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POLICY BRIEF

23-9 "Stan the Man"

On Stanley Fischer and MIT

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Author's Note: This article was written for a Palgrave volume on the MIT Department of Economics. The first part of the title of this article is taken from the title of a February 2023 *Financial Times* article on Stanley Fischer. I was a student and then a coauthor and colleague of Stan for many years. I hope that my admiration for him does not color this article too much. I thank a large number of Stan's students and friends for their suggestions and comments.

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Stanley Fischer had, in effect, two careers, one as an academic and the other as a policymaker. I shall focus here primarily on the MIT component of his life, but it needs to be put in context.[1]

Stan was born in 1943 and grew up in Mazabuka, a town in Northern Rhodesia (now called Zambia), where his family ran a general store. The house in which he was raised was behind the store; it had no running water and was lit with hurricane lamps.[2] His family relocated to Southern Rhodesia (now Zimbabwe) when he was 13 years old. He discovered economics in high school, and left Rhodesia after he won a scholarship to go to the London School of Economics, where he got a BS degree in 1965 and an MS degree in 1966. From there, attracted by the work of Robert Solow and Paul Samuelson, he went to MIT for a PhD.[3]

At MIT he was part of an exceptional group of students. Some of the names within a year of his cohort include Robert Hall, William Nordhaus, Avinash Dixit, Robert Gordon, Ray Fair, Michael Rothschild, Joseph Stiglitz, and Robert Merton. In such an intellectual environment, Stan thrived. He wrote his thesis under Frank Fisher, on lifetime portfolio choice.

1 Much has been written about Stanley Fischer's life and achievements. For an article with more emphasis and details on his role at the IMF and at the Bank of Israel, read the profile written by Prakash Loungani (2013). Another, written when Stan was being considered as the next potential chairman of the Federal Reserve, is "Stan Fischer saved Israel's economy. Can he save America's?" by Dylan Matthews, in the *Washington Post*, February 15, 2013.

2 Prakash Loungani, "A Class Act," *Finance & Development* 50, no. 3 (September 2013).

3 For more on the early part of his life, read "An Interview with Stanley Fischer," *Inside the Economist's Mind: Conversations with Eminent Economists*, P. Samuelson and W. Barnett (eds.), Malden, MA: Blackwell Publishing Ltd., pp. 261–77 (2007).

After finishing his thesis in 1969,[4] he went to the University of Chicago, first as a postdoc, then as an assistant professor. He became friends with another junior faculty member, Jacob Frenkel, and a promising student, Rudi Dornbusch, both of whom became regular coauthors. Like Stan, they went on to have careers both in academia and as economic policymakers and advisers.

In 1973 Stan returned to MIT as an associate professor. He became a full professor in 1977 and, apart from a break as chief economist of the World Bank in 1988–90, stayed until 1994. The first course he taught was monetary economics with Paul Samuelson, a challenge that would have scared anybody. From then on, he typically taught a segment of the first-year macro sequence, and one of the two courses on advanced monetary economics (later called macroeconomics). He was department head in 1993–94.

During his time at MIT, Stan became steadily more interested in actual economic policy, as reflected by his stint at the World Bank. In 1994 he moved to the International Monetary Fund (IMF) as first deputy managing director, working in close collaboration with Managing Director Michel Camdessus until 2000 and then briefly under Horst Köhler, until 2001. He then became vice chair of Citigroup, which he left in 2005 to become governor of the Bank of Israel, a choice reflecting both his commitment to public service and a long-running connection to the state of Israel. He stayed at the bank until 2013, when he came back to the United States. In 2014 he was appointed vice chair of the board of governors of the Federal Reserve, where he served until 2017.

Not surprisingly, Stan has received many honors, among them, Fellow of the Econometric Society, Fellow of the American Academy of Arts and Sciences, and Distinguished Fellow of the American Economic Association. He has received a number of honorary doctorates, and was chosen by *Euromoney* as central bank governor of the year in 2010, and given the Award for Lifetime Achievement by *Central Banking* in 2022.

Academia, international and domestic policy institutions, finance: One might worry about the coherence of such a career. But Stan brought the same attributes to all: a clear analytical mind, great management skills, and an incredible work ethic—indeed an exceptional ethic in general.

They were certainly evident at MIT, where students flocked to his office. When Rudi Dornbusch joined Stan at MIT in 1976, macro and international macro became the most popular fields. Many of the students who took those courses and wrote their thesis with Stan or Rudi went on to dominate the policy spheres for decades to come.

