Appeared in Korean newspaper EDAILY, January 2021 (in Korean). as   
“Macroeconomic stimulus in response to the coronavirus is inevitable”

Prof. Jeffrey Frankel’s answers to questions from Jason Jungnam Kim, Dec. 23, 2020.

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1. What do you think is a risk factor for the global economy next year?  
   
JF: The biggest risk factor is whether we are able to overcome the coronavirus with the help of the new vaccines, or whether progress is slow due to incompetent governments, uncooperative citizens, problematic virus mutations, or other unexpected factors. If we don’t overcome the virus, the world economy won’t return to normal.

2. U.S. stock markets have been rising very steeply recently. The Dow Index  
has recently surpassed 30,000 points for the first time in its history. What  
do you think is the biggest reason the U.S. stock market is rising?  
  
JF: That is simple. Extraordinarily expansionary monetary policy is the reason that the US stock market has climbed so high.  
  
3. The real economy is in a depressed because of the pandemic. In that sense,  
it feels somewhat ironic that the stock market is booming. Some people are  
seeing this as a ‘bubble.’ What about you? How do you predict the U.S.  
stock market will be in the future? Do you think it’s time to prepare for  
the end of the bubble?   
  
JF: It depends on what one means by a bubble. Stock market indices are close to historic highs measured relative to dividends, or earnings, or GDP – whether one looks at current levels of those variables or expected future levels. But today’s stock market is not high because of such economic fundamentals as GDP or corporate earnings. Rather, it can be explained by low interest rates. If one expects US interest rates to return even partway to normal in future years, then one should expect the stock market to do poorly when that time comes.

4. The global economy, including the US, is clearly in crisis. It appears  
Quantitative Easing (QE) is here to stay. What do you think about this? If  
there are side effects, what are they? Can the world economy, including the  
US, go back to before the pandemic?

JF: Traditionally, the side effect or danger sign from overly easy monetary policy has been thought to be inflation (prices in goods markets and wages in labor markets). But such historical episodes as Japan in the late 1980s and the US around 2003-06 suggest another side effect: high asset prices (stock markets and housing). Despite the possible financial risks, however, I think the Fed has done the right thing, in light of the challenge posed by the Covid-19 recession.

With intelligent policy (including fiscal policy and health measures), yes, the world economy, including the US, can get back to a semblance of economic normalcy.

5. COVID-19 vaccination has begun. Do you think vaccines could grow the world  
economy, including the US, in the future?

Yes. Defeating Covid-19 is a pre-requisite to restoring economic health. Thus the supposed trade-off between public health and economic health is largely an illusion. Those countries that managed to limit infections and deaths from Covid-19 in 2020 tended to suffer milder recessions than others.  
  
6. There are concerns that the debt surge caused by QE these days will  
backfire and take a toll on the economy. How do you view the debt situation  
in developed and emerging countries?

JF: Public debt is reaching very high levels in most countries, as a result of large budget deficits -- that is, as a consequence of expansionary fiscal policy, like spending to fight Covid-19 and its effects. [This is not per se a consequence of QE.] In the past, we would have viewed with alarm debt/GDP ratios that are so high and rising so fast. But under the current circumstances, the budget deficits are fully appropriate.

Is the debt sustainable?

* For the US, yes, for a long time. The reason is that the US dollar enjoys the “exorbitant privilege” of being the world’s premier international currency and no other currencies appear to be serious challengers.
* For other industrialized countries, the debt is sustainable so long as the interest rate remains below the GDP growth rate. Long-term bond markets appear to believe that interest rates will remain very low for a long time. This is also what Larry Summers predicted in 2013 when he revived the idea of “secular stagnation,” a prediction that has come to seem prescient. (Among the possible underlying causes for secular stagnation, he cites the disappearance of substantial growth in the size of the labor force. This is particularly relevant for Korea.)
* For many emerging market and developing countries, their debts will probably not be sustainable.

7. The Korean economy is facing a huge crisis due to the COVID-19. And many  
are concerned that the Korean economy now lacks growth engine. From the  
perspective of foreign investor, tell us about the strengths and weaknesses  
of the Korean economy, plus the areas it should focus on in the future?

JF: I understand that Korea’s health and economy have been impacted by the coronavirus. But it has done better than most countries. Very few have done as well as Korea over the last year, with respect to both health and the economy.

8. How do you think the current economic crisis is different compared to the  
past? 

One might view the crisis as a sort of cross between the pandemic of 1918-19 and some of the more severe recessions of recent decades.

9. Bitcoin prices are soaring in addition to the stock market now. How do we  
analyze Bitcoin’s future?

JF: Bitcoin prices are untethered from any sort of valid real fundamentals, and have been since the beginning. It is pure speculation. A game of roulette.

10. Wall Street is cheering as President-elect Biden nominated former Federal  
Reserve Chairman Janet Yellen as the Secretary of the Treasury. Behind it is  
fiscal expansion. Do you think economic growth through national fiscal  
expansion will be possible? I ask you for advice on tax policy for Biden.

JF: US government spending prevented the health crisis from turning into an economic crisis on the order of the Great Depression. Janet Yellen’s appointment as Treasury Secretary is being cheered in part because she is viewed as wanting to extend the government spending, but for other reasons as well. She and the other appointments announced so far by President-Elect Biden are thoroughly sane, competent and qualified for their jobs. That is a big change from most of the appointments in the previous administration.

Biden’s plan, beyond extending income support programs passed by Congress in 2020, is to make major public investments in infrastructure, health, and education, and to partially pay for them by raising taxes on those households with incomes above $400,000. I agree with the overall approach and with most of the specifics, while recognizing that the Republicans will try to block most of these measures, to the extent they retain power in the Senate.

You ask about my advice on US tax policy. I would expand the Earned Income Tax Credit; make the payroll tax more progressive; raise the inheritance tax; and roll back the 2017 slashing of corporate taxation, not primarily be restoring the old tax rate, but by eliminating some major deductions. Ideally, I would institute a substantial carbon tax. I would use the additional tax revenue for a combination of purposes: cutting more distortionary taxes and reducing future deficits.

11. What advice would you give to Korea and other emerging countries for  
economic growth?

I still believe in trade as an engine of economic growth.