

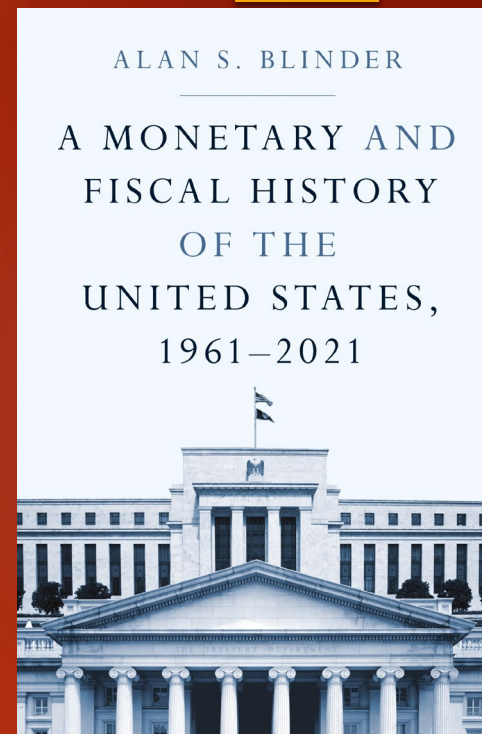
Monetary and Fiscal Policy: 60 Years of Ups and Downs

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Major question for this short talk

Which policy played first violin and which played second fiddle?

-- The roles changed multiple times over 60 years.

ALAN S. BLINDER
A MONETARY AND
FISCAL HISTORY
OF THE
UNITED STATES,
1961–2021



Kennedy, Johnson (*and Martin*)

- ▶ Fiscal policy was the big deal then; monetary policy was supposed to “accommodate” it.
- ▶ When it didn’t (because of inflation), Johnson went to war with Martin.

No conflict under Nixon-Burns

- ▶ The conflict disappeared as Nixon played both instruments.
- ▶ Burns was (too) cooperative.

Carter and Volcker: Monetary dominance

- ▶ Carter gave Volcker free rein, and Volcker used it to crush inflation.

Reagan and Volcker: The epic clash

- ▶ Volcker had started tightening monetary policy in 1979.
- ▶ Reagan's tax cuts began in 1982.
- ▶ Some results of the tight money, loose fiscal policy mix:
 - Sky-high real interest rates
 - A soaring dollar—which created the “Rust Belt”
 - A legacy of chronic, large fiscal deficits—which eliminated fiscal policy as a stabilization tool for decades.

Bush I and Greenspan: Monetary dominance redux

- ▶ A war of words, but not much action.
- ▶ Perceived need to reduce the deficit “crowded out” any thought of using fiscal stimulus to fight the 1990-1991 recession.

Clinton-Greenspan: Peace breaks out

- ▶ Deficit reduction despite nagging concerns about the economy (a negative fiscal multiplier?)
- ▶ “We don’t comment on the Fed” became the Clinton administration’s mantra
 - A huge change from previous presidents.
- The economy boomed despite fiscal contraction. Why?
 - Bond market rallied
 - Productivity surged

Bush II and the Fed: All together now

- ▶ Bush II came in with Greenspan in office. Greenspan endorsed his large “supply side” tax cuts.
- ▶ Bernanke became chair in 2006. The financial crisis struck in 2008.
- ▶ *Modest* fiscal response and *huge* monetary response
- ▶ For the first time in decades, the Fed saw/said that monetary policy was not enough.
- Bernanke’s plea: We can’t do this on our own. Help!

Obama to the rescue, then the Fed took over

- ▶ The Recovery Act (Feb. 2009) was seen as a “massive” fiscal stimulus—about 5% of GDP. But was it too little?
- ▶ After 2010, fiscal policy turned *contractionary* for several years.
 - About 1½% of GDP per year for three years running.
 - Despite urgings from Obama *and Bernanke*
- ▶ The Fed again became “the only game in town.”

Trump before Covid

- ▶ As a candidate, he berated the Fed (Yellen) for being too loose.
- ▶ As president, he berated the Fed (Powell) for being too tight.

Trump and Powell after Covid

- ▶ Congress passed gigantic fiscal stimulus in March 2020 (the CARES Act)
- ▶ The Fed threw the kitchen sink at the recession.
 - Some of it was included in CARES—small incursions into Fed independence.
- ▶ So both policies worked *strongly* together.

Biden upped the fiscal ante

- ▶ American Rescue Plan passed in March 2021.
- ▶ It was criticized for being too large—at the time and since.
- ▶ Notably, the Fed *did not* try to offset it with tighter money.
- ▶ Biden resumed Clinton's “hands off the Fed” rhetoric.

Today: Fighting inflation with monetary policy

- ▶ The Fed got started late, but has been raising rates rapidly.
- ▶ No one advocates fiscal policy to fight inflation.
- ▶ To his everlasting credit, Biden hasn't blamed inflation on the Fed.
 - Will that last if there is a recession in 2023?