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Bakalářská práce

2006 **Martin Pospíšil**

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BAKALÁŘSKÁ PRÁCE

President Bill Clinton’s Economic Policy

U.S. Economic Policy 1993-2000

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Abstract

This paper reviews U.S. economic policy during Bill Clinton's Presidency between 1993 and 2000. It analyses how much the Clinton administration's economic policy contributed to record-long economic expansion, in which GDP growth was unexpectedly strong, inflation and unemployment surprisingly low. Moreover, this period can be characterized with strong business investment and high productivity. The key factors for strong and healthy economic growth in the 1990s were the optimal mix of fiscal and monetary policy, competitive and stable financial sector, and lots of opportunities for investment. Clinton faced huge budget debt and proved that the economy can recover while the government reduces its budget deficit. All Clinton's fiscal measures combined progressive redistribution and budget discipline. By the end of the 1990s, the budget had recorded its third consecutive unified surplus for the first time since 1947-49, as well as the largest surplus relative to GDP since 1948.

Deficit reduction was an important success; however, it brought about, as a side effect, some failures. Reform of Social Security and Medical Service was not successful. The finding of this thesis proves that a cooperation of fiscal and monetary policy is crucial.Clinton was supported by the Fed and its Chairman Alan Greenspan. Elimination of the budget deficit allowed Fed to lower interest rates, what was a motor to increased investments and further economic growth. Exceptional is economic stability of 1990s. Clinton-Greenspan mix of tight budgets and easier money contributed to the outstanding economic performance.

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Abstrakt

Tato práce hodnotí hospodářskou politiku USA během let 1993-2000, kdy byl prezidentem Bill Clinton. Práce analyzuje, do jaké míry přispěla hospodářské politika Clintonovy vlády k rekordně dlouhé hospodářské expanzi, kdy růst HDP byl neočekávaně silný, inflace a nezaměstnanost překvapivě nízká. K tomu lze toto období charakterizovat silnými hospodářskými investicemi a vysokou produktivitou. Klíčové faktory pro silný a zdravý ekonomický růst v devadesátých letech byly optimální mix rozpočtové a měnové politiky, soutěživý a stabilní finanční sektor, mnoho příležitostí pro investice. Clinton čelil obrovskému rozpočtovému dluhu a prokázal, že se ekonomika může zotavit, zatímco vláda snižuje fiskální deficit. Všechny Clintonovy rozpočtové nástroje kombinovaly progresivní redistribuci a rozpočtovou disciplínu. Na konci devadesátých let zaznamenal rozpočet třetí po sobě jdoucí rozpočtový přebytek poprvé od let 1947-49, stejně jako nejvyšší přebytek v poměru ku HDP od roku 1948.

Redukce deficitu byla velkým úspěchem, nicméně nesla s sebou jako vedlejší efekt několik chyb. Reforma sociálního systému ani zdravotnictví nebyla úspěšná. Práce prokazuje, že spolupráce rozpočtové a měnové politiky je stěžejní. Clinton byl podpořen Americkou centrální bankou (Fed) a jejím předsedou Alanem Greenspanem. Eliminace rozpočtového deficitu umožnila Fedu snížit úrokové sazby, což se stalo motorem zvýšených investic dalšího ekonomického růstu. Výjimečná je ekonomická stabilita devadesátých let. Mix Clinton-Greenspan těsného rozpočtu a lehce přístupných peněz přispěl k mimořádnému hospodářskému výkonu.

Prohlášení

Prohlašuji, že jsem bakalářskou práci vypracoval samostatně a použil pouze uvedené prameny a literaturu

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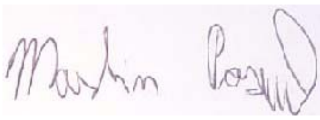

List of Abbreviations

CEA-Council of Economic Advisers

CBO-Congressional Budget Office

EMU-European Monetary Union

EU-European Union

FDI-Foreign Direct Investments

FED-Federal Reserve

FOMC-Federal Open Market Committee

GDP-Gross Domestic Product

IES FSV UK-Institute of Economic Studies Faculty of Social Sciences, Charles University

IMF-International Monetary Fund

NAIRU-Non-Accelerating Inflation Rate of Unemployment.

NBER-National Bureau of Economic Research

NGO-Non-Governmental Organisation

SGP-Stability and Growth Pact

UK-United Kingdom

U.S.-United States

WB-World Bank

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1. Introduction

1.1. Objective Motivation

The miracle of U.S. economic performance in the 1990s was a source of pride at home, of envy abroad, and of puzzlement among economists and policymakers[1] *"*

Bill Clinton's presidency during 1990s brought about a record-long economic expansion, in which GDP growth was unexpectedly strong, inflation uncharacteristically subdued, unemployment dropped to levels not seen during last three decades. Moreover, this period can be characterized with strong business investment and high productivity. The largest budget surplus in history, the lowest unemployment rate in more than 40 years, the fastest growth in real wages for more than two decades; economic performance during Bill Clinton's administration was outstanding. Moreover, while Clinton inherited the biggest federal budget deficit in history, when he left office in 2001, it showed the largest surplus ever - a huge $230bn. During Clinton's second term, real economic growth averaged 4.5 percent per year, and unemployment fell to 4 percent, what would have been considered unattainable at the beginning of 1990s. Strong economic performance is particularly remarkable, when we realize that it was accompanied with low inflation and structural budget surpluses. During 1990s, the U.S. strong economic growth was stimulated by the Clinton's administration. Clinton increased taxes, reduced spending, and the economy experienced the longest GDP growth since WWII. This thesis tries to analyse U.S. economic policy between 1993 and 2001. The U.S. economy has an enormous impact on the world markets; therefore, it is important to understand what economic policies it undertakes. History will remember 1990s as a time of economic accomplishment.

A complete business cycle can be found in 1990s. Starting with recession in 1990-1991, continuing through "jobless recovery" in 1992 that was likely to cause George Bush losing in the 1992 election. The years 1990-1992 set the stage for the boom in the years 1993-2000. Finally, in 2000, the economy returned to

[1] Robert J. Gordon (2000, p.2)

approximately the same point of business cycle it had been in 1990[2] (see Fig. 9, Fig.10 and Fig.11). In February 2000, the American economy set a record for the longest business expansion since records began in 1850.The economic policy in 1990s in the USA is also a dispute about the balance of the government and market.

The European Union seems to be focused too much on itself. With its rising political power, the EU is forgetting that both the U.S. and the EU are rather similar than different and that both face similar problems. Suitability of a monetary union, Social Security reform, fiscal and monetary economy mix, labour mobility, the role of the central bank in the economy, budget federalism, Medicare, these all are issues, where the U.S. draws much inspiration for the EU. Studying Clinton's economic policy can help to find appropriate economic policy for European economy.

1.2. Personal Motivation

The author of this thesis is interested in politics, which is one the reasons why he decided to study economics. The link between politics and economy is obvious and is also discussed in this thesis. The author's generation have been growing up in the age of post-communism, hope of democracy, stability, and peace. We have turned our faces to the USA as the provider of these values. The 1990s will remain the age of Vaclav Havel, whose close relations to the former Secretary of State Madeleine Albright had strengthen Czech-U.S. relations. The U.S. plays the leading role in almost all economic and political issues, including economic transition of Central and East European countries. During the Clinton era, the U.S. was pushing an agenda of human rights and democracy, the U.S. enjoyed more peace and economic well being than at any time in its history. When I first visited the U.S. in 2002, the Clinton era was already over. Al Gore lost in the 2000 presidential elections against George W. Bush, although Gore's political "father" Bill Clinton left office with excellent economic results.

As far as I am concerned, the Clinton's economic success has not got much attention in the Czech Republic. The explanation is that U.S. economy in 1990s did not follow standard recipes of theoretical economy and therefore, it is not simple

2 Unemployment lowered to 3.9 percent in 2000 and began to rise next year.

to understand it. Moreover, U.S. economic policy of 1990s is likely to be omitted by Czech students of economics; for example, only two bachelor theses were written about U.S. in the 1990s (Enron and U.S. Current Account Deficit) at IES FSV UK from 1999 to 2005[3]. Ronald Reagan's economic policy in 1980s, that prescript substantial tax cuts and increased - mostly military- spending, is more interesting for supply-side economists.

It is impossible to cover all topics linked with U.S. economic policy of 1990s. Therefore, the thesis has focused entirely on macroeconomic issues, on fiscal and monetary policy particularly. Macroeconomics allows theoretical explanation of economic policy- stabilisation policy, especially. A careful reader can ask to what extent is Fed's monetary policy a part of Bill Clinton's economic policy. However, there are several issues that were crucial for successful economic performance that were made by the Clinton's administration and supported by the Greenspan`s Fed. For smooth and successful functioning of an economy, cooperation between fiscal and monetary policy is crucial; indeed, this was one of the most important signs of the U.S. economy in the 1990s. Today, with the lag of several years, we are able to evaluate the Clinton Administration's policies without any bias.

An obvious question is what an analysis of this period can bring to a reader in the Czech Republic. I am convinced that there are several issues that we should be interested in. Firstly, fiscal policy is a general topic. Although it is rather nonsense to compare Czech and American economy, fiscal rules remain more or less the same. The theory that increasing taxes and lowered government spending causes lower of the economy remains no longer valid. Clinton faced big fiscal problems at the beginning of his administration and he was able to solve them. Public finance issue is one of the most interesting. In addition, I am convinced that monetary policy of the Fed worked well in the 1990s. Moreover, 1990s brought an opportunity to invest, new economy came into place, and dot-com firms grew rapidly. In conclusion, the 1990s were a golden occasion, but an occasion that had been taken by forelock. There will be another opportunities in the future, some are predictable, some are not. With a good knowledge of the U.S. economic policy of the 1990s, we can understand the economy better.

[3] According to published sources on ies.fsv.cuni.cz (downloaded 03/03/06).

The findings of the thesis can be summarised in the following points: The key factors for strong and healthy economic growth are the optimal mix of fiscal and monetary policy, competitive and stable financial sector, and lots of opportunities for investment. The necessary conditions for a well-functioning fiscal and monetary mix is a respect of both policies of each other. Clinton-Greenspan mix of tight budgets and easier money contributed to the outstanding economic performance.

When Bill Clinton took office, he faced huge budget debt. Clinton policy tried to prove that the economy can recover while the government reduces its budget deficit. It was a new theory that Clinton tried to apply and it was supported by the Fed and its Chairman Alan Greenspan. With the dropped long-term interest rates and inflationary expectations, bonds would yield less; therefore, investors would switch to the stock market. During the 1990s, this theory turned into reality.

From the monetary policy perspective, the lesson is clear: to maintain stable inflation and stable interest rates in the long run, a central bank should raise interest rates substantially in the short run in response to any inflationary threat (see Chapter 4). Even though inflation in the U.S. in 1990s was on average lower than in 1970s and 1980s, it was still higher than in 1950s and in 1960s (see Table 8). What is exceptional is inflation stability of 1990s, which gives a big credit to monetary policy of that period. Moreover, GDP growth had been extraordinary with very low volatility. Unemployment was reduced to numbers not seen for decades. To sum it up, we may talk about very successful and economically stable period. The thesis analyses how much the Clinton administration's economic policy contributed.

1.3. Survey of Literature

Many books were written about this fabulous decade. Nevertheless, every book evaluating a specific economic policy is somehow biased, according to the author's view on the role of state in economy. It is typical for economists that they cite history selectively, according to their view on the role of state in the economy. I did not want to write this thesis in a simplistic political way, although I have used some "political" books like *The Natural: The Misunderstood Presidency of Bill*

Clinton, written by Joe Klein[4]. A very readable book evaluating U.S.monetary policy during the 1990s is Bob Woodward's *Maestro: Greenspan`s Fed and the American Boom;* it gives an interesting insight into the backstage of U.S. economic policy-making in the 1990s. An interesting source is N.Gregory Mankiw's analytical review of Fed's monetary policy (2001). An excellent analysis of U.S. fiscal policy and the Social Security reform is in Elmendorf et al. (2001). Joseph Stiglitz, a former Chief of Economic Advisors, wrote a bestseller *The Roaring Nineties* (2003) about 1990s. Even though he was a part of the Clinton's administration, he is critical about some steps made by Clinton and he wrote one chapter of his book about mismanaging the economy[5]. The conference on the Economic Policies of the Clinton Administration, Kennedy School of Government in 2001 allowed well-known American economists to analyse various parts of Clinton's economic policy. The conference outcomes are summarised in Frankel and Orszag (2002).

I would like to express my thanks to doctor Alan Butt-Philip for his useful comments about the budget federalism, social policy and monetary union, to doctor Phillip Jones for helping me with the use of microeconomic tools, tax and fiscal policy, and to doc. Karel Pulpan for helping me to reduce the original content and guiding me through the writing process. I would like to thank the Faculty of the Social Sciences, Charles University for co-financing my extended stay at the University of Bath through a scholarship in order to help me to finish this thesis.

