ROWING TOGETHER:
LESSONS ON POLICY COORDINATION FROM AMERICAN HISTORY

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Reserve Bank of Australia and Treasury Conference
on Monetary and Fiscal Policy Interactions

September 4, 2025

I. OVERVIEW

It is a pleasure and an honor to be asked to speak at the 2025 Reserve Bank conference. It is incredibly appropriate that this year's conference is joint with the Treasury, given that the topic is monetary and fiscal policy interactions. The organizers suggested that I speak on the history of policy coordination—how it has worked in the past, lessons we have learned, and how we could do better in the future.

The topic of monetary-fiscal policy coordination is one that I have lived as a policymaker and studied as an academic. I served as chair of President Obama's Council of Economic Advisers at the start of his presidency, which was just as the 2008 financial crisis was raging and the U.S. economy was plunging. Faced with an economic crisis unprecedented in most of our lifetimes, monetary and fiscal policymakers were in close alignment. As Figure 1 shows, by late 2008 the Federal Reserve had reduced the federal funds rate from over 5% to near zero; it had also embarked on the first round of quantitative easing. The Obama administration worked with Congress to pass the American Recovery and Reinvestment Act in February 2009—just one month after taking office. At the time, it was the largest countercyclical fiscal stimulus in U.S. history. Estimates of the high-employment surplus, which adjust conventional budget estimates for the effect of automatic stabilizers, swung strongly toward a larger deficit. Both

monetary and fiscal policy were rowing as hard as possible to stabilize financial markets and stimulate aggregate demand.

Some of that policy coordination was explicit. Federal Reserve Chair Ben Bernanke and Treasury Secretary Hank Paulson had jointly gone to Congress in November 2008 to say that fiscal measures were needed to stem the crisis—that the Fed couldn't do it alone. But much of the coordination was simply born of a similar reading of the state of the economy, and a shared belief that stabilizing the financial system and stimulating aggregate demand were crucial to generating recovery.

The result of the aggressive coordinated response was very positive. U.S. GDP hit bottom in the second quarter of 2009 and started rising strongly thereafter. Job growth took longer to stabilize, but it, too, turned around by early 2010.

The 2008 experience was radically different from that of the early 1930s in the United States. The Great Depression is one of the topics I have focused on as an academic. Like the 2008 crisis, banking panics and a stock market crash played an important role in causing the 1930 downturn. In this case, monetary and fiscal policy were again in close alignment—but in the wrong direction, most notably in late 1931 and 1932.

Monetary policy, which had done little to help stem the crisis early in the Depression, turned actively contractionary in the fall of 1931. Figure 2 shows that despite unemployment at about 16%, the Federal Reserve raised the discount rate by 2 percentage points to defend the gold standard.[1] On the fiscal side, Congress enacted the Revenue Act of 1932, which remains one of the largest peacetime tax increases in U.S. history. It was

[1] The unemployment rate data are from U.S. Bureau of the Census (1975), Part 1, series D9.

designed to replace the revenues lost due to high unemployment. The high-employment surplus swung strongly toward surplus.[2]

In this case, the policy coordination was not explicit or publicly discussed. Rather, both monetary and fiscal policies were driven by a common economic model that stressed the importance of remaining on the gold standard and the value of fiscal rectitude.

The consequences of the two contractionary policy moves were just what one would have predicted. The Depression intensified, with GDP falling about a quarter from peak to trough, and the unemployment rate in the United States reached 25%.

These two examples capture one of the main themes I want to discuss this morning. It is not enough for monetary and fiscal policy to be well coordinated. They also need to be moving toward the appropriate goal. To put it another way: rowing together is great when the boat is headed in the right direction; it can be a disaster when the boat is headed in the wrong direction. Coordinated policy was a godsend in 2009; it was a tragedy in 1931.

A corollary to this fundamental point is that sometimes rowing in opposite directions can be preferable. At least then, the boat stays where it is rather than move in the wrong direction. If monetary or fiscal policy is going astray, it is vitally important that the other tool of macropolicy be *un*coordinated.

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[2] I estimate the high-employment surplus as a share of potential GDP for 1929 to 1941 using data from the Bureau of Economic Analysis for nominal GDP (NIPA Table 1.1.5), the implicit price deflator (NIPA Table 1.1.9), and total federal receipts and total federal expenditures (NIPA Table 3.2). The data are from https://www.bea.gov/data/gdp/gross-domestic-product, downloaded 9/14/2025. Specifically, I assume that potential real GDP grew at 2.5% per year and that GDP was at potential in 1929. I multiply total receipts by the ratio of potential GDP to actual GDP in each year to get an estimate of high-employment receipts. I assume that high-employment expenditures were the same as actual expenditures (because automatic spending changes were essentially nonexistent in this period). I then divide the difference between high-employment receipts and actual expenditures by potential (nominal) GDP.

American macroeconomic history is replete with examples of all types of monetary and fiscal policy coordination. Policy has sometimes been coordinated and pulling in the same direction, as it was in 2009 and 1931. Monetary and fiscal policymakers were rowing together. At many other times, policymakers were rowing in opposite directions. Sometimes monetary and fiscal policy were pulling in different directions because policymakers didn't agree. Other times, monetary and fiscal policy were pulling in opposite directions, not because they were uncoordinated, but because both policies were focused on a goal that required this behavior.

In my talk this morning, I want to discuss some of these examples in more detail. I apologize that my examples all come from the United States. As a student of American economic history, those are the cases that I know best. But I hope they will help to identify issues of broader relevance. In describing the cases I want to focus on two important 'whys'. Why was monetary and fiscal policy coordinated in some cases and not in others? And why sometimes when policy was coordinated, was it headed in the wrong direction?

I then want to use the answers to those questions to suggest how policy coordination could be improved. What institutional structures and practices are likely to enhance beneficial policy coordination? What institutional structures are needed to safeguard the ability of monetary and fiscal policy to row in opposite directions when that is preferable? And finally, I want to offer some observations from U.S. history on what is likely to be one of the most common needs for policy coordination in the coming years—fiscal consolidation. What institutions and practices might facilitate desirable and successful policy coordination in this situation?

II. ROWING IN THE SAME DIRECTION

Let me start by talking about other examples from U.S. history that involve monetary and fiscal policy being coordinated and moving in the same direction.

A. The Early Roosevelt Years

The early years of Franklin Roosevelt's presidency in the mid-1930s provide a vivid contrast to the disastrous policies of 1931. Roosevelt came into office in early 1933 in the midst of the final and most severe wave of banking panics. He immediately started taking aggressive countercyclical actions. Figure 3 shows that on the fiscal side, spending on relief and public employment pushed the high-employment surplus back into significant deficit. On the monetary side, the administration found a way to bypass the Federal Reserve (which remained recalcitrant) and increase the money supply.[3] Roosevelt got Congress to suspend the gold standard and let the dollar float. It depreciated about 40% relative to gold, which increased the value of the U.S. gold stock. This allowed the U.S. Treasury to issue many more gold certificates—a kind of currency that was used interchangeably with Federal Reserve notes. The money supply increased 20% between March 1933 and December 1934.

In this case, monetary and fiscal policy were explicitly coordinated, and both were determined by the president. This was a highly unusual development—a quirk related to the gold standard. The direction of policy was determined by ideas. Roosevelt and his advisors rejected the existing gold standard orthodoxy, which led them to devalue and increase the money supply. On the fiscal side, though their ideas were somewhat unformed, there was a proto-Keynesian notion that deficit spending could help increase

[3] See Romer (1992) for a discussion of Roosevelt's monetary and fiscal policies in 1933 and after.

output and employment by stimulating demand. For example, in a campaign speech in 1936, Roosevelt explained why he allowed the budget deficit to rise as it had, saying: "this vicious tightening circle of our declining national income simply had to be broken. The bankers and the industrialists of the Nation cried aloud that private business was powerless to break it. They turned, as they had a right to turn, to the Government. We accepted the final responsibility of Government, after all else had failed, to spend money when no one else had money left to spend."[4]

The result of the coordinated move to expansionary monetary and fiscal policy in 1933 was nothing short of spectacular. The data in Figure 4 highlighted by the yellow bar show that U.S. real GDP grew 11% between 1933 and 1934, and another 9% between 1934 and 1935. Output was still far below trend, but the change was enormous. Prices, which had been falling at a rate of roughly 10% per year in the early 1930s, stabilized almost immediately. This helped lower real interest rates and stimulate interest-sensitive spending.

B. The Mid-1960s and Early 1970s

A second episode where monetary and fiscal policy were coordinated and moving in the same direction in the U.S. was the mid-1960s and early 1970s. Figure 5 shows that both types of policy were highly expansionary, despite the economy starting near, if not at, full employment.

The fall in the high-employment surplus was fueled first by a large tax cut in 1964. Then in the mid- and late 1960s, large spending increases related to the war in Vietnam

[4] Franklin D. Roosevelt, Address at Forbes Field, Pittsburgh, Pennsylvania, October 1, 1936, https://www.presidency.ucsb.edu/documents/address-forbes-field-pittsburgh-pa.

and a large expansion in social spending (often called the War on Poverty) also swelled the deficit. In the early 1970s, President Richard Nixon further increased spending and cut taxes.

Monetary policy was also expansionary. In the mid-1960s, nominal interest rates were essentially flat, but increasing inflation meant that real rates were falling. In the early 1970s, monetary policy became deliberately expansionary. The Federal Reserve increased the money supply and lowered nominal interest rates.

Policy coordination in this period was largely implicit, and driven by similar (misguided) ideas. Fiscal policymakers initially believed in a permanent inflation-unemployment trade-off. They thought they could choose to buy permanently lower unemployment with a little more inflation. For example, in making the case for what became the 1964 tax cut, President John F. Kennedy said: "America has enjoyed 22 months of uninterrupted economic recovery. But recovery is not enough. If we are to prevail in the long run, we must expand the long-run strength of our economy. We must move along the path to a higher rate of growth."[5]

Later, fiscal policymakers switched to a natural rate view of unemployment, but with an unrealistically low estimate of normal unemployment. So, even though unemployment was below 4%, they thought there was room to expand without generating inflation. Monetary policymakers had a similarly unrealistic estimate of the natural rate, which led them to keep expanding as well.

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[5] John F. Kennedy, "Annual Message to the Congress on the State of the Union," 1/14/63, https://www.presidency.ucsb.edu/documents/annual-message-the-congress-the-state-the-union-3. See Romer and Romer (2002) for a discussion of the evolution of policymakers' ideas in the 1960s and 1970s.

The policy coordination became more explicit in the early 1970s when Arthur Burns became Federal Reserve chair. Burns, who was a close ally of President Richard Nixon, acquiesced to the president's demands for monetary expansion to aid his reelection prospects. Ideas were also important. Burns convinced himself and others that it was futile to run tight monetary policy because inflation was relatively unresponsive to slack in the labor market. For example, the FOMC *Historical Minutes* describe Burns as believing that "monetary policy could do very little to arrest an inflation that rested so heavily on wage-cost pressures. In his judgment a much higher rate of unemployment produced by monetary policy would not moderate such pressures appreciably."[6] This led him to favor loose monetary policy, together with wage and price controls.

The result of this coordinated expansionary policy at a time when aggregate demand was already strong was that inflation rose substantially. Figure 6 shows that core inflation rose from just over 1% in 1963 to 5% by the end of 1971.

