From the Editor

Charles Steindel¹

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This issue contains articles dealing with the long-term implications of federal finances, the role of financial stability in Federal Reserve policy, the trade disputes with China, and the role of immigrants in the US economy. All of these are derived from presentations from the 2019 Economic Policy Conference, and we again thank the Peterson Foundation for its financial support. Also in the issue is a discussion of the title insurance industry, and numbers of book reviews, which deal with topics ranging over the course of economics, literally from Adam Smith to the financial crisis.

Nobel Laureate Paul Krugman discusses the potential burdens of federal debt. Along with a number of other scholars, perhaps most prominently Olivier Blanchard of the Peterson Institute, he finds that concerns over debt are overblown. Krugman asserts that it is just not clear that the US is running out of “fiscal space” to address a recession, and, more fundamentally, chronically low interest rates limit the risk of an ever-growing ratio of debt to GDP; basically, the federal government can continue to run what seem to be rather large deficits. Potential “flight” of dollar investors spooked by large deficits also seems to be a rather remote problem. In any event, such flight would enhance the competitiveness of US producers. Krugman argues that debates over fiscal policy should focus on spending priorities, rather than the size of the debt and deficits.

Two senior Federal Reserve veterans, Bill Dudley (former NY Fed President) and Nelly Liang (former head of the Board’s Division of Financial Stability) discuss how one may fit financial stability concerns into monetary policy. Dudley argues that financial stability should not be an outright goal of monetary policy, but that monetary policy should pay attention to a broad array of financial indicators and conditions, which can often vary. This is an argument against tying policy to a Taylor-like rule. Dudley further argues that the importance of financial conditions to the

economy means that the Fed must be transparent about its policies, in order to avoid unsettling conditions. In any event, monetary policy by itself cannot ensure financial stability. Unfortunately, the effectiveness of other tools the Fed may use to stabilize financial conditions is also “quite limited.”

Liang further distinguishes between financial conditions and financial stability. She views financial conditions as encompassing the ease of finance; financial stability is the underlying ability of the financial system to overcome shocks. Loose or easy financial conditions can lead to a buildup of weaknesses that threaten stability. However, monetary policy may wish to stimulate the economy, which can necessitate easier conditions. Liang feels it is important that the Fed, when easing, makes it clear that it is taking care to avoid the buildup of vulnerabilities that may threaten stability.

Adam Posen and Peter Morici discuss a topic that continues to roil markets: trade and other tensions with China. Posen argues that China does pose challenges to the US, but that these do not suggest that the US and others should limit trade. First of all, outsiders, including the US, are essentially unable to use trade barriers as an effective way to change China’s basic policies, especially when weighed against potential damage to the US economy. Posen points out that history shows that in the final analysis statist economic policies simply are not effective. Those who cite specific Chinese actions and goals as concerns are overselling the risks. There are security risks in the IT area, but these are unrelated to the size and growth of the Chinese economy.

Morici’s points are fairly comparable to Posen’s. Certainly, China has not been playing by the normal rules of an open economy. However, US isolation, or attempts to deal with China purely one on one, are unlikely to ameliorate the situation. Joint action with other large economies will be essential.

Immigration is another contentious issue. Francine Blau (recently named a Distinguished Fellow by the American Economic Association) and Jennifer Hunt summarize a National Academy report on the topic. Naturally, immigrant competition in the labor market creates winners and

✉ Charles Steindel
csteindel@nabe.com

¹ Ramapo College, Mahwah, NJ, USA

losers, but looking at the US data, immigration has played a major role in the recent growth of the labor force, and immigrants are becoming increasingly well-educated. The effect of immigration on the wages of the native-born is minimal. Immigrants have a net positive effect on federal finances, though negative, at least in the short run, at the state and local level (due to the costs of educating immigrant children).

Turning away from the aggregate economy, in a *Focus on Industries and Markets* piece, Thomas Hemphill discusses the title insurance industry—one that few of us pay any attention to after closing on a home purchase! The US is almost unique in relying on a private industry to protect homeowners from title problems. Most of the rest of the world uses government title registries to transfer real estate ownerships. The title insurance industry has become fairly concentrated, but is also facing competitive pressure from new entrants rolling out technical innovations.

The issue contains four book reviews. The first is William Seeger's review of *Transfer Pricing and the Arm's Length Principle After BEPS*, by Richard Collier and Joseph Andrus. The book examines recent changes in transfer-pricing accounting rules. The authors are highly critical of the new BEPS regime, arguing that they "have created unnecessary complexity ... in the areas of compliance, tax administration, and dispute resolution." Seeger finds the authors' arguments to be "well-conceived." (this review had been slotted for the April issue and was mentioned in my editorial note, but was inadvertently omitted from the production run).

Preston McAfee discusses Kai-Fu Lee's *AI Superpowers: China, Silicon Valley, and the New World Order*. Lee argues that AI is rapidly expanding and will soon create even more economic disruption. He further contends that China has a comparative advantage over Silicon Valley in the development of AI, reflecting the Chinese state's ability to rapidly mobilize resources, coupled with a much greater trove of data. McAfee is skeptical of some of Lee's claims about the use of AI and the Chinese edge, noting the difficulty of all forecasts of these types.

NABE President Kevin Swift reviews *Adam Smith: What He Thought, and Why it Matters*, written by Jesse Norman. Norman examines the evolution of Smith's thought,

and finds *The Theory of Moral Sentiments* (Smith's philosophical volume that economists frequently note but rarely if ever read) "is in every way as important as *The Wealth of Nations*." Swift, a self-confessed fan of Smith, readily endorses Norman's work.

Ten years out, the financial crisis and its aftermath continue to dominate thinking on aggregate policy. Laurence Ball reviews a book authored by three figures central to addressing the event: *Firefighting: The Financial Crisis and its Lessons*, by Ben Bernanke, Timothy Geithner, and Henry Paulson. The short work addresses the causes of the crisis, the major events (and how the three responded to them), and the aftermath. Ball notes that "Their account of the financial crisis is comprehensive, yet concise and readable." The caveat he discusses is the Lehman failure. Ball rejects their claim that the refusal of the Fed to lend to Lehman in September 2008 primarily reflected a lack of legal authority at the time to do so—the point that is central to his book *The Fed and Lehman Brothers: Setting the Record Straight on a Financial Disaster* (reviewed in the January 2019 issue of *Business Economics*).

Before closing, mention should be made of the recent deaths of two former winners of NABE's Adam Smith Award: Alice Rivlin and Martin Feldstein. Alice and Marty (universally known to economists by their first names) were two giants in the realm of economic policy analysis. Aside from his seminal academic work, Feldstein transformed the National Bureau for Economic Research into the central clearing house of academic economics, and Rivlin, as the founding Director of the Congressional Budget Office, created an institution critical to analysis of fiscal policy and other long-term issues (both had numerous other prominent positions over the course of their careers). It is personally gratifying that in recent years we were fortunate enough to publish works in *Business Economics* by both of them.

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