Opinion

The Importance of Researcher Independence

BY KARTIK ATHREYA

Writers, apparently, are often asked, "Where do you get your ideas?" Economists are rarely asked this question, in my experience. But I would like to say a little bit about it anyway to convey something of how we work within the Richmond Fed's research department.

Our economists — generally, there are a couple of dozen of us in the department — conduct original research in a variety of areas, including macroeconomics, monetary policy, banking, payments systems, and labor markets. In addition, within our team, there is a group of regional economists who study economic trends in our district and carry out research on regional economic issues. Our economists get their research ideas from many places, but with the exception of some work that we do specifically to support President Lacker in considering issues before the Federal Open Market Committee, they are largely free to follow their own instincts in setting the course of their research. I'll share a couple of examples to illustrate how it works.

The first is what we call the Non-Employment Index, or NEI, a measure of the health of the labor market that we began posting on our website late last year. Unlike the standard unemployment rate, the NEI takes into account individuals who are considered to be out of the labor force as well as the likelihood that unemployed workers will return to work. It had its origins several years ago when some of our economists were looking at the standard measures of the labor market's performance and noted that those numbers were pointing in opposite directions: The unemployment rate had started to improve, while the labor force participation rate was still in decline. Motivated in part by this striking pattern, Marianna Kudlyak, one of our staff economists at that time, was working with Fabian Lange of McGill University on how the duration of a worker's lack of employment affected his or her chance of finding a job — and how this information could be the basis of a measure of individuals' connections to the labor market.

Marianna drafted a memo about this work in early 2014 for President Lacker and other economists participating in his preparatory discussions ahead of the Federal Open Market Committee meeting in March. She showed it to a colleague here, Andreas Hornstein, who was enthusiastic and suggested that her work could be the basis of an index of the labor market as a whole, one that would give policymakers a better view of the labor market for some purposes than either the unemployment rate or the labor force participation rate. The three of them — Marianna, Fabian, and Andreas — then collaborated on an article for our scholarly economics journal, *Economic Quarterly*, setting out the methodology of the new index that became the NEI. Today, the Hornstein-Kudlyak-Lange Non-Employment Index, as it's more formally known, is part of the economic data disseminated through the St. Louis Fed's FRED database alongside more traditional labor-force metrics.

Another example of intellectual entrepreneurship here is the work by my colleague Nicholas "Nico" Trachter, whose interests include looking at how retailers set and change their prices. This is an area of obvious interest to the Fed, given our mandate to control the price changes associated with inflation. In 2013, as a professor in Rome, Italy, Nico learned about a large database of retail prices. Roughly at the same time, he met Guido Menzio, a University of Pennsylvania economist known for his work on the effects of market imperfections for macroeconomic behavior, at a lecture. They've been co-authors since then on several major pieces of work that have shed light on "price dispersion," that is, differences in prices among sellers of the same item. This research is part of a strand that is now influencing economists' view of the power of pricing behavior in driving aggregate economic activity.

What these two lines of research have in common is that they came from the bottom up. That's typical here, and there are a few reasons why we operate that way. The first is that the self-directed environment that we've had for a long time helps us compete in the marketplace for economists with top-tier research universities, where such an environment is standard. The second is that we think our economists are the best judges of where they can add value to current economic knowledge. Moreover, beyond the fact that policing research agendas is a good way to drive out the creative and productive, there isn't any real need for us to do so: We make sure to hire economists interested in the kinds of questions that are important at a Federal Reserve Bank. And finally, to ensure quality, we use the standards set by the economics profession at large, through the thresholds for publication at high-quality journals. This is a test that the Bank's research economists are expected to meet, and importantly, it's how we know that the policy advice we get is coming from the right people.

So while we believe in researcher independence, economists in our department have high expectations to meet. What we expect of each other is that we're delivering top-flight work to assist President Lacker in formulating his policy positions and that the rest of our research — the research we share with the world through journal articles, working papers, and our *Economic Brief* series — is meeting the tough standards of our peers in the economics profession. **EF**

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