[4] Joe Klein is staff writer for the *New Yorker* and author of the *novels Primary colors* and *The Running Mate* and two non-fiction books-*Woody Guthrie: A Life* and *Payback: Five Marines after Vietnam*

[5] He argues that the deficit reduction achieved in the 1990s by the Clinton's administration had gone too far (see Stiglitz, 2003)

2. Before the Clinton Administration

Although this thesis is focused on the Clinton's administration, we have to take into account previous decisions and affairs of 1980s, as these largely influenced economic performance of the 1990s. Economy does not stand in a vacuum. There are several factors, that have a big impact on the economic performance and most of them are not easily visible at the first sight.

2.1. Paul Volcker and Ronald Reagan

"Volcker's tough medicine of jacking up interest rates to unprecedented 19 percent to cool the American economy had triggered recession and thrown millions out of work, making him a demon to many on Main Street. But now inflation was down and the Fed achieved a semblance of stability in prices, making him hero elsewhere, especially on Wall Street."[6]

In the late seventies and early eighties was U.S. Fed (Federal Reserve), headed at the time by Paul Volcker, worried about inflation and thus raised interest rates to high levels. Their attempt was to slow down what they viewed as overheated economy. Inflation was brought down really, from 13.5 percent in 1980 to 3.2 percent in 1983. However, some costs had to be paid, and unemployment was among the most visible. The unemployment rate soared to 9.7 percent; it had been the highest level since the Great Depression. Some economists argue that this disinflationary policy had been a source of the Saving and Loan (S&L) crisis in the late eighties. Fed's increase of the interest rates in its fight against inflation had also another consequence. In the seventies, countries all around the world, especially the countries from Latin America had been encouraged to borrow money from U.S. and European banks. These so called petrodollars came from oil producing states. Latin American debt to commercial banks increased at a cumulative annual rate of 20 percent, so that by 1981 their total foreign borrowing was almost 40 percent of GDP. When the U.S. Fed raised interest rates to high levels in 1981, the Latin American countries had

[6] Woodward, 2001, p.15. Bob Woodward, an assistant managing editor of The Washington Post, has authored for example All President's Men (1974), The Final Days (1976), The Agenda (1994) and Shadow (1999).

difficulties to meet their obligations. Alan Blinder[7], in his 1987 book, *Hard Heads, Soft Hearts*, argues that there was too much hysteria about the inflation at the beginning of the 1980s and criticized Volcker for fighting too much against inflation.

The U.S. President Ronald Reagan reappointed Paul Volcker as the Fed Chairman in 1983[8] but wanted him to lower interest rates[9] in order to support investments. Paul Volcker was not a puppet in the hands of the president, however he was aware of the economic performance and lowered interest rates in response to the weak economy. Further decrease of interest rates did not meet full consensus, where Volcker was on the no-more-decrease site. However, because of some noticeable arguments, in 1987 Reagan decided to change the Fed's chairman. Instead of Paul Volcker, he appointed Alan Greenspan. It was also a political decision as Greenspan was, as well as Reagan, a conservative Republican.

[7] Alan Blinder had become the Fed vice chairman in 1994. Before, between 1993 and 1994 he had been a Member of the President Bill Clinton's Council of Economic Advisers.
[8] The president appoints the board of the Fed and the Senate confirms it. Board members are appointed to 14-year terms. The president appoints the Fed Chairman to 4-year term(Source: Federal Reserve).
[9]In general, Fed sets two short-term interest rates. The discount rate and the interest rate the Fed charges other banks for overnight loans.

Box 1: Biography of Alan Greenspan

Alan Greenspan originally took office as Chairman and to fill an unexpired term as a member of the Board on August 11, 1987. Dr. Greenspan was reappointed to the Board to a full 14-year term, which began February 1, 1992, and ended January 31, 2006. He has been designated Chairman by Presidents Reagan, Bush, Clinton, and Bush.

Dr. Greenspan was born on March 6, 1926, in New York City. He received a B.S. in economics (summa cum laude) in 1948, an M.A. in economics in 1950, and a Ph.D. in economics in 1977, all from New York University. Dr. Greenspan also has performed advanced graduate study at Columbia University. From 1954 to 1974 and from 1977 to 1987, Dr. Greenspan was Chairman and President of Townsend-Greenspan & Co., Inc., an economic consulting firm in New York City. From 1974 to 1977, he served as Chairman of the President's Council of Economic Advisers under President Ford, and from 1981 to 1983, as Chairman of the National Commission on Social Security Reform.

Dr. Greenspan has also served as a member of President Reagan's Economic Policy Advisory Board, a member of Time magazine's Board of Economists, a senior adviser to the Brookings Panel on Economic Activity, and a consultant to the Congressional Budget Office. His previous Presidential appointments include the President's Foreign Intelligence Advisory Board, the Commission on Financial Structure and Regulation, the Commission on an All-Volunteer Armed Force, and the Task Force on Economic Growth. Before his appointment to the Board, Dr. Greenspan served as a corporate director for Aluminum Company of America (Alcoa); Automatic Data Processing, Inc.; Capital Cities/ABC, Inc.; General Foods, Inc.; J.P. Morgan & Co., Inc.; Morgan Guaranty Trust Company of New York; Mobil Corporation; and The Pittston Company.

His noncorporate positions have included Member of the Board of Trustees, The Rand Corporation; Director, Institute for International Economics; Member of the Board of Overseers, Hoover Institution (at Stanford University); and Vice Chairman and Trustee, Economic Club of New York. Dr. Greenspan has served as Chairman of the Conference of Business Economists, President and Fellow of the National Association of Business Economists, and Director of the National Economists Club.

Dr. Greenspan has received honorary degrees from Harvard, Yale, Pennsylvania, Leuven (Belgium), Notre Dame, Wake Forest, and Colgate universities. His other awards include the Thomas Jefferson Award for the greatest public service performed by an elected or appointed official, presented by the American Institute for Public Service, 1976 (joint recipient with Dr. Arthur Burns and William Simon); election as a Fellow of the American Statistical Association, 1989; decorated Legion of Honor (Commander) France, 2000; honorary Knight Commander of the British Empire, 2002; and he was the first recipient of the Gerald R. Ford Medal for Distinguished Public Service, 2003.

Source: Federal Reserve

2.2. Supply side economics

The Reagan's **supply-side economic policy** of lowering of taxes and deregulation lead to long-term growth. Reagan said that the tax cuts would pay for themselves through energizing the economy. The theory was that the tax cuts would spur the economy so much that tax revenues would actually increase. Reagan proposed the idea of the Laffer curve called after Arthur Laffer, which claims that as taxes get higher and higher, people work less hard and save less, so much that tax revenue actually decline. This idea comes out of the supply-side economics, which sees the limitations on the economy imposed by the willingness of individuals to work and save. In opposition to it stands demand-side economics, which emphasizes the limitations on the economy by demand; that the production of firms depends on their ability to sell it, therefore it depends on the consumer purchase power. However, the Reagan's growth was still just over half of what it had been in the fifties and sixties

2.3. Military expenditures

Reagan's conservative economic agenda was cutting back on government. On the other hand, Reagan increased many defence expenditures. Several industries received huge state subsidies over 1980s (e.g. computer, semiconductor, and aerospace companies), legitimized by the military relevance of those industries. These expenditures reached 6.2 percent of GDP in the peak of Reagan's era. Government consumption as a contributor to a percentage change in real GDP reached 1.4% in 1985 (See Fig. 1). During Reagan and Bush I terms, have many producers and manufacturers seen their political influence increase. Some advocates of that defence policy argue that these military expenditures helped to the collapse of communist regime in the Soviet Union because the USSR tried to compete with the U.S. and it was the last straw for their malfunctioning command economy. Reagan's supply side economics thought that any increased taxation on the rich would lead to their lack of interest to work more and save more. Those well-known tax cuts in 1981, on which platform Reagan was elected, were affecting the country's fiscal health. Savings and labour supply did not increase as they predicted[10].

[10] On the other hand, Clinton increased taxes and the economic performance even improved.

2.4. Bush sr.

In 1989, new U.S. president took office. George Bush knew that there were serious problems in the economy (see Table 1) but he did not want to reveal them to public because he did not want to do anything that would imply criticism on his predecessor Ronald Reagan. The problem of the 1980s was the income skewing, that the richer got richer and the poor got much less. When Iraqi President Saddam Hussein invaded into neighbouring Kuwait in August 1990, the whole region began to be unstable. Among several sensitive issues, the vulnerability of oil supply[11] of that region was at the top. The future was unclear. Moreover, the U.S. fiscal policy was at this time influenced by the Democrats, who required reducing the federal deficit. To achieve a macroeconomic stability, Fed had to provide smooth and readable policy. According to Bob Woodward (2001, p.69), Alan Greenspan said at the time: *"We are in a sense in economic-political turmoil. It is crucial that there has to be some stable anchor in the economic system. It's clearly not going to be on the budget site; it has to be the central bank."* Greenspan proposed not to lower interest rates[12], although some of the bank presidents wanted to. Situation in 1990 shows how the fiscal and monetary policies are linked together. When Bush I finally signed the budget agreement, which was reducing the deficit (what had been the Democrat's condition), Greenspan[13] reduced interest rates (see Fig. 2).

TABLE 1: LIST OF 10 NEGATIVE CONDITIONS THAT BUSH FACED IN JANUARY 1989 WHEN HE TOOK OFFICE[14]:
the federal budget deficit and local deficits
high business and consumer debt
the so-called junk bond collapse
commercial real estate overbuilding

[11] A number of Iraqi pilots were prepared to kamikaze Saudi Arabia oil fields
[12] In order to provide a degree of stability, he refused to change interest rates at the time
[13] In this case, I write "Greenspan", because Fed was not unanimous about this decision (7-4, which is relatively narrow).
[14] based on Woodward, 2001, p.94.

Department of Defence budget cuts after the fall of the Soviet Union
a Democratic Congress
American business restructuring and layoffs
the Japanese economic troubles
decrease in exports
an uncooperative Fed

2.5. Saving and Loan Crisis in 1989

"*It was too little deregulation that gave rise to the saving and loan debacle in 1989, in which Americans paid more than $100 billion bailing out an important part of the nation's financial system*"

Joseph Stiglitz[15]

Reagan had been pushing deregulation that allowed banks to invest into risky areas. Bank deregulation in 1980 led to problems in the saving and loan industry in the 1980s. In the aftermath of the saving and loan (S&L) crisis, the Bush administration imposed new regulations on banks. The aim was to discourage risky investments. However, there was another consequence. As banks wanted to meet new regulatory rules, they cut back on their lending. They stopped to invest in risky areas, especially in junk bonds[16]. As there was not enough cheap capital, the economy fell into recession. The Fed lowered interest rates but it might have not been quickly enough. Although the recession was described as short and shallow, measured by the gap between the economy's potentiometer and its actual performance, the 1991 recession was almost as bad as the average post-war downturn. Stiglitz (2003, p.88) argues: *"Misguided deregulation and bad tax policies were at the core of the 1991 recession […]. President Reagan's deregulation of the saving and loan associations, in conjunction with the devastation of banks 's balance sheets caused by the Fed's raising interest rates to*

[15] 2003, p.27
[16] Such a security is a bond, usually a corporate bond, that has a higher than average risk of default, but which pays a higher than average interest rate to compensate

unprecedented levels , contributed to the real estate bubble which, when it burst, not only cost American taxpayers well over $100 billion but led to the recession of 1990-1991."

2.6. Recession in 1990-1991

"We're in a slowdown economically in this country, if not recession"

President Bush[17]

Statistics prove that economic performance is a good predictor of election outcomes. Gerald Ford's economy was influenced by the Arab oil embargo in 1973. OPEC demonstrated its power and the oil prices quadrupled. This sent unemployment in the U.S. up and recession came. By the time of the presidential elections, the U.S. economy was recovering. However, Gerald Ford was not reappointed. Nor was Jimmy Carter, his successor. Recession in 1979, a combination of oil shock and probably too high interest rates set by the Fed, helped to use at this Democratic President. It can be cruel, because many of tools and factors are not in the influence of the government. Monetary policy, which entails setting interest rates and controlling the monetary supply, is a tool of the central bank and external shocks as mentioned oil shocks are sometimes unavoidable.

The August 1990 start of the Gulf War caused driving up energy prices. As a result, economy dipped into recession that lasted through the first quarter of 1991. Fed lowered discount rate by 1 percent to 3 ½ percent in December 1991 (see Fig.2), which had been the lowest number since 1964. Overall in 1991, in ten separate movements, the FOMC[18] had lowered interest rates from 7 percent to 4 percent. Fed stopped to target money supply directly because the velocity[19]could not be measured accurately for many reasons. Therefore, the Fed was essentially just setting the Fed funds rate. Blinder and Yellen (2001) argue that the Fed was too slow to cut interest rates in 1990 and 1991. Stiglitz (2000) says that Greenspan had been quite slow to lower interest rates, fearing of creeping inflation. On the other hand, Wayne Anglell, a Fed governor from Texas, was concerned that during the first three months of 1991 Greenspan had pushed too hard for lower rates (Woodward, 2001, p.78). The Fed lowered interest rates in January, 1991 by ¼ percent, than in February by ½ percent.

