

The \$787 Billion Question

Maureen Burke profiles **Christina Romer**, former chair of the U.S. Council of Economic Advisers



WHEN Christina Romer received an e-mail out of the blue in November 2008 from someone wanting to talk to her about the transition team of the newly elected U.S. president, her first instinct was to ignore it. Probably a job seeker who believed she had some connection to Barack Obama's campaign, she thought.

But her husband—and fellow economist—David did an Internet search on the e-mail's sender, Michael Froman. "You might want to call him back," he advised his wife, "He's the head of economic personnel for the transition" between the George W. Bush administration and the new Obama government.

Romer and her husband, both professors at the University of California, Berkeley, were staunch Obama supporters. But Christina (known to her friends as "Christy") had little involvement with the campaign, apart from a few briefing memos she had prepared for Austan Goolsbee, Obama's top economic advisor. So when she was invited to meet with the president-elect in Chicago to discuss being chair of his Council of Economic Advisers (CEA), the experience was "surreal, and a bit terrifying," she says.

The interview took place against the backdrop of growing financial instability that had spread from the U.S. mortgage market to a near global panic. Two months earlier, the giant

investment bank Lehman Brothers had collapsed in the largest corporate bankruptcy in U.S. history. A few weeks later, the New York Stock Exchange suffered its steepest single-day drop in decades. Credit markets were frozen. Then the Bureau of Labor Statistics reported that the U.S. economy had lost 240,000 jobs in October, a sign that the financial crisis was spreading to the real economy.

Obama began the meeting by saying that monetary policy had done all it could to solve the crisis, so using fiscal—taxing and spending—policy was the only option. Though Romer agreed that fiscal stimulus was needed, the academic in her couldn't help disagreeing with the premise of the President's statement. "The Fed really isn't out of bullets. There is still more it can do," even with interest rates approaching zero, she told him. Drawing on her research about how monetary expansion had helped bring the country out of the Great Depression of the 1930s, the two discussed what tools the government had at its disposal and what U.S. President Franklin Roosevelt had done right 75 years earlier. "I was amazed at how much he knew about the 1930s and how incredibly intellectual the discussion was," Romer recalls.

Obama offered her the job on the spot and she accepted. Only three and a half weeks after the election, she left for

Washington on November 30. The next month was a whirlwind as the couple uprooted their family and found employment for David, a school for their youngest child, 12-year-old Matthew, and a house to rent.

Romer later asked Rahm Emanuel, then Obama's chief of staff, why she was approached for the post. Emanuel, now the mayor of Chicago, told her, "That's easy. You were an expert on the Great Depression, and we thought we might need one."

Turning gold into lead

Like Ben Bernanke, the U.S. Federal Reserve Board chair, Romer has devoted much time to studying the causes of and policy responses to the Great Depression. Although mainly focused on monetary policy, this work has led her to believe that the government has a role in stabilizing the economy. So it's no surprise that, chairing the CEA during the country's worst economic crisis since the Great Depression, Romer advocated swift government action that took the form of the massive 2009 stimulus package.

Romer's interest in recessions was shaped, in part, by personal experience. She was born in the St. Louis suburb of Alton, Illinois, to a chemical engineer and a schoolteacher, and later moved with her family to the manufacturing town of Canton, Ohio, in the U.S. industrial heartland. Attending high school there in the 1970s, she witnessed the region's decline—along with the oil price surges that began in 1973 and the recession and inflation that followed. "Economic issues inherently struck me as important because of what I saw around me," she says, prompting her to pursue the subject as her major at the College of William and Mary in Virginia.

In the spring of 1983, when Romer was in her second year of a Ph.D. program at the Massachusetts Institute of Technology (MIT), she got a personal lesson on how recessions affect ordinary people. Her father lost his job, and, not long after, her mother learned that her teaching position for the following year might be canceled. Although funding for Romer's education was secure, thanks to a prestigious National Science Foundation fellowship, she worried about how this would affect her wedding to fellow Ph.D. student David Romer, set for that August. Her parents reassured her that there was money set aside—and with her mother and aunts pitching in to cook food and arrange the flowers, the event went on as planned. Still, she says, this was a "formative experience."

