 *Exchange, Prices and Production in Hyper-Inflation Germany 1920-23*, Princeton UP
19. Jacinto Nunes, Manuel 2009 *Memórias Soltas*, Lisboa: Alêtheia
20. Kolm, Serge Christophe 1977 *La Transition Socialiste La politique économique de gauche*, Paris : Éditions du Cerf
21. Krugman, Paul and Jorge Braga de Macedo 1979 "The economic consequences of the April 25th Revolution", *Economia*, Universidade Católica Portuguesa, Yale Economic Growth Center Paper nº 299
22. Krugman, Paul 2015 "The Blanchard touch", The conscience of a liberal, *New York Times*, Oct 3
23. Léotard, François et Patrick Wajzman 2016, *Paroles d'immortels Les plus beaux discours prononcés à l'Académie Française*, Paris : Jean Picollec
24. Lo, Andrew 2017 *Adaptive Markets— emotional investment theory*, Princeton University Press
25. McKinsey Global Institute 2003 *Portugal 2010: Increasing Productivity*, Lisbon
26. O'Rourke, Kevin comment on [24]
27. Pearlstein, Steven 2015 "The smartest economist you've never heard of", *Washington Post*, Oct 2
28. Reis, Ricardo. 2013. "The Portuguese Slump and Crash and the Euro Crisis." *Brookings Papers on Economic Activity* Spring: 143–93
29. Reis, Ricardo 2015. "Looking for a Success in the Euro Crisis Adjustment Programs: The Case of Portugal" *Brookings Papers on Economic Activity* Fall: 433-458
30. Reis, Ricardo 2017 "Is something really wrong with macroeconomics?" London School of Economics, Mar
31. Tett Gillian 2015 *The Silo Effect: The Peril of Expertise the Promise of Breaking Down Barriers*, New York: Simon & Schuster