C. The Covid-19 Pandemic

The pandemic is my third example of highly coordinated, unidirectional monetary and fiscal policy. Like the Great Depression era, it includes both successful and unsuccessful coordinated policy in one episode.

The data highlighted by the yellow ovals in Figure 7 show that early in the pandemic both monetary and fiscal policy were highly expansionary. Interest rates were dropped rapidly back to zero and quantitative easing was restarted. The fiscal expansion in the U.S. was enormous—almost three times as large as the 2009 Recovery Act. The coordination

[6] Arthur F. Burns, *Historical Minutes of the Federal Open Market Committee*, 6/8/1971, p. 51, https://www.federalreserve.gov/monetarypolicy/files/fomcmod19710608.pdf .

in this case was largely the result of the extraordinary circumstances. The fragility in financial markets and terror among the public led to an aggressive policy response.

The coordinated response initially proved quite effective in the United States. The collapse in output and employment was quickly halted and some of the extreme initial declines were reversed. Inflation remained low.

But as the pandemic dragged on, the coordinated expansionary policy response became more problematic. The green ovals in Figure 7 show that both monetary and fiscal policy in the U.S. remained highly expansionary for an extended period. The Biden administration, which came into office in early 2021 when recovery was well underway, passed an additional $2 trillion fiscal expansion. The Federal Reserve continued with QE and a zero policy interest rate for a solid year after inflation began to rise sharply.

Common ideas played an essential role in the continued coordinated expansion. Both monetary and fiscal policymakers treated the pandemic largely as a shortfall in aggregate demand, rather than primarily as a public health crisis. They also believed that inflation was relatively impervious to the state of the economy—that is, that the Phillips Curve was very flat.[7] This is an idea reminiscent of Arthur Burns's view that slack didn't matter. They convinced themselves that they could run expansionary policy to reduce unemployment and solve other problems, with little or no cost in terms of inflation.

These ideas led the Federal Reserve to revise its policy framework in late 2020 to put more emphasis on the employment side of their dual mandate. For example, Fed Chair Jerome Powell, in announcing the new framework said: "With regard to the employment side of our mandate, our revised statement emphasizes that maximum

[7] See Romer and Romer (2024) for evidence of the Federal Reserve's beliefs in this period.

employment is a broad-based and inclusive goal. This change reflects our appreciation for the benefits of a strong labor market, particularly for many in low- and moderate-income communities."[8] Monetary policymakers embraced the view that a hot labor market was good for society and reasonably costless. The Fed may also have been responding to social developments unique to the U.S. This was the height of the Black Lives Matter movement and there was widespread concern about rising inequality.

Subsequent developments proved that the ideas and policies of the late pandemic period were mistakes. Large transfer payments and low interest rates made people want to spend at a time when many of the goods they wanted to buy were in short supply. Figure 8 shows that inflation soared in 2021 and 2022—reaching its highest level since the 1970s.

D. Lessons and Implications

So, what do we learn from these examples of policy coordination where monetary and fiscal policy were rowing in the same direction? The most fundamental point is very simple: policy coordination does not ensure success. It is not enough for monetary and fiscal policy to be rowing together. They need to be pulling in the appropriate direction. In 1931, the 1960s and early 1970s, and late in the pandemic, policy was highly coordinated and rowing in the same direction—and that caused significant problems. In one case, coordinated policy greatly exacerbated a downturn, and in the other two it contributed strongly to inflation.

The three success stories are all related to dealing with large contractionary shocks: 1933 (late in the Great Depression), 2008–2009 (the global financial crisis), and 2020

[8] Jerome Powell, New Economic Challenges and the Fed's Monetary Policy Review, Jackson Hole Symposium, August 27, 2020, https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm.

(the early pandemic). In each case, coordinated monetary and fiscal expansion played a crucial role in aiding recovery, and did not set off unwanted inflation. Perhaps it is not surprising that the three success stories involved large negative shocks. Cataclysmic shocks have a way of concentrating policymakers' minds and overcoming barriers to coordinated action. Faced with a crisis, policymakers tend to act similarly, and typically get the direction of action right—perhaps because the appropriate direction is not at all subtle.

The fact that coordinated policy has often gone seriously astray in modern U.S. macrohistory should be sobering. It suggests that getting policy right is difficult, and there is no strength in numbers. Just because the central bank and the treasury agree doesn't mean that policy is headed in the right direction. Likewise, policymakers in different countries should be cautious about mimicking others. In the early 1930s many countries followed the U.S. into the Depression by replicating our policy mistakes. And in the 1970s, countries throughout the world followed the U.S. in running inflationary monetary and fiscal policies.

A second main lesson is that economic ideas play a crucial role in driving both policy coordination and the ultimate direction of policy. In a series of papers from the early 2000s, David Romer and I showed that certain key economic ideas played a fundamental role in the macroeconomic policies chosen (see Romer and Romer, 2002 and 2004, and Romer, 2005). Table 1 summarizes our findings. Among the crucial ideas are whether policymakers understood the natural rate hypothesis and had a realistic estimate of normal unemployment. A related crucial idea was an understanding that economic slack would indeed eventually reduce output and inflation (and that a lack of slack would spur

inflation). We showed that sensible ideas about how the economy operates among policymakers have been strongly correlated with desirable outcomes.[9]

Ideas tend to lead to policy coordination because they flow freely across policymakers—including not just across agencies, but also across borders. And *bad* ideas lead to coordinated policy rowing in the wrong direction.

The crucial role of ideas in bringing about policy coordination and setting its direction suggests the value of constantly evaluating and improving our economic models. Both monetary and fiscal policymakers need to frequently update their frameworks. This means that policymaking and research cannot be separated. Central banks and treasuries need to be in contact with academics and private-sector economists to understand when their models and ideas need to evolve—so, conferences like this one are clearly a great idea.

And policymakers should be chosen, at least in part, based on the soundness of their ideas and their willingness to engage with fundamental questions about how the economy operates. If we want policy to row together in the right direction, we need policymakers with sensible and accurate economic models based on facts and research, not on hope and ideology.

III. ROWING IN OPPOSITE DIRECTIONS

So far, I have discussed examples where monetary and fiscal policies in the U.S. have been pulling in the same direction. Such policies are inherently coordinated—either explicitly or implicitly. I want to turn now to examples where monetary and fiscal policies

[9] Many other scholars have also emphasized the role of economic ideas in determining fiscal and monetary policy. See, for example, Mayer (1998) and Nelson (2005).

have pulled in opposite directions in terms of their aggregate demand consequences—where they have been rowing apart. I will start with some cases where rowing apart reflected a lack of coordination.

A. The Volcker Disinflation

The most extreme and famous case of rowing apart in the United States is the Volcker disinflation. In October 1979, Federal Reserve Chair Paul Volcker embarked on a fairly radical program of monetary contraction to reduce inflation. Figure 9 shows that in just a matter of months, the federal funds rate rose more than 6 percentage points. And, after a brief loss of focus in mid-1980, the Fed raised rates further and kept them very high for most of the next two years.

The Federal Reserve's actions were motivated by their ideas about the costs of inflation and how the economy worked. From Volcker's previous speeches, writings, and confirmation testimony, it was clear ex ante that he possessed a straightforward aggregate-demand-based model of the economy that included the key ideas we found to be associated with successful policy. He had a realistic estimate of the natural rate of unemployment, a conviction that inflation was costly, and a firm belief that tight monetary policy would reduce it.[10]

In contrast to Volcker's contractionary monetary policy, fiscal policy became strongly expansionary with President Ronald Reagan's inauguration in early 1981. Reagan had run for election on a large tax cut. The motivation was the idea that a substantial cut in marginal tax rates would set off a supply-side boom. The tax cut was

[10] See Romer and Romer (2004) for discussion of Volcker's economic beliefs prior to becoming Fed chair.

phased in gradually; it reduced the high employment surplus as a share of GDP by about 2 percentage points over three years.

Fiscal and monetary policy were pulling in very different directions in part because policymakers had different ideas about how the economy operated. They also clearly had different policy priorities. Volcker was strongly focused on reducing inflation; Reagan was more focused on long-run economic growth.

Figure 10 shows that the result of monetary and fiscal policy rowing in opposite directions in this case was that output fell and unemployment rose, but presumably not as much as it would have if fiscal policy had also been contractionary. The combination of very tight monetary policy and loose fiscal policy caused interest rates to rise dramatically. High rates caused serious strains in international debt markets, which threatened financial stability. Indeed, that is what eventually got Volcker to back off somewhat.

Volcker succeeded in getting inflation down. Inflation fell from over 10% in 1979 to less than 4% in 1983. There can be little doubt that had monetary policy rowed in the same direction as Reagan's tax cut this reduction would not have happened.

B. <u>The Post-Pandemic Disinflation</u>

The U.S. is currently living through a second case where monetary and fiscal policy have been rowing in opposite directions. Figure 11 shows that following the post-pandemic surge in inflation, the Federal Reserve began raising interest rates strongly in 2022. The funds rate rose from roughly 0 to 5% in less than a year. At the 2022 Jackson Hole Symposium, Federal Reserve Chair Jerome Powell took responsibility for the inflation and pledged to use the Fed's tools to get it down. He said:

> Restoring price stability will take some time and requires using our tools forcefully to bring demand and supply into better balance. Reducing inflation

> is likely to require a sustained period of below-trend growth. Moreover, there will very likely be some softening of labor market conditions. While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation.[11]

The Fed has since resisted calls from President Trump to lower rates, citing elevated inflation and the likely effects of widespread tariff increases.

The Fed's economic ideas have clearly evolved since their 2020 framework review. At this year's Jackson Hole meeting, Chair Powell said they were abandoning many of the changes they had made in the last review.[12] They are moving to a more conventional view of what monetary policy can accomplish and are putting the employment and inflation mandates back on a more equal footing.

Figure 11 shows that fiscal policy has been highly expansionary over the same time period that monetary policy has been tightening. The high-employment surplus fell from roughly 4% of GDP at the beginning of 2022 to more than 6% of GDP in 2023. Moreover, President Trump just signed a substantial tax cut. That action is expected to increase the deficit (as a share of GDP) in 2027 by roughly 2 percentage points relative to the CBO's January 2025 baseline.[13] Like much in Washington these days, the motivation for the tax cut is somewhat mysterious. To the degree that there is an economic idea behind it, it is the old notion of the incentive effects of lower marginal rates. But a better explanation might just be political expediency.

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[11] Jerome Powell, "Monetary Policy and Price Stability," Jackson Hole Symposium, August 26, 2022, https://www.federalreserve.gov/newsevents/speech/powell20220826a.htm.
[12] Jerome Powell, "Monetary Policy and the Fed's Framework Review," Jackson Hole Symposium, August 22, 2025, https://www.federalreserve.gov/newsevents/speech/powell20250822a.htm.
[13] U.S. Congressional Budget Office, "Estimated Budgetary Effects of Public Law 119-21, to Provide for Reconciliation Pursuant to Title II of H. Con. Res. 14, Relative to CBO's January 2025 Baseline," July 21, 2025, https://www.cbo.gov/publication/61570.

Figure 12 shows that the effect of monetary and fiscal policy rowing in opposite directions is that the U.S. economy is roughly staying in place. Growth has slowed from about 2½% per year to 1 to 1½%, and the unemployment rate has risen by 7/10 of a percentage point since 2022. This is likely due in part to high interest rates, but so far, the U.S. economy has been quite resilient.

