An Interview with Robert J. Barro

project-syndicate.org/say-more/an-interview-with-robert-j-barro-2021-04

Project Syndicate, April 20, 2021

20 avril 2021

Robert J. Barro
Says More…

Apr 20, 2021

This week in Say More, PS *talks with* Robert J. Barro*, a professor of economics at Harvard, visiting scholar at the American Enterprise Institute, and research associate of the National Bureau of Economic Research.*

Project Syndicate: *In February, you warned that the US Federal Reserve is squandering the reputational capital that former Fed Chair Paul Volcker bequeathed to it (by maintaining high interest rates despite a recession), noting that, today, "fiscal deficits as a share of GDP are running at unprecedented peacetime levels." But the coronavirus pandemic has often been compared to a war, in terms of its casualties and economic impact, and maintaining high interest rates during such a crisis would, according to the conventional view, exacerbate the recession. How can policymakers balance the need to keep long-term inflation expectations low with the short-term imperative of fostering economic recovery?*

Robert J. Barro: Large fiscal deficits make sense as a way to finance large temporary outlays, such as in a war or to fund major infrastructure projects or emergency transfers. Deficits are also reasonable during a recession, as a means of supplementing government revenue – which would be shrinking, due to declining real GDP – without resorting to a tax hike during a downturn.

1. Share the Intellectual Property on COVID-19

The real question is how much government should have spent after the pandemic-induced recession began last year. In the United States, it made sense to help businesses maintain their connections to employees, such as through the paycheck-protection program, and to expand payments to people who had lost their jobs, such as through extended unemployment insurance.

But the package the US federal government implemented in March 2020 went much further than that. Among other things, it increased unemployment insurance to levels that made working less financially rewarding than leisure for many people.

Overall, at over $2 trillion, that package was much too large, though it was probably helpful overall – that is, it was likely better than nothing. The same cannot be said for the $1.9 trillion "relief" bill that was passed a year later. At that point, the US was already experiencing a V-shaped economic recovery – one that will likely be complete by the third quarter, not because of the government stimulus, but because a highly successful vaccination program will unleash pent-up demand in key sectors, especially travel and leisure.

Given this, the additional stimulus was a waste of money. Moreover, it makes high inflation substantially more likely, and increases public debt to dangerous levels.

PS: *From the Fed's perspective, (slightly) higher inflation doesn't seem to be a problem. Last year, it adjusted its inflation framework, saying that after periods of persistently low inflation, it "will likely aim to achieve inflation moderately above 2% for some time." You've written that we lack a convincing explanation for why inflation has remained subdued for so long. So, what could go wrong with the Fed's new "flexible form of inflation targeting"?*

RJB: The problem is not average inflation targeting, *per se*. It is that the Fed changed its approach specifically to rationalize doing nothing about intensifying inflationary pressures. And this is not a situation where the inflation rate is at risk merely of rising from 1.5% (where it has been for a while) to 2% or 2.5%; instead, the US could be in danger of returning to the uncontrolled inflation that prevailed until Volcker took action in the early 1980s, with rates as high as 10%.

We have learned that the most important determinant of inflation is long-term inflation expectations, which are hard to change. It took tremendous resolve for Volcker to take expectations from something like 6-10% to a range of 2-3%.

When long-term inflation expectations are contained, the Fed has a lot of short-term policy leeway. That is why, since the financial crisis of 2008, it has been able to maintain near-zero short-term nominal interest rates for extended periods. But if the anchor is lifted, and long-term inflation expectations rise to, say, 5% (or more), the US will have to incur heavy costs to get expectations back down. And, frankly, I doubt that the current leaders of the Fed and the Treasury have the Volcker-like credibility that would be needed.

PS: *You were critical of former US President Donald Trump's trade war with China, warning in 2019 that it "could well push the US economy into recession." Now, as the US gears up for a robust post-pandemic recovery, the trade and technology war with China is among the only areas where President Joe Biden is staying the course Trump set. Would you advise Biden simply to give up on curbing China's restrictive trade practices, and "live with a situation that falls short of the ideal"?*

RJB: From a growth perspective, Trump's favorable tax and regulatory policies were offset by his protectionist trade policies, which targeted China above all, but also affected Europe, Canada, Mexico, and others. Trump's protectionism was also reflected in his decision not to participate in the Trans-Pacific Partnership.

The Biden administration's general stance should be to embrace free trade. That said, the situation with China is complicated, owing to its record of technology theft and restrictive business practices, as well as national-security concerns. For example, it makes sense to prevent a company like Huawei – which is effectively an instrument of the Chinese government – from gaining control over the internet's infrastructure. China's ongoing authoritarian shift – including its suppression of Hong Kong and hostility toward Taiwan and in the South China Sea – further reinforces the need for policymakers to tread carefully.

PS: *In praising the tax cuts US Republicans implemented in 2017, you focus almost exclusively on investment and GDP growth. But, in recent years, there has been much discussion about the continuing usefulness of GDP as a measure of economic activity and a proxy for human welfare, with sharply rising inequality perhaps the clearest indicator that there is a problem. Likewise, the focus on employment rates has been criticized for failing to reflect the quality of jobs and the adequacy of incomes. As a self-declared "pro-market" economist, do you think it's time to look beyond these metrics?*

RJB: Real per capita GDP is an imperfect metric, but it remains the best overall gauge of a country's welfare. Some other useful indicators – such as infant mortality, life expectancy, and educational attainment – tend to move closely with real per capita GDP over the medium and long term. That is not the case for income inequality, shifts in which are largely independent of the level and growth rate of per capita GDP. But while US income inequality – with income interpreted broadly to include transfer payments and taxes – rose from the 1970s up to around 2000, it has not changed greatly in recent years.