Romer met her husband-to-be in a course taught by MIT economic historian Peter Temin. As a research assistant for Temin, Romer became fascinated by historical data. The then-prevailing view among macroeconomists was that the U.S. economy was much more stable following World War II than it had been in the decades prior to the war, leading many to conclude that policymakers had finally mastered the art of using monetary and fiscal tools to stabilize the economy. But the modern techniques of collecting and calculating indicators of macroeconomic performance such as real GDP and unemployment began only after World

War II. The prewar series being used in those comparisons were derived by piecing together the available scraps of data using numerous assumptions. As a result, it was hard to tell if business cycles had genuinely changed, or if only the data construction had changed.

So, in a stroke of counterintuitive brilliance, Romer used what Temin dubbed "reverse alchemy"—applying the prewar methods of calculating unemployment and output to the postwar period. Rather than turning lead into gold, she turned gold (the good postwar data) into lead (a postwar series created in the same way as the prewar series). The study, which formed the basis for her doctoral dissertation, revealed that the decades that followed World War II were almost as volatile as the decades (excluding the years of the Great Depression) that preceded it—a marked departure from the conventional wisdom.

"That easy picture of what macro policy had accomplished was simply a figment of the data," Romer says.

Laurence Ball, an MIT classmate who now teaches economics at Johns Hopkins University, says that her dissertation received a lot of attention at the time. "It was threatening to some people for seeming to undermine the evidence that government involvement was a good thing," he recalls. "This is a bit ironic, since she's now an advocate of stimulus and activist policy."

In subsequent papers, Romer has argued that the lack of stabilization was not a sign that monetary and fiscal policy didn't matter. Rather, the problem was that those tools weren't used well. Overly expansionary policy led to inflation, which led to tight monetary policy to bring inflation down. "A lot of learning went on in that early postwar period," Romer says.

Both the times and the people made it exciting to be at MIT, she says. The country was in the middle of a severe recession following the Federal Reserve's tight money policies designed to eliminate the high inflation of the late 1970s. "We were seeing firsthand what happens when a macroeconomy is very sick," Romer recalls. And the view was shared by such faculty luminaries as Stanley Fischer and the late Rudiger Dornbusch (with Temin, coadvisor on her dissertation) and a coterie of fellow students that included Ball and N. Gregory Mankiw, now a Harvard University professor, who preceded Romer as chair of the CEA in the George W. Bush administration.

After obtaining their doctorates from MIT in 1985, the Romers found jobs as assistant professors at Princeton University. Three years later, they moved to Berkeley.

Narrative approach

Romer's research, much of which she does with her husband, reflects her early passion for economic history. A defining characteristic of their work is its use of the "narrative approach"—that is, drawing not just on statistical evidence but also on evidence derived from the historical record. This approach was pioneered by Milton Friedman and Anna Schwartz in their classic 1963 study, *A Monetary History of the United States, 1867–1960*.

Considering the whole picture

Estimating the effects of fiscal policy is difficult, says Romer, because fiscal actions are often taken in response to other things happening in the economy. Separating the impact of those other factors from the impact of tax changes or spending decisions requires sophisticated techniques, along with creativity and hard work, Romer told students at Hamilton College in 2011.

Take the Bush administration's tax cut of February 2008, implemented as a result of the recession's onset two months earlier. Most of it came in the form of tax rebate checks mailed between April and July 2008.

Household income took a noticeable step up when the rebate checks came, Romer said. And yet consumption did not rise at all. In fact, it fell a tiny bit. At first blush, it appears the tax rebate had no effect.

But Congress didn't approve the tax rebate for no reason—it did so at the height of the subprime mortgage crisis, and house prices were plummeting. Most people's main asset is their home, and when house prices fall, people tend to cut back on spending, Romer explained.

"Against that background, the fact that consumption held steady around the time of the tax rebate may be a sign of just how well it was working," Romer asserted. "It kept consumption up for a while, despite the strong downdraft of falling house prices."

The essential lesson, Romer said, is that you can't deduce the effect of a tax rebate or some other policy by just looking at outcomes. You have to consider where the economy was heading in the absence of policy.

