

“MUDDLING THROUGH OR TUNNELING THROUGH”
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Workshop on Monetary and Financial History
Atlanta Fed
23 May 2022

INTRODUCTION

- Wonderful paper on a timely topic.
- Question: Why explains high UK inflation in the 1970s? Why was UK inflation higher than that in most other industrialized countries?
 - ▶ Paper combines careful narrative history and sophisticated econometrics.
 - ▶ Results are interpreted with modern macro theory.
 - ▶ Obvious lessons for policymakers today.

OUTLINE OF COMMENTS

I) Fiscal policy

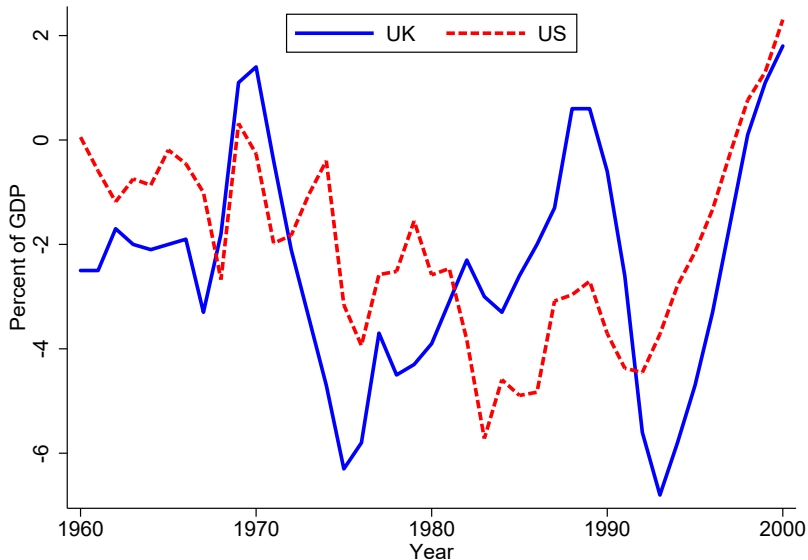
II) Policymakers' thinking

III) Real outcomes

FISCAL POLICY

- The author's begin the paper with a quote from Tom Sargent (1981):
“the historical evidence provide(s) little reason for being optimistic about the efficacy of a plan for gradual monetary restraint which is simultaneously soft on the government deficit.”
- They interpret the UK evidence as being broadly consistent with this view.
- Let me raise some questions about the importance of fiscal policy for UK inflation.

UK AND U.S. BUDGET SURPLUSES / DEFICITS



FISCAL POLICY AND EXPECTED INFLATION

- The author's argue that tighter fiscal policy contributed to lower inflation expectations after the late 1970s.
- The evidence comes from timing - declines in household inflation expectations in the late 1970s / early 1980s occur along with good news about the budget deficit.
- More evidence would be helpful, e.g. how much were households paying attention to the deficit? How widely reported were deficit and debt developments?

WORTHWHILE DISTINCTIONS?

At times, the paper considers three different ways fiscal policy could have contributed to inflation.

- I) “Old Keynesian”: Expansionary fiscal policy increases aggregate demand and inflation.
 - ▶ Small point: it was unclear that this effect was allowed for in the VAR?

- II) “Monetarist”: Institutions were such that expansionary fiscal policy meant increases in the money supply and thus higher inflation.

- III) “Fiscal theory of the price level”: Expansionary fiscal policy raised inflation because it led to concerns about debt sustainability, increasing expected inflation.

A clear distinction between these channels for fiscal policy might help to clarify some of the arguments in the paper.

POLICYMAKER'S THINKING

Policymakers made many mistakes:

- “Go-stop” policies.
- Use of wage and price controls rather than monetary policy to control inflation.
- Money-financed budget deficits.
- Chose goals poorly, e.g. labor government in the mid-1970s aimed for 10 percent inflation.

POLICYMAKER'S THINKING

Why? Authors explain that policymakers misunderstood economy, e.g.

- Thought natural rate of unemployment was lower than it was.
- Doubted that monetary policy could control inflation.
- Thought incomes policy would control inflation.

But why these misunderstandings? And why were they seemingly worse in the UK than elsewhere?

REAL OUTCOMES

A mystery? Macro policy improves post 1980, but real outcomes don't.

UK MACRO OUTCOMES, 1970-79 AND 1985-94

	1970-79	1985-94
Inflation, mean (%)	12.6	4.8
Inflation, std. dev. (%)	5.6	2.0
GDP per capita growth (annualized, %)	2.2	2.1
TFP growth (annual average, %)	1.8	1.3
Unemployment rate (%)	4.6	9.5
Real wage growth (annualized, %)	2.6	2.6

CONCLUSION

- A wonderful paper. Read it!

- Changed how I think about inflation in the U.S. today. (I'm more worried.)