The Marshall Society Interview
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1. How long does it take before developments in macroeconomics start affecting the way in which economic policy is conducted? As the head of the Council of Economic Advisers to the US president, do you have any experience of recent research altering the interpretation of data, and, consequently, policy prescriptions?

Economic research influences economic policy with long and variable lags—and appropriately so. By its nature, research is often speculative. It would be a mistake for someone to take an intriguing hypothesis and turn it into a specific policy proposal before the profession could fully develop and examine the idea.

Nonetheless, academic research can profoundly influence the policy debate. Let me give you two examples.

Milton Friedman and other economists have long been critical of discretionary monetary policy. As an alternative, they have advocated monetary policy rules. This academic debate has encouraged many central banks around the world to adopt inflation targeting as their monetary regime.

Similarly, there is a significant academic literature suggesting that high tax rates on capital income distort saving decisions and impede economic growth. This literature can be viewed as providing the intellectual foundation for President Bush's proposal (signed into law in May of 2003) to reduce the tax on dividends and capital gains. President Bush was not aware of Christophe Chamley's 1986 article in Econometrica on the optimal taxation of capital income, but I am sure that some of his economic advisers were.

2. Do you think in the future the Keynesian/Classical controversy will be conclusively resolved?

There is always a tension in economics between those who see the natural functioning of markets as a grand success and those who see market failure as pervasive. The debate between the Classicals and the Keynesians is part of that tension. Overall, it is a useful debate because, over time, it leads to a synthesis that encompasses the best parts of each vision.

From time to time, someone writes a book that tries to summarize the current synthesis in macroeconomics. About half a century ago, Don Patinkin's book "Money, Interest, and

Prices" offered such a synthesis for its time. David Romer's graduate text "Advanced Macroeconomics" and Mike Woodford's treatise "Interest and Prices" are more recent attempts at synthesis. My own textbooks offer such a synthesis for undergraduates. In reading these books, you can see that both Classical and Keynesian viewpoints have made significant contributions to the field.

3. Are political constraints greater than economic ones in hindering third world growth/development?

Yes, that is often the case. Adam Smith once said, "Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice." Unfortunately, these three prerequisites are sometimes hard to obtain. The impediments are indeed often political.

4. Does it have any metaphorical significance for contemporary macroeconomic thought that your dog's name is Keynes?

Keynes (the dog) was full of "animal spirits." Also, I am a big admirer of Keynes (the man). Otherwise, I don't see any great metaphorical significance to the name.

I should note, sadly, that Keynes (the dog) reached the long run a few years back. My family is still debating what economist our next dog should be named after.

5. What impact do you think your menu costs article has had on Macroeconomics?

I am probably the worst person to answer that question, as no academic can be fully objective about his or her own work. According to the Social Science Citation Index, my 1985 menu cost article is one of my most cited works. (My most cited article is with David Romer and David Weil on the empirics of economic growth.) Citations are an objective, if imperfect, measure of academic success.

I view the menu cost article as one contribution to a larger effort aimed at keeping models of sluggish price adjustment as part of the macroeconomic mainstream. When the article was written, new classical macroeconomics was at its peak, and flexible-price models were becoming the standard paradigm. I thought the rejection of sluggish price adjustment was a mistake, as did many other new Keynesian economists, such as George Akerlof, Larry Ball, Olivier Blanchard, David Romer, and Julio Rotemberg. Today, there is more agreement that sluggish price adjustment needs to have a key place in business cycle theory.

6. How are you finding the contrast between your current policy job in Washington, and academic work?

In economics, as in many fields, there is a tradeoff between depth and breadth. Academia rewards depth. An academic can achieve great fame by devoting his or her career to a narrow area and becoming the world's expert in it. By contrast, policy work gives greater weight to breadth. In my current job as Chairman of the Council of Economic Advisers, I get involved in a diverse range of issues, including tax policy, international trade, energy policy, and financial market regulation. The job requires a broad interest in all areas of economics.

7. What is your opinion of the sustainability of the US deficit, and the fiscal stance of the current administration?

The U.S. economy experienced four contractionary shocks over the past several years years: the end of the high tech bubble, corporate governance scandals, terrorist attacks, and slow growth among some of our major trading partners. In light of these shocks, a budget deficit is a reasonable policy response. An attempt to reduce the budget deficit in the short run would likely have caused the recent recession to be deeper and longer.

The current U.S. budget deficit is about 4 to 4.5 percent of GDP. President Bush has said he wants to reduce the budget deficit in half over the next five years, to about 2 percent of GDP, while making the recently passed tax cuts permanent. This will require continued economic growth, which will bring in more tax revenue, and significant restraint in government spending. In my view, reducing the budget deficit over time through spending restraint is an important goal for U.S. economic policy.

8. How will the teaching of Economics change in the next 20 years?

In the United States, there has been a trend toward more students studying economics before college. I hope and expect that this trend will continue. Economics should be a part of general education in high school, much as history is today. Voters need to understand basic economics if they are to make wise choices when they enter the voting booth.

In a democracy, people usually get the public policies they want. In many cases, the biggest obstacle to good economic policy is ignorance about basic economics on the part of the electorate.

9. Have you always wanted to be an economist? What attracted you to the subject?

When I entered college, I had little idea what economics was. I thought I would major in math or physics. But I always had an interest in public policy. Through my father, who was involved in local Republican Party politics, I had helped out a bit in some political campaigns.

My interest in economics was immediate. As soon as I learned what the field was like, I was fascinated by it. The study of economics seemed a perfect marriage between analytic rigor and social concern.

10. Why do you think your textbook, *Macroeconomics*, has been such a success?

I love economics as a field, and I hope that some of this enthusiasm shows up in my teaching and textbooks. I am a firm believer that the world would be a better place if we had better economic policy, and that we would have better economic policy if more people understood economics.

I am reminded of a quotation from the movie "The Confession:"

"People often think that it is hard to do the right thing. It is not hard to do the right thing; it is hard to know what the right thing is. Once you know what is right, then it is hard to not do the right thing."

In the movie, the character Harry Fertig (played by Ben Kingsley) is not thinking about anything remotely related to economic policy as he says these lines. But the words speak to me nonetheless.