

**EconoFact Chats: Today's Economic Challenges**  
**Larry Summers, Harvard University**  
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**Michael Klein**

I'm Michael Klein, executive editor of EconoFact, a non-partisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at [www.econofact.org](http://www.econofact.org).

**Michael Klein**

For EconoFact Chats, I'd like to interview people who are or were at the very top of government economic policymaking. I also value conversations with economists whose research had a big impact on the profession. I would like to have a discussion with a guest who headed a prestigious university. I'd also like to speak with someone who has worked in financial markets, and understands their dynamics. So to get all these perspectives, I could invite a wide set of people for multiple podcasts. Or alternatively, I could just speak with Lawrence Summers, who is my guest today. Larry has made important contributions in economic research on a range of topics, including fiscal and monetary policies. He served in various roles in government, including Director of the National Economic Council and at the United States Treasury, Undersecretary for International Affairs, and after that, the Secretary of the Treasury. He was the Chief Economist at the World Bank. He was a Managing Partner at the hedge fund D.E. Shaw & Company. And of course, he served as President of Harvard University. So today, I'm getting a wide range of perspectives from one guest. Larry, thanks very much for joining me on EconoFact Chats.

**Larry Summers**

Very good to be with you.

**Michael Klein**

Larry, there's a range of issues I'd like to discuss with you. So maybe it's appropriate to start with what is being called the poly-crisis facing the world; crises in terms of economics, the environment, and politics and governance. Can you briefly describe how these crises are interconnected?

**Larry Summers**

Look, we have a lot of problems. We have a climate change problem. We appear to have a substantially larger potential future pandemic problem than we might have anticipated five years ago. It is less clear that convergence of the poorest countries is going to be a continuing trend than one would have thought a few years ago. There are significant issues, although there's been improvement in the last year or two, in the macroeconomic environment. And there has been a drastic political deterioration, both in terms of the amount of conflict among major nations with the war in Ukraine, the war in the Middle East, the tensions in the Asian Pacific, and the democratic mixed economy model that many thought had emerged as a model triumphant, is under very serious threat from nationalist populism in many countries, including the United States. So, you have a sense of fraying, breakdown, and potentially large risks to human

well-being in many societies. And I think that's what's behind the term poly-crisis. Some of it is driven by events. Some of it is driven by mistaken responses to events.

**Michael Klein**

So, as you said, there are many possible causes of these poly-crisis, but some people looking for a unified answer talk about globalization as a source of economic inequality, environmental degradation, and political upheavals. Do you think globalization deserves this bum rap?

**Larry Summers**

No. I think that any discussion of the human condition has to begin with the fact that, depending on just how you do the numbers, some number like 140,000 people a day have been lifted from extreme poverty, every day, on average, for the last 30-some years. And that is an achievement that is entirely without precedent in human history. I think any discussion of the human condition has to reckon with the fact that when I was born, the chance that a child in the United States would die before the age of five was very, very low, less than one percent. That the chance that that would happen to a child born somewhere on planet Earth was close to 10 percent or more. And that by 2035, it's reasonable to think that that mortality probability will be as low as it was in the United States in 1954, the year I was born. So, I think we have seen stunning progress, and the greater flow of goods, of ideas, of investment across international borders has been a very large part of that, and it would have been unimaginable without interchange between nations. So, there are plenty of questions about the management of globalization that you can debate. I also think it's important to remember that there has not been a major war between major powers in 78 years. And I think there's a reasonable case to make that that is something that has never before happened in human history. And I don't think that is unrelated to the growing interchange between nations. So, should we debate whether there's any role for tariffs? Should we debate whether there's any role for capital controls? There are lots of debates about globalization that are important to have, but the idea that globalization is some root of the fact that we have a crisis is this century's gross economic error, in the same way that the idea that organizing a society on Marxist socialist lines was last century's egregious economic error.

