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There was a time when all great international economists were Canadians; Robert Mundell, this year’s Nobel Laureate, fits the pattern with abandon. He surely is the most creative economist in his field in the second half of this century. Even though his most decisive work lies a few decades back, accomplished by a very young man at the time, it has stood the test of 3 decades better than most of economics and without much amendment. The Dutch philosopher Spinoza said that poetry is a net with which to catch reality; Mundell’s models are just that, too. They are powerful abstractions, stripped to a clean minimum to make a fundamental point of just how the world economy works. A great prize for a great master.

Mundell’s research honored with this prize falls into broad categories. One strand asks how monetary and fiscal policy work in a world of capital movements, i.e., the real world of today and quite unlike that of pervasive exchange control of the 1950s. His argument was this: small countries, for example, Canada, cannot get far away from NY interest rates; if the monetary authorities try to push rates down, one of two things happen. Under flexible rates, money will try and leave and, as a result, the currency depreciates, and that is how stimulus is created. By contrast, under fixed rates, money also tries to and it succeeds, frustrating the attempt to expand the money stock and to push down rates. Drawing on the Canadian experience under fixed and flexible rates that nobody had given much attention, Mundell created today’s understanding of how policy does work in open economies and the conditions under which it can or cannot succeed.
Similarly, he demonstrated that under fixed rates, fiscal expansion works like a charm; under flexible rates, it is useless because currency appreciation offsets the fiscal stimulus. If this sounds like a big deja vue, it is because you learned it in College; in the 1960s, it was the most dramatic revelation of how to think about policy once capital is mobile.

The second line of inquiry is the question of monetary standards. An economy where no nominal quantities—the exchange rate, any of these: the wage rate, the quantity of money—is fixed has no anchor. Economies without a nominal anchor are unstable, and the quality of money is poor. By contrast, hard money regimes do have an anchor such a gold standard, currency boards, or just fixed exchange rates. In exploring alternative monetary regimes, Mundell focused on the conflict between the advantage of a flexible exchange rate, as an adjustment mechanism in international competition and the disadvantage of flexible rates in segmenting the domain of what otherwise might be single money. Money is better the larger its domain, but the fewer exchange rates there are, the larger the need for something else to yield, namely wages and prices, that are notoriously inflexible. Out of this region came the formidable notion of an optimum currency area—mobility of labor within substitutes for exchange rates as a way of solving regional adjustment, and on the outside, the exchange rate does the work. This line of reasoning led to the idea of a European Central Bank and common European money, with a flexible rate on the dollar, long before European politicians and even fewer economists imagined common European money as we have today.

A third direction of thinking has been far more speculative but ultimately just as productive, namely the idea of supply side tax cuts. It caught on with the Wall Street Journal, it caught on with Ronald Reagan, and it was a corner piece of the American boom that is still on today—much to the surprise of the skeptics at the University of Chicago, and
could not figure out what was there other than blind faith in search of a model. And the same goes for Mundell’s recurrent fascination with gold. For most economists gold goes in teeth, around the neck, or on the pinkie. In Mundell’s rendition, it has a more central place as the basis of a monetary standard in a world otherwise without an anchor. Whether he is quite serious in this is open to doubt; he does like on occasion to be outrageous, intellectual, and delights in leaving an audience baffled.

If Mundell is celebrated today for his path-breaking thinking, he deserves no less credit as a formidable teacher. Just about a year ago his students, and their students, got together to honor him on his 65th birthday—the assembly was the Who is Who of international economics, all sharing affection and admiration for a teacher who had never answered a single question but asked many, and he probably never read an exam but was immensely generous in allowing his students to grow and shine. Among the many that deserve mentioning is the former governor of the Bank of Israel, the chief economist of the IMF, and the late Doug Purvis of Queen’s University.

Mundell is not your typical academic nerd. A portrait would be incomplete without highlighting just how much he enjoys the unconventional: he paints, and not pretty flowers; he has been rebuilding a castle outside Siena in Tuscany; he is the proud father of grown up children, and now of a 2 year old; he loves throwing intellectual bombs.