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Revised

Beyond the Ivory Tower: The Role of the Economist in Society

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I am grateful not only for the honor of participating in this distinguished forum, but also for the opportunity to reflect on some of the questions about the role of economics and the economist that arise in the type of policy work done at the IMF.

I will start where most of us start, in the ivory tower, where we learn not only technical economics, but also what it means to be a professional economist.[2] And we also become familiar with the set of incentives that encourages us to behave professionally. I will then consider in turn: the role and responsibilities of those who, while based in the ivory tower, participate in the public debate on economic policy; the role of the policy adviser; and finally, the role and responsibilities of economists in a policy institution such as the IMF.

The theme is simple. In all circumstances, we should behave as professionals. And it helps to have incentives to that end.

I. In the Ivory Tower

Even the economist who spends his or her entire professional life in the ivory tower has an important social role to play beyond the ivory tower, through both teaching and research.

The teaching of introductory courses is critical in spreading an understanding of how the economy works, and thus of how an essential element of daily life works, among people who will spend the rest of their lives immersed in that economy. In this way teaching introductory economics contributes to creating a better-informed citizenry and a better-functioning democracy.

The basics that we teach are far from trivial: the underlying vision of how a market economy functions that is encapsulated in the concept of the invisible hand is not self-evident. The notion that markets can bring order out of apparent chaos, in part by serving as an efficient way of aggregating information, is not only profound [as Ken Arrow's Nobel Prize attests], but also provides a key insight into the operation of any society. Of

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[2] No doubt, most of what I say here about the role of the economist applies also to professionals in other fields.

course, we need also to point out the limitations of simple market mechanisms, and the imperfections of market mechanisms in practice, and what we know about how to improve on them. But in doing that, we should not confuse the doughnut with its hole. [Marty Weitzman on whether demand curves slope down.] [I leave aside the fascinating question of how to deal with differences in the extent to which people see doughnuts and holes in considering how markets work.] Nor – even though the tools of economics enable us to study many non-market phenomena like the role of the family – should we understate the importance of the many things that the simple economic vision omits, such as love and altruism, nationalism and prejudice, and non-market forms of organization.

What about research? We need research, not only to increase the stock of knowledge, but also to keep our minds alive and active. Herb Stein, writing just before the spread of the internet, described the research process well:

> Many economists are at work producing raw economics, in the form of papers. These papers flow into a journal mill, where they are revolved and grated against each other. This process has several products. It is an exercise for economists to develop their skills. It is a way of demonstrating ability to produce a paper, which has a certain symbolic [one could say signaling] value in the industry. Much of the raw economics is ejected from the mill as waste, after having served its purposes as demonstration of practice. Some remains in the mill for a long time, as pure, refined economics. Some is siphoned off in small streams, adding to the stocks of teachable economics and advisable economics.[3]

Do the incentives in the field ensure that research produces the outputs that society needs most? Certainly the academic process as it has developed over centuries in free ~~societies,~~ has put in place a set of incentives, including the circulation and presentation of papers, replication of results, publication, the promotion process, and a variety of prizes, which broadly ensure that errors will be weeded out and that those who make scientific breakthroughs will be rewarded. It would take a massive research project to answer the question of whether the outcome is socially optimal, and – more important – if it is not, whether there is any way of improving on that outcome. At times, particularly in the 1980s, I have felt that research in my own field, macroeconomics, was excessively concerned with analytic rigor, and too little concerned with seeking to answer real world problems. And I have found some of my own most rewarding research has come out of grappling with the solutions to real world policy questions. But almost equally, I am struck in my daily work applying economics by how frequently research that at the time I thought to be mainly academic, has turned out to illuminate real world issues – for instance, the analysis of the role of seigniorage, or the use of various political economy models to understand our interactions with member governments. [Incidentally, when told in the IMF that some argument is academic, I usually counter by saying; "You mean it is logical, and the conclusions follow from the assumptions? What's wrong with that?"]

[3] Hebert Stein, "What Economic Policy Advisers Do", *The American Enterprise*, (Washington: American Enterprise Institute, March/April 1991).

In sum, we can say that our obligations to society as academic economists are to seriousness and the truth: to take teaching and research seriously, and in that work to seek to discover and to present what we see as the truth as objectively and as fairly as we can. We can add that some of the incentives in place in academic life drive research broadly in the right direction. But [as a fee-paying parent of students at some of the great universities,] I am less convinced that we have the right incentives in place to encourage good teaching.

II. Participating in the Public Debate

Many an economist, firmly rooted in the ivory tower, reaches out to participate in public life, through the media, or as a consultant to the private and official sectors. This is undoubtedly potentially to the good: it is good for the profession to have serious economists grapple with real problems, and it is good for the research of many economists to have to confront these problems. Similarly, I am convinced that having good economists seeking to communicate their analysis of real world problems to the public and to decision-makers can be to the good.

