The M.I.T. gang

By Paul Krugman
July 24, 2015 – *The New York Times*

Goodbye, Chicago boys. Hello, M.I.T. gang.

If you don't know what I'm talking about, the term "Chicago boys" was originally used to refer to Latin American economists, trained at the University of Chicago, who took radical free-market ideology back to their home countries. The influence of these economists was part of a broader phenomenon: The 1970s and 1980s were an era of ascendancy for laissez-faire economic ideas and the Chicago school, which promoted those ideas.

But that was a long time ago. Now a different school is in the ascendant, and deservedly so.

It's actually surprising how little media attention has been given to the dominance of M.I.T.-trained economists in policy positions and policy discourse. But it's quite remarkable. Ben Bernanke has an M.I.T. Ph.D.; so do Mario Draghi, the president of the European Central Bank, and Olivier Blanchard, the enormously influential chief economist of the International Monetary Fund. Mr. Blanchard is retiring, but his replacement, Maurice Obstfeld, is another M.I.T. guy — and another student of Stanley Fischer, who taught at M.I.T. for many years and is now the Fed's vice chairman.

These are just the most prominent examples. M.I.T.-trained economists, especially Ph.D.s from the 1970s, play an outsized role at policy institutions and in policy discussion across the Western world. And yes, I'm part of the same gang.

So what distinguishes M.I.T. economics, and why does it matter? To answer that question, you need to go back to the 1970s, when all the people I've just named went to graduate school.

At the time, the big issue was the combination of high unemployment with high inflation. The coming of stagflation was a big win for Milton Friedman, who had predicted exactly that outcome if the government tried to keep unemployment too low for too long; it was widely seen, rightly or (mostly) wrongly, as proof that markets get it right and the government should just stay out of the way.

Or to put it another way, many economists responded to stagflation by turning their backs on Keynesian economics and its call for government action to fight recessions.

At M.I.T., however, Keynes never went away. To be sure, stagflation showed that there were limits to what policy can do. But students continued to learn about the imperfections of markets and the role that monetary and fiscal policy can play in boosting a depressed economy.

And the M.I.T. students of the 1970s enlarged on those insights in their later work. Mr. Blanchard, for example, showed how small deviations from perfect rationality can have large economic consequences; Mr. Obstfeld showed that currency markets can sometimes experience self-fulfilling panic.

This open-minded, pragmatic approach was overwhelmingly vindicated after crisis struck in 2008. Chicago-school types warned incessantly that responding to the crisis by printing money and running deficits would lead to 70s-type stagflation, with soaring inflation and interest rates. But M.I.T. types predicted, correctly, that inflation and interest rates would stay low in a depressed economy, and that attempts to slash deficits too soon would deepen the slump.

The truth, although nobody will believe it, is that the economic analysis some of us learned at M.I.T. way back when has worked very, very well for the past seven years.

But has the intellectual success of M.I.T. economics led to comparable policy success? Unfortunately, the answer is no.

True, there have been some important monetary successes. The Fed, led by Mr. Bernanke, ignored right-wing pressure and threats — Rick Perry, as governor of Texas, went so far as to accuse him of treason — and pursued an aggressively expansionary policy that helped limit the damage from the financial crisis. In Europe, Mr. Draghi's activism has been crucial to calming financial markets, probably saving the euro from collapse.

On other fronts, however, the M.I.T. gang's good advice has been ignored. The I.M.F.'s research department, under Mr. Blanchard's leadership, has done authoritative work on the effects of fiscal policy, demonstrating beyond any reasonable doubt that slashing spending in a depressed economy is a terrible mistake, and that attempts to reduce high levels of debt via austerity are self-defeating. But European politicians have slashed spending and demanded crippling austerity from debtors anyway.

Meanwhile, in the United States, Republicans have responded to the utter failure of free-market orthodoxy and the remarkably successful predictions of much-hated Keynesians by digging in even deeper, determined to learn nothing from experience.

In other words, being right isn't necessarily enough to change the world. But it's still better to be right than to be wrong, and M.I.T.-style economics, with its pragmatic openness to evidence, has been very right indeed.