Inflation has come down a lot. Core PCE inflation peaked at close to 6% in early 2022 and is now at 2½ to 3%. However, inflation has proven quite stubborn about going all the way back down to the Fed's 2% target. As in the Volcker episode, had monetary policy done what President Trump wanted, inflation would almost surely have risen. Inflation expectations have been very twitchy in the United States—suggesting that economic agents are unsure of where policy is heading. A big move toward monetary expansion could have been very destructive. We will likely get a chance to see just how destructive next May when Powell's term ends and President Trump gets to nominate his replacement (or even sooner if the President succeeds in removing another Fed governor, as he is trying to do).

C. Lessons and Implications

The main thing we learn from these examples of uncoordinated policy is that sometimes a lack of coordination can be a blessing. This is an important corollary to my first lesson that policy coordination does not ensure success. Volcker and Powell helped prevent much worse outcomes by refusing to follow the lead of expansionary fiscal policy in 1981 and 2023–2025.

One thing that prevented coordination was the fact that the ideas of the two types of policymakers were very different in these episodes. This reinforces the notion that similar

economic ideas are a common source of policy coordination, and that independence of thought across policymakers can be very valuable. It also reinforces the importance of policymakers constantly seeking to improve their model of how the economy operates.

Finally, these two examples of rowing apart emphasize the value of central bank independence. In the two episodes I described, monetary policymakers didn't have to go along with the direction of fiscal policy precisely because the Federal Reserve is highly independent. Strong central bank independence allows monetary policy to move in an opposite direction when that is desirable. This is a crucial safeguard against policy coordination in the wrong direction—and one that is sadly under attack in the United States.

IV. ROWING APART ON PURPOSE

The two examples of rowing apart that I just discussed involved uncoordinated policy. If you want, monetary and fiscal policymakers were rowing in different directions because they couldn't agree. The last two examples I want to discuss involve rowing apart on purpose: cases where monetary and fiscal policy were pulling in opposite directions in terms of aggregate demand, but policy was highly coordinated. In these cases, policymakers were aligned in their goals and theory of the case, but the situation, they believed, called for rowing apart.

A. The Clinton Fiscal Consolidation

The key example comes from 1993-94—the start of the administration of President Bill Clinton. Clinton had run on a middle-class tax cut and greatly increased spending focused on job training, health care, education. A crucial subset of Clinton's advisors,

including his Treasury Secretary, were very concerned about the high budget deficit.[14] They had the idea that fiscal responsibility could lower long-term interest rates and help private investment. Alan Greenspan, who was Fed chair at the time, also wanted fiscal consolidation. He was invited to the White House to talk with the president. Greenspan argued that debt and deficits were a threat to growth and financial stability. The deficit hawks succeeded in convincing Clinton to abandon his tax cut idea and push instead for a substantial tax increase. They also got him to greatly lower his spending plans to just a few token programs.

In August 1993, Congress passed a significant deficit reduction bill. The bottom yellow oval in Figure 13 shows that the high-employment surplus as a share of GDP quickly rose by more than a percentage point. On the monetary side, policy remained fairly easy. Greenspan famously accepted an invitation to sit with First Lady Hillary Clinton at the speech where the President announced the deficit reduction package. This was viewed as a strong signal of support.[15] In the transcripts of Federal Reserve discussions, it is clear that monetary policymakers changed the direction of policy toward ease. Prior to the tax increase, monetary policymakers had been signaling their concern about inflation. The funds rate was low coming out of the 1990 recession, but in May of 1993 they had switched to an asymmetric directive in favor of tightening. The Fed was widely expected to start raising the funds rate. But, with the passage of the fiscal contraction, they switched back to a symmetric directive and put off raising the funds rate for about six months.[16]

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[14] For a detailed account of the early budget decisions of the Clinton administration see Harris (2005).
[15] See Berry (1993).
[16] The *Transcripts of the Federal Open Market Committee* for the August 17, 1993 and the September 23, 1993 FOMC meetings (https://www.federalreserve.gov/monetarypolicy/fomchistorical1993.htm) provide a good discussion of the fiscal package and the appropriate response of monetary policy.

Policy was pulling in different directions in terms of aggregate demand, but the goal was similar: more balanced policy with a smaller deficit. This was a case of direct (if perhaps tacit) coordination. And ideas were crucially important. Ideas about how deficits affected the economy were the driving force for both monetary and fiscal policy.

As it turned out, the coordinated rowing apart was quite successful in this case. The budget deficit came down dramatically, swinging eventually to an actual surplus—the last time in U.S. history. Real GDP growth accelerated strongly. The data highlighted by the yellow bar in Figure 14 show that the unemployment rate fell and inflation remained low. Long-term interest rates did indeed drop—that is, there was a noticeable flattening in the term structure. While policy likely contributed to these positive developments, luck also played an important role. The U.S. economy experienced a positive supply shock in the form of a slowdown in health care costs, which helped slow inflation. And the diffusion of computer technology is thought to have driven a surge in productivity.

B. <u>The George H. W. Bush Tax Increase</u>

The 1993 example echoes strongly the anti-deficit measures taken under the first President Bush in 1990. Despite having pledged "Read my lips, no new taxes," President George H. W. Bush did just that in October 1990. The policy was motivated by the idea that deficits are costly, and that it was irresponsible to let them persist. Democrats held Congress and would not cut spending unless revenue increases were also part of the package. So political considerations were also important.

The bottom green oval in Figure 13 shows that the high-employment surplus swung strongly toward contraction. In response to the contractionary fiscal actions, monetary policy explicitly rowed in the opposite direction. The transcripts of the FOMC meeting the

day before the budget bill was to be voted on show Federal Reserve Chair Alan Greenspan trying to convince his committee that the budget agreement was a significant fiscal contraction and they needed to counteract it. He said: "what I would recommend at this particular stage, in the context of all of this, is that we go asymmetric toward ease today with an understanding that if the budget resolution passes we go down 25 basis points."[17] Greenspan recommended and got a conditional rate cut. That is, the FOMC voted to cut rates *provided* the budget agreement passed.

Greenspan's reasoning reflected a very conventional and sensible model of how the economy operated. Deficit reduction was good for the long-run health of the economy and the stability of financial markets, but it would lower aggregate demand and cause a short run fall in GDP if they didn't counteract it with monetary ease.

The data in Figure 14 highlighted by the green bar show that as it turned out, the U.S. economy was already headed into recession before the budget agreement passed. So the tax increase was somewhat poorly timed. But the monetary loosening helped cushion the contractionary impact. The 1990-91 recession in the U.S. was relatively mild.

C. Lessons and Implications

These two examples of monetary and fiscal policy rowing in opposite directions but toward a coordinated goal are especially important because they capture a situation likely to arise frequently in coming years. Debt-to-GDP ratios have surged throughout advanced economies in the wake of the global financial crisis and the Covid-19 pandemic. Figure 15 shows that in the OECD, the average debt-to-GDP ratio has increased from under 40% in

[17] *Transcript of the Federal Open Market Committee*, 10/2/1990, p. 41, https://www.federalreserve.gov/monetarypolicy/fomchistorical1990.htm.

1990 to over 100% in 2023. The IMF (2025) also finds this happening to a lesser but still significant extent in emerging economies. As a result, moves to fiscal austerity are likely to be necessary in many countries.

The U.S. experience of coordinated monetary and fiscal policy in the 1990s may provide useful lessons. One lesson is (again) that ideas about how the economy operates matter tremendously. And an independent central bank can be an important source of good ideas. In both the 1990s episodes, Federal Reserve Chair Alan Greenspan discussed concerns about large budget deficits with the administration. That is a perfectly acceptable role for an independent central bank. Independence does not mean that monetary officials cannot communicate with fiscal policymakers. It means the central bank is free to act in the way that it believes appropriate after careful discussion with all sources of information.

For countries like the United States, the largest risk of persistent high deficits and a rising debt-to-GDP ratio is the increasing threat of a widespread turn against our government debt—an event that would have dire implications for financial stability worldwide. Central banks and treasuries could aid the discussion by using their extensive research capabilities to investigate these and other risks. The impact of large deficits on interest rates, exchange rates, and financial risk are all crucial, but understudied topics.

A second lesson is that monetary policy has an important role to play in lessening the impact of fiscal consolidation. The Clinton boom notwithstanding, academic research on the contractionary impact of fiscal austerity is very solid. A pioneering study by researchers at the IMF (2010) showed that fiscal austerity is clearly contractionary. It found that an exogenous fiscal consolidation of 1% of GDP typically reduces GDP by ½% and raises the unemployment rate by 0.3 percentage points. Monetary policy is a powerful

counteracting tool, particularly when policy is not constrained by the zero lower bound. So coordinated fiscal consolidation and monetary expansion is exceptionally valuable.

A third lesson is that an independent, reliable fiscal scorekeeper is vital. I am perhaps unusually attuned to this issue because of recent moves in the United States to politicize the statistical agencies. For monetary policy to be able to play its counteracting role for fiscal austerity, policymakers need accurate information about the true stance of fiscal policy.

There is yet another case from American history that emphasizes this point. In the late 1960s, Federal Reserve Chair William McChesney Martin led the Fed to hold back on tightening monetary policy to address inflation. His argument was that the Johnson administration promised to tighten fiscal policy instead. But the administration did not follow through. Moreover, there is evidence that the administration found ways to hide the costs of the Vietnam War and so minimized the reported size of the positive fiscal impulse. Martin greatly regretted his decision, and the result was a substantial rise in inflation.[18] For monetary and fiscal policy to coordinate on fiscal austerity, both sides need to have data on fiscal policy that they can trust.

V. CONCLUSIONS

This morning, I have taken you on quite a tour of U.S. policy history. I have tried to use that history of monetary and fiscal policy coordination in the United States to identify some of the challenges and to suggest ways to do better in the future. A few central lessons stand out.

[18] For a good summary of Martin's response to fiscal expansion and rising inflation, see Marsh (2022). For evidence on the incorrect estimates of the war spending, see U.S. Joint Economic Committee (1967).

Lesson 1: Policy coordination is not enough to ensure good outcomes. Policymakers not only need to row together, they also need to row in the right direction or toward the appropriate goal. American economic history is full of examples of highly coordinated monetary and fiscal policy that turned out poorly, and examples of uncoordinated policy that turned out better than the likely coordinated alternative. Coordinated policy has been most successful in dealing with large negative shocks and with counteracting fiscal retrenchment with monetary ease.

Lesson 2: Economic ideas matter. Policymakers' understanding of how the economy operates is a key determinant of the direction of policy actions. And common ideas across monetary and fiscal policymakers are a frequent source of policy coordination. This suggests that *sensible* economic ideas are crucial. Policy has gone astray when policymakers had a flawed understanding of how the economy operates. So, a key criterion for choosing policymakers should be the quality of their economic framework or beliefs. Central banks and treasuries can play a valuable role in generating better frameworks through research and active engagement with academics and private sector analysts.

Lesson 3: Because policy mistakes happen, central bank independence is vital. An independent central bank is more likely to avoid passively going along with others' bad ideas. And it is more likely to generate a sensible, evidence-based economic framework, which should help it avoid policy missteps. Independence also allows monetary policy to decouple from fiscal policy when needed. It can forge its own path to counteract destructive fiscal actions. Never has this lesson be more important than in the U.S. today—where Federal Reserve independence is under extreme threat.

