

Financial Figure

From leading a Federal Reserve Bank to becoming a Rochester economics professor, Narayana Kocherlakota wants challenge in his life.

Interview by Peter Iglinski

The unemployment rate in the United States was hovering near 10 percent, the financial sector was ailing, and housing remained in a free-fall. It was 2009—the beginning of the recovery from the Great Recession—and Narayana Kocherlakota was about to plunge into a major policy role, having just taken over as president and CEO of the Federal Reserve Bank of Minneapolis.

And that's just the way he wanted it.

"I went to the Fed because the situation was hard, not because it was easy," says Kocherlakota, the Lionel W. McKenzie Professor of Economics in the School of Arts & Sciences. "I want challenge in my life."

A monetary policy expert who had previously chaired the economics department at the University of Minnesota, Kocherlakota remained at the Fed for six years. Then, with the recovery under way, he returned to academic challenges, this time at Rochester.

The University boasts "one of the top economics departments in the country, and the environment is very conducive to my work in macroeconomics," he says.

The move to Rochester has not only been good for Kocherlakota; it's made a difference to the entire economics department, according to chair Srihari Govindan.

"Narayana has made fundamental contributions to macroeconomics as a researcher, teacher, and as a policymaker," says Govindan. "He's brought his dynamism to bear, not just on the macroeconomists here, but on the department as a whole."

While monetary policy is his primary focus, Kocherlakota also conducts research in the fields of money and payments, business cycles, financial economics, public finance, and dynamic games and contracts. Of special interest to him is the need to improve macroeconomic models by taking into account the different economic risks facing women and various cultural groups.

Kocherlakota teaches undergraduate courses including Money, Credit, and Banking, and graduate courses including Topics in Monetary and Financial Economics. In addition, he maintains a national profile as a regular columnist for Bloomberg's *Bloomberg View*, as well as an expert source for national and international media.

CHALLENGING HIMSELF: A monetary policy expert who had previously chaired the economics department at the University of Minnesota, Kocherlakota took on the role of leading the Minneapolis Federal Reserve Bank just as the Great Recession began. Six years later, with the recovery under way, he returned to academic challenges, this time at Rochester.



You held several academic appointments before becoming president and CEO of the Federal Reserve Bank of Minneapolis. What prompted your move to the Fed?

If you had asked me in 2005 if I wanted to be president of the reserve bank, I would have shrugged it off, because I enjoyed teaching and was engaged in pretty exciting research. But then came the economic downturn of 2007 to 2009, when unemployment reached 10 percent. At that point, it was clear that there would be benefits to having someone with my years of expertise coming to help with the response. I went to the Fed because the situation was hard, not because it was easy. I want challenge in my life.

What brought you to Rochester after your time at the Fed?

Ultimately, the research and academic environment led me here. This is one of the top departments of economics in the country, and the environment is conducive to my work in macroeconomics. On top of that, my wife and I both fell in love with the community when we came to visit.

You've been called an economic dove. Is that a fair description, and what does it mean?

When people talk about monetary policy doves and hawks, there are two different ways the terms get used. To people in the markets, it

refers to your stance on interest rates. If you're favoring low interest rates, you're viewed as a dove, and if you want to raise interest rates, you're viewed as a hawk. But economists actually don't talk about [hawks and doves] in terms of interest rates; they think about it more in terms of the trade-off between inflation and employment. Higher interest rates dampen inflation, which is good if inflation is running too high.

But on the other hand, it's going to reduce the demand for workers, which will push up unemployment. So back to your question—if you're more worried about high inflation, you're viewed as a hawk; if you're more worried about high unemployment, you're viewed as a dove.

When I joined the Fed in 2009, unemployment was very high and inflation was low. I was very worried that, given how much the Fed was doing to cut interest rates, inflation would come back rapidly. In the end, I was wrong; the data on inflation just didn't conform to what I expected to happen. And so I became more worried about the fact that unemployment was high, and simultaneously, inflation was too low—below the Fed's target of 2 percent. That made me viewed as a dove—by economists, because I was less worried about high inflation, and by the financial markets, because I was favoring low interest rates.

I will say that since becoming a dove, I feel like I've not been that wrong about the economy.

