

Discussion

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Alan Blinder's paper is a very interesting and provocative *tour d'horizon* of the issues regarding coordination of fiscal and monetary policies. These issues are salient today, when these two branches of macroeconomic policy seem to be **working** at cross purposes, yielding a mix that no one regards as satisfactory. The consequences of our present separation of powers and responsibilities, compared with centralized authority, have not received sufficient attention from economic analysts. Blinder's paper clarifies the issues and uncovers some interesting possibilities — for example, that under some circumstances separation may do better than centralized authority and, on the other hand, that nonoptimal mixes of monetary and fiscal policy may result, like the superpower arms race, from a "prisoner's dilemma" game between two authorities with differing objectives. That Blinder does not reach any firm conclusions is becoming modesty, given the exploratory stage of the subject.

In addressing the question of coordination, Blinder inevitably is drawn into discussion of other issues of macroeconomic policy, issues which though related to coordination are important whether policy authority is unified or divided. I refer in particular to old issues of rules versus discretion and of fixed versus reactive rules and to the old question of the adequacy of instruments relative to goals. I begin my comments with the latter question.

Are There Enough Tools?

In his discussion of this question, Blinder begins with an optimistic answer, based on the apparent multiplicity of tools, especially fiscal tools. Later he qualifies the answer, mainly on a **kind** of Say's Law

suspicion that with every added tool policymakers will find, or will be charged with, an additional goal. I would emphasize another reason for pessimism, namely that our fiscal and monetary instruments do not have significantly differential effects on the macroeconomic variables whose values are our major objectives, namely unemployment and inflation. In the terminology of the Tinbergen-Theil model, the instruments are virtually collinear in their effects on those two objective variables; consequently we cannot, by manipulation of the **monetary-fiscal** mix, no matter how many instruments we can enumerate, obtain the desired combination of goals, say full employment and price stability. Even if this is not a permanent long-run problem it is a congenital weakness of macroeconomic policy in short and intermediate runs of great economic and political importance.

Blinder knows this too, and that is why he lumps unemployment and inflation into a single goal in the diagrams of his Section III. There neither the fiscal nor the monetary authority can control the division of the demand effects of its policies between prices and outputs. That division depends on the short-run elasticity of supply with respect to nominal demand, on the short-run Phillips tradeoff, and is the same whether spending is varied by monetary means, by fiscal means, or otherwise. The fiscal and monetary policymakers are limited to choosing where they would like to be on the economy's price-quantity **tradeoff** curve, and to balancing that indissoluble compound of outcomes against a separable goal, the investment share of output.

However, before the unwary reader reaches Section III, he or she might be led to believe that we have enough independent instruments, perhaps even enough fiscal tools without any monetary measures at all, to attain all three objectives, output, price, and capital formation. For this reason **and** for the more important reason that much current discussion of macroeconomic policy, by its official authors and by other commentators, appears to ignore the problem, I would like to discuss it further.

In what ways might monetary and fiscal policies affect differentially the **price/output** response of the economy?

For the last 10, 15, or 35 years economists and policymakers have been frustrated by their inability to break the stubborn connection of output and price levels or of unemployment and inflation by any combination of the conventional monetary and fiscal tools of **macro-stabilization**. Right now, most people mournfully agree, if we want

more output and employment in 1983 than the standard forecast we will have to accept a higher price level, a higher year-to-year inflation statistic. The division of response between prices and outputs to variation of net demand pressure is a durable structural feature of the economy. Monetary and fiscal measures affect that structure, if at all, only in the long run; differential effects are small and slow. After all, that is precisely why many of us have long believed that an additional nonredundant independent instrument is needed — incomes policy, Kennedy guideposts, TIP, whatever.

I am aware of the wedge between monetary and fiscal vectors introduced by their open-economy effects in a regime of floating exchange rates. A tight money-easy budget mix is, at least temporarily, less inflationary for the same unemployment outcome. It appreciates the currency and lowers import and export prices. I do not think this differential effect is quantitatively of great importance for the U.S., especially if feedbacks from the rest of the world are taken into account. Clearly the effect is in any case small for the OECD countries as a group and vanishes for the world as a whole.

Differential expectational effects of alternative policy mixes are another possibility. Blinder more or less dismisses these after his interesting discussion of them in Section II. What about longer-run effects via the investment-capital-productivity-wage nexus? The econometric model simulations Blinder reports he finds rather disappointing, as do I. Anyway I have always been a bit suspicious, at least agnostic, regarding the facile assumption that acceleration of productivity growth is, besides being-desirable *per se*, counterinflationary. How will the eventual improvements in real wages be split between money wage increases and price decreases? We don't have a good theoretical or empirical story.

Maybe the policy mix affects the price level, inflation rate, and unemployment rate at which the economy settles down in long-run natural-rate equilibrium. There are some interesting policy tradeoffs involved here. But they mainly have to do with the path of nominal aggregate demand, not with the mix of instruments that supports the path. There may be some role for government job-creating programs and for other measures, fiscal and maybe monetary, that affect the composition of aggregate demand.