Lesson 4: Successful policy coordination requires accurate data and honest budget information. Monetary policy has a crucial role to play in offsetting fiscal policy mistakes or supporting fiscal consolidation. But for it to do this, policymakers must have an accurate picture of where the economy is and the true fiscal impulse. So protecting these crucial inputs to the policymaking process is vital for successful outcomes.

I hope these big-picture lessons from history about monetary and fiscal policy coordination provide a useful starting point for today's conference. I look forward to diving into many of the other crucial issues related to monetary and fiscal policy interactions over the coming sessions.

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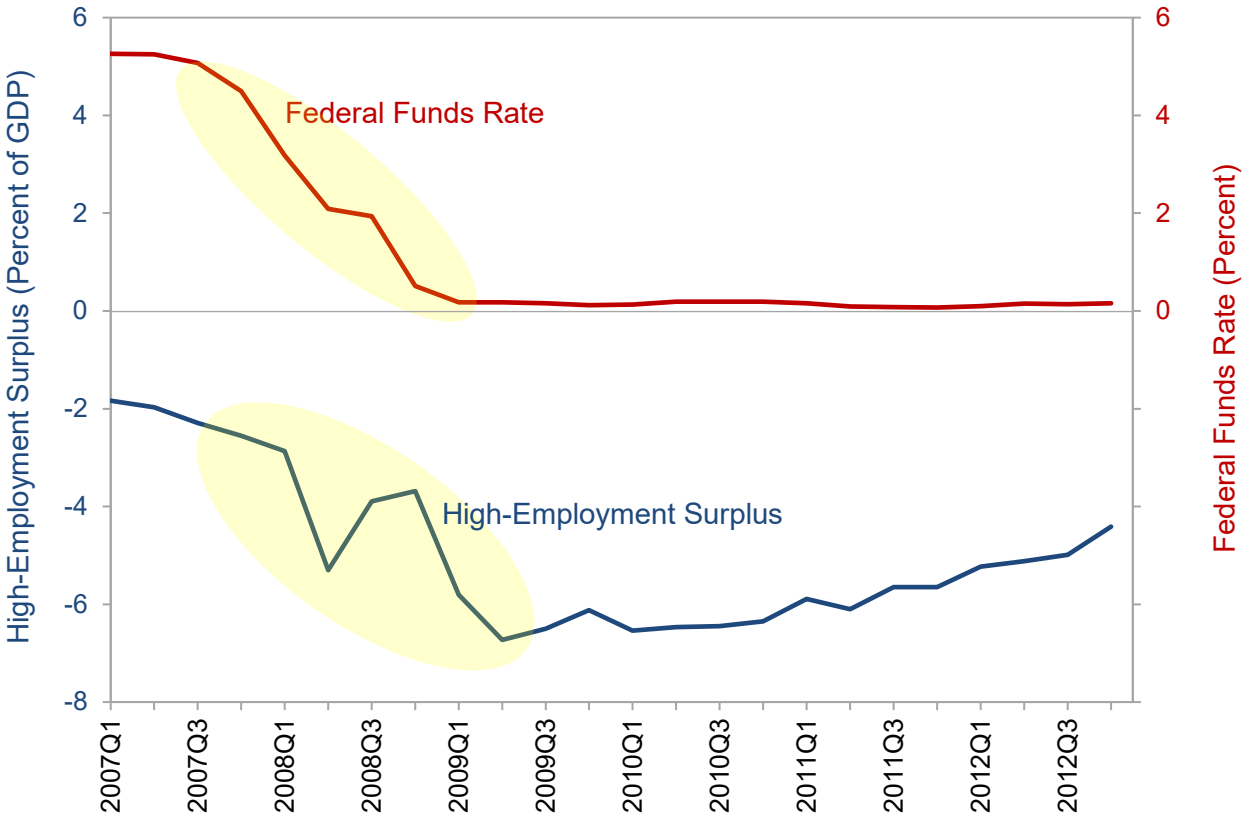
Figure 1

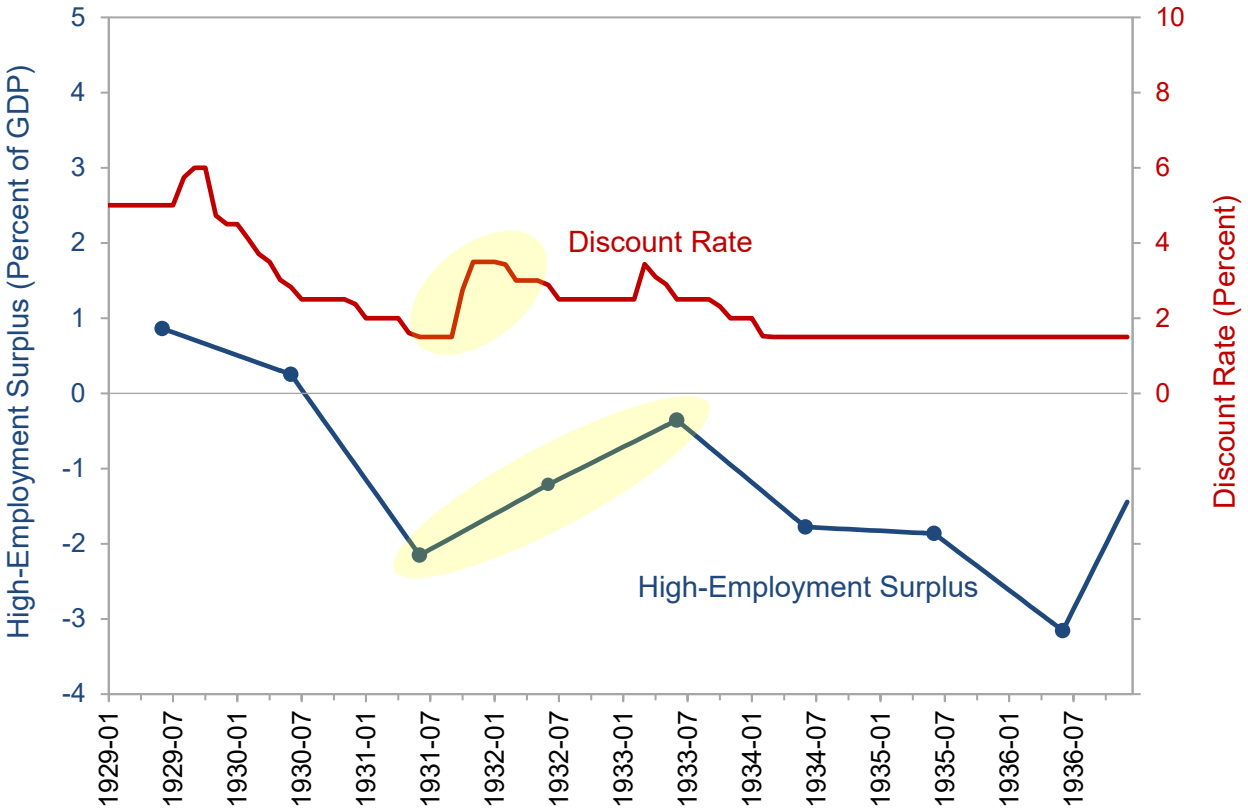
U.S. High-Employment Surplus and Federal Funds Rate, 2007–2012



Sources: The federal funds rate data are from the U.S. Board of Governors of the Federal Reserve System, series FEDFUNDS, retrieved from Federal Reserve Economic Data (FRED), 8/2/2025. The high-employment surplus data are from the U.S. Congressional Budget Office, https://www.cbo.gov/data/budget-economic-data#8, Estimates of Automatic Stabilizers, Nov. 2024, "5. Quarterly - % of GDP," series surplus without automatic stabilizers.

Figure 2

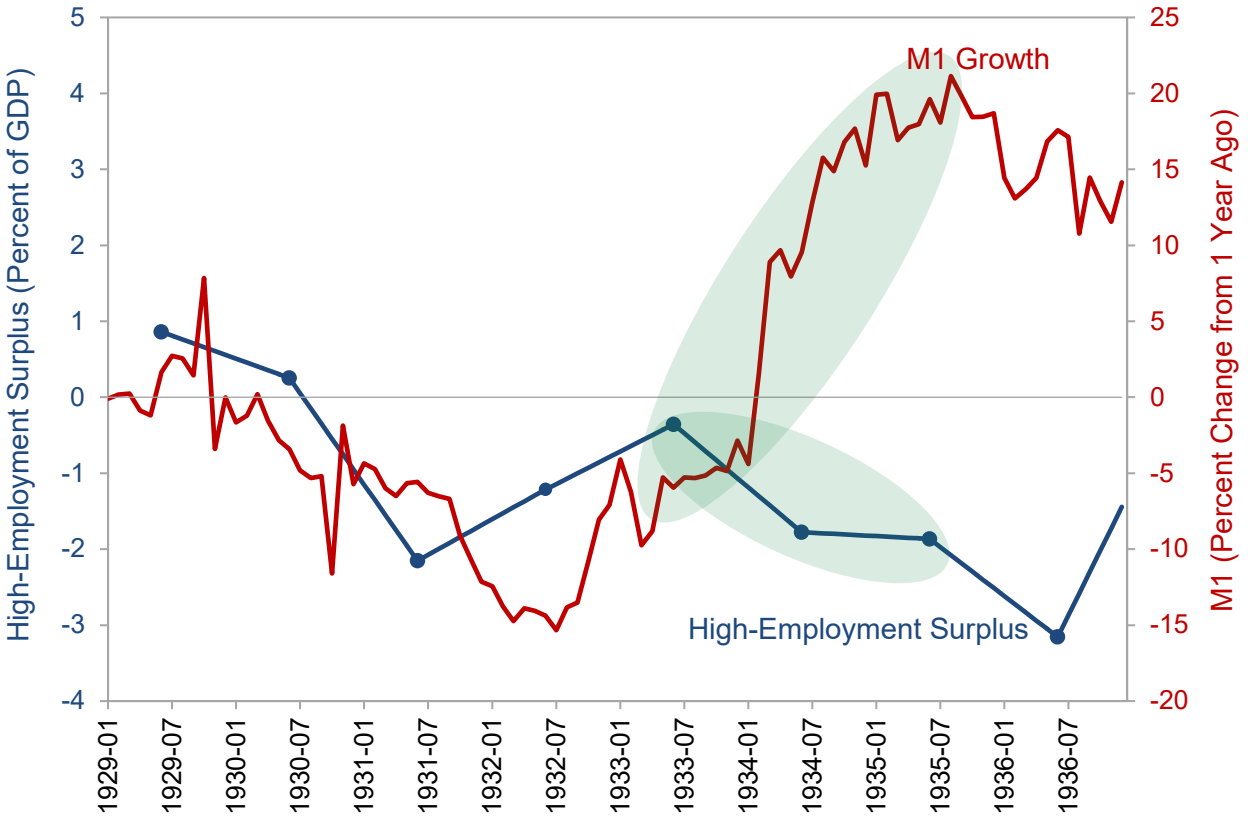
U.S. High-Employment Surplus and Discount Rate, 1929–1936



Sources: The monthly discount rate data are for the Federal Reserve Bank of New York, series M13009USM156NNBR, retrieved from FRED 8/4/2025. The high-employment surplus series is annual, and is based on data from the U.S. Bureau of Economic Analysis and author's calculations. See text for details.

