Larry Summers' Advice to the Biden Administration

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by Robert Huebscher

A multilateral framework is needed to reverse the effects of secular stagnation and should be the primary focus of President-elect Biden's administration, according to Larry Summers.

Summers participated in a program sponsored by the Peterson Institute for International Economics, Rebuilding the Global Economy, and wrote a paper advising Biden's incoming Treasury Secretary. He also spoke via a webinar on November 10.

Having served in the prior two Democratic administrations, Summers will be an influential voice in the Biden presidency. He served as Secretary of the Treasury under President Clinton and as chairman of the Council of Economic Advisers under President Obama.

Summers popularized the use of the term "secular stagnation," which refers to a period of depressed economic demand, which began in the U.S. in 2008 after the global financial crisis (GFC). It is characterized by an excess of savings, depressed investment, low inflation and low (or negative) real interest rates. Those factors combine to bid up the prices of assets, including equities, leading to bubbles and market instability.

Globalization and economic progress have been "corroding" since the GFC, Summers said, especially over the last four years. He said the incoming Treasury Secretary should focus on the international arena because it will be difficult passing domestic legislation and regulation.

Summers cited Tony Blair, who said, "The problem is that the radical are not sensible and the sensible are not radical." Summers said the sensible need to be bold.

Summers outlined three broad priorities.

The U.S. needs to restore international cooperation and commitment during this crisis. In 2008, there were bold domestic and international policies that provided liquidity, kept trade open and drove fiscal stimulus. The response to the current crisis domestically has been bolder and larger, he said, but nothing comparable has taken place internationally.

"Reversing that must be a first priority for the new Secretary of the Treasury," Summers said.

He would like to see an increased role for funding institutions, including the IMF, with industrial countries continuing to stimulate their economies to facilitate global growth. He said he has seen "dozens" of cases where debt restructuring was too late; none where it was premature.

The U.S. must resist protectionism and work to fund the response to COVID, the prevention of future pandemics and solutions to climate change.

His second priority is to lead a "sharp revision" in the discussion of international trade. He downplayed the economic "orthodoxy," which includes the independence of the central bank, inflation targeting, the avoidance of excessive deficits and structural reforms to increase supply. Those are no longer the top-tier issues when real rates are, and will remain, negative. Economists abandoned the then-orthodoxy in the 1930s to fight the Depression, and in the 1970s to fight inflation, said Summers, and we need to be similarly bold now.

Whether you call it secular stagnation or something else, low interest rates and a shortfall in aggregate demand are a manifestation of globalization, inequality and the inability to absorb private savings.

The consequence is that savings flows to asset bubbles, driving instability and rising inequality. This problem cannot be usefully addressed with monetary policy, he said, because rates cannot be lowered.

Our policies must focus on the absorption of private savings, he said. That includes fiscal policy and understanding what is an “acceptable level of debt accumulation.”

Summers previously called modern monetary theory (MMT) a “recipe for disaster.” But his comments in this forum were consistent with MMT, which calls for aggressive fiscal policies to achieve full employment. Summers also said deficits are not “crowding out” private borrowing, which is also consistent with MMT.

One of the policies likely to be supported by the Biden administration is infrastructure spending. This was addressed by Peter Blair Henry, a co-presenter on the webinar and a professor of economics at Stanford University. He called for investing in emerging and developing economies, which are lacking in roads and power generation. Without such aid developed countries would continue to face immigration pressure. The U.S. should not view such infrastructure support as an act of charity; it will serve the long-term interests of the developed world – and it should be done in a “green” framework.

Fiscal expansion needs to be coordinated globally, Summers said, which is a lesson from the international business cycle and the propensity for global markets to increasingly import over time. “If one country expands fiscally and others don’t,” he said, “it will support demand outside its borders and increase its trade deficit, with an impact on flows of labor.”

Summer’s third priority is to build international cooperation to reform corporate tax policies. Corporate tax rates in the U.S. were lowered by the Trump administration.

The U.S. cannot win a “race to the bottom,” Summers said, and must establish an appropriately high level of corporate tax rates. The same is true of regulation, he said.

Summers stressed that the relationship with China will “shape everything that happens” with the U.S. internationally. He offered broad, high-level advice, such as the need to “make concessions” and “evaluate our leverage.” He advised against resurrecting the TPP and instead advised to seek a comprehensive, multilateral dialog around topics such as China’s resistance to US exports.

“What matters is whether we restore the power of the American example rather than specific agreements,” Summers said.

The dollar is without competition now as a reserve currency, but the U.S. must recognize that it must be more disciplined about not taking advantage of its position through retaliatory policies, Summers said, in a not-so-obscure reference to tariffs imposed under the Trump administration.

Actively devaluing the dollar is a serious mistake, he said, and instead we should focus on building “strong fundamentals.” “Trashing your currency is wrong; no country can devalue its way to prosperity.”

He told the incoming Treasury Secretary that, “Your credibility is an essential national asset. It will need to be preserved and used when appropriate, not in pursuit of short-run objectives.”