The Federal Reserve System: Where Is the Economy Going?

Made of 12 regional headquarters overseen by a seven-member board, few federal institutions are as closely watched as the Federal Reserve System or as influential.

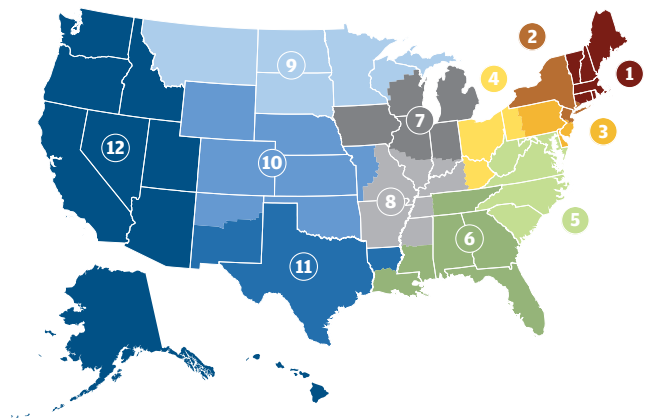
Former Minneapolis Fed president Narayana Kocherlakota says one of the system's main goals is to keep inflation as low as possible while maximizing employment.

The Fed's main—and most closely watched—mechanism for doing that is determining short-term interest rates, or the daily rate

that banks charge one another. The effects of those rates ripple through the economy. While not an exact science, the Fed's decision making is deliberately designed to be forward looking.

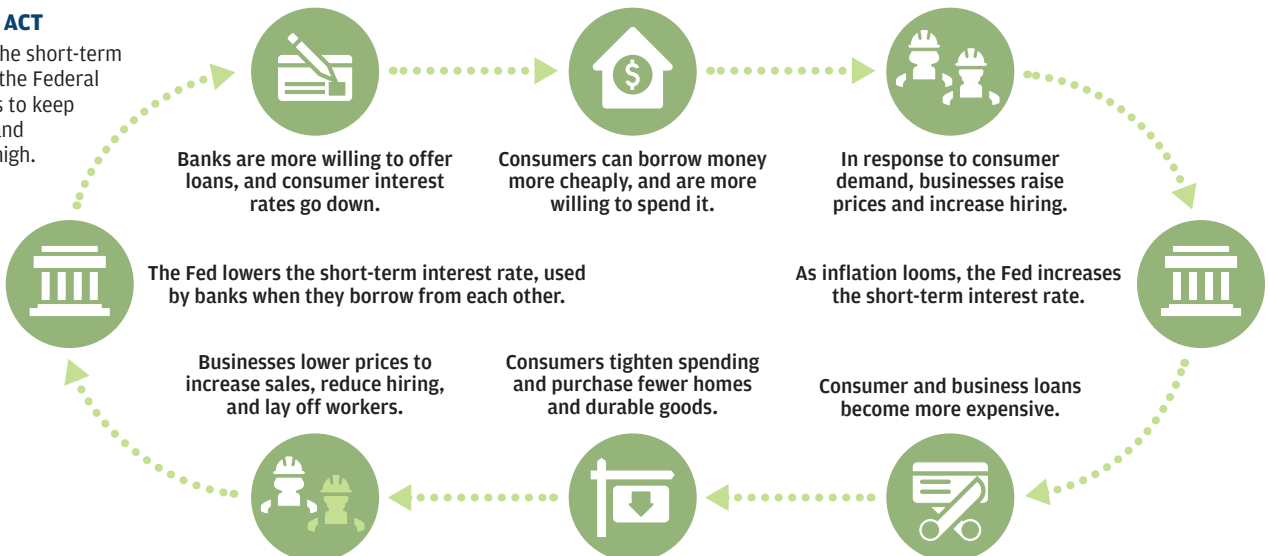
"The main thing to consider is knowing where the economy is going to go, because the decisions take a while to influence the economy," Kocherlakota says. "If you lower interest rates today, it won't have an effect today, but it will have an effect down the line in 18 months or so." —Peter Iglinski

U.S. FEDERAL RESERVE DISTRICTS



BALANCING ACT

By adjusting the short-term interest rate, the Federal Reserve seeks to keep inflation low and employment high.