What was behind the success? A number of factors.

First, Stan's and Rudi's own research. They were working on the central macroeconomic issues, using simple models and methods, and their students (myself included) aspired to the relevance, simplicity, and elegance that characterized their work. Two examples make the case. Rudi arrived at MIT on the heels of publication of "Expectations and Exchange Rate Dynamics" (1976), in which he argued that, contrary to the hopes and predictions of advocates of flexible exchange rate regimes, under such regimes and with capital mobility,

4 "Essays on Assets and Contingent Commodities," 1969.

exchange rates were likely to undergo large fluctuations.[5] The paper, which now has more than 8000 citations, largely shaped the field for decades. Soon after, Stan published "Long-Term Contracts, Rational Expectations, and the Optimal Money Supply Rule" (1977).[6] With the introduction of rational expectations in the 1970s, a number of researchers, from Robert Barro to Robert Lucas to Tom Sargent, had argued that the scope to use monetary policy was very limited. Only unexpected policy, or an information advantage of the central bank, could affect output. Stan showed that, if nominal wages were set for a period longer than the time it took for monetary policy to react, then even anticipated monetary policy could, and indeed should, be used. That paper, together with papers by John Taylor and Guillermo Calvo,[7] led to the New Keynesian approach to macroeconomics, with an emphasis on nominal rigidities and other imperfections, an approach that largely dominates the field today. There were other important papers, notably two elegant papers on trade, written jointly by Stan, Rudi, and Paul Samuelson, looking at trade with a continuum of goods, in Ricardian and Heckscher-Ohlin models (1977 and 1980, respectively).[8]

Second, the style of research, with an emphasis on simplicity and transparency and on finding simple but formal models to get insights about difficult questions. Not that techniques were not valued when they were useful, and indeed we students were in awe of Stan's use of stochastic calculus in his macro finance papers; but there was no attempt to impress or to show off. Insights, not methods, were at a premium. Paul Krugman put it well in a 2015 post[9]: "MIT students developed a style that was either wonderfully pragmatic or disgustingly lacking in rigor, depending on your tastes: models derived from micro foundations were always the goal, but when observed experience was clearly at odds with what the models predicted, you'd just impose realistic behavior and leave its ultimate explanation as a project for the future.... I think it's obvious why this approach was better suited for producing future central bank governors, chief economists, and even pundits than an approach that elevated purity over realism."

Third, Stan's and Rudi's intellectual attitude. Even as macro was going through wars of religion, there was no sense of "us versus them" but instead an openness to alternative views, reflecting perhaps the fact that Stan and Rudi had spent time at Chicago, but also intellectual humility and the notion that there was much to learn from other approaches. In the advanced monetary economics class I took from Stan in 1974, we spent half the time on an early draft of the 1976 book by Robert Barro and Herschel Grossman on the disequilibrium approach to macro,[10] and half on the 1972 article by Robert Lucas, "Expectations and the Neutrality of Money."[11] Add to that the social norms that had developed at MIT

5 *Journal of Political Economy* 84, no. 6: 1161–76.

6 *Journal of Political Economy* 85, no. 1: 191–205.

7 Taylor, John B. 1980. Aggregate Dynamics and Staggered Contracts. *Journal of Political Economy* 88, no. 1: 1–23; Calvo, Guillermo A. 1983. Staggered prices in a utility-maximizing framework. *Journal of Monetary Economics* 12, no. 3: 383–98.

8 These and Stan's other publications are listed in a selected bibliography at the end of this article.

9 "Empire of the Institute," *New York Times*, February 28, 2015.

10 *Money, Employment, and Inflation* (Cambridge University Press).

11 *Journal of Economic Theory* 4, no. 2: 103–24.

since the creation of the department and the influence of Paul Samuelson and Robert Solow, among others, with students working together and thesis advisers closely guiding their advisees both intellectually and personally.

Stan was known for reading what we produced literally line by line, and for inviting us for brunch or dinner on Sundays with his wife Rhoda. He was known as a tough but helpful and kind adviser. To a new advisee, he would say, "I want to see you every week, especially if you have nothing to say," which was a strong incentive to have something to say. For a number of years, the informal thesis seminar was replaced by a running seminar, in which thesis students would run with Rudi and Stan around the Charles River. One of us would be asked to present his or her work while running. When the argument became too involved, Rudi or Stan would accelerate the pace to force the speaker to slow down their presentation. It made for simpler and clearer presentations.