[17] In a television interview on January 2, 1991
[18] Federal Open Market Committee
[19] velocity is the number of times money changed hands

Then, Fed lowered interest rates by ¼ percent to 5 ¾ percent on April 30 (see Fig.2). The economy had begun to pull out of recession, when there had been a single quarter contraction of output in 1992. The fourth quarter showed even robust 4.3 percent growth. However, unemployment remained below the level of 1990; almost 3.5 million people lost their job between 1990 and 1992.

George H.W. Bush failed to get reelected in 1992, in spite of record poll results in the aftermath of the Gulf War victory. Many experts argue that it was mainly due to the poor economic performance. Bush might have made a mistake when reappointing Alan Greenspan the chairman of the Federal Reserve Board, although it was not a bad decision for the economy. According to present time polls, around 75% of the people on Wall Street favoured Greenspan's reappointment[20]. However, Bush was not satisfied with this solution and some years later he said:" I reappointed him and he disappointed me.[21]"Woodward (2001, p.94) argues that Bush's loss was similar to the loss of Winston Churchill, who had been thrown out of office after victory in World War II. Bill Clinton was reelected because of very good economic results, whereas last three presidents to lose-Gerald Ford, Jimmy Carter, and George Bush-did not succeed because the economy was not doing well.

[20] Woodward (2001, p.82)
[21] The Wall Street Journal, Aug 25, 1998, p.A16

3. Bill Clinton

Properly functioning institutions are the basis for successful economy and evolution of the market. Douglass North[22] (1996) was an elegant exponent of this view; in his analysis of the development of market economies, he points out the importance of supporting institutions to the market. Successful market economies develop because a society created framework conductive for their development. On the contrary, where these supporting institutions are not created nor do not function properly, market economies do not evolve. This is one of the critiques of the so-called Washington Consensus[23] that tried to apply one-fit-all approach to all transforming countries and omitted institutions. The Reagan and Bush I administration left the office with large debt; however, institutions had been strengthened. Banks were saved, recapitalised. In terms of institutions, the U.S. economy is one of the most favourable. Enforceable law and contracts, properly defined property rights, they all are signs of the U.S. market system.

3.1. Initiatory Conditions

"It's the economy, stupid"

1992 campaign slogan[24]

TABLE 2: PRESIDENTIAL ELECTIONS 1992	
President Candidate	Percent
Bill Clinton	43
George Bush (Bush I)	38
Ross Perot	19

[22] Douglass North was awarded the Nobel Prize.
[23] The Washington Consensus was prepared in the 1980s and included the agreement of the World Bank, International Monetary Fund. Later, in the 1990s, its ideas were used during transformation of former command economies in the Central and Eastern European countries, the Czechoslovakia (the Czech Republic) including.
[24] The slogan was devised by political strategist James Carville and pointed out the fact that Clinton would be engaged in solving economic problems, like cutting the deficit or reducing unemployment.

Clinton inherited a set of problems from Bush I. The economy was in a recession, with slow productivity growth, growing inequality, and huge and growing fiscal and trade deficits. In spite of "supply side" reforms of the president Reagan era, Clinton was supposed to accelerate growth and to cope with an increasing inequality in America. Ronald Reagan had borrowed money to finance his budget deficit from the period that was later the Clinton era. Therefore, the Clinton's administration had to pay back by paying down the deficit in some way. The irony was that Clinton would probably not have been elected if Reagan had not created the deficits (Woodward, 2001, p.97).

Bill Clinton had taken economy more seriously than any other issue. When President Clinton took his office in January 1993, unemployment was 7.3 percent, while GDP in the first quarter of that year was shrinking at –0.1 percent. Accelerated by the recession, the budget deficit had swollen to 4.7 percent of GDP, up from 2.8 percent in 1989. It was clear that the economy was not managed well. When the economic advisers to President Clinton came to Washington, they were poised to address many of the problems that gave rise to the bubble and its bursting; to restore balance, between the role of collective action and private, between government and the market; to create foundations for strong, long-term growth (Stiglitz 2003, p.46).

Box 2: Biography of William J. Clinton

William Jefferson Clinton was the first Democratic president since Franklin D. Roosevelt to win a second term. He could point to the lowest unemployment rate in modern times, the lowest inflation in 30 years, the highest home ownership in the country's history, dropping crime rates in many places, and reduced welfare roles. He proposed the first balanced budget in decades and achieved a budget surplus. As part of a plan to celebrate the millennium in 2000, Clinton called for a great national initiative to end racial discrimination. After the failure in his second year of a huge program of health care reform, Clinton shifted emphasis, declaring, "the era of big government is over." He sought legislation to upgrade education, to protect jobs of parents who must care for sick children, to restrict handgun sales, and to strengthen environmental rules.

President Clinton was born William Jefferson Blythe IV on August 19, 1946, in Hope, Arkansas, three months after his father died in a traffic accident. When he was four years old, his mother wed Roger Clinton, of Hot Springs, Arkansas. In high school, he took the family name.

He excelled as a student and as a saxophone player and once considered becoming a professional musician. As a delegate to Boys Nation while in high school, he met President John Kennedy in the White House Rose Garden. The

encounter led him to enter a life of public service.
Clinton was graduated from Georgetown University and in 1968 won a Rhodes Scholarship to Oxford University. He received a law degree from Yale University in 1973, and entered politics in Arkansas.
He was defeated in his campaign for Congress in Arkansas's Third District in 1974. The next year he married Hillary Rodham, a graduate of Wellesley College and Yale Law School. In 1980, Chelsea, their only child, was born.
Clinton was elected Arkansas Attorney General in 1976, and won the governorship in 1978. After losing a bid for a second term, he regained the office four years later, and served until he defeated incumbent George Bush and third party candidate Ross Perot in the 1992 presidential race.
Clinton and his running mate, Tennessee's Senator Albert Gore Jr., then 44, represented a new generation in American political leadership. For the first time in 12 years both the White House and Congress were held by the same party. But that political edge was brief; the Republicans won both houses of Congress in 1994.
In 1998, as a result of issues surrounding personal indiscretions with a young woman White House intern, Clinton was the second U.S. president to be impeached by the House of Representatives. He was tried in the Senate and found not guilty of the charges brought against him. He apologized to the nation for his actions and continued to have unprecedented popular approval ratings for his job as president.
In the world, he successfully dispatched peace keeping forces to war-torn Bosnia and bombed Iraq when Saddam Hussein stopped United Nations inspections for evidence of nuclear, chemical, and biological weapons. He became a global proponent for an expanded NATO, more open international trade, and a worldwide campaign against drug trafficking. He drew huge crowds when he travelled through South America, Europe, Russia, Africa, and China, advocating U.S. style freedom.
Source: The White House[25]

3.2. Clintonomics

Clinton administration was somehow different from previous Democratic visions. Traditional Democratic rhetoric had been government spending rather than private investment and fiscal discipline. Clintonomics wanted to adopt some of Reagan's pro-market measures and link it with traditional Democratic values, such as progressive taxation environment protection. Clintonomics involved also public-sector reform; defence reconversion and reinventing government allowed previously low-productivity resources to be shifted to more productive uses (Frankel and Orzsag, 2002, p.12).

[25] http://www.whitehouse.gov/history/presidents/bc42.html (downloaded 11/12/05)

In the 1994 election, Republicans won majorities in both the Senate and the House of Representatives, often called the **Gingrich revolution**[26]. The Republicans took control of both houses of Congress for the first time in 40 years. The Republican leadership said that it had a mandate for their policy, which included large tax cuts and the balanced budget amendment[27], known as the "Contract with America." The Clinton administration could not ignore Republicans; therefore, the budget included small middle-class tax cuts as well as various spending cuts. The Democrats accused the Republicans that they proposed "deep cuts in federal spending amount to war on children" (New York Times, February 25, 1995, page 1).

Critics of Mr. Clinton called him a populist. They accused him of allowing public opinion to determine his (not only) economic decisions. However, for example solving the Mexican bailout was not in a short run interest of a median voter[28], and proved to be successful. When we are analyzing Clinton's economic policy and the Democratic shift more to the "right" in 1990s, and when we use microeconomic tools, such as median voter theory, we can easily explain why Clinton was politically successful[29]. Clinton moved more to the centre simply in order to get more votes. Median voter[30] theory explains the growth of consensus in two-party politics[31]. To be fair in evaluating Bill Clinton's shift to the "right," we have to point out the Republican takeover of the Congress. Democrats faced Republican opposition to major initiatives; therefore, the administration was forced to adopt modest agenda in many areas. However, deregulation and capital gain tax cuts provided part of the common policy.

[26] Newton Leroy Gingrich is an American polititian who is best known as the Speaker of the United States House of Representatives from1995 to 1999. In 1995 he was named Time's magazine Man of the Year for his role in leading the Republican Revolution in Congress.
[27]President Clinton attacked the balanced budget amendment and charged that the Republicans' proposed "deep cuts in federal spending amount to war on children" (*New York Times*, February 25, 1995, page 1).
[28] The work of Anthony Downs (1957) suggests that when polititians are vote maximisers, the median voter preferences are critical in determining the outcome of a majority voting rule.
[29] However, it was not only the Republicans, who pushed Clinton more to the right. Lloyd Bentsen, Bill Clinton's Treasury Secretary was a right wing, pro-market Democrat He was the Democratic Chairman of the Joint Economic Committee in 1980, amid stagflation and the intellectual collapse of the reigning Keynesian revolution. The JEC's annual report in 1980 was titled "Plugging in the Supply Side." He was an adherent of supply side economics. He passed away in 2006.
[30] For more about vote maximizing and median voter theory see e.g. Cullis and Jones (1998)
[31] Similar analysis could be made in the United Kingdom, where Tony Blair has shifted his labour party more to the "right".

The old Democrats were seen as pro-regulation and anti-business. At the time, the new Democrats wanted to join forces with the old Republicans and deregulation became a common policy. The so called new Democrats tried to link pro-business issues with the middle class and poor. The Clinton administration included other important policies: free trade, visible reduction of the deficit. The Republican takeover of Congress had a big impact on Clinton’s administration strategy. Clinton was forced to adopt more modest goals in many areas. In fairness to Mr. Clinton, the Republican's takeover of Congress prevented him from pursuing a legislative agenda of his own.

Most important events of the beginning of Clinton’s era were rather ambiguous. On the one hand, there was the successful enactment of the 1993 budget agreement, on the other hand, it was the failure to enact the administration’s Health Security Act[32]. The Clinton administration’s proposal for national health care reform proposal wanted to extend universal health care insurance to more than 40 million Americans. When the CBO released its analysis of the administration proposal, it estimated that the proposal would on balance increase the deficit. In the end, no comprehensive healthcare reform plan passed the Congress in 1994. However, it was Clinton’s failures of his first two years in office, which allowed the Republicans to seize control of the House of Representatives for the first time since the early 1950s. Clinton had problems in his second term as “Republicans fear him and loathe him, and the Democrats resent him as the cause of being in the minority” (Ullmann, 1998, p.62).Clinton’s Re-election in 1996 was particularly important because the Democrats could not afford to lose presidency after losing the Congress in 1994.

TABLE 3: ELECTIONS 1996	
President Candidate	Percent

[32] It would go beyond the extent of this thesis to analyse Health Security Act and its consequences. For discussion about national heath care reform see for example David Cutler & Jonathan Gruber, 2001. "Health Policy in the Clinton Era: Once Bitten, Twice Shy," NBER Working Papers 8455, National Bureau of Economic Research, Inc.

Bill Clinton	49
Bob Dole[33]	41
Ross Perot	8

[33] Bob Dole is a former Republican Senator

4. Fiscal and Monetary Policy

4.1. Deficit, National Debt, and Budget reduction

"*He believed from the start that deficit reduction was the predicate, that we couldn't have a credible activist government unless we could get the budget under control.*"

Hillary Clinton[34]

The 1990s witnessed two fundamental changes in U.S. fiscal policy. Firstly, there was a dramatic improvement in the budget balance, and secondly, we could see a shift to a new political consensus in favour of balancing the budget excluding Social Security rather than the unified budget. The factual end of the Cold War caused an inevitable change in public investments and a budget shift from the cold-war defence-based economy to a peaceful economy, and a shift to a new political consensus. However, the 1990s did not witness significant changes in Social Security policy, although alternative visions of Social Security reform received tremendous analytic and popular attention (Elmendorf et.al, 2001).

