Discussion

Christina D. Romer*

Peter Temin has written a first-rate paper on the causes of American business cycles since 1890. It is careful, analytically serious, and exceedingly provocative. But, I suspect that he knows I am likely to disagree with much of what he says.

The task that Temin was given by the organizers was a daunting one—to summarize a century of American macroeconomic history in a 30-page paper. Temin, I think rightly, chose not to blaze new empirical ground, but rather to synthesize the existing literature. I strongly agree with his view that we can learn a great deal from reading what many sensible people have to say about the causes of recessions in the past. Indeed, I will go further and suggest that we can learn more from an "essay in economic historiography" than from running simple, unstructured regressions that ignore the nuances of causes and structural changes.

Temin took as his job to identify the conventional wisdom and then to classify the cause of each recession into one of four categories—domestic and foreign monetary shocks and domestic and foreign real shocks. (Since he lumps into real shocks everything from oil price shocks to drops in consumer confidence, it would be more accurate to describe his categories as monetary shocks and nonmonetary shocks.) His conclusion is that cycles over the last century have not been caused by a single predominant factor—indeed, the most striking feature of recessions is the diversity of their causes. Domestic factors have been more important than foreign, though not dramatically so. To the extent that a change has

*Class of 1957–Garth B. Wilson Professor of Economics, University of California, Berkeley.

occurred over time, it is away from monetary factors and toward real factors.

Given Temin's research strategy, there are two ways one could disagree with him. First, one could argue with his classification scheme. Second, one could argue with his portrayal of the conventional wisdom. Alas, I plan to do both. I will suggest that a more sensible classification scheme and a broader reading of the conventional wisdom indicate a crucial role for domestic monetary shocks, at least in the interwar and postwar eras.

With his classification scheme, Temin chooses to treat most policy changes as endogenous. Even in recessions where tight monetary policy is conventionally thought to be the proximate cause of the downturn, Temin looks instead at what caused the tight policy. Only a change in the Federal Reserve's usual behavior is classified as a monetary shock.

This focus on ultimate causes, I think, takes an overly narrow view of what constitutes the monetary regime. Because Fed behavior is invariably triggered by something, and because there is almost always some continuity in Fed behavior, it comes dangerously close to assuming that monetary policy shocks never cause recessions. Let me give you an extreme example that may illustrate the danger of Temin's classification scheme. Suppose that the Fed's "usual behavior" includes cutting the money supply in half every time the American League wins the World Series. Temin would attribute the recession that likely follows an American League victory to a real shock rather than to a monetary one, because the Fed has not deviated from its normal behavior. And yet, a more monetary-policy-caused recession is hard to imagine.

A more reasonable alternative involves asking whether the monetary change was the inevitable, or even just the likely, result of the trigger, or whether a genuine choice was involved. If a conscious choice was made to respond in a certain way or if alternative policies were understood and discussed at the time, then monetary policy should share at least some of the blame for the recession.

Following this criterion would lead one to classify the cause of many twentieth-century recessions quite differently than Temin does. Most important, it would change the way one views the deepening phase of the Great Depression (the 1931 recession in Temin's classification scheme). Temin attributes this recession solely to an international shock; he argues that in failing to respond to the financial panics the Federal Reserve was simply following its usual behavior. However, the fact that the Federal Reserve had been set up largely to prevent or contain panics and that reasonable men *at the time* were urging the Fed to intervene, suggests to me that the Fed's behavior was not purely endogenous or predetermined. While the gold standard no doubt constrained the Fed's behavior at some point in the Depression, the size of the U.S. gold reserves in 1930 and early 1931 makes it very likely that the Fed could have responded aggressively to at least the first two waves of banking panics. Indeed, the fact that the Fed was able to engage in very expansionary open market operations for several months in the spring of 1932 without an overwhelming gold drain casts doubt even on the view that the gold standard prevented a serious response after a devaluation mentality became prevalent in 1931. Therefore, to the extent that the financial collapse was a major factor in the acceleration of the real decline between 1930 and 1933, domestic monetary factors must be given some role, if not the central role, in this, the worst depression in U.S. history.