**Michael Klein**

So, as you well know, Larry, these days there are politicians who are calling for a withdrawal of America from the world stage, and a more nationalist policy. When you served in various roles in the Treasury Department, you were involved in policies that were more internationalist to support countries like Mexico that were facing deep crises. There's a famous Time magazine cover from 1999 that featured your picture along with that of Treasury Secretary Robert Rubin and Federal Reserve Chairman Alan Greenspan that had the title "The Committee to Save the World." And by the way, I noticed that you're the only one of the three not smiling in that photo. Should Americans have a special role in fostering economic stability in open trade and financial markets?

**Larry Summers**

I think it's always best when global decisions are made in some global way. They have more wisdom that feeds into them. They're likely to have more legitimacy and be more widely accepted. That's why I'm a very strong supporter of the international financial institutions, the IMF and the World Bank and the other development banks, and I think they have huge potential

to play. I think inevitably, given that the United States is the largest economy in the world, given that the U.S. share of world wealth has actually substantially increased over the last generation, something most people would not have expected; given the centrality of the dollar to the world economy, I don't think it's easy to imagine a well-functioning global system that makes rules, that solves problems, that provides collective goods with a United States that is turned inwards and nationalist. We had a kind of experiment during the interwar period when Britain was exhausted and no longer able to lead a global system, and the United States had substantial capacity but was not yet ready to recognize that obligation. Arguably, the subsequent generation was the worst 25 years in human history. Again, I think there's a ton that can be debated about moments when the United States has overreached, when the United States has tried to do too much, when the United States has imposed values that may not be the right one, but on the broad gross judgment, is American leadership essential to a healthy global economy, and is it imaginable that the United States will be prosperous and secure in the absence of a healthy global economy? I think no, we won't be without a global economy, and it is hard for me to imagine a healthy global economy without our leadership.

### **Michael Klein**

So you're talking about government policies, and governments can make policies, but to paraphrase a famous saying, 'governments plan and God laughs.' COVID was a powerful example, perhaps not of God laughing, but of the best laid plans being disrupted by an unexpected and devastating development. Monday morning quarterbacking has its flaws, but nevertheless, how would you rank the US government's response to the economic challenges presented by the pandemic?

### **Larry Summers**

I'm not an expert, but I would not be inclined to give us very high grades. I say that simply by looking at the grossest of statistics, the fraction of our population that died, compared to the fraction of other countries' populations that died. We had some advantages relative to many countries, a younger population, a lower population density. We had some disadvantages, probably less well-developed immune systems on average in the United States. But weighing the advantages and the disadvantages, my instinct is that our performance was rather poor. And I think that reflects something about the extent of inequalities in our system, something about the degree of decentralization and fragmentation, and perhaps excessive emphasis on market forces that leads to an overemphasis on private health relative to public health, and therefore made us ill-suited to responding to what was a central public health problem. I think in retrospect, there was quite a bit of asserting that was done that went beyond the knowledge of the people who were making the assertions. I think that over time, we will come to see that the lost schooling of large numbers of children who were not in fact at appreciable risk had very substantial costs in stunting their mental growth and in their livelihoods over time.

### **Michael Klein**

Turning from the health aspects to the economic aspects, one of the legacies of the pandemic was the highest inflation rate since the early 1980s. Surprisingly to many people, inflation has come down without a recession. You were recently quoted in the New York Times as saying, 'I was of the opinion that soft landings were the triumph of hope over experience. This is looking like a case where hope has triumphed over experience.' Why do you think that happened?

### **Larry Summers**

I think it's a very important question and I guess I would say three things. We don't know yet what's going to happen at the end of this episode, and we don't know where inflation is going to settle, and so I think we should not rush to judgment. We knew all along that there was a lot of transitory inflation caused by supply bottlenecks in conjunction, in my view, with big increases in demand. As those supply bottlenecks ended, transitory positive inflation was going to be replaced by transitory deflationary forces. That's some of what we're observing, so we can't be sure yet what the underlying rate of inflation was.

The second thing that I would emphasize is that expectations which we know, or economists at least think have been a very substantial determinant of inflation, have stayed very anchored through this period. Why? Maybe it's the 40-year history before. Maybe it's the fact that the Fed was very resolute after having been very late. I don't think maybe it was the fact that we did a much better job than we have done historically as a country in respecting the independence of the Fed. So, I think credibility plus history anchoring expectations more than I might have expected through an acceleration of inflation is probably a second aspect of it.

