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New chief rocks Minneapolis Fed

Glen Stubbe, Star Tribune

Narayana Kocherlakota cuts an unprepossessing figure as he walks amid the pillared halls of the Federal Reserve Bank of Minneapolis.

He is short, slight and walks deliberately: head slightly bowed, as if pondering statistical models that fill the 50 papers he's published as an economist.

If he seems out of place here, he is. At 46, Kocherlakota is the youngest and newest regional Federal Reserve president in the nation. He's considered one of the world's foremost macroeconomists. His studies pick a part conventional wisdom on everything from asset bubbles to the soundness of long-term stock investing. But he also has an affection for rap music, guitarist Jack White, long walks with his wife, Seinfeld reruns and pro football.

In September Kocherlakota took the helm of the Federal Reserve Bank of Minneapolis, replacing Gary Stern, the second-longest-serving regional president in Fed history. In an interview last month, his first since taking the position, Kocherlakota immediately set

himself apart from his mild-mannered predecessor by criticizing the institution that just hired him. Although he agrees the Fed needed to intervene during the financial crisis a year ago, he faults the central bank for failing to articulate its case for the colossal bailouts of Wall Street firms.

"We're still living with that failure," he said.

Though virtually unknown outside of academia, Kocherlakota represents a small but increasingly influential cadre of bright, young, opinionated academics moving to the center of the economic stage. They are openly suspicious of government's ability to bolster economic growth, while still believing that, by using mathematical models, it's possible to predict behavior and prevent the sort of speculative bubbles that led to the Great Recession, the worst economic downturn since the 1930s.

Three decades ago, Kocherlakota likely wouldn't have been considered for a top spot at one of the 12 regional Fed banks that comprise the country's central banking system. The Fed -- which sets interest rates and controls the nation's money supply -- preferred the safety of bankers and bureaucrats steeped in "real-world" experience instead of abstract theorists.

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But the financial crisis has exposed the inadequacy of both the current regulatory framework and the traditional toolkit for solving the nation's economic ills, some experts argue. The Fed has turned to thinkers like Kocherlakota who challenge conventional economic theory. Today, seven of the 12 members of the policy-setting Federal Open Market Committee (FOMC) are economists, including Federal Reserve Chairman Ben Bernanke.

"When you're entering uncharted territory, you can't just say, 'Let's do what we did last time,' because there was no last time," said John Cochrane, a finance professor at the University of Chicago. "At times like this, you need theorists."

Kocherlakota won't be a voting member of the FOMC until 2011, but Fed watchers are already combing through his writings and statements to gauge if he'll be a hawk or a dove on inflation. Those who have worked closely with him over the years insist he's not an ideologue, though his background as an economist has made him suspicious of government spending.

"He'll base his decisions on a rigorous analysis of the data," said Chris Phelan, a

longtime friend and University of Minnesota economics professor. "If the data ever said markets didn't work, then I think he would change his mind and say markets don't work."

Indeed, data is in his blood. His parents earned Ph.D.s in statistics from Johns Hopkins before teaching at the University of Manitoba in Winnipeg. As a child, Kocherlakota read biographies, from athletes to Winston Churchill to Ghandi, and for fun solved statistical problems supplied by his parents. By middle school, so far ahead of his peers, he skipped two grades. He finished high school, where he excelled in debate, in two years.

At 15, Kocherlakota enrolled at Princeton University determined to study public policy and become an attorney. But after taking a number of social science courses, Kocherlakota said he found himself drawn to the Math Department, where classes were more intimate, and, he says, "much more fun."

His junior year, Kocherlakota happened upon a book, "A Mathematical Approach to the Social Sciences." It demonstrated how formulas could explain economic behavior. "It was a huge epiphany for me," he says.

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He pursued his doctorate at the University of Chicago, which was at the forefront using mathematical techniques to build economic models. Lars Hansen, an economist there, hired Kocherlakota as a research assistant and says he was immediately impressed.

"Most [graduate students], you give them a paper to read, and they'll search for typos," Hansen said. "Give it to Narayana, and he'll find tough conceptual questions. He was not going to be a 'yes' person."

It's clear Kocherlakota won't be a rubber stamp for official government policy. Last year, he was among 270 economists who signed a petition protesting the Obama administration's economic stimulus plan. The petition, published in a number of major newspapers, was paid for by the Cato Institute, a libertarian think tank.

Kocherlakota said he signed, not necessarily because he was opposed to the stimulus plan, but because he disagreed that economists were unified behind a stimulus as good for the economy. "I didn't view that as being a settled question within the academe," he said.

In his research, Kocherlakota has a history

of staking out counterintuitive positions. For instance, in a 1996 study, he poked holes in the widely held belief that young people should own more stocks and gradually rebalance toward less-risky government bonds. He pointed out that the possibility of a disastrous decline in stock prices is exacerbated over time. "Over a 30-year period," he wrote, "the events of 1929 can occur 30 times."

Outwardly mild-mannered, Kocherlakota has said he plans to model his management style after former pro football quarterback Joe Montana, known for his ice-cool disposition. "I don't think anger serves any purpose in life," he said in an internal Fed publication. "I find it a totally wasted emotion."

He's also decisive. As chair of the University of Minnesota's Economics Department, Kocherlakota recruited multiple economists to the school at once, instead of the plodding approach previously used. Nine new hires joined the faculty in less than two years.

Were it not for those hires, the Economics Department might have attracted fewer quality students, potentially leading to a downward spiral, said several former colleagues. "The problem was, people were disagreeing over who we should get," said

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Prof. Tim Kehoe. "Narayana cut through that."

It remains to be seen how Kocherlakota's style will play at the Fed. He has already pledged to make its research -- much of it cutting-edge but full of complex equations -- more accessible to the public.

"Those equations can be translated into words -- every one of them," he said.

Within days after Kocherlakota took the position, Art Rolnick, director of research, was receiving e-mails and calls from Kocherlakota at all hours of the day -- and on weekends. "If he's got an idea, or sees something that he thinks is really interesting, then he's going to tell you about it right away," Rolnick said. "It's part of his nature."

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