Other factors contributed to the excitement and to the type of topic that students worked on.

One was the state of the field. Lucas and Sargent had in no uncertain terms denounced what they saw as a flawed approach to macro, arguing not only for major methodological changes but also for rational expectations as the baseline assumption. This assumption, when used in existing models, led to very strong results, not only about the use of monetary policy, as I indicated above, but also about time consistency and other issues. The challenge for us was to explore implications of rational expectations *and* allow for imperfections, to see what to keep and what to get rid of in the old wisdom. This made it very easy to find thesis topics by going back to old questions and old answers, and exploring what was implied by the assumption of rational expectations coupled with other imperfections—as Stan had done with the implications of labor contracts, and Rudi had done in his article on expectations and exchange rates. We could do it by exploring the relation between the stock market and output, investment and the stock market, the dynamics of exchange rate corridors,.... The set of issues to reexamine was nearly infinite.

Another was Stan's and Rudi's increasing interest in policy issues. Rudi was heavily involved in Latin American economies. Stan had a strong attachment to Israel. He had visited the Bank of Israel for a year in 1979 and was asked by George Schultz in 1983 to join a small group to advise Israeli economic policy. Later, both Latin American and Israeli experiences with high inflation and then disinflation led Rudi and Stan to write a series of papers and a book with Guido Di Tella and Michael Bruno, *Inflation Stabilization*, in 1988.

Watching them led us students to conclude that thinking about policy issues was both interesting and useful, even if it did not always yield academic publications in top journals. This probably explains why so many students ended up holding important policy positions. A nonexhaustive list of Stan's students who played an important policy role includes (* *indicates thesis advisees*):

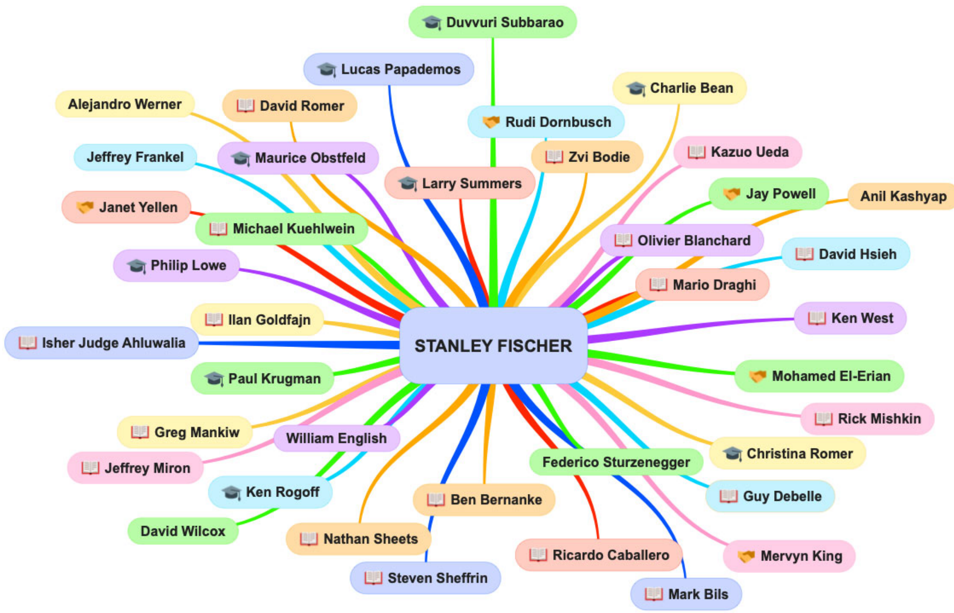
- Pedro Aspe, secretary of finance, Mexico (1988-94)
- Charles Bean, deputy governor, Bank of England (2008-14)
- Ben Bernanke,* chair, Council of Economic Advisers (2005–06) and Federal Reserve Board (2006–14)