BY THE WAY . . .

PS: *In 2016, you and Tao Jin wrote that among the measures that could have promoted a faster recovery after the Great Recession were public infrastructure, such as highways and airports, and fiscal discipline (including a moderate debt-to-GDP ratio). In view of this, how do you assess the Biden administration's proposed $2 trillion, eight-year infrastructure plan?*

RJB: A major infrastructure package, combined with comprehensive tax reform (to finance the outlays), could have been a good idea. But, immediately after spending so much money on the second "stimulus" program, the US simply cannot afford it. The level of public debt has grown too large, so rather than continuing to expand it, we need to focus on how to manage it.

In addition, the proposed infrastructure program provides relatively little spending on actual infrastructure, such as roads, bridges, airports, ports, and energy and water facilities. Instead, it would channel large amounts of funding to other areas, such as subsidies for electric vehicles and alternative energy, climate action, elderly home care, and job training.

PS: *Regarding the COVID-19 pandemic, you wrote last year that "it makes sense to increase accessibility and benefit levels for programs like unemployment insurance, food stamps, and Medicaid." The American Rescue Plan Act includes provisions designed to increase coverage, expand benefits, and adjust federal financing for state Medicaid programs, as well as a limited extension of unemployment benefits and food assistance. Do you think the ARPA went far enough in these areas? More broadly, if such programs are so vital to protect the most vulnerable during a crisis, is there not a case for making their expansion permanent*

RJB: On health care, the answer is yes. I favor a universal public health-insurance system, likely an expanded version of Medicaid. The idea would be to ensure that everyone has access to baseline health care, while allowing individuals to spend more if they wish. This system is analogous to those in some European countries, such as the United Kingdom and France.

On unemployment insurance, however, the US went much too far during the pandemic. Existing unemployment-insurance programs in the US strike a reasonable balance between providing income to people who have lost jobs and discouraging people from accepting work. The expansion included in the COVID-19 stimulus program should therefore not be made permanent.

Finally, the food-stamp program is a mistake and should be eliminated. It is better to provide poor people – particularly those who have lost jobs – with money. A universal basic income could be a reasonable mechanism by which to achieve this. In fact, it was part of the "negative income tax" that Milton Friedman proposed in the 1960s. But such a system should replace – not augment – existing transfer programs.

PS: *In your 2002 book,* Nothing is Sacred: Economic Ideas for the New Millennium*, you showed why even the most widely accepted beliefs should be open to analysis. A generation later, are there some sacred cows you wish would die – or at least be re-examined?*

RJB: Minimum-wage legislation is essentially a prohibition on formal employment for persons with productivity below a designated level. It should therefore be eliminated.

Furthermore, it is a bad idea to tax income on capital, because it amounts to a double tax – first when production and income occur, and then when the invested portion yields capital income. By this logic, we should not tax capital gains, corporate income (separate from income of owners), or inheritance, either. The best tax is a value-added tax at a uniform rate, with few exclusions. Outside of the US, VAT – implemented more efficiently in some countries than others – is an important source of government revenue.

PS: *In 2019, you and Rachel M. McCleary published* The Wealth of Religions: The Political Economy of Believing and Belonging*, and you teach classes on religion and political economy at Harvard. What inspired you to delve into the "economics of religion"? Which findings have struck you as particularly surprising or important?*

RJB: Religion is one of the most important cultural influences in society. And it can largely be analyzed much like a market, through the lens of economics or social sciences. For example, the Reformation in the 1500s brought in Protestantism as a competitor to Catholicism, thereby breaking the inefficient monopoly that Adam Smith discussed in *The Wealth of Nations*. As Max Weber showed in his 1904 book *The Protestant Ethic and the Spirit of* Capitalism, Protestants' emphasis on work, thrift, and education supported the Industrial Revolution in parts of Europe.

Of course, not all aspects of religion are economically productive. For example, the resources consumed by formal religion – including time spent in church – can be counter-productive. And some religions, such as Islam, impose restrictions that can hinder economic growth. These restrictions relate to corporate legal form, the functioning of credit and insurance markets, and respect for private property.

Our ongoing research concerns the saint-making process as a way for the Catholic Church to energize the faithful, especially to counter the competitive threats from Evangelical Protestantism. Under Pope Francis, this process has emphasized martyrs, notably in places like Latin America, which the church historically neglected.

Barro recommends

We ask all our Say More contributors to tell our readers about a few books that have impressed them recently. Here are Barro's picks:

- **Principles of Political Economy and Taxation**

  by David Ricardo

  Economics for many decades has been dominated by journal articles, rather than books. But there are a few classics that are undoubtedly worth reading. Beyond the aforementioned Smith and Weber, this 1817 book by Ricardo is effectively the first work on macroeconomics, and thus essential reading.

- **Principles of Economics**

  by Alfred Marshall

  Published in 1890, this was the first organized treatment of microeconomics. It is another must-read.

- **Capitalism and Freedom**

  by Milton Friedman

  This 1962 work is probably the best book on economics ever written for a general audience. It includes many original ideas that are now familiar: the negative and flat-rate income tax, all-volunteer armed forces, privatized social security, flexible exchange rates, and rules for monetary and fiscal policy. In *Getting It Right* (1996) and *Nothing Is Sacred* (2002), I echo and attempt to extend Friedman's work.

Robert J. Barro

Writing for PS since **2013**
10 Commentaries

Robert J. Barro, Professor of Economics at Harvard, is a visiting scholar at the American Enterprise Institute and a research associate of the National Bureau of Economic Research.