"Economists have a name for this problem: omitted variable bias," Romer said. "Anytime one is looking at the relationship between two variables, like consumer spending and the tax rebate, you need to worry that a third variable, like the fall in wealth, is influencing both of them."

Omitted variable bias is the central problem in most empirical research in economics, she noted.

In a seminal 1989 paper, "Does Monetary Policy Matter? A New Test in the Spirit of Friedman and Schwartz," the Romers used the narrative approach to identify seven episodes in the postwar era when, because of concern about inflation, the U.S. Federal Reserve, the nation's central bank, attempted to bring down inflation using monetary policy to slow economic growth. In each instance, they found that the Fed's policy actions caused output to be far below what one would predict based on developments before the policy change, providing "decisive evidence" that changes in monetary policy matter to the real economy.

What made this study unique was that, in identifying and analyzing the seven episodes, the Romers pored over forty years' worth of minutes of Federal Open Market Committee meetings and other records to discern the Fed's intentions and understand the rationale behind its policy decisions.

Though it can be tricky to use, the narrative approach holds a distinct advantage over a purely statistical approach, write the Romers (who are codirectors of the monetary economics program of the National Bureau of Economic Research),

because it brings in "additional information that can solve the problem of identifying the direction of causation between monetary factors and real economic developments."

More recently, the Romers have used this method to gauge the impact of fiscal policy on economic activity. A key lesson that cuts across all their work is that the effect of a policy can't be deduced just by looking at the outcomes—one has to consider what else is going on in the economy and the reasons for the policy actions (see box).

How much is too much?

At Berkeley's commencement in 2011, Romer told graduates that "working in the White House was simply the hardest thing" she had ever done. But those two years were also the "most important and meaningful of my life," she said. This period was difficult, in part, because her husband was no longer a colleague—he had arranged to work as a visiting scholar at the International Monetary Fund. At separate organizations, not only did they cease collaborating on a daily basis, but government confidentiality rules often prevented them from even discussing her work. She missed hashing things out with the person whose judgment she'd trusted most for nearly three decades.

With its 14-hour workdays, the job was also unbelievably intense. On their arrival in Washington, Romer and the other members of Obama's economic transition team had immediate work to do. One of her first tasks in December 2008 was to assemble forecasts as a starting point for a policy response from a range of sources—including the Federal Reserve and a number of private sector analysts. But almost all these forecasts underestimated the severity of the economic problems that the new administration would face.

"We were just watching the forecasts deteriorate in front of our eyes," she recalls. "As more data came in, there was this gradual dawning of just how wretched the recession would be."

It was in this rapidly changing environment that Obama's incoming economics team—the designated heads of the National Economic Council (Lawrence Summers), Treasury (Timothy Geithner), Office of Management and Budget (Peter Orszag), and Romer—began planning a policy response just after the Thanksgiving holiday, in late November. The economy needed a stimulus package, all agreed, but there was debate about the appropriate size.

As recounted in Noam Scheiber's book *The Escape Artists: How Obama's Team Fumbled the Recovery*, Romer estimated that a \$1.8 trillion stimulus package (a combination of spending, taxes, and transfers to states and localities) was needed to fully eliminate the gap between what the economy was producing and what it was capable of producing. Those calculations helped to push the size of the recommended package upward, but only four options ranging from \$550 billion to \$890 billion made it into the economics team's memo to Obama.

On February 13, 2009, the U.S. Congress passed the American Recovery and Reinvestment Act—a \$787 billion fiscal stimulus bill. Though this was the largest fiscal stimulus in U.S. history, it was only about half as large as Romer's \$1.8 trillion figure.

Romer admits now that, because the magnitude of the crisis was revealing itself only gradually, a lesser stimulus was probably the only politically viable option. However, in hindsight, it is clear that “even bigger [than \$787 billion] would certainly have been better. Part of the pain that we’ve been living through is because we didn’t have enough at that time.”