Figure 3

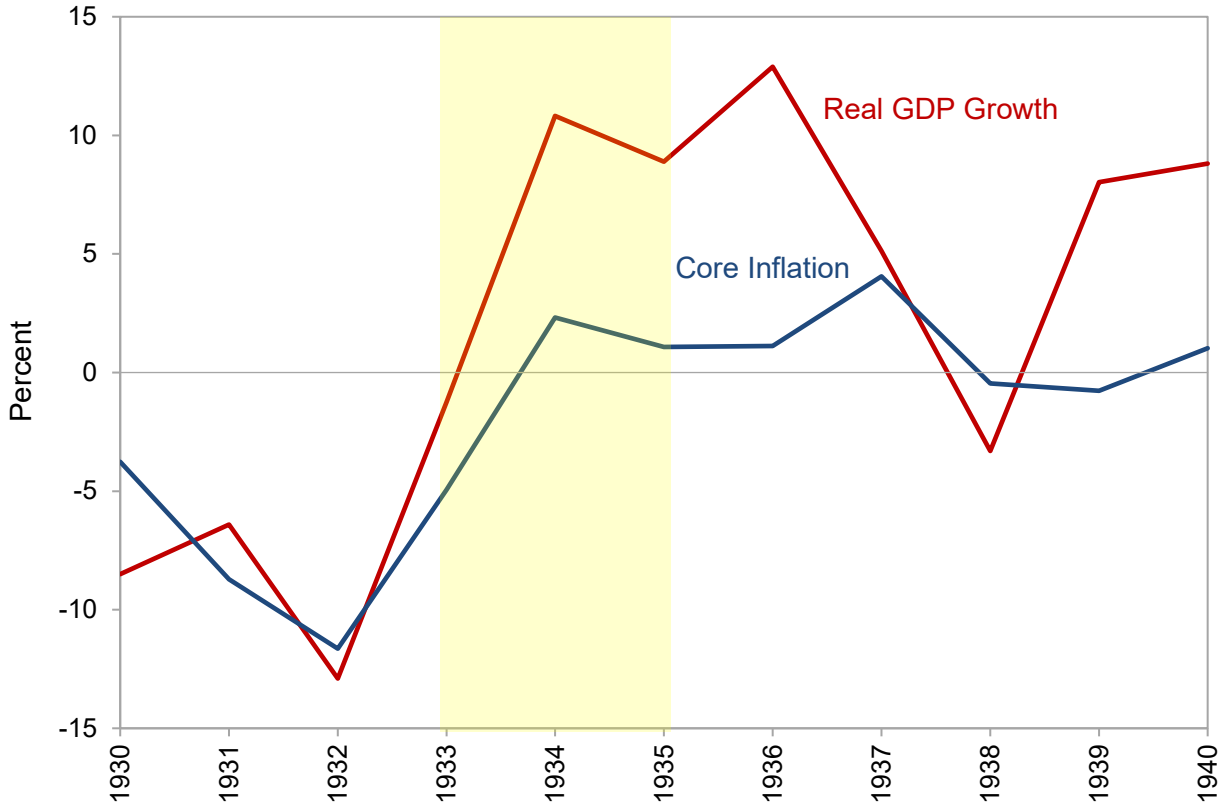
U.S. High-Employment Surplus and Money Growth, 1929–1936



Sources: The data on M1 growth are from Friedman and Schwartz (1963), Table A1. The high-employment surplus series is based on data from the U.S. Bureau of Economic Analysis and author's calculations. See text for details.

Figure 4

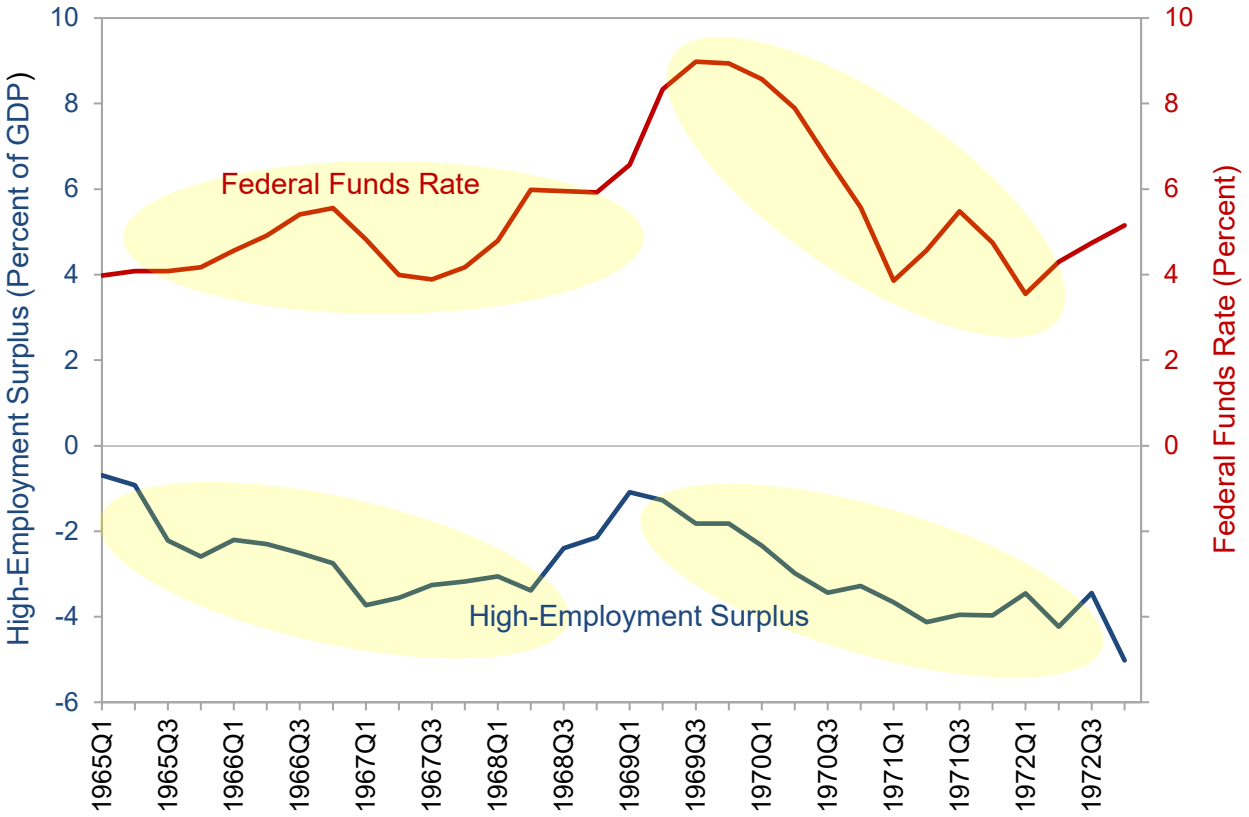
Real GDP Growth and Core Inflation, 1930–1940



Sources: The real GDP data are from the U.S. Bureau of Economic Analysis, NIPA Table 1.1.6, downloaded 9/15/2025. The series for core inflation is based on the PCE price index less food and energy, also from the BEA, NIPA Table 2.3.4.

Figure 5

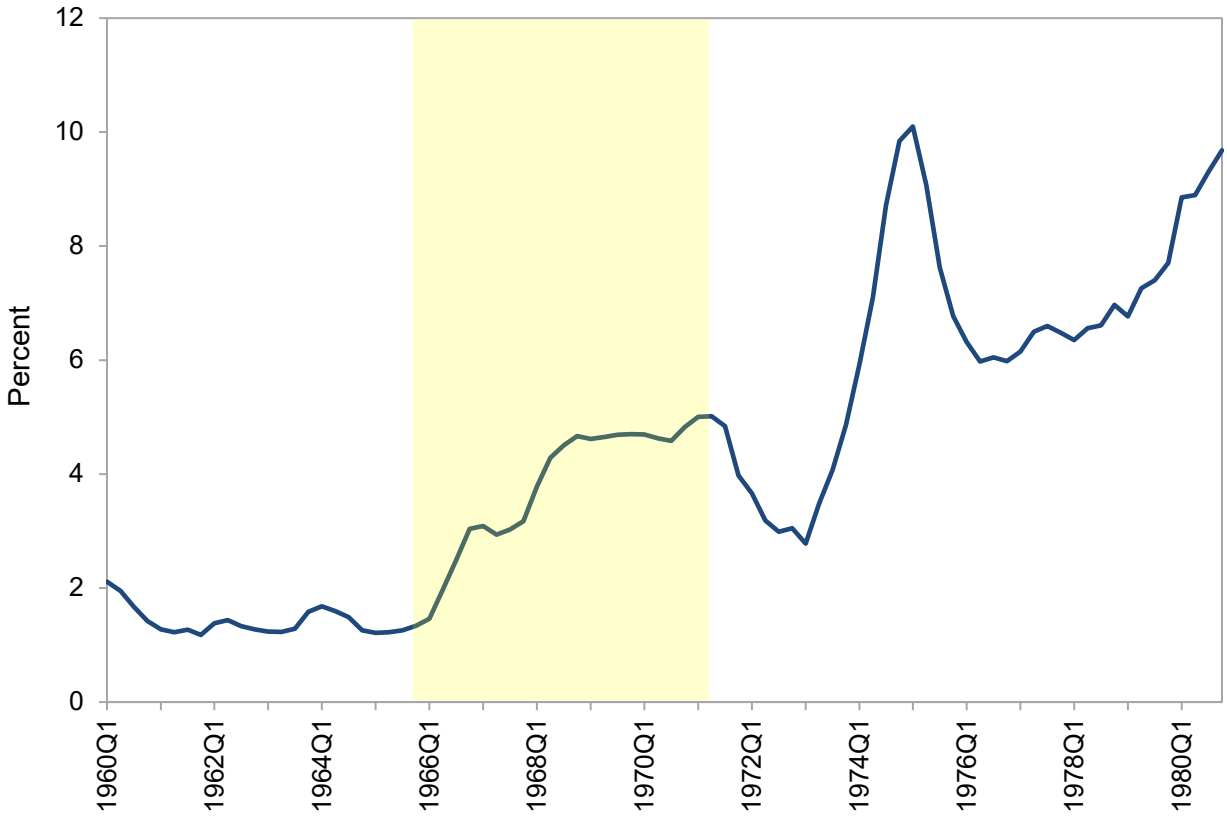
U.S. High-Employment Surplus and Federal Funds Rate, 1965–1972



Sources: The federal funds rate data are from the U.S. Board of Governors of the Federal Reserve System, series FEDFUNDS, retrieved from FRED, 8/2/2025. The high-employment surplus data are from the U.S. Congressional Budget Office, https://www.cbo.gov/data/budget-economic-data#8, Estimates of Automatic Stabilizers, Nov. 2024, "5. Quarterly - % of GDP," series surplus without automatic stabilizers.

