Davos Debrief Comments
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This was my first visit to the World Economic Forum in Davos. A tremendous number of people and topics of discussion were crowded into a few days in that small town. HKS professors who were there, besides me, included Graham Allison, Iris Bohnet, David Gergen, Ricardo Hausmann, and Jonathan Zittrain; some faculty from other Harvard schools were there as well. I spent much of my time talking with supporters and potential supporters of HKS, but let me comment here on three substantive things I did.

First, I participated in a discussion about why measured productivity growth has been so low for the past decade—in the United States and many other countries—despite the apparently rapid rate of technological change we are seeing. The other participants in the discussion included Ned Phelps (a Nobel Prize winner in economics), Mike Spence (ditto), Erik Brynjolfsson, Nouriel Roubini, Xavier Sala-i-Martin, and others. Many participants (including I) agreed that new types of output were measured quite poorly and therefore that measured growth in inflation-adjusted output was falling short of actual output growth by more than had been true in the past—which implies that measured productivity growth was falling short of actual productivity growth by more than had been true in the past. Some participants (including I) agreed that it takes time to translate technological change into higher productivity, especially with complex production functions such as those for education and health care, and thus that we have not yet seen all of the productivity gains to come from recent technological progress. But some participants (also including I) argued that the technological progress we're seeing is narrower in scope than had been true in some past waves of innovation and that other aspects of economic dynamism have also diminished (in the United States, that includes the rate of business start-up and mobility of people across states), which implies that actual productivity growth has declined as well. On this view, "The Fourth Industrial Revolution" in the title of this year's conference has been, at least so far, less significant than the previous industrial revolutions.

I also argued that the quotation used to frame our discussion—an old line of Paul Krugman's that "productivity isn't everything, but in the long run it is almost everything"—was less appropriate these days for two reasons: First, because we have lived through nearly a decade during which the constraining factor for economic growth in much of the world has been the demand for goods and services rather than potential output, and that situation still affects some parts of the world and will recur in others. And second, because growth in median household income has been well below productivity growth in the last few decades, while in preceding decades, growth in median income was close to productivity growth.

Second, I was interviewed about the current state of the global economy and about the U.S. federal budget. In my view, the probability of a recession in the United States this year is fairly low. However, I am very concerned that when the next recession strikes---which it will at some point---monetary policy and fiscal policy will not respond strongly enough to limit the lost jobs and income. In each of the last three recessions, the Federal Reserve cut the federal funds rate by 5 percentage points or more. But market forces will probably keep interest rates much lower in the coming decades than they were in preceding decades, so the funds rate will stay below 5 percent, and the Fed will not have enough room to cut the funds rate by as much as it has in the past. I expect that the Fed will engage in quantitative easing if it cannot lower the funds rate further, but that will not be a full substitute for further reductions in interest rates. Moreover, many Members of Congress are reluctant to use reductions in taxes or increases in federal spending to spur demand for goods and services during recessions. Some Members think that such countercyclical fiscal policy would not be effective (a view that is not consistent with the evidence) or are concerned about the high level of federal debt and projected further increase under current law (which is an appropriate concern but not one that should preclude the use of countercyclical fiscal policy).

Regarding the U.S. federal budget more generally, I think the high and rising federal debt represents a serious problem. Because debt cannot increase indefinitely relative to the size of the economy, we will ultimately need to cut spending or raise taxes relative to what will occur under current law. However, because interest rates will probably remain significantly below their historical average, the economic benefits of deficit reduction will be significantly smaller than they would be otherwise. (For an explanation of that point, you can read a paper I just co-authored about optimal budget policy, which we will be released at a Brookings conference next Friday.) Therefore, we do not need to reduce the debt to its average historical level.

Third, I attended a fascinating session on neuroscience---about which I know nothing, which is why I went to the session. A Stanford professor described her research on ant behavior. She is learning how ant colonies can adjust the effort they undertake to find food---which should vary based on the availability of nearby food---without any overall direction but just with each ant responding to the ants nearest to it. After a short lecture, the professor led a discussion of whether there are analogies in human behavior. I noted that this is a little like what happens in idealized markets, where no one is in charge and people's responses to the incentives they face directly aggregate to a successful overall economy.

In closing, I would note that a number of participants in the conference were somewhat distracted by the sharp declines in global stock prices and oil prices that were occurring, and there was much discussion about what those declines implied, or revealed, about the prospects for the global economy. And those financial-market issues were combined with a very high degree of concern about the refugee crisis and the spread of ISIS's reach around the world, which may have dampened the mood at the conference this year relative to other years.