- Olivier Blanchard,* chief economist, International Monetary Fund (2008–15)
- Guy Debelle,* deputy governor, Reserve Bank of Australia (2016–22)
- Mario Draghi,* governor, Bank of Italy (2006–11); president, European Central Bank (2011–19); prime minister, Italy (2021–22)
- William English,* director, Division of Monetary Affairs, Federal Reserve Board (2010–15)
- Ilan Goldfajn,* governor, Central Bank of Brazil (2016–19); president, Inter-American Development Bank (2023–)
- Anil Kashyap,* external member, Financial Policy Committee, Bank of England (2016–22)
- Gregory Mankiw,* chair, Council of Economic Advisers (2003–05)
- Frederic Mishkin,* governor, Federal Reserve Board (2006–08)
- Lucas Papademos, governor, Bank of Greece (1994-2002); vice-president, European Central Bank (2002-10); prime minister, Greece (2011-12)
- Kenneth Rogoff,* chief economist, International Monetary Fund (2001–03)
- Christina Romer, chair, Council of Economic Advisers (2009–10)
- Duvvuri Subbarao, governor, Reserve Bank of India (2008-13)
- Lawrence Summers, secretary, US Treasury (1999–2001); director, National Economic Council (2009–11)
- Kazuo Ueda,* governor, Bank of Japan (2023–)
- Sweder van Wijnbergen,* secretary general, Ministry of Economic Affairs, the Netherlands (1997–99)
- Alejandro Werner,* director, Western Hemisphere Department, International Monetary Fund (2013–21)
- David Wilcox,* director, Division of Research and Statistics, Federal Reserve Board (2011–18)

Stan's influence far beyond MIT was also due in part to his two textbooks. *Macroeconomics*, coauthored with Rudi Dornbusch, was aimed at undergraduates and radically different from the existing texts: It not only developed the theory but gave numbers, described economic events, and discussed actual policy choices. It was an immediate bestseller. The first edition came out in 1978, and the book is now in its 13th edition (with Dick Startz as a coauthor). The second one, written with me, came out in 1989; we had not conceived it as a graduate textbook, but it quickly became one. In addition, in 1986 Stan created a new journal, *NBER Macroeconomics Annual*, based on a yearly conference, with the goal of publishing frontier applied research on macroeconomic issues and policies, which he thought was not given enough space in the leading academic journals. The journal is still thriving today.

In 2023 a *Financial Times* article described Stan's influence ("Stan the Man") and created a map of his students, coauthors, or close friends in the economic world. It speaks louder than any list.

Just one degree of Stan Fischer



Note: This map is an extension of the original map in the February 2023 *Financial Times* article. Handshake icons show close colleagues, books show people whose PhDs Fischer directly oversaw, and academic caps indicate people who studied under him.

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Although I was asked to write about Stan at MIT, it clearly would not do justice to him if I didn't also discuss at least briefly his other career as a policymaker. Throughout, he kept on top of academic developments and incorporated the relevant ones in policy decisions.

As respected as Stan was at MIT, he was even more so at the International Monetary Fund (1994–2001), where he had to deal with a succession of crises: the Mexican crisis (1994), the Asian financial crisis (1997), the Russian crisis (1998), and the Argentinian crisis (1999–2002). He also had to address transition in Eastern Europe, and he played a major role in redefining the role of the IMF in that context. His thoughts, articulated in various articles and lectures, are compiled in a book, *IMF Essays from a Time of Crisis*, and they show how he built on his analytical work to think about the issues and help make the many tough decisions that the events required. He became a legend at the Fund, working extremely long hours, sending emails in the middle of the night to an exhausted staff. Together with Michel Camdessus, he is widely seen as one of the most important figures in the history of the Fund.[12]

After a stint at Citigroup (2002–05), Stan became governor of the Bank of Israel, where he again made fundamental contributions. An anecdote reveals his commitment to Israel: When he accepted the position he had all rudiments

12 Stan's farewell speech at the IMF gives a frank assessment of his views and his contributions. Lawrence Summers' speech on the same occasion is also worth reading.

of Hebrew. He decided that, as the central banker of Israel, it was essential that he speak the language, so he learned it, not as an easy feat given his other commitments, and spoke only Hebrew at the bank.

He transformed the bank. He introduced inflation targeting, accepted but refined the role and the limits of exchange rate management, and developed a culture of transparency and clear communication. He often stood tough against an equally tough prime minister, Benjamin Netanyahu. He was widely liked by the general public: I remember running with him along the sea in Tel Aviv; people would recognize him along the way, and thank and applaud him—which was highly unusual, to say the least, for a central banker.

Back in the United States, he was appointed vice chair of the Federal Reserve, a sign of humility after having been number 1 in Israel. He worked closely with Janet Yellen and chaired the Committee on Financial Stability and the Committee on Economic and Financial Monitoring and Research. He retired from the Fed in 2017.

In short, it is hard to think of any other macroeconomist alive who has had as much direct and indirect influence, through his own research, his students, and his policy decisions, on macroeconomic policy around the world.

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