I believe that Temin's narrow rule also leads him astray in classifying several postwar recessions. Consider the 1973 recession. Temin says that monetary policy need be given no role because it was simply responding to the inflation caused by the oil price shock and "a respectable central bank resists inflation." First, I think one could argue with this somewhat cavalier description of usual Fed operating procedures; throughout the late 1960s and early 1970s the Fed showed itself to be quite willing to tolerate inflation. Therefore, there may have been a deviation from usual Fed behavior, and thus a domestic monetary shock, even in the Temin sense. More important, even if the Fed did usually fight inflation, the decision to contract substantially in 1974, when the economy was already in a downturn and many were calling for loosening, was still far from inevitable or even particularly likely. The Fed almost surely made the right decision to fight inflation in this case, but it most definitely made a decision and should be given both blame for the recession that followed and credit for restraining inflation. Finally, one has to mention the evidence that expansionary monetary policy bears much of the responsibility for the inflation of the early 1970s. Both De Long (1997) and Taylor (1998) point out that inflation was already very high and rising before the first oil shock in 1973. Thus, to the extent that the Fed was responding to inflation of its own creation, it is especially hard to absolve it of all blame for this recession.

What is surely true is that monetary policy and the oil shock share responsibility for the 1973 recession, just as Temin says they do for the 1981 recession. Indeed, I would suggest that monetary policy shares the blame for many of the postwar recessions that Temin attributes to nonmonetary factors. I think that Temin's view of policy, together with a limited view of the conventional wisdom, leads him to miss this crucial fact.

Let me give just a few examples. Temin attributes the recessions of both 1957 and 1969 to a decline in government spending—a domestic real shock in his classification scheme. And yet, the decline in the high-employment surplus preceding both recessions was actually quite small. Indeed, in the case of 1957 it is almost impossible to discern in the data: With the exception of a small, temporary rise in the first quarter of 1958, the ratio of the high-employment surplus to GDP fell nearly continuously from 1956 to the start of 1959. In both cases, however, I believe the conventional wisdom attributes the decline, at least partially, to tight monetary policy. I know that it is the view expressed in at least one of the papers cited by Temin (my paper with David Romer (1989)). Before both downturns the Federal Reserve made a conscious decision to tighten in order to reduce inflation, and in both instances this decision was reflected in higher real interest rates. While Temin does not mention these tightenings, I suspect that he has dismissed them as "business as usual" at the Fed. However, in both cases alternative polices were certainly considered and urged; nothing made the decisions inevitable or even very likely. Therefore, a more reasonable classification scheme would have to give domestic monetary factors at least part of the blame for these contractions.

If Temin adopted a somewhat less narrow definition of monetary policy shocks and considered multiple causes, his findings would be very different, especially for the postwar era. Monetary shocks not only played a role in 1957, 1969, and 1973, as I have argued, and in 1981 as Temin notes, but also played a role in 1948, 1980, and 1990. Thus, there is a crucial common link in postwar recessions: Monetary policy was one of the top two factors in nearly every postwar downturn.

This key role of postwar monetary shocks lies behind my own view of the fundamental change that has occurred in the cause of recessions over time. The key change has not been from monetary shocks to real shocks or vice versa, but from random shocks from various sources to governmental shocks. Before World War I, recessions were, as Temin suggests, generated by a wide range of monetary and nonmonetary shocks arising from the private sector—or, at least, not arising from conscious decisions by the government. By the end of World War II, the government had learned how to counteract most shocks and did so quite effectively. However, because of a tendency toward overexpansion and the increasing prevalence of supply shocks, inflation periodically got out of hand. In response, the Federal Reserve (and to a lesser degree the fiscal authority) has had to generate recessions to curb inflation.

It is this move toward government-caused (and controlled) recessions that accounts for an important change in the distribution of cycles over time. Cycles have become less frequent in the postwar era because the government is counteracting many shocks. Cycles have also become more concentrated in the moderate range because monetary policy and fiscal policy now eliminate small random recessions and prevent collapses such as the Great Depression. Postwar cycles have been of moderate size because that is what it takes to reduce inflation.

I like this view of the change in the cause of cycles over time not only because it strikes me as fundamentally right, but because it suggests that we do not have to choose between the two polar views identified by Temin. Both the no-single-shock and the only-monetary-shock stories are right for the appropriate eras. Temin is correct that in the prewar era recessions had a variety of causes, most of them unrelated to government actions. The view summarized by Dornbusch is correct for the postwar era: Policy, especially monetary policy, has played the crucial role. I might not have used Dornbusch's dramatic language—the Fed has acted more like a doctor imposing a painful cure on a patient with an illness than like a murderer—but the result in terms of recessions has been the same.

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