When Clinton took his office, the long-term rates[35] were at about 7 percent, which was unusually 3 percent higher than the short-term fed funds rate. Alan Greenspan supported the Clinton deficit-cutting plan; although Greenspan was a Republican, he had to admit that increasing taxes on the wealthy would help to restore public finance. The Fed does not control the long-term interest rate directly; however, there are certain keys how to influence it. With a credible deficit reduction, long-term interest rates drops, this reduces the borrowing and supports the economy. Moreover, increased investment from long-term interest rates had to offset the direct effect of higher taxes and lower government expenditures (Stiglitz, 2003). Clinton administration produced a plan that raised taxes mainly on the rich, reduce deficit spending, and adhere strictly on caps on non-defence spending. Stiglitz (2003, p.42) argues: *"President Clinton was persuaded to make deficit reduction his number one*

[34] Klein, 2002, p. 49
[35] 10-year and longer rates

priority. This meant, of course, putting aside much of the social. But standard economics held that deficit reduction would slow down the recovery and increase unemployment, it shortly made the economy worse. But slower economic growth could lead to larger deficits. So it was necessary to ensure greater deficit reduction in future years. "

David M. Jones (2001, p.53) notes that it was mainly Fed, who calculated that the negative impact on the economy from increased taxes would be more than offset by the positive impact of lower real interest rates arising from increased long-term fiscal discipline . This Clinton policy tried to prove that the economy can recover while the government reduces its budget deficit. It was **a new theory** that Clinton tried to apply. With the dropped long-term interest rates and inflationary expectations, bonds would yield less; therefore, investors would switch to the stock market. Finally, budget reduction could become very risky; the theory was simple, result were uncertain. However, both cutting expenditures and increasing taxes are politically impassable. Bill Clinton decided to cut spending but also to increase taxes, mostly on the rich. This group was the one that profited the best from the low taxation during last two republican presidents, Reagan and Bush. It was expected, and especially opposition called, that the increase of the taxation would lead to economic recession.

Klein (2002) argues that there was one aspect of the early Clinton operation that was entirely professional: the work on economic plan of action, particularly the formulation of the President's first budget, which would have to be presented almost immediately after election. Deficit had to be brought under control as large deficits were not sustainable in the long run. By 1992, the deficit amounted to almost 5 percent of America's GDP (see Fig. 3). This excluded the tax revenues that were supposed to go into the Social Security trust fund. Social Security had been taken officially "off-budget" in 1983, and this action was reaffirmed in the budget legislation of 1985 and 1990 (Koitz, 1998).With Social Security, the deficit figure would be even higher. The national debt was growing too, around a percentage of GDP. Three of Clinton's economic advisors Rubin, Altman, and Shapiro were "deficit hawks[36]," who believed that if the annual budget deficit was brought under control, interest rates would be reduced and the economy would begin to grow again. The rest of Clinton's economic advisors agreed that deficit reduction was important but they placed more emphasis on encouraging economic growth trough government spending in education, social services, and other traditional liberal public works (Klein, 2002, p.48). Joseph Stiglitz (2003, p.93) says that the circumstances of 1992 were unusual, that normally deficit reduction would not lead to economic recovery. The deficit reduction is according to Mr. Stiglitz not a good solution to a short-run economic downturn and it may be even bad for long-run economic growth[37].

TABLE 4: MEMBERS OF THE COUNCIL OF ECONOMIC ADVISORS DURING THE CLINTON ADMINISTRATION			
Laura D'Andrea Tyson	Chair	February 5, 1993	April 22, 1995.
Alan S. Blinder	Member	July 27, 1993	June 26, 1994.
Joseph E. Stiglitz	Member	July 27, 1993	
	Chairman	June 28, 1995	February 10, 1997
Martin N. Baily	Member	June 30, 1995	August 30, 1996.
Alicia H. Munnell	Member	January 29, 1996	August 1, 1997.
Janet L. Yellen	Chair	February 18, 1997	August 3, 1999.
Jeffrey A. Frankel	Member	April 23 1997	March 2, 1999.
Rebecca M. Blank	Member	October 22, 1998	July 9, 1999.
Martin N. Baily	Chairman	August 12, 1999	January 19, 2001.
Robert Z. Lawrence	Member	August 12, 1999	January 12, 2001.
Kathryn L. Shaw	Member	May 31, 2000	January 19, 2001.

[36] Deficit hawk is an American political slang term for those who place great emphasis on keeping the federal budget under control, and deficits low.
[37] The European Union has seen its economic policies in the so-called stability pact, limiting the size of government deficits. Europe says expansionary fiscal policy is not the medicine needed in economic downturn.

Source: Council of Economic Advisers.
http://www.whitehouse.gov/cea/about.html

4.2. Key fiscal policy points

In the book The Agenda of Bob Woodward (1994) we can find how deficit reduction moved in the centre in Bill Clinton's agenda, although this was not the agenda on which he has been elected. He came to the White House mainly to create jobs and later on, he and his team of economic advisers (see Table 4) were persuaded that without deficit reduction, financial markets would not support his policy and without this support he would not be able to accomplish the rest of his agenda.

4.2.1. 1990 budget agreement (OBRA90)

The Bush I administration's 1990 budget agreement represented an important step towards fiscal discipline and included marginal tax rate increases, by further raising taxes[38] on the highest-income payers and reduced spending. In January 1990, the CBO[39] projected that the unified budget deficit would exceed $100 billion during the fiscal year then under way and would remain at about that level for the following five years (see Fig. 4). Two years later, the CBO projected that the budget deficit would hit $350 billion in fiscal year 1992, fall by half over the following four years, and then turn up again to pass $400 billion in 2002 (Elmendorf et al., 2001).

4.2.2. 1993: The First Clinton Budget (OBRA93)

In their economic plan Putting People First, Bill Clinton and Al Gore wrote (Clinton and Gore, 1992, p.7): *"Our strategy puts people first by investing more than $50 billion each year over the next four years [...]. To pay for these investments and reduce our national debt, we will save nearly $300 billion by cutting spending, closing tax loopholes, and requiring the very wealthy to pay their fair share of taxes."* The budget shift towards non-defence expenditures meant that if the Clinton

[38]See Kohout, 2006.

[39] Congressional Budget Office

administration brought down military expenditures to a 3 percent, they could reduce much of the deficit. The budget plan wanted to cut $500 billion from spending the deficit over the next four years by increasing taxes and cutting expenditures. However, this Clinton's deficit reduction plan did not get any support from the Republicans[40]. The Republicans majority in the Congress permanently used various strategies to implement their own fiscal policy. Firstly, they refused to pass appropriations bills for the following fiscal year until their amendments had been met. Secondly, they pointed out the statutory limit on federal debt. In November 1995, the Clinton administration was on track to exceed the debt limit by November; doing so would have caused the government to default for the first time in history, because it would have been unable to borrow sufficient funds to meet its obligations (Elmendorf et al, 2001). Taking various fiscal operations[41], the administration avoided this threat, while being strongly criticizes by the Republican opposition. By April 1996, President Clinton and the Congress essentially agreed to disagree: they passed a modest budget package that funded the government at close to current-law levels and made small changes in tax policy. Many observers believed that President Clinton had won the battle over the shutdown and had staked out the political centre as a fiscally disciplined moderate. Frankel and Orzsag (2005, p.5) argue that the fiscal discipline created by the 1990 budget agreement and extended by the 1993 budget deal substantially reduced the scope for policy-makers to create or expand programs in a dramatic way.

[40] The House and Senate passed separate budget plans by very narrow margins in May and June, but the outcome of the conference process was still very uncertain. Finally, in August, the The House approved a deficit-reduction plan by a 218-to-216 vote, with all Republican members voting against and nearly all Democrats voting in favour. The next day, the Senate passed the bill, on a vote of 50-50, again with all Republicans voting against, and with Vice President Al Gore casting the tie-breaking vote in favour of passage. As Bob Woodward (2001, p.110) notes, the only real Republican support had come from Greenspan. It was signed into law as OBRA93.

[41] Treasury Secretary Rubin ordered the suspension of new investments for the federal employees' defined-contribution retirement plan and the early redemption of some bonds held by the civil service defined-benefit retirement fund. In mid- February, with the impasse over the debt limit still continuing, Rubin suspended investment of Treasury's Exchange Stabilization Fund, redeemed additional securities prior to maturity from the civil service retirement fund, and authorized a set of asset exchanges among a government trust fund, a government corporation, and the Treasury (Elmendorf et al, 2001).

Table 5: The First Clinton Budget[42]	
Tax increase:	**Spending reduction (cuts in):**
A new top income tax bracket	defence spending
Removal of the wage cap for Medicare taxes	Medicare provider reimbursements,
Broad-based energy tax	a range of nondefense discretionary spending

4.3. Net national saving[43]

Federal saving helped to improve the situation of net national saving. Between 1992 and 1997, a decline in saving by households, businesses and state and local governments offset some of the rise in federal saving, but total national saving still increased by almost 3 percent of GDP(see Fig. 12). After 1997, national saving declined, however this was caused mainly due to a sharp drop in non-federal saving[44]; federal saving continued to increase due to substantial budget surpluses. Elmendorf et al.(2001) argue that the significant increase in the nation's capital stock generated by the investment boom of the 1990s benefited the economy in several ways. First, it helped productivity to rise: **labour productivity** increased nearly twice as fast between 1995 and 2000 as between 1975 and 1995. Second, it helped contain inflation: the rate of change in the price index for personal consumption expenditures excluding food and energy drifted downward through most of the decade, even as the strength of the economic expansion increased. Strong economic growth brought about a growth in tax revenue and huge budget deficits in the 1980s were replaced by substantial budget surpluses in the 1990s. This shift accounted for improvement in net national saving between 1993 and 2000 (see Fig.12), which lowered long-term interest rates and allowed boost of private-sector investment during 1990s.

[42]For more about First Clinton budget, see Elmendorf, Liebman and Wilcox(2001), Woodward (1994) or Reich (1997). For discussion about the budget see Blinder and Yellen (2001)
[43]Net national saving is total saving less capital depreciation.
[44]The consensus view attributes that decline primarily to the dramatic runup in stock prices. See for example Elmendorf et al. (2001)

Conventional wisdom indicates that the nation should save more now in preparation for the retirement of the baby boom generation. With lower fertility and rising longevity, the output generated by each worker will need to support the consumption of a larger number of workers and retirees in the future than it does today.

4.4. How did it work?

The theory says that increasing taxes or reducing expenditures in an attempt to reduce the deficit would slow down the economy. Standard economic texts[45] see government necessity only when there are significant externalities, anticompetitive practices, and other market failures[46]. Traditional economic analysis of deficit reduction implies that increasing taxes or reducing government spending depress economic activity in the short run but raise savings, investment, productivity, and the overall productive capacity of the economy in the future. An alternative view on the short-run effect of deficit reduction was developed in the 1980s[47]. However, in 1993, this theory was still only a theory and had not been tested before. The idea is straightforward: an expectation of lower future deficits reduces future short-term interest rates, and these lower short-term rates would be capitalized into lower current long-term interest rates. Lower long-term interest rates could stimulate business investment and other interest-sensitive spending immediately, offsetting at least some part of the direct contractionary effect of deficit reduction. The net effect on short-run output would depend in part on the size of the reduction in the current deficit compared with the expected reduction in the future deficit (Elmendorf et al, 2001). In reality, the bond market believed that the deficit would decline in future and so the interest rates came down. However, in 1993 things did not work smoothly at the beginning. Elmendorf et al. (2001, p. 15) write:

"A July 15th memo to the President from the Council of Economic Advisers reportedly noted that the economy was weaker than had been anticipated and that

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[45]See for example R.A. Musgrave and P.B. Musgrave (1989) or Cullis and Jones (1998).
[46] Market failures usually include positive (e.g. health or education) or negative (various pollution) externalities, insufficient supply of public goods , merit wants (e.g. government safety regulations or drug legisaltion), asymmetry of information (consumers are not as well informed as producers or vice versa-e.g. moral hazard and adverse selection in insurance), imperfect market structure (monopoly, oligopoly), and equity (market can be efficient but not fair).
[47] See for example Blanchard (1984) or Branson (1985).

the budget plan then working its way through Congress was more contractionary in direct terms than the President's original proposal. Nonetheless, the Administration retained its public commitment to deficit reduction."

By lowering the deficit, the Clinton administration ended up recapitalizing a number of American banks. The Clinton administration adopted new regulations to require banks to maintain adequate capital in case their loan portfolios weakened. Perspective, long-term loans are risky even if there is no chance to default, because it can decrease in case when interest rates increase (Stiglitz, 2001).

4.5. 1997: Second Clinton's Budget

In 1997, Clinton had negotiated a balanced budget with the Republican majority in Congress. There was, for the first time in forty years, a prospect of a surplus, and the Republicans wanted that money for a tax cut. As public seemed to be more interested in preserving its own old-age pensions than it was in tax cuts, the Clinton administration decided to put money into Social Security. *"But everyone knew that the budget wasn't really well balanced,"* Robert Rubin, who was then Treasury Secretary, said. *" Surpluses were being projected-not the sort of surpluses we eventually got; no one saw those coming at that point- we also expected that discretionary spending was likely to exceed the forecast. A tax cut would probably throw us back to deficits."* (Klein, 2002, p.7).

The CBO estimated that this legislation would produce much less deficit reduction than OBRA90 or OBRA93 (see Fig. 4), but would lead to a balanced unified budget in 2002 (Elderman, p.23). However, Medicare spending fell more than CBO estimated, therefore the budget in next years was better than expected.