How about "supply-side" effects other than those associated with capital formation? Labor supply, work effort, managerial and entrepre-

neurial performance? Many of the same doubts raised above would apply. These too would take a long time and have uncertain effects on nominal, as opposed to real, magnitudes.

Is There Enough Coordination?

Even if the fiscal and monetary authorities cannot affect the macroeconomic price-output supply curve, there is still, indeed there is *a fortiori*, the interesting issue of coordination. The two authorities may disagree about the terms of tradeoff, about where on it they would like to be, and about where the economy will end up under various fiscal and monetary policies. Acting independently, they may choose policy mixes that are nonoptimal by either preference set, especially if goals other than unemployment and inflation are valued. I find it highly credible that fiscal-monetary tug-of-war has over the years, spectacularly right now, led to a mix that penalizes capital formation and growth. Now the mix penalizes distributional equity as well, because the regressive tax and transfer "reforms" adopted to stimulate investment and saving are nullified by the other constituents of the policy mix.

Blinder suggests that uncoordinated policy decisions may score better than coordinated policy. This may occur if the authorities differ about models and forecasts, while reality is some probability mix of their views of the world. As I see it, this is an example of the benefits of diversification. As Bill Brainard showed long ago, when you are uncertain of the effects of instruments, you should diversify and use in some degree all the instruments available even if their number exceeds the number of targets.

Nevertheless I vote for coordination. Diversification does not necessitate decentralization, i.e., the establishment of independent centers of power each with its own bag of tools. If it did, why stop at two? Why not give each member of the FOMC a monetary instrument to control — a Bank discount rate, certain open market operations, this or that reserve requirement, one or another deposit interest ceiling? Let the Senate decide outlays, the House taxes, and the Treasury investment tax credits and depreciation allowances? One answer clearly is that there are costs and wastes in running at crosspurposes policies virtually identical in effects. We don't want to diversify across outcome preferences, anyway not with the accidental weights that weapon assignments would give the various controllers. We do want to take rational

account of the uncertainties of models, forecasts, and policy effects, but in the light of a single authoritative set of preferences over outcomes. A central policymaker can weigh these uncertainties and risks, given all the available information — the Federal Reserve's model, forecasts, and estimates of policy effects along with those of CBO, OMB, private econometricians, and sages who use pants seats and envelope backs.

Outcome preferences are essentially political. In my view they are choices that elected officials must ultimately make — in our constitutional system that means some mysterious blend of President and Congress. I have difficulty understanding the political legitimacy of the outcome preferences of the Federal Open Market Committee, much beyond the extent the Committee and its Chairman can persuade the Congress and President of their validity. The governors are far removed from responsibility to the electorate, and the bank presidents even farther. Yet I do not doubt that, like other central banks, the Fed would be very influential even if its technical independence were sacrificed to coordinated making of monetary and fiscal policy by President and Congress.

After all, monetary policy decisions are the most momentous macroeconomic decisions the federal government makes. As the Fed has become more monetarist, these decisions have become more determinative. As the structure of the banking and financial system is made more monetarist by abandonment of interest rate ceilings even on transactions money, this becomes more and more true. Moreover, let us not forget that the Fed is the "follower" in Blinder's terminology. To put the point another way, the Fed is up at bat at least 12 times to the budget-makers' once.

It seems to me anomalous that when the budget is planned and eventually voted, the process is completely detached from the gentle and amateurish surveillance the Congress exercises over monetary policy. On the one hand there are budget and tax committees; on the other hand there are banking and finance committees. Never the twain shall meet. In the course of the budget process the Congress considers and adopts a view concerning the economic forecast, because that affects budget estimates. To a lesser degree the Congress also considers the macroeconomic effects of the budget, though I am not sure they have even the signs of the relevant multipliers right all the time. Monetary policy, so decisive for the course of the economy and the

budget itself, is taken to be an uncontrollable external factor, like OPEC or Japan or demography. The possibility that the policy mix might be changed does not really get considered. It seems to me that the President and Congress should agree as to the desired path of, say, nominal GNP over the coming fiscal year, and that both the budget and the monetary policy should be in a coordinated manner committed to that target.

Are There Enough Rules?

Blinder's concluding section contains interesting material on policy rules, fixed or reactive. This is an old and complex set of issues, to which Blinder is led by the observation that the coordination problem would be solved or evaded if one or both policymakers were bound by rules and thus prevented from gameplaying. I do not have time or space to enter the big debate about rules. I confine myself to three remarks. First, I do not think that rules should be adopted simply in the interest of coordination; there are better ways to achieve coordination. Second, I think policy rules are a myth of economic theorists' simplified models. It is in practice impossible, politically in a democracy, economically in a dynamic and uncertain world, to prescribe in advance for all contingencies the behavior of future Presidents, legislators, and central bankers. It is in practice dangerous, and therefore not credible, that responsible officials will not react to the circumstances of the day as they and their constituents perceive them. It is in practice impossible to draw a line between responsive, "feedback" rules and discretion. Third, the damage which this economy and that of the United Kingdom are suffering because of self-imposed fixed rules, and self-imposed blindness to their economic effects, should make us very skeptical about proceeding further on this path.