

Acceptance speech

19 June 2025

Michael Woodford, awardee in the Economics, Finance and Management category (17th edition)

When I began to study economics in the late 1970s, the field of macroeconomics was viewed by many as being in a state of crisis. The mid-20th century Keynesian macroeconomic models had fallen into disrepute after the stagflation of the 1970s, which they were felt to have poorly described. Critics stressed two key limitations of the models in particular: a lack of adequate attention to the endogenous determinants of wage and price inflation, and a lack of attention to the role of private-sector expectations in shaping macroeconomic outcomes, and to the way in which those expectations should predictably shift in response to changing economic conditions and changes in policy.

An initial response of macroeconomists to the perceived defects of the Keynesian models was to argue for the use of models in which labor, product and financial markets were all assumed to be in competitive equilibrium at all times, and in which household and firm decisions were assumed all to be based on intertemporal optimization under correct expectations about the economy's future evolution. But these "New Classical" models implied such perfect coordination of private economic decisions that there should be neither any need for government policy to improve economic outcomes, nor much scope for traditional tools of stabilization policy, such as monetary policy, to have effects that would not be simply offset by adjustments of private behavior. As a consequence they were of little use as guides to policy design.

The work for which I am being honored, along with my colleagues Olivier Blanchard and Jordi Galí, has developed a new generation of quantitative macroeconomic models – known as New Keynesian models – which also derive household and firm behavior from intertemporal optimization. But unlike the "New Classical" models, they allow for imperfectly competitive markets, and hence for market power on the part of both firms and labor unions, which allows the adjustment of wages and prices to be attributed to the decisions of identifiable economic agents, and thus to be dependent on the objectives and beliefs of those parties. And, crucially, they posit that wage and price setters do not instantaneously reconsider their demands at each moment, but instead economize on information and decision costs by leaving wages and prices fixed for variable intervals of time. The resulting models are

in much greater conformity with observed economic time series, allowing a revival of the program of macroeconomic modeling by policy institutions such as central banks. They also imply that monetary and fiscal policies can substantially affect the way the economy responds to unexpected economic developments, and that well-designed policies can do much to improve the stability of both prices and economic activity.

My own work has shown how the analysis of macroeconomic stabilization within such a framework allows stabilization policy to be considered in an integrated way with the methods used in the field of public finance to analyze the microeconomic distortions associated with alternative tax policies. This has made it possible to analyze the joint use of monetary and fiscal policies for stabilization purposes within a common framework, and to calculate the welfare effects of policies in a way that simultaneously considers the benefits of aggregate stabilization and the efficiency of resource allocation. My work on the optimal conduct of monetary policy has provided theoretical foundations for flexible inflation targeting, both as an approach to decision making within central banks and as a framework for communication with the public about the central bank's policy commitments.

Work of the kind that is honored by awards such as this is seldom truly the work of a lone scholar, and this is certainly true of my own case. Probably the two most important of my collaborators on the work for which I am being honored have been the late Julio Rotemberg of Harvard Business School, who was central to the formulation and estimation of the earliest New Keynesian DSGE models, and my former Princeton colleague Lars Svensson, now at the Stockholm School of Economics, who played a key role in shaping my understanding of how models could most productively be used in the conduct of monetary policy.

My work would also not have been possible without institutional support, above all from the University of Chicago, Princeton University, and Columbia University for the past twenty years, which have each generously provided me with time to pursue fundamental research, and the opportunity to teach students who have themselves in many cases made crucial contributions to the advancement of my research program. And finally, I would like to express my gratitude to the BBVA Foundation and the members of the committee for honoring me with this prestigious award.