Is Larry Summers Really Right About Inflation and Biden?

The Harvard economist is getting plaudits for the warnings he issued early last year, but some Administration officials and economists are questioning the basis of his arguments.

By John Cassidy

*"He certainly had those inflationary concerns very early," an economist said, of Summers. "He also put out plenty of other scenarios—enough that he almost couldn't be wrong."*Photograph by Melissa Golden / Redux

With retail prices surging, wages failing to keep up, and the Federal Reserve moving to raise interest rates, Larry Summers, the Harvard economist and former Treasury Secretary, seems to be everywhere. Last week, Ezra Klein, the *Times* columnist, featured Summers on his podcast. Summers is also an economic commentator for Bloomberg News, and he writes columns for the Washington *Post*. In one of his latest articles, he declared, "The Fed's current policy trajectory is likely to lead to stagflation . . . and ultimately to a major recession."

Summers, who is sixty-seven, has seldom balked at expressing strong opinions. Over the decades, his views on globalization, financial deregulation, women in science, and Obama's 2009 stimulus package, which he helped to craft as the head of the White House National Economic Council at the time, have caused controversy. Now, though, he is receiving plaudits for being ahead of the pack in warning that inflation could reëmerge as a major economic problem. At the same time, Biden Administration officials and some economists are questioning the basis of Summers's arguments. Earlier this week, I spoke with some of these people, and then with Summers himself.

Be the first to know when John Cassidy publishes a new piece.

The latest on politics and the economy.

E-mail address

Sign up

By signing up, you agree to our User Agreement and Privacy Policy & Cookie Statement.

In a column published in February, 2021, Summers questioned the historic size of President Biden's $1.9-trillion COVID-relief proposal, which Congress passed the following month, and wrote, "There is a chance that macroeconomic stimulus on a scale closer to World War II levels than normal recession levels will set off inflationary pressures of a kind we have not seen in a generation." At the time that column

appeared, the rate of consumer-price inflation was below two per cent. Today, it stands at 7.9 per cent. “Larry deserves credit for identifying the danger of inflation,” Austan Goolsbee, an economist at the University of Chicago who worked in the Obama Administration, said. “At the start of 2021, the only people saying that were the folks that had predicted hyperinflation every year since 2008.”

Goolsbee also claimed, however, that Summers’s analysis of why inflation could reëmerge, which he has doubled and tripled down on over the past twelve months, hasn’t necessarily been borne out by events. Whereas Summers emphasizes the role that Biden’s American Rescue Plan played in stimulating demand throughout the economy, and the failure of the Fed to react quickly enough to rising prices, Goolsbee and others emphasize pandemic-related factors, particularly the impact of the coronavirus on global supply chains and the American labor market. “This distinction has been lost in the popular political debate, where the fact of high inflation overshadows everything,” Goolsbee said. “But it does matter for thinking through how to respond going forward.”

The first imperative, in assessing Summers’s contribution, is to clarify what he predicted. Appearing on Bloomberg’s “Wall Street Week” show on March 19, 2021, he said, “I think there is about a one-third chance that inflation will significantly accelerate over the next several years, and we’ll be in a stagflationary situation like the one that materialized between 1966 and 1969.” Summers said that there was also a one-third chance “that we won’t see inflation, but the reason we won’t see it is that the Fed hits the brakes hard, markets get very unstable, the economy skids downwards close to recession.” Finally, he added, there was “a one-third chance that the Fed and the Treasury will get what they are hoping for, and we’ll get rapid growth, which will moderate in a non-inflationary way.” Discussing Summers’s predictions, Tim Duy, a longtime Federal Reserve watcher who is now chief U.S. economist at SGH Macro Advisors, recently commented, “He certainly had those inflationary concerns very early. The counter is that he also put out plenty of other scenarios—enough that he almost couldn’t be wrong.”

As 2021 went on, and the inflation rate picked up sharply, Summers amped up his inflation warnings. “Look, we are seeing exactly what you would have expected with a central bank behind the curve,” he said, on Bloomberg, after the inflation rate rose to 5.4 per cent in September. Now he is warning that the war in Ukraine, through its impact on the prices of energy and commodities, will add to inflationary pressures, and he is comparing the current situation to the nineteen-seventies, when gas lines and rising inflation took a brutal toll on the Carter Administration. “In the late sixties and in the early seventies, we made mistakes of excessive demand expansion that created an inflationary environment,” Summers said to Klein, last week. “And then we caught really terrible luck with bad supply shocks from OPEC, bad supply shocks from elsewhere. And it all added up to a macroeconomic mess. And, in many ways, that’s the right analogy for now.”