What's your opinion of President Trump's nomination of Jerome Powell to take over as Federal Reserve chair?

I would have preferred that he had reappointed Janet Yellen, who had done an outstanding job of fulfilling the Federal Reserve's dual monetary policy mandates of price stability and maximum employment. But I also think that Jerome Powell, who served as Federal Reserve governor, was an excellent nomination. I had the opportunity to work closely with Jay during my time as president of the Federal Reserve Bank of Minneapolis.

My takeaway from that experience is that he is deeply knowledgeable about the workings of the Federal Reserve, and deeply committed to its public service mission.

What economic issues keep you up at night?

I worry a little bit about monetary policy, of course. Specifically, I'm concerned about how low inflation has remained in the US. What do I mean when I say that? While the Fed's target for inflation is 2 percent, it's actually been running closer to 1 percent. That doesn't sound like a big gap, but it means that if the Fed faced a recession, there would be less capacity for them to help the economy. If the Fed can't significantly reduce interest rates, there would be less of a stimulus to encourage people to spend in order to help us get out of a recession.

On the financial regulation front, I'm probably even more concerned. There's a real push to roll back a lot of the regulations that were adopted in the wake of the recent financial crisis. I think you always should be reevaluating what you've done, but I think those regulations have, by and large, made us safer in terms of lessening the probability of a crisis.


The final thing that keeps me up, when I do think about this, has to do with the actions taken by the Fed to bolster the financial system in reaction to the crisis in 2008. Those moves, made by Chairman [Ben] Bernanke and others, were both important and critical. The situation would have been much worse had the Fed had not acted as it did. Yet I see a lot of skepticism in Congress, both on the left and the right, about letting the Fed maintain the ability to act in a future crisis. That could make any future economic crisis much worse than what we experienced in 2008.

You've called for greater diversity in macroeconomic models. What would that involve?

Economists on the microeconomic side have long studied how policies would differently affect African Americans or Hispanics, as opposed to whites. But on the macro side, we're just starting to use what people call heterogeneous agent models, which respect the fact that different people have different circumstances. But there's still insufficient attention to differences in economic outcomes based on gender, and there's virtually no work in macroeconomics with respect to the fact that economic outcomes for African Americans are systematically different than for whites.

Now why does this matter? For one thing, how does a recession affect a given person? How does the risk of the recession affect a person's decision to save money versus spend it? Well, if you think that people are only facing the average amount of risk, you're missing the fact that the risk of being unemployed in a recession is actually much lower for white Americans than it is for African Americans. So if you're looking at whites, you're going to be exaggerating how much risk they face, and if you're looking at African Americans, you're going to be underestimating their risk. And that can affect your modeling of consumer demand, and affect your model of the macro economy, as a result.

What's one thing about you that might surprise people?

I'm a lot better at foosball than people probably think I am. A lot better. 



FOUNDING FIGURE: Lionel McKenzie developed an international reputation as an influential scholar after World War II, as he helped build Rochester's doctoral program in economics during a nearly five-decade career on the Rochester faculty.

ECONOMIC HISTORY

Carrying a Tradition Forward

Narayana Kocherlakota is the first person to hold the professorship named for Lionel McKenzie, who founded the University's PhD program in economics.

After joining the department in 1957, McKenzie enjoyed an international scholarly reputation during his 45-year career at Rochester. That was particularly true in Japan, where he was known as "the father of Japanese mathematical economists," thanks to his many doctoral students who came from that country.

McKenzie is best known as a pioneer of modern general equilibrium theory, which explains how supply, demand, and prices function in economic markets.

Jerry Green '67, '70 (PhD), the David A. Wells Professor of Political Economy and the John Leverett Professor at Harvard University and one of McKenzie's PhD students at Rochester, says McKenzie was "one of the great leaders in the field of economics" in the decades following World War II.

Most recently the Wilson Professor Emeritus of Economics, McKenzie died in 2010.

Kocherlakota says it's "an honor to carry on the tradition" of economic scholarship that McKenzie launched just over 60 years ago.

—Peter Iglinski