4.6. Social Security

"I think Social Security is off the table for the foreseeable future. We have so many other more pressing and more immediate problems and we ought to focus on the ones that are immediate, not the ones that are 20 years out" [48]

[48] A Democratic Senator (Washington Post, December 12, 1994, page A8)

Social Security is the U.S. government program that had been established in 1935 and covers almost all U.S. workers[49]. The 1990s did not witness any fundamental reform of Social Security policy. President Clinton pursued **Social Security Reform**, which was based on general revenue contributions to the trust fund and centralised investment in equities rather than creating individual accounts. However, his proposal was not adopted, even though there was a consensus that both Social Security and Medicare Trustees needed (and still need) a fundamental reform[50].

The improvement in federal finances in the 1990s is remarkable. At the beginning of the 1990s, federal budget deficit was around 4 percent of GDP (See Fig. 4), and the public debt reached nearly 50 percent of GDP[51]. By the end of the decade, the budget had the largest surplus since 1948(see Fig. 7) (Douglas W. Elmendorf in Orzsag and Frankel, 2002, p.63) and the public dept had dropped to 35 percent[52]. The primary causes for a long-term instabilities and imbalances of continue to be the aging of the population and rising medical costs[53] Moreover, spending on medical care is projected to rise faster than GDP for decades to come due both to population aging and to the adoption of new medical technology.

Clinton was aware of these imbalances of both Medical and Social Security Trustees. Three important commissions on entitlement reform during the 1990s considered changes in Social Security.[54] Nevertheless, nothing revolutionary happened in these areas during Clinton's first term (1993-1996). None of the proposals came close to being enacted, even though the situation was clear to be unstable in the long run. As the fiscal deficits were the number one problem at the

[49] Including the author of this thesis, a former U.S. worker.

[50] For example, the Social Security Trustees projected in 1997 (Board of Trustees, 1997) that Social Security outlays would rise from 11 percent of payroll in 1997 to 20 percent of payroll in 2075, requiring a 50 percent increase in the payroll tax if no other changes were made.

[51]This was the first time since 1950s that the public debt had so high share of GDP

[52]The U.S. would therefore fulfil the so called Maastricht Criteria of the EU

[53] This is not a specific U.S. problem. The EU is experiencing the same situations with declining fertility and rising life expectancy (See Graph the ratio). Among steps that try to solve this problem, immigration of young educated families with children have proved to help the population curve in the future. Nevertheless, immigrants can not be the only solution for the aging of population. Substantial reforms of medical and social systems both in the U.S. and in the EU are necessary. However, they are- or will be- financially and politically demanding.

[54] For discussion and proposals of these three commissions see Elmendorf et al. (2001). This thesis only mentions the outcome of the reform. The Commissions were: The Bipartisan Commission on Entitlement and Tax Reform co-chaired by Senators Bob Kerrey and John Danforth, the 1994-1996 Advisory Council on Social Security chaired by Edward Gramlich, and the 1997-1998 National Commission on Retirement Policy co-chaired by Senators John Breaux and Judd Gregg and Congressmen Jim Kolbe and Charles Stenholm.

time, a reform of a system that was projected to remain solvent for at least another 30 years was put off the table[55].

During the preparations for his second inaugural address, President Clinton had told his advisers that he wanted to make strengthening Social Security one of his top goals for his second term. This second term was rather different. There was no threat of huge budget deficits, after more than 40, there was a prospect for a budget deficit. However, President Clinton was pushed by the Republicans to use this budget surplus for deep tax cuts. Clinton, on the other hand, was afraid of these cuts, as "likely to have adverse distributional consequences and to reduce national saving at a time when the country should be saving more to prepare for the retirement of the baby-boom generation" (Elmendorf et al., 2001, p.35).Stiglitz[56] strongly opposed any privatization attempts of Social Security. In his bestseller The *Roaring Nineties*, he points out the stock market crash of 2000 and says (2003, p.197) that it highlights perhaps the greatest weakness of privatization:" it leaves individuals vulnerable to to the irrational pessimism of the stock market." Stiglitz solution of Social Security problems is in adjusting the retirement age and taxes, not –even a partial-privatization.

In 1998, the Clinton's administration adopted "Save Social Security First" strategy. Its basis was to reserve the entire unified budget surplus pending Social Security reform[57]. Bill Clinton also presented five principles that should guide Social Security Reform (see Table 6).

TABLE 6: FIVE PRINCIPLES THAT GUIDE SOCIAL SECURITY REFORM
strengthen and protect Social Security for the twenty-first century
maintain universality and fairness
provide a benefit people can count on

[55]The Czech Republic's pension system is projected to be remain solvent until about 2030 and obviously, the approach of Czech politicians and the lack of any reform effort is comparable.
[56] Stiglitz (2001, p.193) argues:" The United States has an extremely successful Social Security system. It has virtually eliminated poverty among the aged by providing income security to millions of Americans."
[57] This strategy did not mean that the entire surplus would necessarily be used for reform, but rather that the President would not support other uses of the surplus—either for tax cuts or spending increases—until reform was accomplished and it became clear how much of the surplus was needed to finance that reform (Elderman et al., 2001, p.38).

	preserve financial security for low-income and disabled beneficiaries
	Maintain fiscal discipline

There were a couple of options how to reform the Social Security[58]. However, relatively little time was spent analyzing traditional reform options such as raising the retirement age, adjusting the indexation of benefits, or changing the tax status of benefits. Nearly all Social Security reform proposals involved some investments in private financial assets. The debate is important for Czech policy makers, who will have to make the decision whether to favour individual accounts or collective investing, while reforming Czech pension system.

In the 1999 State of the Union Social Security Proposal, President Clinton decided to pursue Social Security reform based on bolstering the Social Security trust fund rather than on creating individual accounts. Ultimately, the President decided to stick with the unified budget approach to budgeting that had been the norm since the Johnson Administration. In his 1999 State of the Union address, President Clinton built on the earlier strategy to "Save Social Security First" by proposing a specific budget framework for Social Security reform and long-term fiscal discipline. This framework proposed an allocation of unified budget surpluses. In contrast with prevailing practice, this allocation extended over the unusually long time frame of fifteen years because there were insufficient resources in the first ten years to accomplish all of the President's objectives. Greenspan provided crucial support for transfers to the Social Security trust fund while reiterating his strong opposition to government investment in private markets: [Greenspan] endorsed President Clinton's proposal to let federal budget surpluses accumulate by locking up most of the money in the Social Security and Medicare trust funds. But he attacked Mr. Clinton's plan to invest as much as 15 percent of the Social Security trust fund in the stock market, arguing that it would be "virtually impossible" to insulate investment managers from political influence[59].

[58] For all of possibilities, see Elderman et al. (2001)
[59] Wall Street Journal

TABLE 7 THE TURNAROUND IN THE FEDERAL BUDGET (SHARE OF GDP; FISCAL YEARS)

Year	Unified Budget Balance	Receipts	Non-Interest Outlays	Debt Held by Public	Individual Income Taxes	Defense Spending	Entitlement Spending
1986	-5.0	17.5	19.4	39.6	7.9	6.2	10.5
1987	-3.2	18.4	18.6	40.6	8.4	6.1	10.2
1988	-3.1	18.1	18.2	40.9	8.0	5.8	10.1
1989	-2.8	18.3	18.1	40.5	8.2	5.6	10.2
1990	-3.9	18.0	18.6	42.0	8.1	5.2	10.9
1991	-4.5	17.8	19.0	45.4	7.9	5.4	11.8
1992	-4.7	17.5	19.0	48.2	7.7	4.9	11.5
1993	-3.9	17.6	18.5	49.5	7.8	4.5	11.2
1994	-2.9	18.1	18.1	49.4	7.8	4.1	11.3
1995	-2.2	18.5	17.5	49.2	8.1	3.7	11.2
1996	-1.4	18.9	17.2	48.5	8.5	3.5	11.1
1997	-0.3	19.3	16.5	46.0	9.0	3.3	10.9
1998	0.8	19.9	16.3	42.9	9.6	3.1	10.8

1999	1.4	20.0	16.1	39.7	9.6	3.0	10.7
2000	2.4	20.6	15.9	34.7	10.2	3.0	10.5
Source: CBO (2001).							

4.7. Monetary Policy

"In Greenspan we trust"[60]

According to the theory, the Federal Reserves' sole responsibility is to push unemployment as low as possible without igniting increased inflation[61]. Lowered interest rates can contribute to the deficit reduction because GDP will be higher; lower rates lead to more investment and therefore to more output and more employment. Today, the interaction between the Federal Reserve and the Administration is more informal but also perhaps more continuous. However, that relationship is less focused on monetary-fiscal policy coordination than on regulatory and international economic issues. This change has reflected the smaller role of fiscal policy in stabilization ever since the early 1980s, when the Reagan Administration shifted the focus to longer-run issues related to encouraging more rapid trend growth. Stabilization policy since that time has been dominated by the Federal Reserve, with coordination of policies becoming especially important at major turning points in the thrust of fiscal policy-for example, when the Clinton Administration decided to make a reduction in the structural federal budget deficit the substantial part of its economic policy strategy in 1993.

Chairman Alan Greenspan's job was quite impressive. Greenspan followed a tight monetary policy at the beginning, and followed his predecessor Paul Volcker's steps. A permanent surge in productivity growth during 1990s, arising mainly from high-tech investment boom, had lifted the non-inflationary level for real

[60] The title of one articles praising Alan Greenspan. See Rob Norton (1996).
[61] Officially, the Fed is mandated to do its best to achieve maximum employment. The legal act that says so is called The Humphrey-Hawkins (Full Employment and Balanced Growth) Act of 1978.

GDP. Greenspan was more tolerant of rapid growth during 1996-2000. FED tightened its policy stance in 1999 sufficiently to absorb the extra liquidity provided in 1998 to cope with the global financial contagion. Nevertheless, Fed Chairman did not begin a series of counter-cyclical rate hikes until early 2000, when he perceived that in aggregate demand growth exceeded growth in potential supply, thereby exerting increased strain on an already tight labour market and threaten an escalation in wages and prices[62].

There are different opinions on one of the most important issues when evaluating any central bank governor, on his **transparency**. In the 1990s, the Fed became more transparent. At 1994 meeting, the Fed began to announce its funds-rate target after each meeting, together with its assessment of economic conditions and its policy bias moving forward[63]. The change meant that monetary policy was now better understood by the public and by markets. David M. Jones (2001,p.19) argues that:" Significantly, Greenspan has been more transparent about Fed policy intentions than any of his predecessors"[64], financial market often seemed to be not sure about future Fed's actions. During 1990s, many nations[65] adopted some form of inflation targeting[66]; however Fed's policy avoided any commitment to a policy rule. It used some kind of discretionary policy at economic stability of the 1990s proved that it this policy might work well. Arguably, the uncertainty could have been caused by the fact that Fed did not undertake standard inflation-targeting policy. Today (2006), new Fed Chairman Ben Bernanke formalized this policy in Fed, what has been seen as a logical step towards higher transparency.

[62] Now What Alan, Greenspan Struggle to rescue the economy and keep pace with the new president, David M. Jones, The International Economy, March/April 2001, pp.18-53
[63] http://online.wsj.com (downloaded 12/1/06)
[64] Jones 2001,p.19
65For example the Czech Republic
66Basically in inflation-targeting regimes, the central bank is responsible for achieving a publicly announced target for the inflation rate. While the objective of controlling inflation enjoys wide support among both academic experts and policymakers, and while the countries that have followed this model have generally experienced good macroeconomic outcomes, many important questions about inflation targeting remain.(Bernanke and Woodford, 2005).Ben S. Bernanke has been nominated to replace Alan Greenspan as chairman of the Federal Reserve Board of Governors on February 1, 2006. Bernanke is widely expected to advocate that the Fed move away from a discretionary monetary policy toward one based on inflation targeting.

4.7.1. *Inflation*

Apart from the Republicans, there was another issue, the inflation, which threatened the budget reduction. There were significant inflationary signs in 1993, at the time, when the European economies were also “under stress.” The proposed U.S. health care reform, which Hillary Clinton supervised, was supposed to bring additional inflationary pressures. Therefore, there was an obvious problem for the Fed: either not to raise interest rates in order to support the Clinton’s administration fiscal policy or to raise the rates in order to cope with the inflation. The latter would be according to New York Times “a declaration of war” to the White House[67]. The Fed decided to raise interest rates by ¼ percent in February 1994[68]. It was the first move of the rates after 15 months of having them at 3 percent and it was the first increase after five years[69]. Therefore, Greenspan required unanimity in the FOMC and he communicated this increase with the President. Later in 1994, the FOMC raised interest again (see Fig.2), the Fed was afraid of a financial bubble. The Clinton’s administration did not appreciate these increases, as they came to slow down the economy.

There was substantially less inflation than in 1970 and in 1980s. (See Table 8). . N.Gregory Mankiw (2001) argues that the truly remarkable feature of the 1990s was not just its low inflation, but its low and steady inflation (See Table 8). Mankiw’s calculations uncover **the historical stability of inflation** during 1990s. He demonstrates that the more weight is given to inflation stability, the more exceptional the monetary policy of the 1990s appears. The Table 11 shows that the average productivity growth is not exceptional; however, if we split the decade in half, we can see outstanding growth in the second half. The relationship among unemployment, inflation, and productivity is not yet fully uncovered by economists[70]

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[67] *The Federal Reserve Prepares for a Rate War*. June 1, 1993, Tuesday By Steven Greenhouse (Special to The New York Times); Financial Desk Late Edition - Final, Section D, Page 1, Column 5

[68] It was the first time in the history of the Fed, when FOMC publicly announced a fed funds increase (Woodward, 2001, p. 121).