Communicating with non-specialists on occasion demands that we follow the advice traditionally given to writers for the *Economist* magazine: "Simplify, then exaggerate". Or, in the words of the greatest polemicist of our profession, Keynes, "words must be wild". But only up to a point. Even when we step outside the ivory tower, we are still academics – we have the same obligations to seriousness and truth that we do inside.

This can pose real problems. Simplicity sells and convinces, and the line between simplification and over-simplification is a fine one, as summarized in the saying that for every complicated problem there is a simple answer – and it is wrong. And there is always a temptation, for the sake of influencing the real world, to oversimplify. The obligation not to oversimplify arises from the fact that words have consequences, and that those who succeed in selling a misleading argument should bear responsibility.

That may not be a sufficient incentive to stop oversimplification, for there is no guarantee that any consequences will be visited on the perpetrator, and frequently we have no way of knowing definitively for a long time, or ever, whether the arguments were right or wrong. It is an article of faith – to which I subscribe – that a free press, and vigorous public debate, should help to drive society towards the right outcome, even though each of us has often been sure that the wrong arguments succeed – that [in Frank Knight's words,] the bad arguments drive out the good.

There is one more incentive for not oversimplifying: the academic economist who engages in public debate has also to face his or her colleagues. While the knowledge that public debate and the scrutiny of professional colleagues are powerful incentives for getting the argument right, they are surely not sufficient – for the political divide ensures that views need only to pass the test of approval of a subset of the public and the profession.

Underlying all this is a deeper point: that in policy discussions, as opposed to analytic arguments, there may not be sufficient information to determine what is the right solution, and that preferences that are very difficult to uncover affect recommendations. We should seek to uncover the differences in preferences and values, but we cannot expect to overcome them through purely logical arguments.

III. The Policy Adviser

In the United States, and also in Israel, there is a tradition of the ivory tower economist taking time off to serve in government as a policy adviser. In that role, he or she has the obligation to seek solutions to the problems confronting the policymaker, and to maintain professional standards in doing so. In that role he or she should act like a democrat [with a small "d"], seeking to persuade rather than to speak ex cathedra, and being prepared to debate the issues raised by critics.

Of course, here too we need the right incentives, which is why transparency is so important – this is the most powerful mechanism, albeit as just noted not a perfect one, for making sure the adviser will think hard about getting the argument right.

There are at least two important differences between policy advising and academic economics. The first is that there is a bottom line. If you are asked what impact some policy will have, it is no use replying that it all depends on the precise specification of the model. I learnt this most clearly from Herb Stein, who once asked me over a dinner in Washington in 1984 what the policy options were in Israel. I replied with a lengthy and no doubted learned analysis of the state of the economy, the role of the budget deficit, of indexation, of monetary policy, and the balance of policy views among the various participants – in short, a very good exam answer. When it was over, Herb asked me: "Well, but what do we want them to *do*?" That is the bottom line question for any policy adviser.

The second difference is the set of constraints. The policy adviser will frequently be told that some policy proposal is not politically possible. The political objections need to be explored, for they are often less insoluble than it initially seems. But in the end, it is primarily for the politicians to judge what can and cannot be done.

Life for the adviser becomes complicated when politics produces policies that are either n'th best, or which the adviser opposes. No-one going into a policy job should have the illusion that he or she will win every battle. After losing an internal debate, everyone has to draw his own conclusions, to decide whether to stay to fight another day, or to leave, to be freer to speak up. Although, after working on the inside, I am less impressed than I used to be by the use of the resignation option, economists should not stay in a policy job if they fundamentally disagree with the economic policy intentions of the government for which they are working.

Policy advisers often find that measures they are sure will yield long-term benefits are rejected because of their short-term costs. Short-termism is an occupational hazard in any democracy, but societies have shown themselves willing to tie their hands for the long-term good. Giving independence to the central bank independence is an obvious example; putting in place transparency frameworks for fiscal and monetary policy is another.

A word on the role of politicians. Economists who talk of political constraints tend to sound exasperated. The longer I have been in the policy business, the more my respect for the role of politicians has increased. They are the people who face the voters and have to sell policies, and take responsibility for their implementation. They – and the people they represent – will pay the price if the policies turn out wrong. And they are far more likely than we technocrats are to see the big picture. For example, a purely economic analysis could well have argued against the creation of the state of Israel. The state came into being through an act of political will, but *ex post* it is certainly an economic as well as a political success.