And the third aspect is that surely the underlying shocks had a transitory element. The fiscal policy was in significant part relaxed. Some of the bottleneck forces were responded to, and so what you had was a set of things that in retrospect may have driven price increases, but didn't drive an ongoing process of inflation. I was of the view that if you looked at post-war American history, basically whenever unemployment got below four with inflation above four, there tended to be a recession as part of the process of bringing inflation down. That was an almost universal regularity, and that was what was behind my comment about soft landings being the triumph of hope over experience. But this landing appears so far to be a better descent – I'm not sure it's yet a landing – than we've observed historically, and I think what I suggest are some of the reasons why.

### **Michael Klein**

On the expectations we have a really nice memo by Ken Kuttner of Williams College where he looked at the link between inflation expectations and the actual inflation rate and he found historically if inflation went up by one percentage point inflation expectations went up by 0.8 percentage points. But more recently when inflation goes up by one percentage point inflation expectations only went up by two tenths of a percentage point, so as you're suggesting there seems to have been a real shift in the way people think about inflation, and that probably as you're suggesting also had a big role.

### **Larry Summers**

I think that's right and you know how much that's because, if you look at inflation from 1950 through 1985 it looks a lot like a random walk. And, if you look at inflation since 1985 it looks more like white noise. So people forecast extrapolatively random walks from the last observation, and people should and do, do the opposite with respect to white noise. So some of it may be the time series process, some of it may be the approaches that the Fed is taking to communicating its policy intent. I think it's a difficult thing to completely sort out.

**Michael Klein**

So on inflation, it's still above the Fed's two percent target—the personal consumption expenditures price index showed inflation of 2.6 in December—and in its most recent meeting the Fed left interest rates unchanged, but it also made it clear that it needs to see more progress on inflation before reducing borrowing costs. Larry, do you think that getting inflation down to the target rate of two percent is going to require a slowing of the economy and if so, why not just be satisfied with 2.6 percent. There's nothing special or magical about two percent is there?

**Larry Summers**

As we've been discussing I think the prospects of a soft landing are better than I would have guessed but by no means assured. I thought setting a two percent inflation target was ill advised, and that was the advice that I gave President Obama when the Fed wanted to do it in 2011. I did that because I thought in a world of 'unknown unknowns,' of Knightian uncertainty one didn't know what was going to come, and it was a mistake to get overly attached to specific numerical targets that might end up looking quite different in contexts one did not foresee. However, having set that target, having reinforced that target rhetorically constantly for a decade, I think simply to abandon it because it was difficult to achieve would be to do substantial damage to credibility that might ultimately require more costly, rather than less costly disinflation. So I would not support abandoning the two percent inflation target, given the degree of commitment that has been attached to it.

**Michael Klein**

Turning to more long-standing issues, one of the biggest challenges facing this country is the stagnant levels of income among many people in the middle class and the difficulties we've seen in raising people out of poverty. These are obviously multifaceted problems, but what do you see as viable policies to improve the lives of people who have not seen much go right for them economically over the last few decades?

**Larry Summers**

Look I think that a substantial amount of that has to do with policies to promote education and training. I think we massively over invest in the human capital, and public support for the development of the human capital of the more cognitive half of the population, relative to the half of the population whose strengths are more characterological, and often more physical and so it appalls me to see how little we do for helping those who've dropped out of high school transiting to work, relative to forgiving the debts of very very fortunate Ivy League graduates. I think that's something that we very much need to address. I have been a strong supporter of place-based policies. I think that we have substantial concentrations of economic distress that with the right kind of place-based wage subsidies, we can level out the economy across the country, and help some very very distressed communities. I think that even though it's not fashionable to say anymore, the available evidence is that a rising tide lifts all boats and I think in general if we can do things that accelerate productivity growth, and accelerate GDP growth, those things will tend to raise incomes of all sectors of the population. So, I prefer to address these things in the context of the promotion of investment, and the promotion of greater prosperity. There's certainly a scope and it's certainly an important area of policy for more progressive taxation, starting with the enforcement of the tax law. I was appalled to discover that over a three-year period late in the last decade there were a hundred people who had incomes of

over ten million dollars who didn't deign to file a tax return, and the government didn't even manage to notice before the statute of limitations had run. I can't imagine clearer evidence of insufficient enforcement effort.