[69] The Dow Jones index dropped nearly 100 points to 3871 (see Fig.6) on the day, the FOMC announced the increase. This had been the largest one-day loss since 1992.

[70] Laurence Ball and Robert Moffitt (2001) explore this link in the 1990s: If workers’ wage demands lag behind news of productivity, accelerating productivity may lead to lowering the natural rate of employment (U_n). If the central bank is unaware of the falling U_n and may leave more decline in the economy than it realises, putting downward pressure on inflation. Therefore, the surprising acceleration from the poor productivity growth of the 1970s and 1980s may have acted like a lucky shock to the aggregate supply.

TABLE 8: INFLATION EXPERIENCE, DECADE BY DECADE	***1950s***	***1960s***	***1970s***	***1980s.***	***1990s***
Average inflation	***2.07***	***2.33***	***7.09***	***5.66***	***3***
Maximum Inflation	9.36	6.20	13.29	14.76	6.29
Date of Maximum Inflation	Feb 1950	Dec 69	Dec 79	Mar 80	Oct 90
Standard deviation of inflation	2.44	1.48	2.72	3.53	1.12
Source: Department of Labor, Gregory N, Mankiw (2001)					

*4.7.2. **Fed and NAIRU***

The non-accelerating inflation rate of unemployment, NAIRU[71], is such a level of unemployment below which inflation will start to increase. In fact, the term is a bit misleading. It should be the no-increasing level of inflation, NIIRU. The theory is based on the so-called full employment rate, which is the lower rate, at which the economy can go without triggering inflation. Policy reactions were different in the late 1990s because the economy appeared to have experienced a sharp change in behaviour along at least two dimensions. Unemployment could have been allowed to decline, because throughout 1998 and 1999 inflation not only failed to accelerate in response to the continuing decline in unemployment but even decelerated. This called into question the continuing relevance of **the Phillips curve**, the long-standing mainstream view that unemployment should not be allowed to fall

[71] http://www.econ.jhu.edu/people/ball/aeawp.pdf (downloaded 03/02/06)

below the natural rate or NAIRU, for that would inevitably be accompanied by an acceleration of inflationary. The second change of behaviour was in the growth of productivity. At the end of the decade, no consensus had yet emerged to explain the positive correlation of inflation and unemployment in the late 1990s. Gordon (2001) attempted to explain this "malfunctioning" of the Philips Curve. Alan Greenspan hypothesized the theory of the "traumatised worker", someone who felt job insecurity in the changing economy and so was accepting smaller wage increases (Woodward, 2001, p.168). George A. Akerlof[72] in his paper The Macroeconomics of Low Inflation (1996) argues that driving inflation too low might be a source of higher permanent unemployment. Bill Clinton, as a Democrat, was more interested in unemployment than inflation. When he appointed Alan Blinder[73] and Janet Yellen as Fed members, he attempted to shift Fed from fighting inflation to fighting unemployment[74]. Nevertheless, between 1994 and 1995, the interest rates doubled from 3 percent to 6 percent (see Fig. 2). The first interest rates cut came on July 6, 1995, by ¼ percent, then by another ¼ percent in December that year, taking the Fed funds rate to 5 ½ percent.

The member of the Federal Reserve board Laurence H.Meyer wrote in 1997: *"I am a strong proponent of the Phillips Curve and the NAIRU concept*," and added that economy was growing at an "unstable growth", which low unemployment would lead to high inflation (Wessel, 1997).Stock and Watson (1999) argue that although the combination of low unemployment and low inflation in the late 1990s casts doubts on the "Philips Curve" trade-off between these variables, careful statistical analysis suggests than unemployment and related variables are among the most useful data in forecasting inflation.

However, inflation was not rising and there were even no signs of it, moreover the unemployment rate dropped to 4.9 percent (see Fig.10), which had been the lowest number since 1973.

[72] George A. Akerlof is the 2001 Nobel Laureate in Economics. Akerlof is the husband of Janet Yellen, member of the Board of Governors of the Fed and President's Council of Economic Advisors during the Clinton's presidency.
[73] I write about Blinder's critique of Volcker's anti-inflationary in chapter 2
[74] However, The New York Times noted that emphasising jobs over inflation was like "sticking needles in the eyes of central bankers" (The New York Times, September 26, 1994)

Woodward (2001, p.153) writes about Greenspan's policy before 1996: The economic analysis he has given Clinton in December 1992 was working. The payoffs he anticipated were evident; the intermediate- and long-term interest rates were below their levels at the beginning of the 1995. Bond prices, which usually move in the opposite direction as interest rates, were up substantially, and the stock market was up about 35 percent with the Dow Jones Index (Fig. 6)) at 5117-its best in two decades. During 1990s, inflation was consistently below the forecasts made by conventional Phillips curve specifications. This raised the possibility of a large decline in the NAIRU in the mid-1990s or possibly a broader breakdown of the Phillips curve altogether[75]. However, Stock and Watson (1999) argue that this poor performance is associated with the specific use of unemployment rate as the activity indicator.[76]

TABLE 9: THE FEDERAL RESERVE BOARD IN THE EARLY 1990S
Alan Greenspan
Vice Chairman David W. Mullins[77]
Susan M. Phillips
John P. LaWare
Edward Kelley Jr.
Lawrence B. Lindsey
Wayne D. Angell

At the time, the Fed's econometric models said that the NAIRU was somewhere 6.0 and 6.2. However, unemployment fell through the 6.0 and the Fed did

[75] See Gordon (1998) or Stock and Watson (1999) for a discussion.
[76] Instead of unemployment rate, they see more valid Phillips Curve forecasts using alternative activity measures
[77] David Mullins pushed for rate cuts. During his first 2 ½ years on the Fed, short-term interest rates were cut from 8 ¼ to 3 percent (Woodward, 2001)

not increase interest rates. There are important hypothesis if we want to analyse monetary policy of the central bank. Firstly, the theory says that it takes six months to a year for the full effects of changes in monetary policy to be felt. Secondly, high inflation damages long-term economic growth. This hypothesis is controversial, as it has only been proved in countries with much higher inflation rates than those ever seen in the United States. Thirdly, when inflation gets going, it s very difficult to bring it back under control. Finally, the inflation hawks claim that they must take anticipatory action because the costs of combating inflation are higher than benefits that the economy might register while rapidly growing. As the Fed raised interest rates, the Clinton administration began to fear that the brakes were being applied too early and too hard. Unemployment continued to fall and inflation remained moderate. The growth in 2000 reached 5.0 percent (see Fig. 11) and inflation was under 3.5 percent.

TABLE 10: THE FEDERAL RESERVE BOARD AFTER 1996
Chairman Alan Greenspan
Vice Chairman Alice Rivlin
Janet Yellen
Laurence H.Meyer
Susan M.Phillips
Edward Kelly Jr.
Lawrence B.Lindsey

*4.7.3. **Interest rate policy***

TABLE 11 MONEY SUPPLY	***1960s***	***1970s***	***1980s***	***1990s***
M1				
Average	***3.69***	***6.35***	***7.78***	***3.63***
Standard deviation	2.15	1.61	4.1	5.42
M2				

Average	**7.05**	**9.49**	**7.97**	**4.04**
Standard deviation	1.63	3.22	2.29	2.39
Source: Department of Labor				

The central bank influences interest rates by adjusting the money supply[78]

Looking and the Table 9, that the average growth of money supply was smaller than in previous decades. Mankiw (in Frankel and Orzsag, 2002) argues that this supports the quantitative theory of money. Fundamentally, this theory says that slower money growth and lower inflation go hand in hand. On the other hand Mankiw argues that the data give no support to the monetarist view [79] that: "*...stability in the monetary aggregates is a prerequisite for economic stability*"(ibid, p.34). Indeed, when we look at the data, the volatility (standard deviation) was relatively high in the 1990s, although the economy was in a period of no significant macroeconomic shocks. Alan Greenspan was confident that monetary aggregates are not so much reliable[80], the Fed chose to shift its policy to use the short-term interest rate as an intermediate target. The most interesting finding of Mr. Mankiw in his analysis of Fed's monetary policy in 1990s is the following data.

TABLE 12: THE FEDERAL FUNDS RATE, DECADE BY DECADE[81]				
	1960s	***1970s***	***1980s***	***1990s***
The typical response of the federal funds rate to a one-percentage-	***0.69***	***0.85***	***0.88***	***1.39***

[78]Basically, the money supply is the price of money in the economy

[79]Monetarist view: Milton Friedman is the most known proponent of this type of monetary policy. It simply requires the central bank to use a stable growth of the money supplly, therefore the economy would avoid high inflation or deflation.

[80]"Greenspan Upbeat on U.S. Economy," Financial Times, February 20, 1993.

[81] Numbers are computed using 120 months of data for each decade. The first line is derived from an ordinary least-squares regression of the federal funds rate on a constant, the unemployment rate, and the core inflation rate over the previous 12 months.

point increase in core inflation[82]				
Standard deviation	1.78	2.54	3.38	1.39
Source: Federal Reserve, Department of Labor, Mankiw (2001)				

In the 1990s, the rise of inflation was met by an even larger rise in the nominal interest rate (an average respond was 1.39 percent, see Table 12). Moreover, high responsiveness of interest rates to inflation was accompanied with low volatility. Mankiw explains it in this way: "the more Fed responds to inflationary pressures when they arise, the less of problem inflation becomes, and the less it has to respond to later" (Frankel and Orzsag, 2002, p.36). **The lesson** is clear: to maintain stable inflation and stable interest rates in the long run, a central bank should raise interest rates substantially in the short run in response to any inflationary threat[83].

The Fed continued to cut interest rates through October of 1992, bringing the Fed funds rate to 3%, where it would remain for 16 months (See Fig. 2). Inflation was around 3% in 1992. The economic recovery continued throughout 1993, and by February 1994 the Fed had once again become concerned about inflation and raised interest rates, in several moves from 3% to 6% in 1995. The inflation was brought under control, while economic growth picked up and unemployment fell.

During 1996 and 2000 productivity grew by 2.4% a year on average. Technological improvements helped productivity to recover after a long decline started in 1970s. Wages rose, stimulating demand, and company's earnings and share prices grew. Some called it "the economic miracle." However, the growth had also a negative signs, Alan Greenspan called it the "irrational exuberance." The Fed faced a choice. Either it would increase interest rates and risk causing an economic downturn,

[82]A measure of inflation which excludes certain items that face volatile price movements. Core inflation eliminates products that can have temporary price shocks (i.e. energy, food products) because these shocks can diverge from the overall trend of inflation and give a false measure of inflation. Core inflation is thus intended to be an indicator of underlying long-term inflation.
[83]See Taylor (1999)

or keep monetary policy accommodative and risk feeding an asset bubble. The Fed did relatively little to move interest rates between 1996 and 1999 (See Fig 2.)[84].

[84] The only exception was three consecutive quarter-point cuts in 1998 after Russia defaulted on its debt

5. Economic Performance

5.1. The New Economy

The economy was changing during the Clinton's presidency. The technological innovation and especially the computer revolution, the Internet, that all had become a part of prosperous economy. Therefore, it is difficult to find out what affected the economy more, whether the deficit reduction or technological changes. The so-called New economy, that took place in the nineties, represents among others just-in-time production, a shift of production of goods to the production of ideas. Manufacturing had shrunk to 14 percent of total output and even smaller proportion of total employment. In 1990s, the age of outsourcing started; firms began to focus on their core competencies by outsourcing certain activities[85]. Of course, this has come about with a rapid increase in the number of new firms. Since 1980s, new technologies came up, clustered around technology and new media, as well as around biotechnology and new materials[86]. These new technologies have led to a series of product (computers, CD-ROMs) and process innovations (e.g. the use of information within organisations), as well as to the rise of entirely new companies and industries (Stubbs and Underhill, 2000, pp.321-323). New technologies, computers, IT, allowed a new type of production (Just-in-time production). The source of the shift from stocking products weeks or months in advance to orders within days had following causes. Firstly, the technology allowed such a production. Secondly, it helped producers to find mistakes and fix their products relatively quickly. Thirdly, it was a necessary, because IT technologies get older very quickly. Stiglitz (2003, p.8) notes: *"There were some fundamental reasons for optimism. The investments in research that the country had long been making finally seemed to be paying off."* The IT revolution was certainly a positive factor for strong economic growth on the 1990s.is Important phenomenon, which is named "dot-com start-up" of firms took place in the 1990s.

[85] See C.K. Prahalad and Garry Hamel, 'The Core Competence of the Corporation', Harvard Business Review (May-June 1990): 79-91

[86] For more, see Rob van Tulder and Gerd Junne, European Multinationals and Core Technologies (London, and Sons, 1988)

In 1990s relative prices for IT technologies fell significantly and until 1999, world prices for oil also remained low [87]. Due to appreciation of the dollar and deflation in East Asia, U.S. import prices were low. Therefore, there was a downward pressure on inflation, which prevented overheating of the rapidly growing economy.