IV. The Role of Economists in the IMF.

There are over 1000 economists on the staff of the IMF, working on 183 countries. Their job is to deliver the best technical analysis they can of the prospects and problems confronting the countries on which they work, and to suggest alternative policy solutions to those problems – solutions that seek to maximize the social benefits of those policies [while minimizing their social costs].

Much of this work is devoted to *surveillance* of the global economy and individual economies, essentially reporting on these economies in the first instance to the 24-member Executive Board of the IMF, on which all members are represented. Much of this output is subsequently published, in the case of multilateral surveillance primarily in the well-known *World Economic Outlook*. Surveillance of individual economies is presented in the Article IV report, which members are now allowed to publish if they wish. The decision to allow publication of these (and other) reports is among the most important of the recent reforms of the IMF, for publication leads not only to a better-informed public, and better-informed investors, but it is also I believe an important incentive for the staff to produce the best analysis they can – knowing that their work will be read by the press and by colleagues outside the Fund.

Lending is the IMF's best-known activity. To receive an IMF loan, a country specifies in a *letter of intent* the policies it will be undertaking during the period it receives the loan. Disbursement of the loan is then conditional on implementation of certain of these policies. IMF conditionality became more and more detailed during the 1990s; in response, the Fund is now attempting to streamline conditionality, to focus on the areas of the Fund's expertise and mandate, notably macroeconomic – monetary, fiscal, and exchange rate policy – and financial sector policies, the latter in coordination with the World Bank.

These loan conditions are negotiated by IMF staff under the guidance of the management of the Fund, and are later presented to the Executive Board for approval. In presenting proposals to the Board, the management is seeking to find a set of policies that will produce a sustainable macroeconomic situation, in a way that minimizes the social costs of the adjustment, while maximizing the benefits, including those from the recovery of sustainable growth. This means pushing and probing the analysis presented by the staff, worrying about the impact of the policies we propose on the people of the country in which they are to be implemented. Staff and management also need to form judgments about what policies are likely to be implemented, and about the political sustainability of the policies we recommend.

The ideal policy package is one that is "owned" by the country that is to implement it, meaning that the government has proposed it, believes in it, and has the political support needed to sustain it, and that our staff believes the policies will succeed. Such programs exist, though reaching them may require lengthy technical discussions between the policymakers and the IMF staff. But often ownership is weak, and the international community has in effect to decide whether to support a particular reformist policy line or group of reformers within a country. Nigeria is a good example of this dilemma. If we took a purist approach and never supported any program in which ownership is less than complete, then we would be supporting many fewer programs than we do.

Two questions then arise. First, how far should we go in pressing stronger policies to reduce the risks of failure? There is no simple answer to this question, but one simple rule goes a long way: do not ask the foreign policymaker to undertake policies that you would not be prepared to in his or her position. This is of course close to Hillel's famous rule.

The second question is how to reach the judgment on what loans to support. These judgments are inevitably political as well as economic, and they are, and should be, made by the owners of the IMF, the shareholders, represented in the Executive Board. Before taking a difficult loan to the Board for approval, the management will have consulted extensively with the members of the Board, who represent the member countries. The fact that the management rarely loses a Board vote is often seen as a sign of the power of the management; rather it is a sign of the care we take in consulting the Board before formally presenting a proposal.

On occasion, perhaps more often that that, we are accused of being too political, both in deciding to whom we lend, and in deciding what conditions to attach to our loans. [and it has even been suggested that we – the management – should be independent but accountable, on the model of the modern central bank]. I believe that the decisions we make on to whom to lend, and under what circumstances, are rarely purely technical. Rather, while there are many technical issues in the design of every program, the decision to lend may involve a political element – consider for instance the loans we are now making to Nigeria and Indonesia, or the loans made to Russia in the past. It is for that reason that the accountability of the management and staff of the IMF, through the Executive Board, to the countries that own us, is essential.

The economics can take us only so far. But it is our duty to take our professional responsibilities seriously. Like doctors, our task is to help keep our patients healthy when we can, and help cure them when we cannot. Like doctors, this puts us in a powerful position with the potential to harm our patients. Let me therefore conclude by arguing for our own version of the Hippocratic Oath – principles the economist should live by.

A good start would be the advice that Hippocrates laid down for the medical profession in his book *The Epidemics*, namely: "As to diseases, make a habit of two things: to help, or at least do no harm." In more detail, the oath might go like this:

"According to my ability and professional judgment, and within the political constraints I am given, provided they are reasonable, I will advise those policies that I consider would be best for those who would be affected by them. I will abstain from any recommendation that I would not be willing to implement in the same situation. I will seek always to persuade and not to coerce. I will always be willing to explain what I have recommended and why. I will assess as best I can the impact of the policies I recommend on all members of society, not simply those that have asked and paid for my advice. And I will always maintain the highest professional standards of which I am capable.