



Paul Samuelson and Monetary Analysis

Paul Samuelson, who turns 90 on May 15, won the Nobel Prize in economics in 1970 “for the scientific work through which he has developed static and dynamic economic theory.” Although he is perhaps best known for his work in the field of international trade, Samuelson has described himself as the “last ‘generalist’ in economics,” a description reflected in the fact that his collected scientific papers contain over 500 pages of material on monetary analysis and on macroeconomic policy.¹

Samuelson made a key contribution to monetary analysis as one of the earliest economists to adapt Keynesian economics to incorporate a greater role for monetary policy. As Samuelson once put it, “Economists of my generation have had to unlearn a lot in the sphere of monetary policy.” As he saw it, the initial Keynesian revolution that followed the publication of Keynes’ *General Theory* in 1936 had led to the view that monetary policy was an ineffective means of influencing aggregate demand. “As one who lived through those times, I can testify how money got lost by economists,” Samuelson observed. Samuelson distinguished this “1936 ‘Model T’ version of Keynes” from the eclectic version of Keynesianism that he developed, in which monetary policy was an important tool of demand management. Reflecting this development, Samuelson wrote in 1962, “Contrary to the opinions of many contemporary economists (and to some of my own earlier views), I believe that monetary and credit policies have great potency to stimulate, stabilize, or depress a modern economy.” By the early 1960s, Samuelson’s economics textbook included a discussion of how “monetary policy does have an important influence on the total of spending,” an important development because his text was a major tool in the teaching of Keynesian economics.² This revision of Keynesian economics went in the direction of the “counterrevolution” that monetarists launched against Keynesianism. Samuelson, however, played down the similarities between his views and monetarism, telling the *Wall Street Journal* in 1984, “The day I become a monetarist is the day I have lost my marbles.”

Another contribution that Samuelson made to monetary analysis has itself been the subject of much subsequent debate and revision. In 1960, Samuelson and Robert Solow published an article studying the Phillips curve—the relationship between inflation and unemployment—in the United States.³ The message taken by the economics profession from Samuelson and Solow’s paper was that government policies that stimulated aggregate demand could buy a permanently lower unemployment rate at the cost of a higher average inflation rate. Subsequent contributions by Milton Friedman and Edmund Phelps established the “natural rate hypothesis,” which overturned the view that there was a permanent trade-off between inflation and unemployment.

Defenders of Samuelson and Solow’s paper point out that the authors acknowledged that changes in inflation expectations could shift the trade-off relationship, an insight that is a key component of the natural rate hypothesis. But Samuelson and Solow’s discussion acknowledged only that the Phillips curve could undergo shifts, not that its long-run shape was vertical, which is the most important message of the natural rate hypothesis. The natural rate hypothesis, and therefore the belief in no long-run inflation/unemployment trade-off, has come to be widely accepted in the economics profession. Samuelson, however, appears to have remained skeptical, reaffirming in a 1978 interview that he had been “warning for 25 years that our mixed economy doesn’t know how to command price stability with efficient full employment.”

—Edward Nelson

¹*The Collected Scientific Papers of Paul A. Samuelson*, published by MIT Press in five volumes from 1966 to 1986, is the main source for the quotations from Samuelson given here.

²See Blinder, Alan S. “Ruminations on Karl Brunner’s Reflections,” in R.W. Hafer, ed., *The Monetary Versus Fiscal Policy Debate*. Totowa, NJ: Rowman and Allanheld, 1984, pp. 117-26.

³Samuelson, Paul A. and Solow, Robert M. “Analytical Aspects of Anti-Inflation Policy.” *American Economic Review*, May 1960, 50, pp. 177-84.