The traditional Keynes model argues that increased government spending should increase employment. However, when Clinton took the office, the federal deficit was high and cumulatively unstable that this policy could not work anymore, whereas the economic growth from deficit reduction could increase unemployment. Sometimes, it is the IMF that is now lead by pre-Keynesian ideas and is finding its support in Clinton administration's deficit reduction rhetoric, to force developing countries to reduce their deficits.

5.2. Deregulation

"*The changing world meant that America had to change its regulatory structures.*" [88]

Much of the regulatory structure that governed the U.S. economy was first established in the 1930s. However, the strength of the American economy in the fifties and sixties restored the faith in markets. The deregulation trend began during the Jimmy Carter administration (1977-1981), including deregulation in airlines, trucking, and banking sectors. Ronald Reagan deregulated telecommunications. All these steps were made in order to make the U.S. Economy more successful and more efficient.

In the 1990s new technologies, globalisation, more integrated economy raised the questions whether the old regulatory structure is satisfactory. Although President Jimmy Carter started with deregulation in transportation (airlines and trucks), allowing firms to set prices and standards on their own and freeing up entry, the big part of deregulation were left upon Clinton administration. However, Robert

[87] See Frankel, Chapter 8
[88] Stiglitz, 2003, p.112

E.Litan and Carl Shapiro[89] point out that antitrust enforcement became more active in the 1990s, what was contributively for the whole economic performance.

As new regulations were adopted to react on the Saving and loan crises (See Chapter 2.5), banks were required to maintain adequate capital on which to draw in case their loan portfolios weakened. The amount of capital banks need is related to the extent of the risk they take. There was also the danger of a decrease in the value of assets. Long-term government bonds are risky, even if there is little or no chance of default. When interest rates rise, they can decrease in worth. Fed decided to allow banks to treat long-term government bonds as risky free, even though the government was imposing tighter standard s on banks after S&L crises. However, long-term interest rates fell from over 9 percent in September 1990 to under 6 percent by October 1994. This was partly due to cutting deficit of Clinton's administration. The price of long-term bonds increased and because long-term interest rates were now low, it made long-term government bonds less attractive. The banks started to look elsewhere for profit and went back to lending, their real business. It was this secondary effect of cutting deficit that caused recapitalizing of banks that were able to lend money and support economic growth (Stiglitz, 2003). This was supported by Fed's late decrease of interest rates in reaction of underestimated recession in 1991.

The economic policy in 1990s in the USA is also a dispute about the balance of the government and market. There has been a battle of ideas between those who advocate minimalist role for the state and those who see the government as playing an important role not only in correcting failures and limitations of the market but also in working towards greater social justice. The question is not only about the balance of the state and the market but also about the balance between the government and the non government organizations (NGOs) and global corporations. We can see arguments about how much of the collective action should be taken and at what level, at the local, national or global. In the EU, the principle of subsidiarity is pushed ahead.

[89] Robert E. Litan is Vice President and Director of the Economic Studies Program at the Brookings Institution. He served as Deputy Assistant Attorney General in charge of Civil Antitrust Enforcement from 1993 to 1995. Carl Shapiro is the Director of the Institute of Business and Economic Research and Transamerica Professor of Business Strategy at the Haas School of Business at the University of California at Berkeley. He served as Deputy Assistant Attorney General for Economics in the Antitrust Division of the Justice Department from 1995 to 1996.

5.3. Globalisation

Globalisation is the closer integration of the countries in the world because of lowering of transportation and communication costs. Some do not agree some even protest. The largest protests of protectionists, environmentalists and those who say that globalisation devastates the poor and not developed countries took part during the meeting of the World Trade Organization (WTO)in 1999 in Seattle. Globalisation made everybody in the world interdependent. It means more than the freer movement of goods, services, capital, and people but also the freer and faster movement of ideas. Today, in the era of Internet we can immediately get to know what as happened on the other side of the globe, we can read articles of people with different points of views. Globalisation also promised the end of the business cycle. However, crises in Korea, Indonesia, Thailand in 1997 followed by Russia on1998 and Brazil 1999 proved that globalisation has not brought about the end of business cycles.

Both old and new trade theories[90] conclude that trade improves economic performance. U.S. Exports grew rapidly and politically unpopular increase in imports caused trade deficit in the 1990s.Robert Z. Lawrence argues that even the increases in imports and in the trade deficit during the 1990s, though politically unpopular, were a useful safety valve during the strongest phase of the U.S. Expansion. They released pressure that would otherwise have shown a higher inflation and interest rates (Frankel and Orzsag, 2002) proved that economic cycles with upturns and downturns are an internal part of economy.

Multinational companies seek to produce and market the same product in the same way all over the world, which has opened a heated debate on the role of multinational companies in the global market, and the possible consequence of exploiting countries' comparative advantage. Due to ongoing internationalisation, multinational companies have tilted the balance of power among key players in the world market in their favour. The establishment of EU in 1992 may be seen as an attempt of European government to improve their position. However, the EU was confronted with 15 industrial systems in 1990s, which made forging more difficult

[90]Old trade theory is based on the assumption of absolute and comparative advantages, first analysed by Adam Smith and David Ricardo in 18th and 19th centuries. New trade theory is the economic critique of international free trade from the perspective of increasing returns to scale and the network effect. It also takes into account changing technology and imperfect competition.

than in the U.S. Foreign policy has undoubtedly become an arm of economic policy - more so than under any previous president. Mr Clinton was quick to grasp the implications of globalisation - the close interaction of competing world economies.

5.4. Unemployment

"Clinton said, 'I have a jobs program, and my jobs program is deficit reduction'."

Robert Rubin[91]

In 1994, the unemployment rate started the year above 6 percent and was decreasing (see Fig.10). Unemployment is determined by many factors, such as flexibility of the labour market, power of labour unions, minimum wage, or demographic structure of the workforce. Lower unemployment usually means higher output, however, unemployment is not the solely factor determining GDP growth. Mankiw (in Frankel and Orzsag, 2002) even argues that whatever the cause for long-run decline in unemployment, few economists would credit the monetary policy. Indeed, according to standard theory, the Fed has no ability at all to influence unemployment and real growth in the long run (Mankiw in Frankel and Orzsag, 2002, p.25). Among the most decisive factors influencing U.S. economic performance, we can include technological progress, which has been enormous in the 1990s.

[91] Stevenson (2000). Robert Rubin was the head of the National Economic Council and later Treasury Secretary during Clinton's presidency.

TABLE 13: UNEMPLOYMENT AND GDP	1950s	1960s	1970s	1980s.	1990s
Unemployment					
Average	4.51	4.78	6.22	7.27	5.76
Standard deviation	1.29	1.07	1.16	1.48	1.05
Real GDP[92] Growth					
Average	4.18	4.43	3.28	3.02	3.03
Standard Deviation	3.89	2.13	2.8	2.68	1.56
Source: Department of Labor, Department of Commerce, N. Gregory Mankiw in Frankel and Orzsag (2002)					

Mankiw demonstrates that the average level of unemployment during the 1990s was lower than it was during the previous two decades. However, what is more important for evaluating monetary policy are not averages but the standard deviations (see Table 3). Unemployment and GDP growth were more stable during the 1990s than ever before. Taking to account that the economy enjoyed low volatility in inflation, we may talk about unusually stable period. 18 million of jobs were created between 1993 and 2000 (10 million from 1993 to 1997, and another 8 million between 1997 and 2000). Unemployment had fallen below six percent and by April 2000 below 4 percent for the first time in three decades[93].Primarily, labour productivity increased nearly twice as fast between 1995 and 2000 as between 1975 and 1995.

TABLE 14: PRODUCTIVITY GROWTH	1950s	1960s	1970s	1980s.	1990s
Average productivity growth	2.8	2.84	2.05	1.48	2.07
Standard deviation of productivity growth	4.29	4.2	4.3	2.91	2.62
Source: NBER					

[92]Real GDP growth is the growth rate of inflation-adjusted GDP from four quarters earlier
[93] However the following decline caused that two million jobs were lost in a mere twelve months. We could register the longest decline in industrial production since the first oil shock, between July 2000 and December 2001. The unemployment rate increased from 3.8 percent to 6.0 percent

5.5. Current account deficit[94]

The rise of the U.S. current account deficit over the past decade appears to have coincided with a pronounced new phase of globalization that is characterized by a major acceleration in U.S. productivity growth and the decline in what economists call home bias. As Alan Greenspan (2005) pointed out in his speech, one of the signs of the 1990s is **reduced home bias**. This pre-justice to invest mostly in home country of the investor decreased and therefore investments and their yields have been less dependent on asymmetric shocks. In brief, home bias is the parochial tendency of persons, though faced with comparable or superior foreign opportunities, to invest domestic savings in the home country. The decline in home bias is reflected in savers increasingly reaching across national borders to invest in foreign assets. The rise in U.S. productivity growth attracted much of those savings toward investments in the United States. The greater rates of productivity growth in the United States, compared with still-subdued rates abroad, have apparently engendered corresponding differences in risk-adjusted expected rates of return and hence in the demand for U.S.-based assets. Home bias implies that lower risk compensation is required for geographically proximate investment opportunities; when investors are familiar with the environment, they perceive less risk than they do for objectively comparable investment opportunities in far distant, less familiar environments. Home bias was very much in evidence for a half century following World War II. Domestic saving was directed predominantly toward domestic investment. Because the difference between a nation's domestic saving and domestic investment is the near-algebraic equivalent of that nation's current account balance, external imbalances were small. However, starting in the 1990s, home bias began to decline discernibly, the consequence of a dismantling of restrictions on capital flows and the advance of information and communication technologies that has effectively shrunk the time and distance that separate markets around the world. The vast improvements in these technologies have broadened investors' vision to the point that foreign investment appears less risky than it did in earlier times. Accordingly, the weighted correlation between national saving rates and domestic investment rates for countries representing four-fifths of world gross domestic product (GDP) declined from a coefficient of around 0.97 in 1992, where it had hovered since 1970, to an estimated low of 0.68 in 2005.

[94] This thesis does is not focused on the U.S. current account deficit, this problem is properly worked out in Viktor Hanzlik's Bachelor thesis "Sustainability of the U.S. Current Account Deficit" at IES FSV UK from the year 2005.

International trade has been expanding as a share of world GDP since the end of World War II. The expansion was largely a grossing up of individual countries' exports and imports. In the 1990s, expanding trade was associated with the emergence of ever-larger U.S. trade and current account deficits, matched by a corresponding widening of the aggregate external surpluses of many of U.S. trading partners, most recently including China and the OPEC countries.

Indeed, the increasing dispersion of current account balances is closely tied to the shrinking degree of correlation of country shares of saving and investment. Obviously, if domestic saving exactly equalled domestic investment for every country, all current accounts would be in balance, and the dispersion of such balances would be zero. Thus, current account imbalances require the correlation between domestic saving and investment-which reflects the ex post degree of home bias-to be less than 1.0.

Home bias, of course, is only one of several factors that determine how much a nation actually saves and what part of that saving, or of foreign saving, is attracted to fund domestic investment. Aside from the ex ante average inclination of global investors toward home bias, the difference between domestic saving and domestic investment-that is, the current account balance-is determined by the anticipated rate of return on foreign investments relative to domestic investments as well as the underlying propensity to save of one nation relative to that of other nations. Indeed, all these factors working simultaneously determine the extent to which domestic savers reach beyond their borders to, on net, invest in foreign assets and thereby facilitate current account surpluses and the financing of other countries' current account deficits.

6. Evaluation and Conclusion

6.1. Fiscal Policy: Evaluation

"There's no question if we're holding down spending, a Democratic president, and a Republican House and Senate is the proper combination."

Milton Friedman[95]

All **Clinton's fiscal measures** combined progressive redistribution and budget discipline. It is important to point out very suitable conditions for doing this. Firstly, it was the end of the cold war, which allowed Clinton to reduce military expenditures, significantly. Secondly, new economy brought about large amount of investments and big profits. To sum it up, economic conditions for progressive fiscal conservatism were unusually good. Fiscal discipline in 1990s appeared to promote strong economic growth even in the short run. As we can see from the Fig. 8, by the end of the 1990s, the budget had recorded its third consecutive unified surplus for the first time since 1947-49, as well as **the largest surplus** relative to GDP since 1948.

The 1993 budget package (OBRA93) was politically difficult. It was very risky policy, and its success was dependent much on the bond market. If the bond market believed the deficits would decline in the future, interest rates would become down. This should have lead to increasing investments, as they are believed to be a function of interest rate. However we could see in 1991 and later in 2001 that this does not have to be true, that investment often did not respond much to interest rates. In Fig. 4, we can see a significant shift between 1998 and 2001 budget projections. From the Fig. 4 we can see, the CBO's budget outlook worsened between 1990 and 1995, but improved steadily thereafter. It is because Medicare spending fell well below CBO projections.

