

## Discussion

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In writing this paper Alan Blinder accepted a difficult charge: the issue of coordination of monetary and fiscal policy is much discussed at a shallow level but it is hard to know how to write a scholarly paper on the subject. Although I have numerous criticisms to offer, the paper is without question a stimulating one that breaks new ground in the analysis of policy coordination issues.

Blinder has chosen a theoretical approach rather than a historical and institutional one. His paper is not about actual policy, but about a framework within which actual policy in the United States or any other country might be analyzed. Given this theoretical outlook, it would have been better if he had not attached labels such as "Administration" and "Federal Reserve" to the players in his models. He should have referred simply to "policy authority A" and "policy authority B." He should have avoided making off-hand comments about the preferences and attitudes of the Administration and Federal Reserve, since he offers no supporting discussion for these comments and the paper is not really about actual policy and actual policymakers.

### *Targets and Instruments*

Blinder begins, quite naturally, with the conventional targets and instruments framework. He makes the important point that there are many fiscal policy **instruments**, such as taxes and subsidies, in addition to overall levels of government spending and taxes. And I am sure that he would not object to adding regulatory instruments to the list. With these instruments fiscal policy has enormous capacity to affect resource allocation and distribution.

That fiscal policy has allocative and distributional effects is not a

matter of dispute. But what about monetary policy? Here there is an important long-run/short-run distinction. At the level of abstraction of this paper, it seems sensible to argue that in the long-run monetary policy affects nominal magnitudes and fiscal policy real magnitudes. In the long-run, these separate effects make the coordination issue moot. The results in the DRI and MPS simulations reported by Blinder reflect, I suspect, the fact that investment and growth are not much affected by monetary policy because of the long-run near neutrality of money. There is, though, an ambiguity here because there can be an interaction between inflation and the tax system that depresses investment. But the fact that the tax system need not be neutral with respect to inflation leads me to label the real effects of higher money growth in the long-run a fiscal policy phenomenon rather than a monetary policy phenomenon.

Even if the coordination issue disappears in the long run due to the neutrality of money, there is still a short-run coordination issue that needs discussion. For there to be a coordination issue the policy ineffectiveness proposition in the rational expectations macro literature must fail. More conventionally, it must also be assumed that countercyclical stabilization policy is feasible in spite of policy lags and the inaccuracies of economic forecasts. If stabilization policy is not feasible Blinder has no paper. Even though I personally have grave doubts about the feasibility of successful countercyclical policy, for present purposes I will take the possibility as given and will go on from there.

For the most part, Blinder's analysis within the targets and instruments framework is sound. I have, however, two comments.

Blinder questions the relevance or importance of expectational effects. My analysis is different. It is not that the rational expectations hypothesis fails but rather that it is extremely difficult for policymakers to change expectations. We have an excellent current U.S. example: the 1982 tax bill reversed about one quarter of 1981's tax cut. People are well aware of the fact that tax cuts advertised to be permanent do not always turn out that way, and tax increases advertised as temporary do not always turn out that way either. In most countries the economic and political forces responsible for secular trends and cyclical responses in government policy are very deeply entrenched. When a fundamentally new policy is introduced, expectations may appear to be irrationally sticky — that is, to reflect old policies for an "unreasonably" long period of time. Thus, my analysis is that it is not that

expectational effects are unimportant but rather that it is very difficult to change expectations quickly because it is so difficult to change policy in fundamental ways.

My second comment concerns Blinder's paragraph where he argues that "the real world seems to be characterized by a shortage of instruments in the relevant empirical sense." I disagree — the problem is that the government has too many objectives rather than too few instruments.

### *Explaining Non-Coordination*

In the third section of the paper Blinder discusses three reasons why separate policy authorities may not be well coordinated. They may have different objectives, different economic models, and different forecasts. My concern about the analysis in this section is that the checks and balances justification for separate policy authorities is incomplete and perhaps wrong.

In terms of the economic theory of economic policy there can be no justification for separate policy authorities. For economic analysis to say anything about alternative governmental organizations we must be able to provide a preference ordering for the different outcomes under different policy organizations. That requires that we take the different preferences of members of the society and somehow aggregate those preferences into a social utility function. Having done that, a single coordinated policy authority will always be able to reach a result at least as good as separate policy authorities.

