John Taylor's Influence on Fiscal and Other Economic Policies

Michael J. Boskin
Tully M Friedman Professor of Economics
Hoover Senior Fellow

Stanford University

- Others have spoken today and will speak tomorrow commemorating John's influence on monetary policy
    - I will add a brief perspective on his (and my) development of thinking on monetary policy rules
- Again, others including Valerie, will comment in more detail on his short run fiscal policy analyses
- Others are commenting on his government service, focused on his time at the treasury in the Bush '43 Administration
- So, to avoid too much repetition I will comment briefly on some of these, but also in more detail on his time at the Council of Economic Advisers.
- Let me start with the tremendous influence of his classic paper on Staggered Contracts on Thinking about the Short Run Macro Economy
    - He provided a coherent framework for considering sticky wages, rather than just assuming it
- John was a leader in shifting the balance of thinking in the profession toward relying on monetary policy, as opposed to fiscal policy, for short-run
    - The critiques of discretionary fiscal policy are several, including lags and the risk the effect of the policy would occur late and risk an upsurge of inflation and the politicization of the policy for other purposes, rendering it ineffective and too costly.

- In his own writing and jointly with John Cogan and Volker Wieland he presented real time estimates of the effects of attempted fiscal stimulus and concluded that, despite their effects on disposable income, they had little effect on consumption (they were mostly saved) and multipliers on purchases were small (about 0.6)
    - These results have held up remarkably well in careful ex post studies; indeed, Valerie Ramey reworking several prominent studies to make them relatively consistent comes to a virtually identical conclusion; and even lower for transfers, which have dominated relative purchases in recent episodes.
- John et al. and Valerie and others have stressed the difference between permanent, predictable and temporary actions, disentangling automatic stabilizers from discretionary policy, disaggregating various types of spending.
- John on rules beyond monetary policy rules. While we were at the CEA together, we spent much time on the development of NAFTA and the WTO and the rules that would underpin them. John played a key role in preventing a trade war with Japan and in assisting the USTR in progressing the trade deals.

- We had many discussions about monetary policy rules and the old debate on rules versus discretion, monetarists vs fiscalists, Milton's money growth rule. But we also discussed and debated fiscal rules, such as balanced budget amendments, balancing the budget over the cycle, stabilization of debt/GDP ratios, etc. That led to:
  - After numerous discussions of alternatives, landing on "rules-based" as what we thought was most appropriate across all these policy areas, including for monetary policy. By that we meant rules form the foundation, and provide the compass, to be abandoned only temporally for good and transparent reasons, well explained. He has always been very proud of the fact that this was the first time it was laid out in an official U.S. government policy document.

- This also led to the idea of PAYGO rules for fiscal policy, a marginal balanced budget rule, in which tax cuts or spending increases would have to be offset. The PAYGO rule was implemented in 1990. It survived for quite some time, was abandoned briefly when the budget was finally balanced, reinstated, removed, honored at times and breached at times.
  - I am not sure whether to consider it a positive or negative that Democrats hated it because it made it more difficult to raise discretionary spending and Republicans at times deplored it for making it more difficult to cut taxes.
  - It also continued and deepened my thinking about how important it was to develop a set of measures that would be sufficient to describe the budget position, taking account of the fact that there is no mark to market adjustment, no inflation adjustment, no present value accounting, no separate budget for tangible capital, etc.

- Once the moral suasion of a balanced budget had eroded, the search for a disciplining device led to Gramm/Rudman/Hollings requiring the President to project declining deficits to a balanced budget over a few years, which led to optimistic projections, which led to extending the time frame; ditto the Maastricht rules.
- Attempts to declare line item vetoes, enhanced recission authority were stopped by the courts. A cap on discretionary spending, walling off defense, were part of 1990 budget bill, more famous for Bush agreeing to a tax hike; it came back again in 2011 following President Obama yanking the rug out from his Simpson-Bowles Commission proposal.
- Finally, on a personal, as well as professional, note it was a tremendous benefit to me to work alongside John from morning to night, day after day, for 2 years on the Council of Economic Advisers, in a very difficult political environment (Republicans had tiny minorities of 164 reps and 43 Senators) for the making of economic policy, with a recession and first Gulf War. He was of immeasurable assistance in helping steer the resolution of the saving and loan, and 3rd world debt of the money center banks, twin financial crises, helped prevent a hyper inflation in Panama after we got rid of Noriega, helped restore credible economic forecasts and much, much more that I do not have time to mention.