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If You Have the Answers, Tell Me

By N. GREGORY MANKIW

AFTER more than a quarter-century as a professional economist, I have a confession to make: There is a lot I don't know about the economy. Indeed, the area of economics where I have devoted most of my energy and attention — the ups and downs of the business cycle — is where I find myself most often confronting important questions without obvious answers.

Now, if you follow economic commentary in the newspapers or the blogosphere, you have probably not run into many humble economists. By its nature, punditry craves attention, which is easier to attract with certainties than with equivocation.

But that certitude reflects bravado more often than true knowledge. So let me come clean and highlight three questions that perplex me. The answers to them may well shape the economy in the years to come.

How long will it take for the economy's wounds to heal?

When President Obama took office in 2009, his economic team projected a quick recovery from the recession the nation was experiencing. The administration's first official forecast said economic growth, computed from fourth quarter to fourth quarter, would average 3.5 percent in 2010 and 4.4 percent in 2011. Unemployment was supposed to fall to 7.7 percent by the end of 2010 and to 6.8 percent by the end of 2011.

The reality has turned out not nearly as rosy. Growth was only 2.8 percent last year, and the first quarter of this year came in at a meager rate of 1.8 percent. Unemployment, meanwhile, lingers well above 8 percent, and according to Ben S. Bernanke, the Federal Reserve chairman, is expected to keep doing so throughout this year.

Economists will long debate whether President Obama's policies are to blame or the patient was just sicker than his economists realized. But there is no doubt that the pace of this recovery will come nowhere close to

matching the one achieved after the last deep recession, when President Ronald Reagan presided over a fall in the unemployment rate from 10.8 percent in December 1982 to 7.3 percent two years later.

Looking ahead, an open issue is whether the recession will leave scars that prevent a return to jobless rates that were considered normal just a few years ago. A striking feature of today's labor market is the rise of long-term joblessness. The average duration of unemployment is now almost 40 weeks, about twice what it reached in previous recessions. The long-term unemployed may well lose job skills and find their future prospects permanently impaired. But because we are in uncharted waters, it is hard for anyone to be sure.

How long will inflation expectations remain anchored?

In 1967, Milton Friedman gave an address to the American Economic Association with this simple but profound message: The inflation rate that the economy gets is, in large measure, based on the inflation rate that people expect. When everyone expects high inflation, workers bargain hard for wage increases, and companies push prices higher to keep up with the projected cost increases. When everyone expects inflation to be benign, workers and companies are less aggressive. In short, the perception of inflation — or of the lack of it — creates the reality.

Although novel when Professor Friedman proposed it, his theory is now textbook economics, and is at the heart of Federal Reserve policy. Fed policy makers are keeping interest rates low, despite soaring commodity prices. Why? Inflation expectations are "well anchored," we are told, so there is no continuing problem with inflation. Rising gasoline prices are just a transitory blip.

They are probably right, but there is still reason to wonder. Even if expectations are as important as the conventional canon presumes, it isn't obvious what determines those expectations. Are people merely backward-looking, extrapolating recent experience into the future? Or are the expectations based on the credibility of policy makers? And if credibility matters, how is it established? Are people making rational judgments, or are they easily overcome by fear and influenced by extraneous events?

Mr. Bernanke and his team may learn that, in turbulent times, expectations can become unmoored more easily than they think.

How long will the bond market trust the United States?

A remarkable feature of current financial markets is their willingness to lend to the federal government on favorable terms, despite a huge budget deficit, a fiscal trajectory that everyone knows is unsustainable and the failure of our political leaders to reach a consensus on how to change course. This can't go on forever — that much is clear.

Less obvious, however, is how far we are from the day of reckoning.

Winston Churchill famously remarked that "Americans can always be counted on to do the right thing, after they have exhausted all other possibilities." That seems to capture the attitude of the bond market today. It trusts our leaders to get the government's fiscal house in order, eventually, and is waiting patiently while they exhaust the alternatives.

But such confidence in American rectitude will not last forever. The more we delay, the bigger the risk that we follow the path of Greece, Ireland and Portugal. I don't know how long we have before the bond market turns on the United States, but I would prefer not to run the experiment to find out.

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So those are the three questions that puzzle me most as I read the daily news. If you find an economist who says he knows the answers, listen carefully, but be skeptical of everything you hear.