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Larry Summers will bring brillance, creativity to post

Treasury in good hands

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"The Treasury can play a key role in maintaining the low rate of inflation the Fed has achieved."

Our friend Larry Summers is an economics superstar, not because of his achievements in Washington but because of his earlier contributions to economic research. While the skills he developed and honed during a decade in Washington will serve him well as Treasury secretary, the combination of creativity and common sense that shaped his academic research will be key to his policy making.

Before going to Washington, Larry was one of the most productive economic researchers, working on a wide range of policy-relevant subjects, including saving incentives, taxation, corporate investment, and unemployment. His work was innovative and sound, based on careful analyses of data and an understanding of how people and businesses behave.

Economic colleagues were pleased but not surprised when the America Economic Association a few years back awarded him its John Bates Clark medal, a prize given every two years to the economist under the age of 40 who has made the most significant contributions to economics.

Larry got his first taste of Washington policy making when he served as the senior domestic policy economist of the Council of Economic Advisers in 1982-83, when Martin Feldstein was chairman and Ronald Reagan was president. Larry provided sound advice on a broad range of issues and was an effective representative in meetings with senior officials from a variety of government departments, where he helped to check calls for unwise spending initiatives. Larry*s willingness to serve in a conservative Republican administration and his effectiveness while there show that he is certainly not the stereotypical liberal academic. Larry understands the importance of markets and of incentives and is likely to be an effective counterweight to bad liberal advice from other quarters of the Clinton administration.

Larry returned to teaching and research at Harvard but left again for Washington a few years later as chief economist of the World Bank and adviser to World Bank president Barber Conable, a former Republican congressman. Although this move surprised his friends, Larry*s work there gained him valuable knowledge of emerging economies. While at the World Bank, Larry supported market-oriented policies in trade and the environment that sometimes attracted the wrath of environmentalists.

Larry joined the Clinton Treasury with responsibility for international economic policy but immediately was also an influential adviser to Secretary Lloyd Bentsen and later Secretary Robert Rubin on a wide range of domestic issues. The Mexican financial crisis in January 1995 was a high-profile assignment for Summers. Although US aid to Mexico was criticized by many at the time, we supported the move then and continue to believe it was appropriate in the context of the recently concluded NAFTA agreement and in recognition of both our special relation with our southern neighbor and the major economic reforms that Mexico had achieved.

Mexico*s rapid recovery confirmed for many the wisdom of the policy, though critics have complained that helping Mexico to repay its loans to US banks only encouraged more unwise lending to others. We would argue that the tough US policy taken toward the Russian financial crisis last year showed that the banks will not always be protected and that the administration can distinguish between countries that have taken appropriate policies and others.

Looking ahead, the international economic situation will continue to absorb much of the energy of the Treasury department. The International Monetary Fund*s response to financial crises in Asia during the past two years has caused much damage to previously high-growth economies and has engendered anti-West and anti-American sentiment. There is much talk now about developing a "new international architecture" and about a major new lending role for the IMF.

Summers was a key player in managing the international financial crisis. Now it is time for Secretary Summers to steer policy in a different direction, using the influence that flows from his position as Treasury secretary and from his intellectual reputation to convince the emerging market countries that they need to help themselves through better policies and cannot rely on the United States or the IMF to save them in times of trouble. The key advice is to avoid the financial imbalances that result from large current account deficits, from excessive short-term foreign liabilities, and from weak domestic banking systems. More international reserves, better access to foreign credits, and exchange rates that reflect market conditions are further key lessons for professor Summers to teach to his finance ministry counterparts around the world.

Here at home, the Treasury can play a key role in maintaining the low rate of inflation that the Federal Reserve has achieved. If inflation begins to rise, as the most recent CPI inflation report suggests could happen, the Fed will and should respond by increasing the rate of interest. Everyone from homeowners with adjustable rate mortgages to politicians up for re-election in 2000 will attack the Fed and call for lower rates. If that occurs, Summers can make an important contribution to price stability and long-term growth by publicly supporting the Fed*s anti-inflationary policies.

Summers has also been a central figure in helping President Clinton think through Social Security reform. If the president wants reform, he knows that his current proposal is just a first move toward congressional negotiations. It is significant that the administration has not even submitted its proposal in legislative form. Summers understands the economics and politics of Social Security as no Treasury secretary before him has or indeed could have. Treasury Secretary Summers will be ideally qualified to help the president develop a more workable, economically sensible, and politically acceptable Social

Security policy.

Although there are less than two years left in the Clinton administration, there are formidable challenges and great opportunities facing Summers during this time. We have the highest regard for Summers*s ability and will watch his performance with optimism.

Martin Feldstein, the former chairman of the Council of Economic Advisers, and his wife, Kathleen, also an economist; write frequently together on economics.