Figure 6

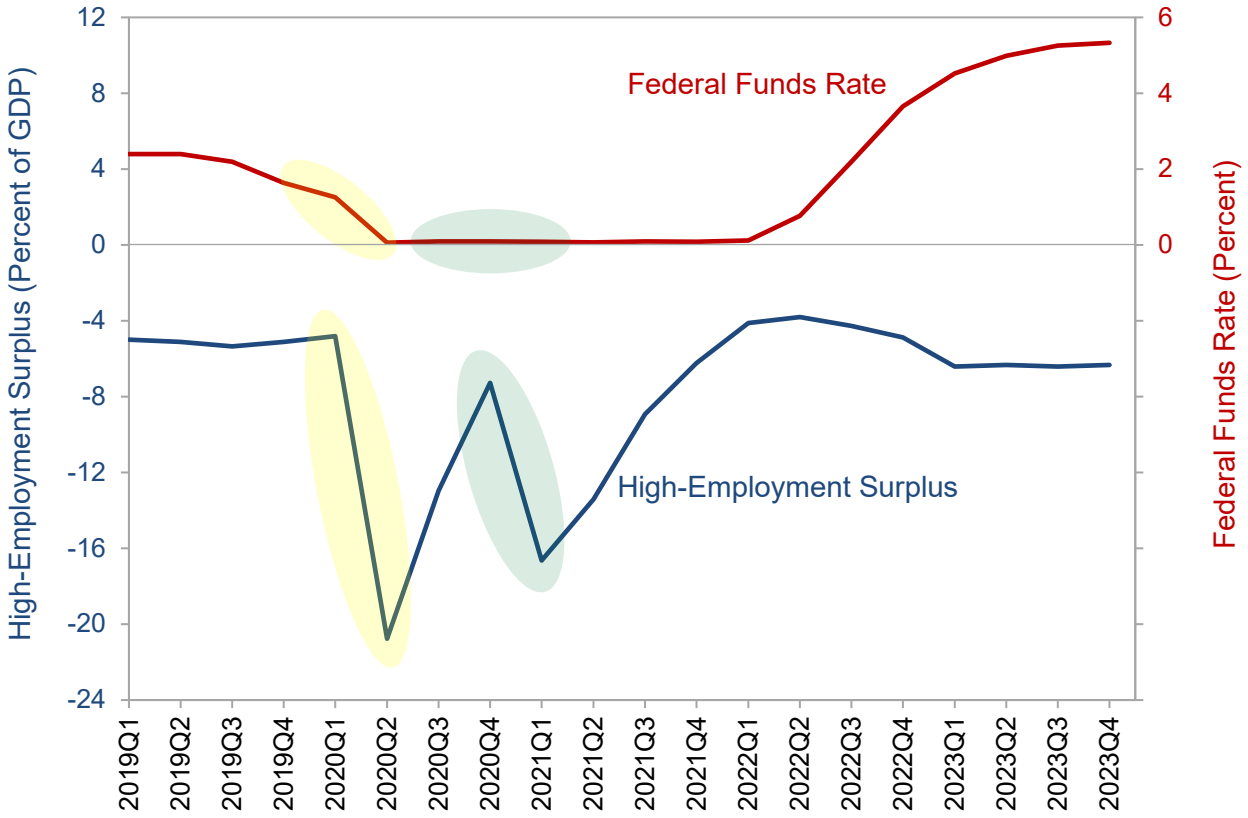
Core PCE Inflation, 1960–1980



Sources: The core inflation data are from the U.S. Bureau of Economic Analysis, personal consumption expenditures excluding food and energy (chain-type price index), percent change from one year ago, series PCEPILFE, retrieved from FRED, 8/4/2025.

Figure 7

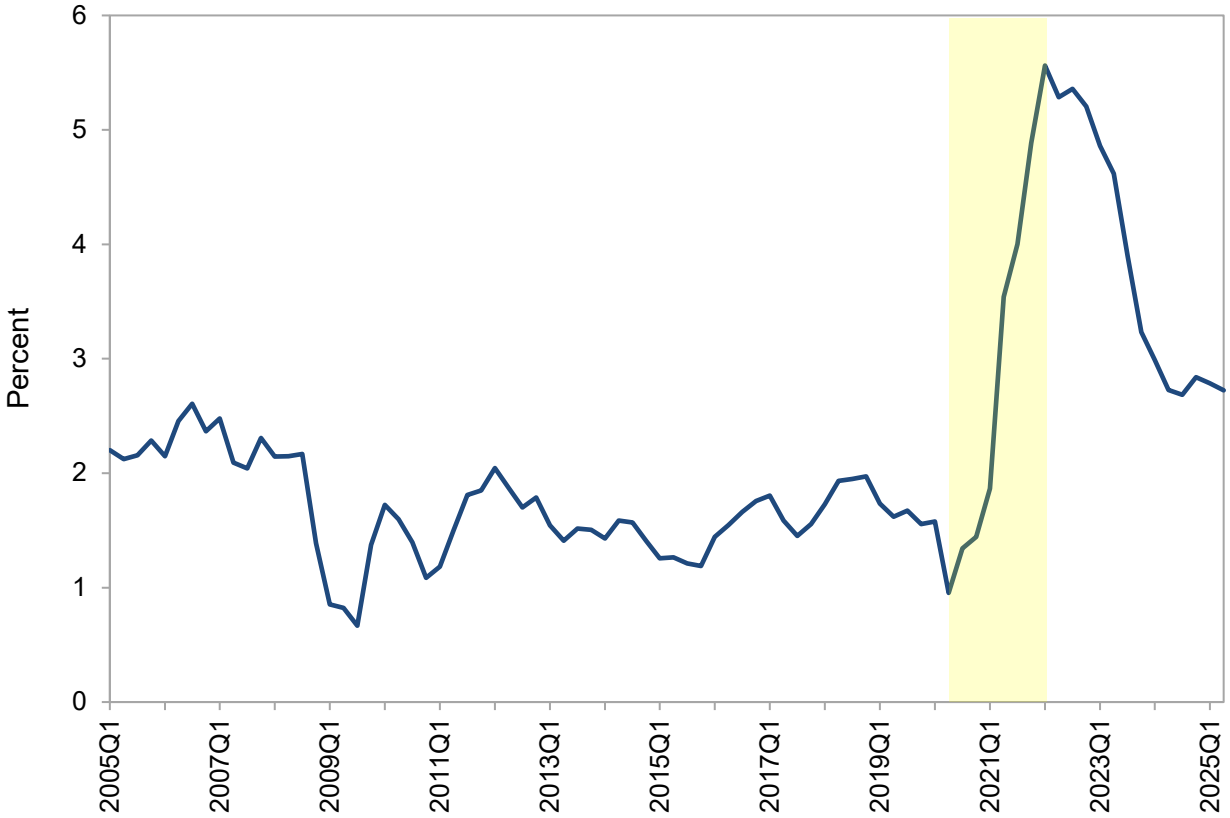
U.S. High-Employment Surplus and Federal Funds Rate, 2019–2023



Sources: The federal funds rate data are from the U.S. Board of Governors of the Federal Reserve System, series FEDFUNDS, retrieved from FRED, 8/2/2025. The high-employment surplus data are from the U.S. Congressional Budget Office, https://www.cbo.gov/data/budget-economic-data#8, Estimates of Automatic Stabilizers, Nov. 2024, "5. Quarterly - % of GDP," series surplus without automatic stabilizers.

Figure 8

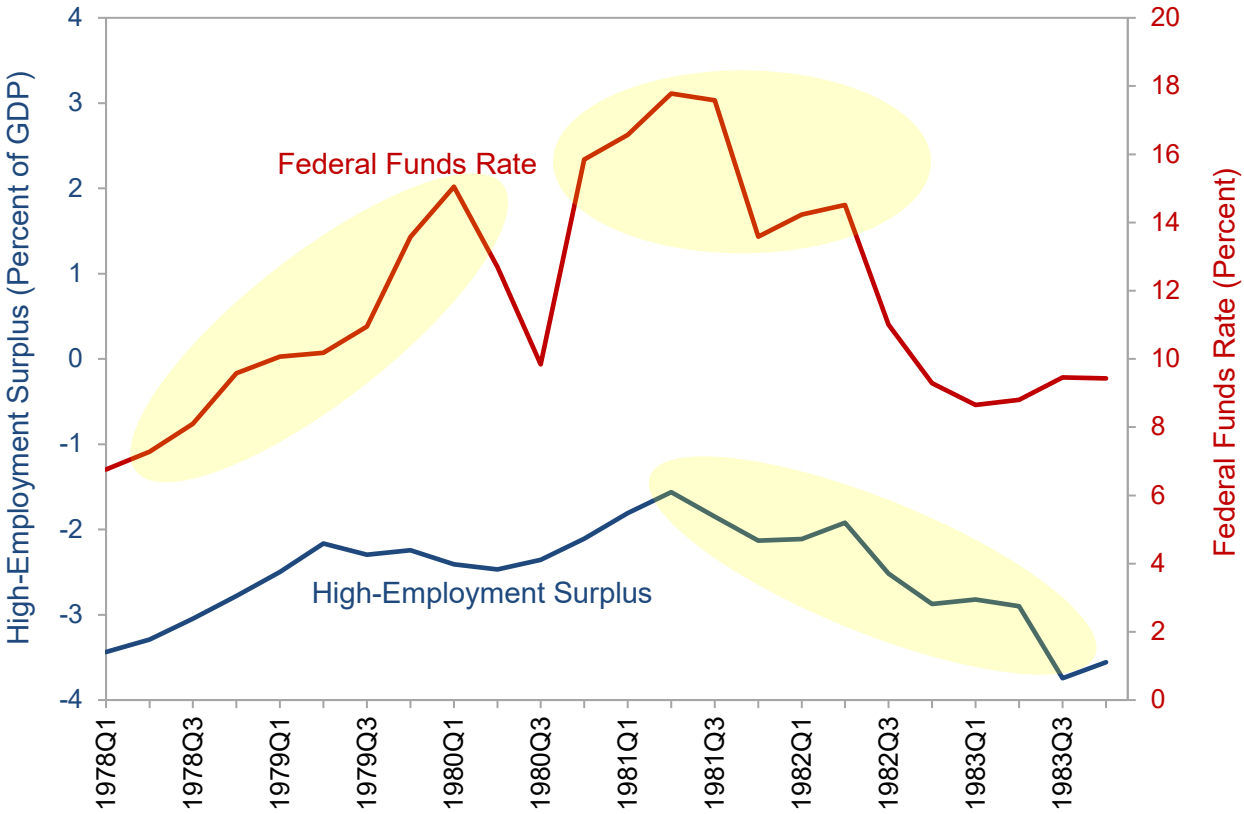
Core PCE Inflation, 2005–2025



Sources: The core inflation data are from the U.S. Bureau of Economic Analysis, personal consumption expenditures excluding food and energy (chain-type price index), percent change from one year ago, series PCEPILFE, retrieved from FRED, 8/4/2025.

