THE FEDERAL RESERVE BANK of ST. LOUIS

NEWS RELEASE

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<u>Media Advisory</u>
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St. Louis Fed's *Review*: Using the Gravity Model to Estimate the Costs of Protection The Inflation-Output Variability Tradeoff and Price-Level Targets Eighty Years of Observations on the Adjusted Monetary Base The Welfare Cost of Inflation

ST. LOUIS, Mo. — The latest edition of *Review*, the Federal Reserve Bank of St. Louis' journal of economic and business issues, features the following articles:

• **"Using the Gravity Model to Estimate the Costs of Protection."** Economists are nearly unanimous in their opposition to trade protectionism. Nevertheless, their estimates of the actual burden that protectionism imposes on the economy have been surprisingly small. Economist Howard J. Wall presents an estimation of trade protectionism that captures some of the effects and distortions that are not captured by existing methods. He found that during 1996, worldwide protectionism reduced U.S. exports by more than 26 percent. During that same period, U.S. protectionism decreased U.S. imports from non-NAFTA countries by more than 15 percent.

• **"The Inflation-Output Variability Tradeoff and Price-Level Targets."** Economists William T. Gavin and Finn Kydland, and mathematician Robert Dittmar describe a popular

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monetary policy framework based on a neoclassical Phillips Curve model. With their model, the choice between an inflation target vs. a price-level target depends on the gap between potential GDP and real GDP. If output is relatively persistent, as it appears to be in the G-10 countries, then targeting the price level results in a better tradeoff. The implication of their research is that central banks should set objectives for a price level, not an inflation rate.

• **"Eighty Years of Observations on the Adjusted Monetary Base: 1918-1997."** Recent trends in empirical macroeconomic research have increased the importance of long-time series of macroeconomic data. Among the more important of such data are quantitative measures of monetary policy, such as the adjusted monetary base. Previously published data for the Federal Reserve Bank of St. Louis' adjusted monetary base began in 1935 (seasonally unadjusted) and in 1950 (seasonally adjusted). In their analyses, St. Louis Fed economists Richard G. Anderson and Robert H. Rasche develop a consistent time series for the adjusted monetary base that begins in 1918, shortly after the founding of the Federal Reserve System.

• **"The Welfare Cost of Inflation: A Critique of Bailey and Lucas."** Estimating the welfare gains from ending inflation requires taking a stand on money demand. A form of the money demand function that seems to describe the U.S. experience — known in technical jargon as the double log form — seems to work well in countries and times where inflation was moderate. Economist Alvin L. Marty argues that the double log form would not likely work well in extreme cases, where policy is set to achieve Milton Friedman's optimal money stock or, at the other extreme, hyperinflation.

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