

A conversation with Laurence Ball on April 17, 2014

Participants

- Laurence Ball – Professor of Economics, Johns Hopkins University
- Alexander Berger – Senior Research Analyst, GiveWell

Note: This set of notes was compiled by GiveWell and gives an overview of the major points made by Professor Ball.

Summary

GiveWell spoke with Professor Ball about his views on monetary and fiscal policy and suggestions for how a philanthropist could most effectively advance macroeconomic research and policy.

Macroeconomic research

There are serious problems with the current state of macroeconomic research. Amongst other changes, there should be more applied research on a broader range of topics.

Macroeconomic models

Dynamic stochastic general equilibrium (DSGE) models, which are widely used in academic macroeconomics, are not very useful in explaining ordinary macroeconomic phenomena. These models place too much emphasis on theoretical elegance, mathematical sophistication, and microeconomic foundations, relative to making plausible empirical claims. DSGE models continue to be popular in academia despite their limited utility because economists feel pressure to do sophisticated mathematics in order to get tenure.

Laurence Meyer, a member of the Board of Governors of the Federal Reserve and a co-founder of Macroeconomic Advisers, has been one of the most successful macroeconomic forecasters. He has attributed his forecasting accuracy to his reliance on older economic ideas from his time as a graduate student and argued that new models add little to our understanding of the economy.

Before the 2007-2008 financial crisis, most economists had not seriously considered the possibility that excessive leverage in the financial sector could lead to bank failures and an economic crisis. The financial sector usually was not included in macroeconomic models before the crisis. Since then, some economists have begun to model the financial sector, though the more important question than "how or why did the financial crisis occur?" is "what should we be doing to get the economy going from here?"

New types of economic data

GiveWell asked about the value of collecting new or different kinds of economic data, such as qualitative surveys of employers about their pricing or hiring behavior.

Truman Bewley, an eminent economist at Yale University, talked to ordinary workers and unemployed people about unemployment and wrote a book on his findings called *Why Wages Don't Fall During a Recession*. A generation ago, people might have said "that is not real economic research," but economists today may be more sympathetic to that kind of data collection. That said, collecting such data is not likely to fit the career incentives of most academics, especially young ones.

Fiscal policy

At the zero lower bound, it is easier to design effective fiscal policy than monetary policy. Lawrence Summers is right that a fiscal stimulus would be very effective in improving the economy under current conditions. However, it is difficult to see a political scenario that would lead to such a bill passing in the near future.

A comparative advantage of automatic stabilizers is that they wouldn't require rapid congressional action during a recession in order to be implemented, which might make them more successful. On the other hand, most economists believe that, compared to monetary policy, fiscal policy is a blunt instrument that does not permit fine control over the economy. The importance of automatic stabilizers in the future depends on how likely the zero lower bound is to continue to be a problem; if we move away from the zero lower bound, a return to more standard monetary policy tools for addressing recessions would be appropriate. Some economists, including Lawrence Summers, think the zero lower bound is likely to continue to be a major problem going forward.

Unconventional monetary policy

The recent discussion amongst academic macroeconomists has been too narrowly focused on the Federal Reserve's current policies of quantitative easing (QE) and forward guidance; it would be better if academics were doing research on a more expansive portfolio of unconventional monetary policy options.

There are a number of unconventional monetary policy approaches that are worth considering more extensively. Unconventional policies that Ben Bernanke had discussed in the context of Japan when he was an academic include:

- A 4% inflation target. Policymakers at the Federal Reserve are opposed to raising the inflation target. While some theoretical models have computed the optimal

inflation rate to be very close to zero, Professor Ball is skeptical of these results and believes that more rigorous empirical research would show that a higher inflation target would be beneficial.

- Depreciating the dollar
- Targeting longer-term interest rates
- Helicopter drops, i.e. printing additional money to distribute to consumers in order to stimulate demand

More research may also be warranted on other even less conventional approaches, such as:

- Direct intervention by the Federal Reserve to aid struggling small banks
- A program for the Federal Reserve to subsidize, guarantee, or buy loans for small businesses.

The Federal Reserve

Relationship between policymakers and academics

Nearly all of the leading American monetary economists have worked for the Federal Reserve at some point, or aspire to do so. The close ties between monetary economists and the Federal Reserve make them reluctant to criticize the conduct of U.S. monetary policy – they would be criticizing decisions made by their friends and professional colleagues. These close ties may also mean that Federal Reserve research and research conducted by academics are not as independent as they seem.

Reluctance to pursue unconventional monetary policy

Prior to becoming chair of the Federal Reserve, Ben Bernanke endorsed more aggressive unconventional monetary policies than he tried to enact as chair of the Federal Reserve. The Federal Reserve acted swiftly and certainly with unorthodox actions when it appeared that some of the largest banks in America could fail during the 2007-2008 financial crisis, but did not apply the same urgency to monetary policy aiming to accelerate the recovery.

The Federal Reserve is generally cautious in its policy because it is concerned that if it attempted more aggressive measures, members of Congress might try to limit its independence.

Funding opportunities in macroeconomics

Opportunities to use money to advance macroeconomic policy fall on a spectrum from pure political advocacy to pure academic research.

Political advocacy

The Center on Budget and Policy Priorities' Full Employment project, run by economist Jared Bernstein, does research but is more on the advocacy end of the spectrum. It commissioned papers, including one coauthored by Professor Ball, that were launched at an event in Washington, D.C. that was intended to market its policy recommendations to journalists.

Other activities in this area that a philanthropist could fund are:

- Lobbying of Congress
- Advocacy for stronger financial regulation.

It would be good for unions and advocates for low-income people to be more vocal in calling for the Federal Reserve to aggressively address unemployment. In the past, liberal populists criticized the Federal Reserve for raising interest rates too much during economic prosperity, but today the main critics are on the political right.

Research

A grant could provide financial support for an economics professor to do research instead of teaching for a summer or a semester. The National Science Foundation (NSF) has an economics program that provides some grants. However, it is unclear to what extent the grants cause research to be done that would not have occurred otherwise.

Another funding opportunity might be to commission an edited volume. John Taylor, a conservative economist, edited *The Road Ahead for the Fed*, which included policy essays written by ten prominent conservative economists. This is somewhat similar to CBPP's Full Employment project but has a more academic tone.

Organizations that could implement these projects

Organizations that a funder might be able to work with to support economic research or advocacy might include:

- The National Bureau of Economic Research (NBER). The NBER is committed to ideological balance and avoids making policy prescriptions, so it is unlikely to be a good fit for a funder aiming to support advocacy efforts, but it may be an appropriate venue for some research support.
- The Brookings Institution.
- The Peterson Institute for International Economics (PIIE).
- CBPP's Full Employment project.

A funder could also issue requests for proposals and fund research independently.

Other people to speak with about macroeconomic policy

- Adam Posen – President, Peterson Institute for International Economics
- Greg Mankiw – Professor of Economics, Harvard University

All GiveWell conversations are available at <http://www.givewell.org/conversations>