Summers’s critics claim that his narrative doesn’t fit all the facts. Although he blames inflation primarily on serious domestic-policy mistakes in Washington, prices are also rising rapidly in other advanced countries, which responded to the pandemic with very different macroeconomic policies. Last month, the official estimated inflation rate for the euro zone hit 7.5 per cent, which isn’t far below the U.S. rate. “In Europe, they didn’t do the big stimulus that we did, but the inflation is now almost as high as ours,” Goolsbee told me. “It’s a global phenomenon. It’s not primarily coming from U.S. stimulus.”

In the view of Goolsbee and some other economists, the main reason that inflation has risen so much more than the Administration and the Fed expected is that the Delta and Omicron variants prolonged the pandemic and its damaging effects on supply chains and the labor market. “Policymakers had a clearly formed view of how things would work out,” Claudia Sahm, who is the director of macroeconomic research at the Jain Family Institute and a former Fed economist who has defended its policies, said. “The idea that inflation was going to come back down was tied to the assumption that the vaccines would

work and we'd be out of the pandemic. Larry doesn't talk much about the pandemic."

[*Support The New Yorker's award-winning journalism.* Subscribe today »]

Members of the Biden Administration also question Summers's figures. In his Washington *Post* column from last February, he cited an estimate by the Congressional Budget Office that the output gap—the difference between actual G.D.P. and the maximum level of G.D.P. that can be sustained with available labor, capital, and technology—was about fifty billion dollars a month. Summers wrote that the "proposed stimulus will total in the neighborhood of $150 billion a month," and contended, "That is at least three times the size of the output shortfall." A senior White House official pointed to external estimates from Goldman Sachs and Moody's Analytics that the output gap was far larger than the C.B.O. estimate. Citing internal White House figures, he also said that the actual spending from the American Rescue Plan during 2021 was about ninety billion dollars a month, rather than the hundred and fifty billion that Summers assumed. That's a big difference. The senior White House official claimed that, if you adjust for a larger output gap and the actual outlays, the argument that the Rescue Plan was inflationary doesn't hold up.

I also spoke with J. W. Mason, an economist at John Jay College and a fellow at the liberal Roosevelt Institute. Mason pointed out that even at the end of 2021, after the stimulus was injected into the economy, there was no output gap, according to Congressional Budget Office estimates. Inflation-adjusted G.D.P. was, in fact, still slightly below, not above, its potential level. "If Summers was right about the stimulus being too large, we would have seen a positive output gap develop, but we didn't," Mason said. "He got the right inflation outcome, but he didn't provide the right reasons we got there. The fact that inflation has been high is not, in and of itself, vindication of any particular theory of inflation, or any particular policy view."

With the surge in inflation having gone further and lasted longer than policymakers expected, Summers wrote in a recent column that bringing the problem under control may well require the Fed to rapidly raise interest rates to “5 percent or more—something markets currently regard as almost unimaginable.” In making this argument, Summers frequently points to the emergence of persistently high inflation rates in the nineteen-seventies, and says that the Fed needs to act quickly and decisively to prevent a repeat. “That’s really what the crucial issue is today,” he told Klein. “Are we going to keep things under control or are we going to allow [inflation] expectations to fully increase?” This historical argument can also be queried, though. In an e-mail to me, Brad DeLong, an economic historian at Berkeley who served in the Clinton Administration, pointed out that other inflation spikes in American history have turned out to be short-term, including the ones that occurred in 1920, 1948, and 1951. The high inflation of the nineteen-seventies was unusual in that it turned out to be long-lasting. What type of inflation do we have now? “We do not know,” DeLong said. “It could be analogous to 1974. It could be analogous to 1951, or 1948, or 1920.” In a follow-up e-mail, DeLong went on, “Larry is very sharp, but he is not infallible. And, as I see it, if Jay Powell does what Larry wants and Larry is wrong, we are then in a definite pickle. If Jay Powell stands near-pat now and waits for six months for the situation to clarify, he can quickly catch up.”

VIDEO FROM THE NEW YORKER

Some of Summers’s critics also accuse him of downplaying very tangible benefits that the American Rescue Plan delivered to many ordinary Americans whose livelihoods were stricken by the pandemic. “It was about providing families with economic relief to get them to the other side,” Claudia Sahm said. “It did provide a lot of relief: we really gave families a lot of income.” Jared Bernstein, a member of the White House Council of Economic Advisers, also took issue with interpreting the results of the Rescue Plan solely in terms of inflation. “You also

need to look at the extent to which it reduced child poverty, the extent to which it prevented evictions, the fact that it produced the strongest labor-market recovery I have ever seen," Bernstein told me. "When we arrived, less than one per cent of adults were fully vaccinated. Today, more than seventy-five per cent of adults are fully vaccinated. The unemployment rate was projected to stay much higher than it has done. If you try to reduce the impact of the American Rescue Plan to one number—the inflation rate—you are not doing anywhere near a complete analysis."

