

OPINION

A Nobel laureate's polite plea to the Fed: Go slowly in fighting inflation

Today's economy faces unique challenges, says noted economist Peter Diamond.

By [Scot Lehigh](#) Globe Columnist, Updated July 19, 2022, 7:08 p.m.
[35](#)



Peter Diamond, right, Institute Professor of Economics at the Massachusetts Institute of Technology, speaks with MIT President Susan Hockfield during a 2010 press conference after Diamond was awarded a Nobel Prize in Economics. Aram Boghosian for The Boston Globe/Aram Boghosian for The Boston Globe

[Peter Diamond](#) is not just a former Institute professor at MIT — that is, one recognized by a topflight university for his brilliance — he's also a [Nobel Prize winner in economics](#), an honor awarded for his contribution to the understanding of unemployment and labor markets. And he's someone president Barack Obama nominated to the Federal Reserve Board of Governors, though [his bid to join the central bank's board was thwarted by the Senate Republicans' political myopia](#).

So when Diamond has some ideas to share, I'm ready to listen and learn. And he has some thoughts now as the Fed tries to tame inflation.

Advertisement

Related: [US inflation hit 9.1 percent over the past year, highest rate in 4 decades](#)

Diamond thinks that with the workforce changes triggered by the COVID-19 pandemic, the energy- and food-supply disruption caused by Russia's war against Ukraine, and the increasing agricultural toll taken by the accelerated [droughts](#) and [fires](#) of climate change, we are in uncharted economic territory. He worries that the current state of economic complexity increases the already substantial risk that the Fed could crash land the economy if it hits the interest-rate brakes too hard.

Get Weekend Reads from Ideas

A weekly newsletter from the Boston Globe Ideas section, forged at the intersection of 'what if' and 'why not.'

Enter Email

The [Fed's inflation-taming effort has already commenced](#), of course, and the central bank has signaled it will continue aggressively in that direction as it tries to bring down inflation to [2 percent](#). But that may be too harsh and traditional an approach for a time when the world has been struck by a succession of chaos-causing tsunamis.

"I think what may happen is that we will get a serious recession and they won't get inflation down to 2 percent," Diamond said in an interview. "It is not going there if the war is still going on, if the next round of COVID is worse than the last one, and if climate change hits us harder and sooner than expected. That is a risk the Fed must pay attention to."

Advertisement

Related: ['It's really a mess': The growing split between workers and bosses on returning to the office](#)

Part of the reason why Diamond worries the Fed may have the wrong read on the economy is because of an emerging, COVID-catalyzed, mismatch between the type of employment workers want and the kind of jobs companies offer. After the experience of pandemic-era employment, [many want jobs that let them work in substantial part from home](#). But even companies that could offer more extensive work-from-home arrangements frequently aren't inclined to do so. That's often because they are organized around having employees at the office and changing that model requires planning and investment.

That mismatch, Diamond thinks, can lead to a misreading of labor-market barometers. One of the principal ways that economists assess the strength of the labor market is by comparing the number of jobs available to the number of job seekers. The so-called [Beveridge Curve](#) holds that the lower the rate of unemployment, the more job vacancies there will be in relation to job seekers.

There are now [about two vacancies for every job](#) hunter, a historically unprecedented ratio, Diamond said. Ordinarily, that would suggest an ultra-tight labor market, strong upward lift on wages as companies compete for available workers, and thus more inflationary pressure. It may lead the Fed to believe it can slow the economy while still retaining enough employment to keep the country from sinking into recession.

But if that high ratio of job openings to job hunters comes because workers are in search of more satisfactory work arrangements, this traditional measure of the labor market isn't an accurate gauge for today's situation.

Advertisement

Related: [US weekly jobless claims at highest point in nearly 8 months](#)

Meanwhile, Diamond's own study of inflationary Latin American economies, particularly as pertains to pensions, has led him to this conclusion: If inflation is running at an annual rate of less than 5 percent, it is possible to adjust for rising prices fairly effectively by increasing federal financial supports, unemployment benefits, food aid to the poor, and so forth.

"Yes, people still notice inflation and yes, it is still a political problem, but it is not a killer," he said.

Put it all together and this is where the Nobel Prize-winning economist lands: At its current rate, inflation is not such a serious problem that it justifies remedies so strong they could throw the economy into recession.

"My message to the Fed would be, yes, we need to cool the economy, but we need to go slowly in doing so, and see how this plays out, because we shouldn't have confidence in our predictions," he said. That means the Fed should signal its determination to reduce inflation, but underscore that uncertainty requires that that be a gradual effort.

Related: [As the child tax credit ends, one family navigates a new, familiar reality](#)

That's obviously a tough political message at a time when [Americans overwhelmingly cite rising prices as their chief economic concern](#).

“A slow response may not be attractive politically,” Diamond said, “but getting the policy right is more important.”