Figure 9

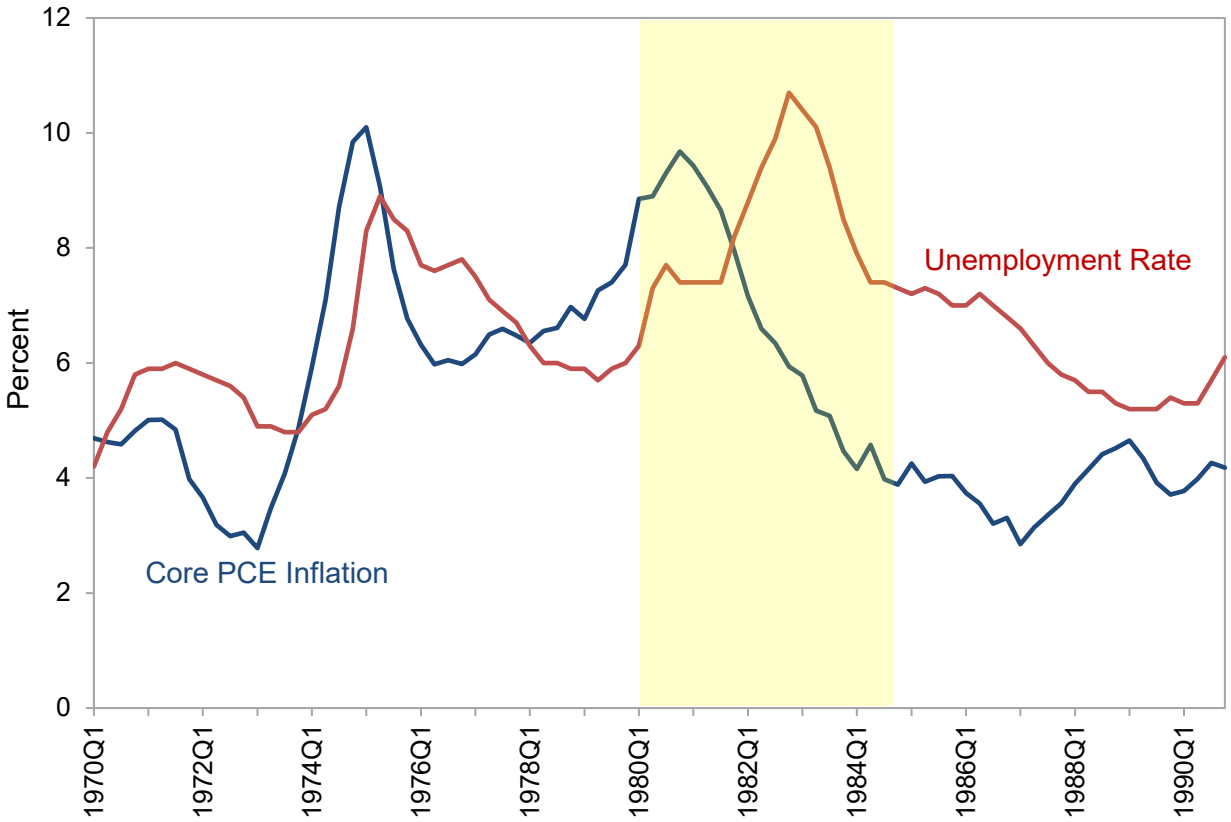
U.S. High-Employment Surplus and Federal Funds Rate, 1978–1983



Sources: The federal funds rate data are from the U.S. Board of Governors of the Federal Reserve System, series FEDFUNDS, retrieved from FRED, 8/2/2025. The high-employment surplus data are from the U.S. Congressional Budget Office, https://www.cbo.gov/data/budget-economic-data#8, Estimates of Automatic Stabilizers, Nov. 2024, "5. Quarterly - % of GDP," series surplus without automatic stabilizers.

Figure 10

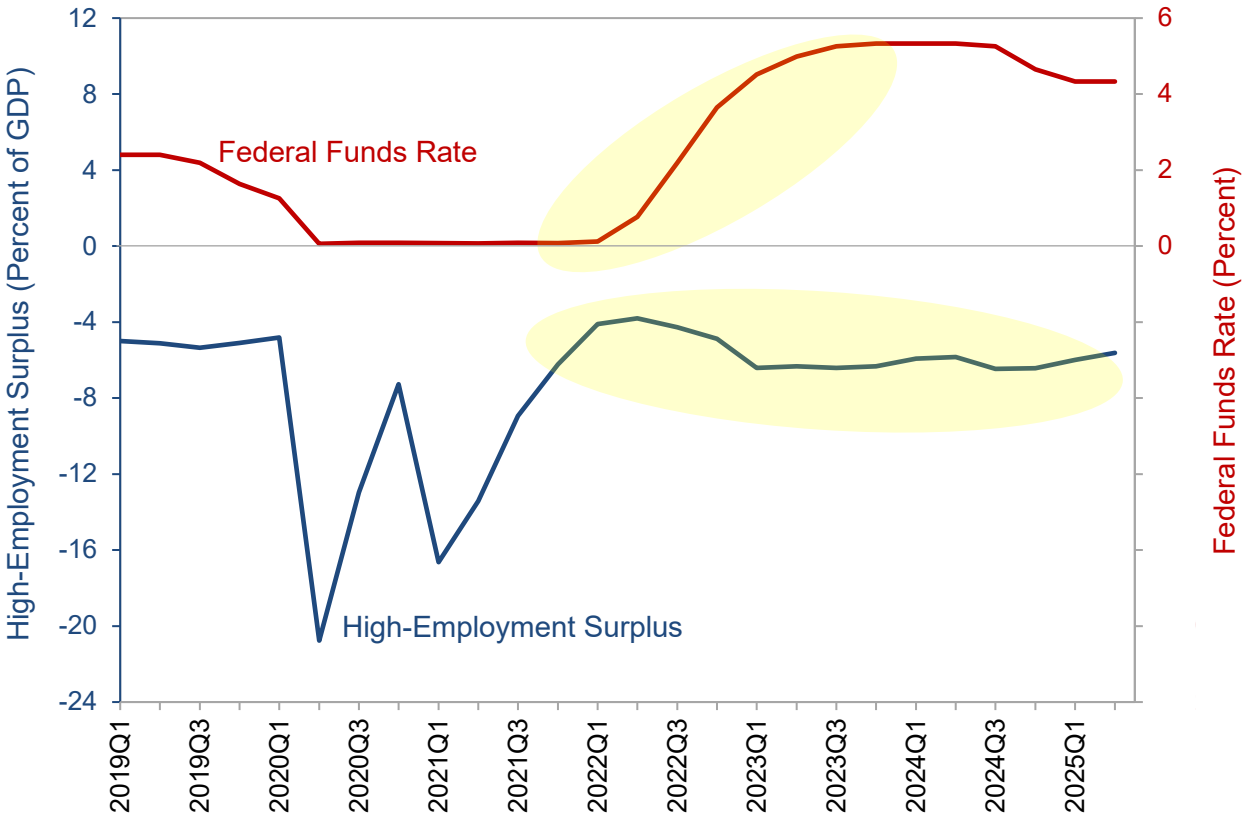
Core Inflation and Unemployment, 1970–1990



Sources: The core inflation data are from the U.S. Bureau of Economic Analysis, personal consumption expenditures excluding food and energy (chain-type price index), percent change from one year ago, series PCEPILFE, retrieved from FRED, 8/4/2025. The unemployment data are from the U.S. Bureau of Labor Statistics, series UNRATE, retrieved from FRED, 8/4/2025.

Figure 11

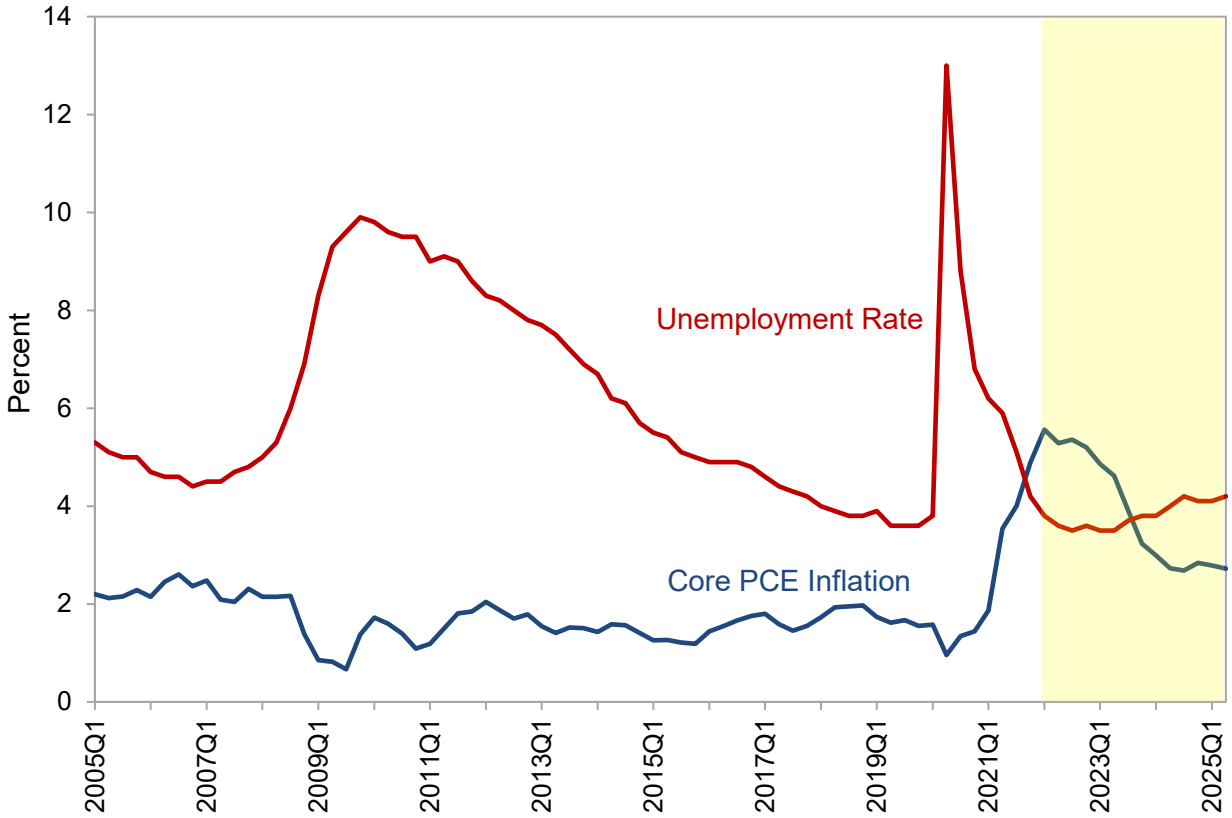
U.S. High-Employment Surplus and Federal Funds Rate 2019–2025



Sources: The federal funds rate data are from the U.S. Board of Governors of the Federal Reserve System, series FEDFUNDS, retrieved from FRED, 8/2/2025. The high-employment surplus data through 2024Q1 are from the U.S. Congressional Budget Office, https://www.cbo.gov/data/budget-economic-data#8, Estimates of Automatic Stabilizers, Nov. 2024, "5. Quarterly - % of GDP," series surplus without automatic stabilizers. For the period 2024Q2–2025Q2, when the CBO high-employment surplus series is not available, I approximate it using quarterly data on net lending or net borrowing from the U.S. Bureau of Economic Analysis, National Income and Product Accounts, Table 3.2., divided by nominal GDP. This is reasonable because unemployment was roughly equal to estimates of its normal or full-employment level throughout this period. To deal with conceptual differences between the CBO's measure of the surplus and the NIPA series, I subtract the difference between the NIPA and CBO series in 2024Q1 from all later observations.

