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U.S. ECONOMY

What You Need to Be on the Fed…and It Isn't a Ph.D.

The real value of economics is in how you think, not your degree

Jerome Powell, current chairman of the Federal Reserve, doesn't have an economics degree. **PHOTO:** ANDREW HARRER/BLOOMBERG NEWS

By Greg Ip

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Neither Stephen Moore nor Herman Cain, political allies that President Trump hopes to put on the Federal Reserve Board, has a Ph.D. in economics. For fans and even some foes, that's a virtue, not a vice.

In these populist times, knowing too much economics means you're out of touch, arrogant, and wrong. Few institutions have suffered the backlash against elitism and credentialism as much as central banks, which are mostly run by professional economists.

Sen. Ben Sasse, a Nebraska Republican, nicely captured this sentiment by saying about Mr. Moore, an advocate for lower taxes and other conservative causes: "Steve's nomination has thrown the card-carrying members of the Beltway establishment into a tizzy, and that says little about Steve and his belief in American ingenuity, but a lot about central planners' devotion to groupthink."

Anti-elitism is an odd look for Mr. Sasse, Ph.D. (Yale) and former college president (Midland University), but he's hardly alone. Mr. Moore has a master's degree in economics but despises the Ph.D. economists who staff the Fed: "It's filled with hundreds of economists who are worthless, who have the wrong model in their mind," he said in an interview last year. "They should all be fired and…replaced by good economists."

In truth, this isn't really a debate about whether you need a Ph.D. to serve on the Fed: you don't. Paul Volcker didn't have a Ph.D. Alan Greenspan earned his long after establishing his reputation as a forecaster. Current Chairman Jerome Powell doesn't have an economics degree; neither did the Fed's longest serving chairman, William McChesney Martin.Marriner Eccles, chairman during the Depression, didn't have a degree at all.

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The debate, rather, is whether economics and economic models are useful tools for central bankers. Economics isn't just complex equations and forecasts. It is also a way of disciplining your thinking, making sure things add up, asking when one variable changes if others are also changing, ensuring your assumptions and predictions don't contradict each other, and testing your hypotheses against alternative hypotheses and evidence. Plenty of non-economists adhere to that discipline and plenty of degree-carrying economists don't.

Economics can be insular, and even Janet Yellen, who chaired the Fed before Mr. Powell, agrees the Fed has been top-heavy with Ph.D. economists like her. "It's not always been clear that this led to an improvement in policymaking," she said in a 2012 interview for an oral history of the Fed, released Friday. She praised the contribution of non-economist governors who, she says, are always asking themselves if the arguments of economists are "relevant to the world as I'm experiencing it through my contacts, whether they're bankers or businesspeople or whatever?"

Consider some simple questions: Can the unemployment rate fall to zero and business capacity utilization rise to 100% without any effect on wages or prices? Can everyone's wages double without any effect on inflation? Can interest rates fall without any effect on demand, such as for houses? If you said no, congratulations, you understand economics.

That, of course, leaves a vast terrain on which reasonable people can and do disagree: Do wages rise when unemployment is 4% or 2%? Does inflation rise when wages rise 4%, or 6%? Will higher productivity or lower profits prevent higher wages from passing through to prices? Do mortgage rates have to drop to 4% or 3% before demand for homes reacts?

Professional economists and central bankers wrestle with these questions every day. When their predictions are wrong they ask why. For example, they are currently debating whether inflation has become less sensitive to unemployment and economic capacity because people's expectations of inflation are so firmly anchored or official data understate true unemployment.

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Critics who want more diversity of viewpoints at the Fed usually mean their own. Those on the left say it should worry less about inflation and keep monetary policy looser. Those on the right say it should worry more about asset bubbles and keep policy tighter.

For his part Mr. Moore claimed on Bloomberg last week that "one fundamental idea...is endemic at the Fed, which I think is completely wrong, which is that growth causes inflation. Growth does not cause inflation." In other words, no matter how high capacity utilization or how low unemployment gets, they cannot cause prices to rise.

Mr. Moore, instead, argues the Fed should target commodity prices, but he hasn't always done so coherently or consistently. When commodity prices fell by 57% under President Barack Obama, Mr. Moore kept warning about inflation. After they fell 14% under Mr. Trump he warned of deflation. More broadly, why target something that makes up so little of what Americans consume? If Chinese demand or reduced Saudi output pushed up prices of commodities relative to consumer goods and services, the Fed would have to tighten monetary policy until consumer prices fell—as happened during the Great Depression.

If Mr. Moore is confirmed to the Fed, perhaps he can explain it all to his new colleagues, and not just the Ph.Ds.

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