In the hot seat

What Romer most regrets about her tenure as CEA chair is a report she issued in January 2009 with Jared Bernstein, an economic advisor to vice president-elect Joseph Biden. The Romer-Bernstein report laid out a case for fiscal stimulus, with the goal of convincing both Congress and the public that aggressive stimulus was necessary. A proposed roughly \$800 billion stimulus would prevent unemployment from rising above 8 percent, Romer and Bernstein wrote—whereas without it, unemployment would hit 9.1 percent. When unemployment ended up topping 10 percent, many conservatives seized on Romer-Bernstein as evidence that the stimulus had not worked. (Of course, unemployment likely would have climbed much higher without the stimulus, many economists now argue. Romer and Bernstein’s real error was in having a baseline forecast that was much too optimistic.)

“Inexperience played a big role in the way we built the case,” Romer says. “I like the idea of providing information and trying to convey why we were suggesting a particular policy action. But I should have been more politically astute about how we did it.”

Romer left her post in September 2010, after almost two years of grueling service—roughly the typical tenure for a CEA chair. There has been speculation that frustration with what some view as the Obama administration’s premature shift away from stimulus toward a focus on deficit reduction played a role in her decision to leave. Or, that a conflict with Summers—whom she has known since grad school when he was on the faculty at MIT—was responsible for her departure. But Romer says that’s nonsense—she resigned so the family could return to California, where her youngest son would start high school.

“There was a rumor I was leaving because I couldn’t stand dealing with Larry Summers. So I spent the whole day that my departure was announced saying, ‘No, I really love Larry Summers; it’s not that.’ Finally Tim Geithner called and said, ‘Listen, if you don’t say something nice about me, they’re going to think I drove you away,’” she recounts with a chuckle.

The “cool factor”

Romer is happy to be back at Berkeley, where her second child, Paul, is now starting a Ph.D. program in chemistry after graduating from MIT. (Katherine, her oldest, is in a Ph.D. program in biology at MIT, and Matthew is now a high school junior.)

Looking back at her time in Washington, Romer marvels at the difficulty of juggling work at the White House and family life. “There was just no way to balance things,” she says. After that first month of being on the transition team, Romer

recalls coming home two days before Christmas, exhausted and empty-handed.

“Our two older kids had come home, put up a tree, baked the cookies, and I had no presents. I was just, like, ‘I am so sorry,’” Romer remembers. “They said, ‘Mom, it’s okay. You have so upped our cool factor.’ I guess there was something about working for Barack Obama that made up for a lot.”

Romer is keeping her hand in the public sphere through the “Economic View” column in the Sunday *New York Times*, which she alternates writing with five other prominent econ-

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omists. It’s just the right amount of public exposure for now, she says. “I still care a lot about policy issues, and it’s a forum where you can make a careful argument and talk about the evidence.”

An issue that continues to trouble Romer deeply is the U.S. unemployment rate (7.9 percent in January 2013). In a recent column, she discussed how the Federal Reserve could be much more aggressive in pursuing policies that would spur growth. The current jobs crisis requires a bold solution, she says—such as targeting a path for nominal GDP (the total dollar value of the economy). This essentially means the Fed would pledge to do whatever it takes to return nominal GDP to its precrisis trajectory in order to improve expectations of future growth, even if it means abandoning its current cautious course. “If Christy were running the Fed, she would be doing something very decisive,” says Ball. “She’s been outspoken—and appropriately so—about the terrible situation with high unemployment.”

Romer feels it’s important to educate the public on economic issues. “The truth is, whether we’re talking about monetary policy or fiscal policy, it’s complicated.” Part of the problem is that politicians tend to oversimplify.

“They say, ‘All we need to do is cut taxes and that will deal with the budget deficit.’ Well, no it won’t. Likewise, the Democrats say, ‘We can keep all our entitlement programs as long as we raise taxes on the wealthy.’ Not going to work—there’s just not enough money even among the wealthy to pay for what’s coming down the line on Social Security and Medicare,” she says.

Romer uses speaking engagements, the newspaper column, and her teaching post to impart her views on the country’s complex economic challenges. “If you’re willing to take the time and speak in a way that nonexperts understand, I think you can eventually get through.”

Ever the teacher, Romer seems to be right back where she belongs. ■

Maureen Burke is on the staff of Finance & Development.