Figure 12

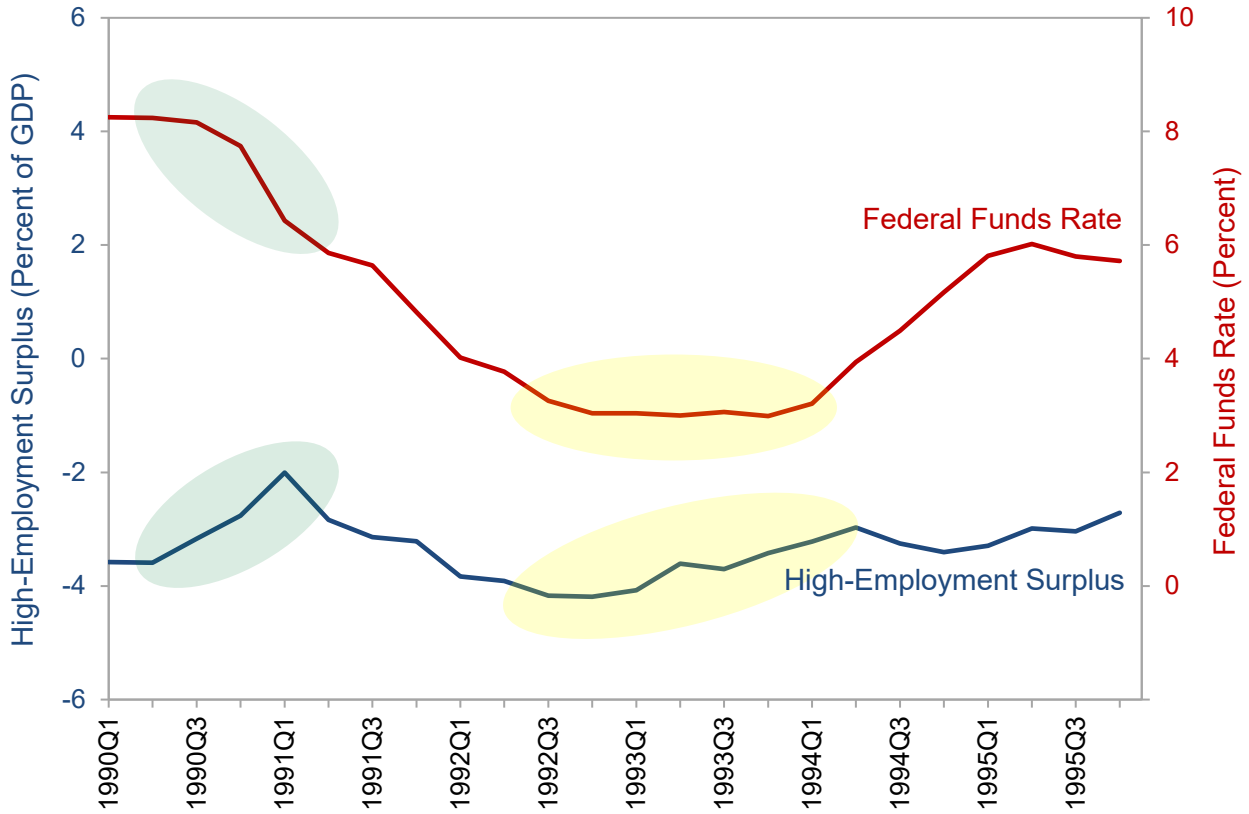
Core Inflation and Unemployment, 2005–2025



Sources: The core inflation data are from the U.S. Bureau of Economic Analysis, personal consumption expenditures excluding food and energy (chain-type price index), percent change from one year ago, series PCEPILFE, retrieved from FRED, 8/4/2025. The unemployment data are from the U.S. Bureau of Labor Statistics, series UNRATE, retrieved from FRED, 8/4/2025.

Figure 13

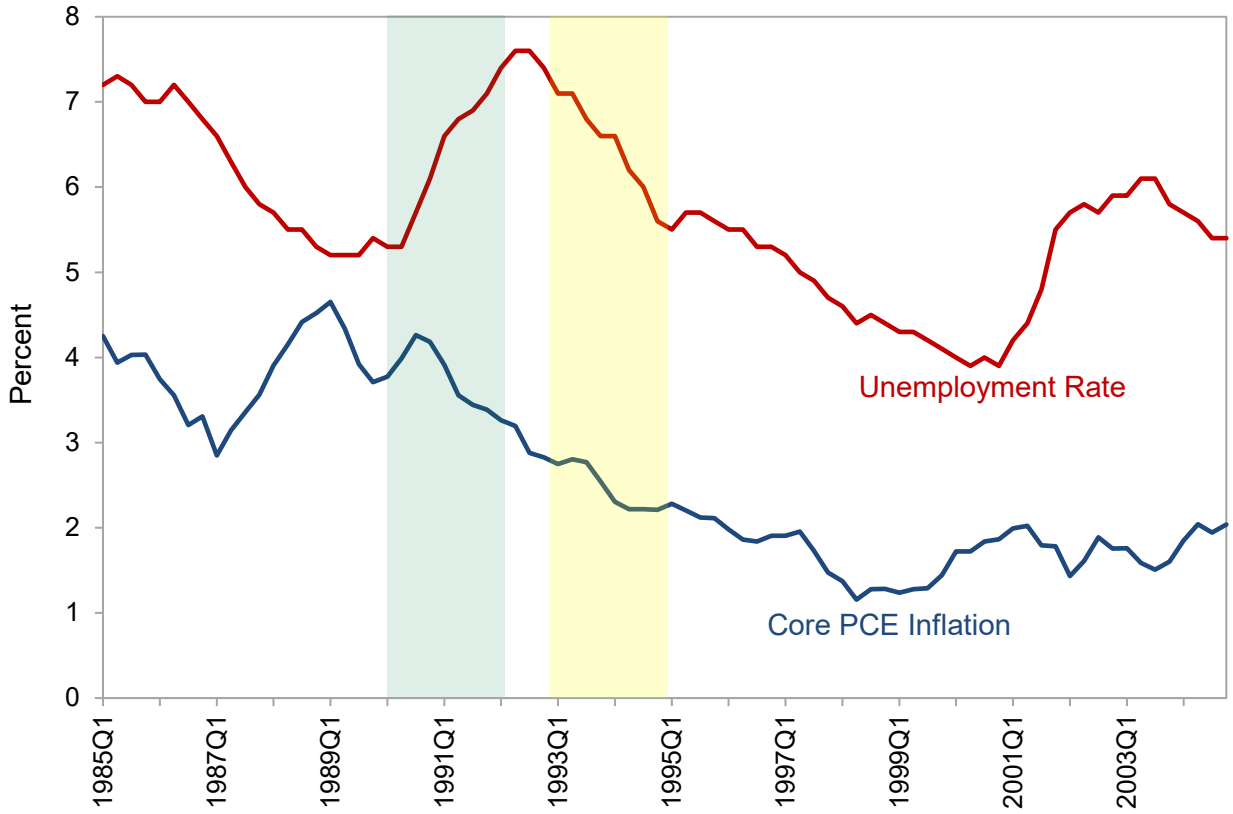
U.S. High-Employment Surplus and Federal Funds Rate, 1990–1995



Sources: The federal funds rate data are from the U.S. Board of Governors of the Federal Reserve System, series FEDFUNDS, retrieved from FRED, 8/2/2025. The high-employment surplus data are from the U.S. Congressional Budget Office, https://www.cbo.gov/data/budget-economic-data#8, Estimates of Automatic Stabilizers, Nov. 2024, "5. Quarterly - % of GDP," series surplus without automatic stabilizers.

Figure 14

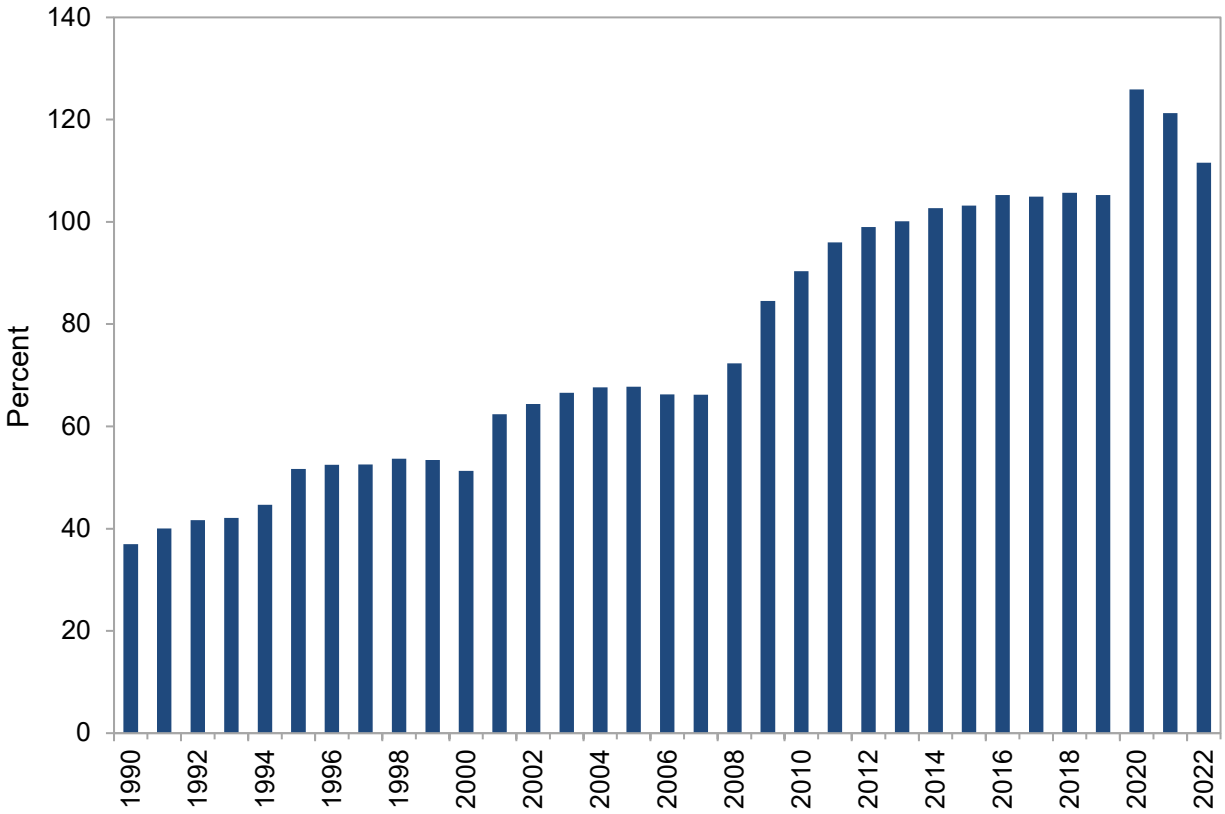
Core Inflation and Unemployment, 1985–2004



Sources: The core inflation data are from the U.S. Bureau of Economic Analysis, personal consumption expenditures excluding food and energy (chain-type price index), percent change from one year ago, series PCEPILFE, retrieved from FRED, 8/4/2025. The unemployment data are from the U.S. Bureau of Labor Statistics, series UNRATE, retrieved from FRED, 8/4/2025.

Figure 15

Average Debt-to-GDP Ratio in OECD Countries, 1990–2022



Source: World Bank, World Development Indicators, Central government debt, total (% of GDP) for OECD members, series GCDODTOTLGDZSOED, retrieved from FRED, 9/15/2025.

Table 1

Characteristics of Policymakers' Economic Framework in Different Eras

Characteristic	1950s	1960s	Early 1970s	Mid 1970s	Late 1970s	1980s & Early 1990s	Late 1990s
Normal u or $\bar{u}$	4.5-5%	4%	4%	5.5%	5.0%	6-7%	5%
Belief in a permanent π-u trade-off	No (Perhaps a positive relationship)	Yes	No	No	No	No	No (perhaps a positive relationship)
Sensitivity of π to slack	Medium	N/A π varies with u	Initially high, then very low	Medium	Very low	Medium	Medium

Source: Based on Romer and Romer (2002).