Precisely the same argument holds with respect to differences of opinion on economic models and economic forecasts. For example, the optimal economic forecast is obtained from a weighted average of independent forecasts with the weights depending on the forecasting accuracy of the independent forecasts. Policy administered by a single authority on the basis of this optimal composite forecast must be at least as good as the policy results obtained from independent policy authorities.

Having said all this, I nevertheless have considerable sympathy with Blinder's notion that there's a checks and balances argument for independent policy authorities. But the argument must flow from political theory rather than economic theory. What is involved, I suppose, is that we are never sure that the electoral process will return to power officials who are successful according to some social welfare

criterion and fail to return to power officials who are not successful. And what happens when the voters misjudge the person who is elected? There is the old refrain, "If only I had known, I never would have voted for the bum."

The issue here is the restraint of power rather than the optimal use of power. Multiple and partially independent policy authorities provide this restraint. The checks and balances system limits the damage from electoral mistakes.

### *Gaming*

The most interesting and innovative part of the paper involves the application of game theory to the problem of understanding what happens in a world of separate policy authorities.

To apply the game theory approach to policy formulation in the United States we will need at least three players—the Administration, the Congress, and the Federal Reserve System. In addition, it is worth emphasizing that much of the gaming we observe involves attempts by each authority to force some other authority to take unpleasant action. A major advantage of a unified authority is that responsibility is clear and gaming to shift blame is much more difficult. In contrast, policy coordination is usually not a problem when pleasant policies are involved. Each authority naturally wants to corner the kudos, but is ordinarily willing to share the credit with other authorities if necessary to obtain the implementation of popular policies.

In the classic prisoners dilemma, communication between the prisoners can lead to a superior result from their point of view. However, in economic policy, **when** the problem arises from the need for unpleasant action it is not clear that consultation among policy authorities is sufficient to produce the superior result. There seem to be cases in which no one wants to be associated with unpleasant policies even if the responsibility is shared by all policy authorities.

The difficulty here is that we are accustomed to thinking of policy authorities as acting to maximize a social welfare function which depends on how they define the "public interest." In fact, the actions of policy authorities are all too often determined by the private interest, including interest in reelection, of the authorities themselves rather than by any notion of the public interest. Even shared responsibility among authorities for unpleasant policies in the public interest may not be sufficient to overcome the private interest an individual authority may have in a different policy.

Perhaps hidden by Blinder's game theoretic structure is the fact that different policy authorities need coordination precisely because they represent different political and economic constituencies. The views of different authorities are not self-contained but are derived from these constituencies. The possibility that consultation among independent authorities may lead to a superior result tends to hide the problem that there may not be *any* effective political mechanism to provide the consultation and coordination among competing constituencies required to realize the superior solution. Pareto moves are frequently stymied by the apparent impossibility of finding a mechanism through which winners can compensate losers. Once we look behind the policy authorities to the constituencies they represent, the game theoretic approach displays the structure of the problem very clearly. It is disquieting to contemplate the possibility that in many cases there just may not be any effective political mechanism to coordinate competing constituencies.

Finally, Blinder's discussion of nonreactive policy rules is entirely within the context of his analysis of gaming issues. It is worth emphasizing that advocates of nonreactive rules have 'traditionally not been interested in issues of coordination and gaming but rather in **expectational** issues and in the restraint of government power. Blinder does not give much weight to the expectational arguments, as noted earlier, and seems to prefer a system of checks and balances based on dispersed power (which inevitably raises gaming and coordination issues) rather than on rules that limit power.

### *Conclusions*

I have gotten a lot out of reading and thinking about this paper, even though Alan Blinder may feel that I got the wrong things out of it. I have concluded that in the purely economic theory of economic policy there is no normative case for a divided policy authority. I also believe that the much discussed problem of a lack of coordination between monetary and fiscal policy is really not as serious a matter of economic theory as the volume of discussion would lead one to believe because the effects of monetary policy are primarily nominal and the effects of fiscal policy primarily real.

The real issues involve political theory. I end with some questions: In our democratic and pluralistic society, how much difference does the *form* of governmental institutions make? Does it really matter whether

or not the central bank is independent? Might not our apparent lack of policy coordination reflect the preferences **and/or** schizophrenia of the voters and the public choice mechanism rather than the nature of our governmental organization? If I may borrow Blinder's automobile analogy for a different purpose, might we not be in a car with multiple steering wheels, brakes, and accelerators without fully realizing it?