### **Michael Klein**

We have a memo by Bill Gale about funding the Internal Revenue Service where he shows that's one of the highest returns you can get to get back money that should be owed, and is owed on taxes. So finally, Larry, we've discussed a number of different policies, and economists can propose policies but there's a political process that needs to be understood and addressed to get these policies implemented. In your extensive experience in government what do you see as the role of economists in making policy? How effective are their arguments, and what can economists do to help shape legislation and policies that they think would have widespread benefits – the kinds of things that you advocated in the podcast today?

### **Larry Summers**

Look, I think sound analysis clearly presented matters over time. I think the most sophisticated discussion in terms of the actual impact and the way to think about economists, and the process that I ever heard was provided by Milton Friedman many years ago, and you can believe in the analysis whether or not you believe in any of the policy views that Milton Friedman had. Milton's view was that when the deal is actually being struck, the main issues are of politics and personality, and it's helpful for the participants to get a certain amount of economic advice, but economic advice is not the essence of the problem. But that the role of economic scholars is to cause there to be an inventory of well-thought-through ideas, so that when political opportunities open those ideas can be adapted. And so, for example Friedman himself had been a warrior in the vineyards for what was seen as a crackpot idea – the volunteer army. And then Vietnam changed the whole constellation around that issue, and a set of carefully thought-out proposals for a volunteer army were there for the taking. Monetarism was a kind of lonely crusade as a way of thinking about economics, but when inflation had risen spectacularly in the 1970s and the orthodoxy wasn't working, monetarism, even though he didn't believe in many of the details, provided a framework for Paul Volcker to do what was necessary to resist inflation. Economists' ideas about charging for pollution rather than simply relying on command-and-control regulation haven't been adopted nearly as much as you or I would like to see, but have had an enormous influence around the world and carbon pricing is one of the centerpieces of discussions of climate change policy. Ideas around prizes and procurement to drive scientific progress had a lot to do with operation warp speed, which is the thing that the United States probably did right to great global benefit during the COVID period.

So, I think economists inside of government have to work on the priorities of the day and the ongoing legislative struggles, the ongoing evaluation and design of regulations. But, I think the economists outside of government work best by identifying problems, understanding their roots and the models that best can be used to understand those problems, and thinking about solutions, and waiting for political windows to open, because one of the things I've learned most clearly in all my time in Washington is that the transition from inconceivable to inevitable can actually be quite right, quite dramatic at particular moments, but one can't predict exactly when those moments will come.

**Michael Klein**

Well, I like to think that at EconoFact, we try to help the public understand better those development of ideas that you've discussed, so there's a wider understanding of what might be better policies. And also famously you said the first obligation of an economist in government is to stop stupid ideas, right?

**Larry Summers**

There's a great deal that needs to be resisted. Economists have the gift of thinking about how the whole system fits together, and that can often lead one to see through what all the various feedbacks from a given policy were going to be. It's not an accident that when you have price controls, you have more corruption from bribery. It's not an accident that when you restrict flows of capital, you have black markets, and black market exchange exchange rates. It's not an accident that when you regulate one class of firms engaged in a given activity, say for example banks involved in lending, that the activity may shift out of the sector that you regulate, into a sector that you don't regulate at all, and so you may end up with less regulation of lending rather than more. It's not an accident that when you insist on ever more elaborate standards before a new drug can be approved, that in addition to protecting some people from bad drugs, you delay some people's access to good drugs, and economists tend to recognize that those things need to be balanced. So, I do think there is a distinctive economic perspective that leads to wiser and better decision making.

**Michael Klein**

Well you certainly illustrated that today. Thank you for joining me on EconoFact Chats. I really enjoyed our conversation, Larry.

**Larry Summers**

Thank you.

**Michael Klein**

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