

## References

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***The Macroeconomics of Fiscal Policy.*** RICHARD W. KOPCKE, GEOFFREY M. B. TOOTELL and RICHARD K. TRIEST (Editors). Cambridge, MA: The MIT Press, 2006, Pp. 1X, 383. \$40.00.

During the three decades following the publication of John Maynard Keynes, "General Theory of Employment, Interest, and Money" in 1936, countercyclical fiscal policy became preferred stabilization policy among academics and practitioners. Conversely, the past four decades have witnessed the decline of fiscal policy in favor of monetary policy. However, large sustained budget deficits especially in United States made fiscal policy superior again in the eye of some economists and the macroeconomic policy option started to swing back towards a renewed consideration of fiscal policy. Thus, discussions of fiscal policy have renewed attention to the effects of fiscal deficits on macroeconomic variables.

By bringing together elite researchers and policy makers to review the efficiency and consequences of fiscal policy, this excellent book includes a great collection of papers and offers a state-of-the-art consideration of where fiscal policy stands today. Instead of examining what the theory should say about the data, this book explores what the data say about the theory. Contributors deal with the effectiveness of United States fiscal policy as a stabilization tool and the impact of fiscal decisions on macro economy in both the short run and long run.

After discussing the practical arguments against the implementation of discretionary fiscal policy, Alan S. Blinder concludes that fiscal policy's inability to accomplish countercyclical stabilization in usual circumstances means that monetary policy should be relied upon as the primary policy tool for macroeconomic stabilization: "Today's conventional wisdom holds that discretionary changes in fiscal policy are unlikely to do much good, and might even do harm" (page 52). On the other hand, Blinder indicates that the appropriate times to supplement

monetary policy with fiscal stimulus are when a recession is unusually long or deep or when short-term nominal interest rates approach zero.

Oliver J. Blanchard agrees with Blinder regarding the effectiveness of fiscal policy in stimulating aggregate demand and output in the short run and virtue of exploiting intertemporal substitution in formulating a fiscal stimulus. On the other hand, Blanchard offers the caveat that recent empirical evidence examining the effect of fiscal stimulus on output is mixed. Blanchard makes an interesting point regarding the use of automatic stabilizers: “We suffer from enormous schizophrenia in that we basically accept the automatic stabilization we have: We neither want to reduce it nor to increase it. There is absolutely no reason, however, why history would have given us the optimal automatic stabilizers” (page 64). Blanchard then makes some suggestions to improve fiscal stabilizers: “There is a distinction between truly automatic stabilizers and those that are triggered..., that depend on some aggregate measure crossing some level” (page 66).

Christopher A. Sims begins with criticizing Blinder’s analysis regarding the current consensus view on what is good macroeconomic policy. Sims claims that the growing popularity of the view that at least a portion of the fluctuation in economic activity associated with the business cycle is part of a necessary reallocation of resources is one of the reasons that resulted in countercyclical fiscal policy going out of fashion. By noting that the fluctuation also partly reflects market failure, Sims affirms fiscal policy as useful in offsetting the inefficient aspects of the fluctuation. Sims also criticizes the title of Blinder’s paper because it refers to discretionary fiscal policy although most of his text refers to countercyclical fiscal policy. Sims’ main disagreement with Blinder concerns what Sims sees as an omission: that fiscal stimulus may exacerbate “intergenerationally unfair crowding out”. Sims points out the importance of paying attention to the consequences for intergenerational equity of using fiscal policy for stabilization purposes. Sims agrees with Blanchard and Blinder that judicious use of countercyclical fiscal policy can be effective in some conditions, especially when monetary policy is less flexible and interest rates are already very low.

Alan J. Auerbach answers the question of whether fiscal policy has been used in a prudent manner. Auerbach analyzes the evolution of American fiscal policy over the post-World War II era, and illustrates how fiscal policy has helped stabilize the economy over this period.

Referring to several econometric studies, Auerbach indicates that both tax and expenditure policies respond countercyclically, with tax revenue decreasing and expenditures increasing in response to an increase in the gap between actual and potential Gross Domestic Product (GDP). Auerbach also links deviations from the estimated econometric relationships with specific historical events such as the 1993 Clinton tax increase and the 2001 and 2003 tax cuts.

James S. Duesenberry claims that the history of the major fiscal-policy changes of the past four decades shows that actual fiscal policy generally has not been good stabilization policy. Duesenberry favors adoption of fiscal policies that avoid the potential conflict between long-term objectives and short-term stabilization. To address this problem, Duesenberry would like to see greater use of semiautomatic fiscal stabilizers, such as an extension of unemployment benefits when a pre-specified trigger point is reached, along with a goal of balancing the budget at full employment.

Although he agrees with Auerbach overall conclusions, Douglas W. Elmendorf argues that fiscal policy in recent decades is best described as consisting of two major episodes of dramatic deficit increases, the tax cuts in the Reagan and the George W. Bush administrations, along with a period between these episodes of incremental adjustments toward restoring balance to the budget. Balancing the budget excluding Social Security and Medicare on average over the business cycle, and reforming the social insurance programs to achieve long-term solvency are Elmendorf's policy recommendations.

C. Eugene Steuerle reviews the post-war fiscal policy focusing on the three major tax cuts and discusses the sustainability issue. W. Elliott Brownlee, Van Doorn Ooms, and Rudolph G. Penner also analyze the fiscal policymaking process in the early Reagan years and all three authors reach common results. They conclude that fiscal policy was largely abandoned in favor of monetary policy as the primary tool of countercyclical stabilization. By focusing on the long-run implications of fiscal-policy choices, Benjamin M. Friedman notes that the economic implications of a budget deficit depend critically on whether it is transitory or persistent and claims that fiscal stimulus might be beneficial in the short run when resources are underutilized even though the long-term effects of persistent deficits are undesirable.

Barry P. Bosworth believes that the impact of the public debt needs to be evaluated in the context of how it arose, and views the deficits as a

transfer of income between generations. Susanto Basu evaluates the long-term economic consequences of persistent budget deficits as unethical because it promotes current living standards at the expense of the economic welfare of future generations. Jean-Philippe Cotis, Jonathan Coppel, and Luiz de Mello provide econometric evidence to suggest that private saving in the United States generally does not increase to offset the effects of increased budget deficits. William H. Buiter believes that the high rate of productivity growth in the United States simultaneously makes saving for the future less compelling and increases the attractiveness of the United States as a destination for foreign investment, arguably the driver of the large United States current account deficit.

Although the current account and fiscal deficits are linked through the saving-investment identity, Edwin M. Truman notes that they are not analytical or behavioral twins. Jeffrey A. Frankel compares the two twin-deficit periods by focusing on how increases in the budget deficit are split between reductions in investment and increases in the current account deficit. Catherine L. Mann points that a large portion of the fiscal deficits of recent years is due to tax cuts that have boosted consumer spending, which, in turn, has contributed to widening the trade and current account deficits. Alice M. Rivlin asserts that the only politically feasible way to reduce today's current account deficit is to solve the fiscal imbalance.

To summarize, this volume reveals, with some diversity of opinion, that monetary policy should be the main stabilization tool although fiscal policy can play a stabilizing role, particularly in relatively severe downturns and low inflation periods.

It is highly recommended for graduate, research, and professional collections.

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