Icaught up with Summers by phone and put some of these points to him. He had just done an online event for the Council on Foreign Relations, he had a new column in the Washington *Post*, and, as always, he was well primed to defend his views. He dismissed the suggestion that he had hedged his prediction of higher inflation. "I described two bad things that could happen," he said. "I said they were much more likely than the consensus view, and I acknowledged the possibility that something good could happen, and it would work out. Today, the good outcome looks much less likely. And one of the bad outcomes has already happened, and the other looks substantially more likely."

In defending his argument that excessive demand fuelled by Biden's relief plan was the primary cause of the inflation spike, Summers pointed to the fact that the nominal G.D.P.—output not adjusted for price changes, which economists regard as a measure of demand—expanded by more than ten per cent in 2021. "If you have nominal G.D.P. growth at double-digit rates in an economy with any type of limitation on capacity, you are going to have excessive inflation," he said. He also pointed to a study by researchers at the Federal Reserve Bank of San Francisco, which compared recent inflation outcomes across O.E.C.D. countries and concluded that, in the United States, "income transfers may have contributed to an increase in inflation of about 3 percentage points by the fourth quarter of 2021"—that is, most of the over-all jump last year. The paper's conclusion certainly supports Summers's analysis.

When I asked Summers about the White House's claim that the spending estimates for the American Rescue Plan in his original Washington *Post* article turned out to be too high, he said that he hadn't seen the White House's figures. He also defended his own figures, saying, "The hundred-and-fifty-billion-dollar figure referred to the total stimulus the economy would receive with the nine-hundred-billion-dollar measure passed in December and the proposed Rescue Act. I don't think there is any argument that the combined stimulus was unprecedentedly vast." Summers added, "If the argument is that the money has not yet been spent, that makes the stimulus even more problematic because it's going to be coming at a time when there is overheating." Regarding disputes about the output gap, Summers said, "The fact that inflation went up a lot and there are massive labor shortages across the country suggests that demand was very high relative to potential supply, which was my central point." He went on, "Look, the job of macroeconomic policy is to balance demand and supply. If you get accelerating inflation, that means you failed."

This is the sort of directness that irritates Summers's critics, delights his admirers, and disguises the fact that, in some areas, there may be more agreement than is evident from the public back-and-forth. At this stage, most economists agree with Summers that, during 2021, strong demand, boosted by the American Rescue Plan, played at least some role in the inflation surge. "You've seen a broadening of inflation pressures in the economy, and an acceleration of wage growth," Tim Duy, the SGH economist, said. "That's all consistent with demand-driven inflation." Even Sahm conceded to me that some of the extra federal spending eventually showed up in higher prices, but she added that the main cause of higher inflation was "fundamental disruptions under the hood" of the economy caused by the pandemic.

Ultimately, what matters now is whether we really are on the verge of returning to the nineteen-seventies. "I said a year ago, Vietnam is the right analogy. Inflation goes from one per cent to six per cent in four years of super-expansionary fiscal policy," Summers told me. "Brad

DeLong and the President's Council of Economic Advisers said [to] look at World War Two and the Korean War. Those parallels, where price controls were central, so far have not proved out."

In his most recent column in the Washington *Post*, Summers reiterated his call for sharply higher interest rates. He told me: "Prompter action from the Fed in the nineteen-seventies would have obviated the need for the Volcker recession, so prompt action against the threat of inflation is essential now." With the Labor Department set to release the Consumer Price Index for March next week, the inflation-policy debate will only intensify. In the end, though, a lot of the animus toward Summers in Democratic policy circles is political. Many Democrats think that he has been giving ammunition to the Republicans, who cite him regularly, and understating the broader benefits that Biden's policies have delivered, which include record job growth in the first year of his Presidency.

Summers said, "The benefits from the American Rescue Plan depend on a strong economy, which is threatened as overheating leads to declining real wages and, quite possibly, recession." He added, "The Rescue Plan has crowded out political space for desirable long-term investments in the Build Back Better plan. And Carter's demise suggests that inflation is a grave threat to progressive politics."

Actually, it was Republican opposition and Senator Joe Manchin that sank the Build Back Better plan, and it's far from certain that Manchin would have supported the initiative if the American Rescue Plan had been smaller. It's certainly true, however, that Biden and the Democrats have been damaged politically by the inflation surge. How it plays out from here, and who is blamed, will go far to determine ultimate attitudes toward Biden's economic record, and to the Summers critique.