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Germán Bernácer Prize 2017. Acceptance Speech

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Dear Mrs Bernácer, Dear Vice-President de Guindos, Dear Governor Hernández de Cos, Dear Mr Alvarez, Dear Mr de la Dehesa, Dear members of the Bernácer Prize selection committee, Dear distinguished guests,

It is a great privilege and immense pleasure to be awarded this prestigious prize and I thank the selection committee for bestowing it on me and Banco Santander for sponsoring it. This prize really is a wonderful institution and I hope it will continue to encourage research that is ambitious in its objective to speak to important social challenges. I also wish to thank the Banco de España and the Observatorio del Banco Central Europeo for their generous hospitality and warm reception, and particularly Mrs. Lopez who put together this event.

I would like to use this opportunity to thank the many people who have helped shape my views and have supported me over the years. First and foremost, I would like to thank my fiancée Anna for being the best possible team player I could imagine and always pushing me to think big. The same goes for my parents and siblings who unfortunately could not be here today.

I also owe great intellectual gratitude to my PhD dissertation advisors at the University of Chicago, Rob Townsend, Bob Lucas, Fernando Alvarez, Paco Buera. And also to all my co-authors and colleagues at Princeton and elsewhere from whom I have learned so much, particularly Greg Kaplan, Gianluca Violante, Jean-Michel Lasry and Pierre-Louis Lions.

I found a very nice quote by Germán Bernácer that I would like to start with, namely the opening paragraph of his 1950 paper “Money and Freedom.” Bernácer writes:

“The problem of distributing in quality and quantity the products of human industry, constitutes the central problem of Economics. Some people may be inclined to think that the first and foremost object is to produce goods, but the bottlenecks of distribution and the social problems arising from it condition production in such a manner, that the problem of distribution seems to me paramount today.”

The key word here is, of course, “distribution.” Now the word “distribution” has two very interesting meanings that are very related but not exactly the same. The first is how Bernácer uses it above, namely to mean “distribution of the economic pie.” But it also has a second, very precise mathematical meaning, namely the “distribution of a variable” which is simply a way of describing all the heterogeneity of that variable, for example the “distribution of wealth” or the “distribution of firm sizes.” Obviously, it is no coincidence that these two words are the same because really wherever there is heterogeneity there is also inequality.

What I have worked on over the last few years, and for which the committee has so generously awarded me this prize, is trying to understand the role of heterogeneity in macroeconomics. Because of the connection between heterogeneity and distribution I just mentioned, I like to use the word “distributional macroeconomics” to describe the area I work in.

What I mean is simply a way of thinking about classic macroeconomic questions – for example: what is the effect of monetary and fiscal policy? what explains long-growth? and so on – in terms of distributions of microeconomic variables as opposed to how people
traditionally think about them namely in terms of aggregates only. Typical examples here are the distributions of income and wealth.

And the basic idea is very simple: people are different and different people react differently to macroeconomic shocks and policies – and perhaps this matters not only for these people themselves but also for the aggregate behavior of the economy they live in. In a way, it is one of these things that seems obvious to everyone except us economists.

Now, there has been a flurry of work in “distributional macroeconomics” over the last few years, both by my coauthors and myself as well as many others, including some people here in this room. And, on a very broad level, the main message that comes out of this body of work is: it is hard to coherently think about the macroeconomy if one ignores distribution.

Instead, this recent work suggests that there is a rich interaction between inequality or distribution on the one hand and the macroeconomy on the other hand. So on the one hand, macroeconomic shocks and policies affect inequality. But on the other hand, inequality affects macroeconomic aggregates. Or perhaps another way of saying all of this is: the macroeconomy really is a distribution (of microeconomic variables).

Since we are at a central bank here, let me expand a bit more on this with an example you will be very familiar with: monetary policy and its transmission mechanism. This is something I examined together with my coauthors Greg Kaplan and Gianluca Violante. And we find two things:

First and relatively obviously, monetary policy has distributional effects. For example, one effect of an interest rate cut is that it tends to benefits borrowers but hurt savers. So to think about that one obviously needs to take into account heterogeneity, in particular in wealth.

But second, and perhaps less obviously, we find that taking into account this heterogeneity is also crucially important for understanding what happens to aggregates like consumption and GDP. The logic is simply that how different people respond to both interest rate changes and, even more importantly, the resulting changes in their labor incomes does not “wash out” at the aggregate level.

Concretely this means the following: Even a central bank that has the sole objective of fulfilling its mandate of delivering price stability and perhaps also full employment and economic growth – so things that are explicitly not about inequality or distribution – can learn something useful by taking into account inequality and the distributional effects of its policies. And I should note that this is quite different to what comes out of more conventional macroeconomic theories.

Quite apart from this, another important advantage of explicitly taking into account heterogeneity and inequality is that it opens up the door to bringing microeconomic data to the table in order to empirically discipline macro theories. This is, I think, particularly powerful for central banks many of which have access to (or collect themselves) high-quality micro data on household and firm behavior.
In conclusion, let me say again how deeply honored I am that my work is being recognized with the Bernácer Prize. This is especially so because I think Bernácer was very prescient in emphasizing the importance of distribution and, arguably, even already the interaction of distribution with production and the macroeconomy.

Thank you very much.