On the contrary, Joseph Stiglitz (2003, p.54) argues that the deficit reduction went too far. Even though, the deficit reduction had brought America out of recession. Stiglitz argues that the deficit would have been reduced significantly even if Clinton had cut back expenditures a little less. He says that if Clinton had used the

[95] Lochhead, 2005

additional funds to finance more investment in research and development, technology, infrastructure and education, it would have brought a stronger growth. But the national debt would have been higher. Deficit reduction is, according to Stiglitz normally not a solution to a short-run economic downturn; it may even be bad for long-run economic growth. *"The circumstances of 1992 were unusual; normally, deficit reduction would not lead to an economic recovery."*

In July 2003, Valtr Komarek (2003) strongly criticized the then-prepared reform of fiscal policy in the Czech Republic. He argued that this reform would slow down the Czech economy and accused their authors of being too much focused on variables, like inflation and budget deficit, without understanding the basic constants, like the wealth of nations or employment. In his article, Komarek uses the past two decades of the U.S. fiscal policy as examples. On the one hand, he argues, the Reagan administration's policy of deficits was practically successful, although the debt-GDP ratio reached 50 percent. On the other hand, the successive Clinton's fiscal policy of projected budget surpluses was not successful. Ironically, he notes, at the time when it reached balanced budgets, the policy led to "fall of the stock market and economic recession."

While the Clinton administration's fiscal policy helped to bring the budget deficit under control and reduce the level of debt to GDP from 50 percent down to 35 percent, the administration was only partially able to ensure fiscal discipline for the future.

6.2. Monetary Policy and the Contribution of the Clinton's Administration

"Skilful exercise of macroeconomic policy, both fiscal and monetary, contributed significantly to the strong economic performance of the 1990s" [96]

The finding of this thesis proves that a cooperation of fiscal and monetary policy is crucial. During 1980s, the budget deficit was a source of conflict between the president and the central bank. Blinder and Yellen (2001) note than in the

[96] Frankel and Orzsag, 2002, p.8.

Reagan-Volcker years, it led to a ruinous policy mix of loose fiscal policy and extremely tight money. On the other hand, Clinton-Greenspan mix of tight budgets and easier money contributed to the outstanding economic performance. Woodward (2001, p.222) noted the irony, that was in the air when Clinton was leaving the office. Greenspan, at 73, had already served 12 years and would get to be chairman for another 4 years. Clinton at 54 had served eight years as president and the Constitution barred him from seeking a third term. The man 20 years older could go on, while the younger man would have to leave office.

Cooperation between fiscal and monetary policy is important on order to achieve a smooth functioning of the economy. The decline of the Czech economy in the 1997 as was partly caused by the inability of these key policies to co-operate. In general, the key factors for strong and healthy economic growth are the optimal mix of fiscal and monetary policy, competitive and stable financial sector, and lots of opportunities for investment. The U.S. economy 1993-2000 had it all. The **U.S. fiscal-monetary link** in the 1990s was the key to a successful economic policy, to successful economy. Critiques can say that during such a period, the administration's economic policy is not so important, as the economy follows its own right path. However, economic policy is important. A strong and respectful partnership between fiscal and monetary policy is vital for economic performance. A smooth co-operation brought about the significant economic growth in the 1990s.According to Bob Woodward (2000, p.221), Alan Greenspan told Clinton in 2000: *"I couldn't have done it without what you did on the deficit reduction. If you had not turned the fiscal situation around, we couldn't have had the kind of monetary policy we've had."*

The Clinton administration influenced monetary policy in several ways. Greenspan and Clinton got along very well. The Clinton's administration made important contributions to monetary policy, because it did not involve into the monetary policy almost at all. Bill Clinton reappointed Greenspan in 1996,[97] although Greenspan was a conservative Republican, Clinton reappointed Greenspan in 1996 and in 2000. It supported the credit of the whole Fed. Moreover, the Clinton administration avoided public comments about Federal Reserve policy during whole

[97]Greenspan remained on the Board of Governors until 2006.

eight years, which means it fully respected its independence[98]. It was not only Clinton, it was also Clinton's treasury secretaries-Bentsen, Rubin and Summers, who were responsible for the smooth cooperation between fiscal and monetary policy. Governor Laurence H. Meyer [99] says:

"My experience on the Board is that the Clinton Administration has respected the independence of the Federal Reserve to a degree that, given the accounts of others, may exceed that of any previous Administration. To be sure, President Clinton has had opportunities to make appointments to the Federal Reserve Board and he has twice reappointed Alan Greenspan as Chairman. But to my knowledge the Administration has never made any public or private effort to influence monetary policy."

Moreover, **elimination of the budget deficit** allowed Fed to lower interest rates, what was a motor to increased investments and further economic growth. The Clinton administration reduced U.S. budget deficit and turned it to surplus; something very improbable at the beginning of 1990s[100]. During 1980s, the budget deficit was a source of conflict between the president and the central bank. Blinder and Yellen (2001) note than in the Reagan-Volcker years, it led to a ruinous policy mix of loose fiscal policy and extremely tight money. On the other hand, Clinton-Greenspan mix of tight budgets and easier money contributed to the outstanding economic performance.

Many economists laud Alan Greenspan, the chairman of the Federal Reserve, America's central bank, whose judicious management of interest rates has helped create to conditions in which commerce has thrived. It is not without reason that Wall Street financiers commonly refer to the "Greenspan Boom". Many financial analysts argue that Mr Clinton's greatest contribution to the economy has been to leave its management to the chairman of the Fed.

[98]Mankiw argues that the administration's respect for Fed independence may have contributed to the increased responsiveness of interest rates to inflation.

[99] Remarks by Governor Laurence H. Meyer At the University of Wisconsin, LaCrosse, Wisconsin October 24, 2000

[100] Not many economists predicted this fiscal transformation. Among those who did predict the budget surplus, stands Larry Lindsay. His 1990 book, The Growth Experiment contains a chapter titled "The Great Surplus of '99."

Gali et al. (2003) argue that the Fed's response to a technology shock in the Volcker– Greenspan period is consistent with an optimal monetary policy rule. And, in the Pre- Volcker period the Fed's policy tended to overstabilize output at the cost of generating excessive inflation volatility. N. Gregory Mankiw argues that *"no aspect of U.S. Economic policy in the 1990s is more widely hailed as a success than monetary policy"* (Frankel and Orzsag, 2002, p.19). Senator John McKain during his presidential bid, even said that if anything was to happen to the Fed chairman, as president he would prop up his body, give him some sunglasses, and keep him on the job as long as possible.

6.3. Did Clinton cause the boom?

Recent poll of American historians ranked Bill Clinton in the middle range of the country's 42 presidents, but fifth in terms of his economic management. In 1993, the new budget theory was something new and the Clinton administration showed a lot of courage to put it into practice. However, some analysts argue that the Clinton administration could not take credit for the success of the U.S. economy during 1990s because the success was due to factors other than the administration's policies. The Republicans point to the creativity and productivity of American companies, especially in the hi-tech sector, which has fuelled much of the prosperity.

Deficit reduction moved in the centre in Bill Clinton's agenda, although this was not the agenda on which he has been elected. It is a real puzzlement. He came to the White House mainly to create jobs and later on he and his team of economic advisers were persuaded that without deficit reduction, financial markets would not support his policy and without this support he would not be able to accomplish the rest of his agenda. Deficit reduction accelerated the decline in interest rates, which helped recapitalized the banks.

When the new Bush administration passed significant tax cuts in 2001, even though that recent polls showed that people would prefer paying higher taxes and putting more money into Social Security and Medicare, it was clear that the budget policy changed. Moreover 9/11 Terrorist attacks' aftermath, like the War against terrorism, brought about huge budget deficits and the Bush administration was likely to spend the entire surplus made by Clinton. But this is another story. Jeffrey

Frankel argues: *"Nevertheless, the large surpluses of the late 1990s remain as historical evidence that fiscal responsibility is feasible and is not inherently incompatible with a Democratic Presidency"* (Frankel and Orszag, 2002, p.9)

However, it was not only deficit reduction that caused the recovery. **Changes in the economy** were inevitable. The computer revolution, the launch of the Internet, technological innovations and especially the process of globalisation were inseparable parts of Clinton's success in the nineties. The IT revolution was certainly a positive factor for strong economic growth on the 1990s. Important phenomenon, which is named "dot-com start-up" of firms took place in the 1990s. Compared with Europe, the U.S. has always relatively competitive labour markets and goods[101]. In February, 2000, the American economy set a record for the longest business expansion since records began in 1850 (Gordon, 2000, p.3).

Alice M. Rivlin (in Frankel and Orzsag, 2002, p. 52) argues that there were **favourable economic factors** influencing the economic performance. Firstly, the economy was at a point in the technology cycle when extraordinary volume of innovation was ready for implementation. Secondly, the U.S. Economy is extremely competitive, which is a result of American firms' responses to globalisation, and several decades of increasingly procompetitive policies, such as freer trade and deregulation. Thirdly, there are smoothly functioning capital markets. Finally, strong fiscal policy dedicated to reducing the federal budget the national debt.

It is necessary to point out that the basis of the 1990s economic success is not the Clinton's policy itself. The basis is the U.S. socio-economic system[102] based on liberalism, well defined property rights, properly working institutions, stable political and economic environment, and democracy with long lasting tradition, respected formal and informal rights. Therefore, the U.S. is prepared to take advantage of such an opportunity, which the 1990s brought.

[101] For a comparative study, see HM Treasury (2003)
[102] I would like to express my thanks to doc. Karel Pulpan for reminding me this important fact.

6.4. Failures and Successes

There were successes and failures in the nineties. One of the successes is that unemployment fell, inflation was low, and productivity rose. N.Gregory Mankiw notes that *"if a nation enjoys low and stable inflation, low and stable unemployment, and high and stable growth, the fundamentals are in place to permit prosperity for most of its citizens"* (Frankel and Orzsag, 2002, p.21). In the U.S in the 1990s they did, indeed.

Although the average levels of inflation, unemployment, and real GDP growth were not exceptional in the 1990s, Mankiw demonstrates the stability of these measures, which is unparalleled in U.S. economic history. Accelerating productivity growth resulting from advances in information technology helped to lower unemployment and inflation. There were other forces next to deficit reduction that made inflation not to rise. America had weaker unions, increased international competition, increasing productivity. They all were at play, so it was the lower inflation as well as deficit reduction that lowered long-term interest rates. These forces lead to boom that marked the nineties in America. But without deficit reduction, there was a threat that deficit and expenditures would go out of control.

However, **in legislative terms**, the benchmark against which Democratic presidents are judged, Mr Clinton does not have much to show for his eight years in office. Clinton's 1993 **tax changes** were concentrated on those who were most able to pay, those who had seen their income to grow the most in the last 20 years, to the upper 2 percent. After decades of experiences with different tax policies, some things have proved to be evident. It is not true that cutting taxes always result in higher tax revenue and that raising taxes always reduces revenue, both is the basis of the Laffer curve[103]. However, it is true, as supply-side economists argue that raising taxes can be counterproductive, if they reduce economic activity. We might conclude that in the 1990s, the **Laffer curve** did not work[104]. The Clinton's administration increased taxes, reduced spending, and the economy experienced the

[103] Doctor Phillip Jones from the University of Bath calls it "the Laugher curve." For his analysis, see Cullis and Jones (1998)

[104] We might observe that the Laffer curve does not work in the new millennium either. As President George W. Bush's Council of Economic Advisors put it in 2003: "Although the economy grows in response to tax reductions (because of higher consumption in the short run and improved incentives in the long run), it is unlikely to grow so much that lost tax revenue is completely recovered by the higher level of economic activity." (Wall Street Journal)

longest GDP growth since WWII. It is typical for economists that they cite history selectively, according to their view on the role of state in the economy. Tax policy has always been a source of exciting discussion. Revenue rose in the 1990s after President Bill Clinton raised taxes. Revenue fell after President George W. Bush cut taxes in 2001. David Wessel (1997) argues that there is an arithmetically accurate case that taxes can remain at current levels if Americans accept a government that spends less.

Deficit reduction was an important success; however, it brought about, as a side effect, some failures. The Clinton's administration was not successful in promoting health care reform, mostly because the focus was on deficit reduction. Among failures we include the inability to enact the administration's **Health Security Act.** The ambitious health plan, the brainchild of Hillary Clinton in the first year of the administration, was defeated. It seems to be the most glaring piece of unfinished business of the Mr Clinton years. The outgoing president might point to welfare reform, a legislative package agreed with the Republicans, as his crowning congressional achievement. He would argue that the welfare measures - including strict work requirements and time limits on how long recipients could claim the dole - have helped boost employment and remove the stigma of unemployment. But they have also left far fewer protections in place for people who leave their jobs. America's social safety net has shrunk.

Reform of Social Security and Medical Service was not successful, although Clinton pushed relatively hard for this issue. The 1990s did not witness significant changes in Social Security policy, although alternative visions of Social Security reform received tremendous analytic and popular attention. President Clinton decided to pursue Social Security reform based on general revenue contributions to the trust fund and centralized investment in equities rather than creating individual accounts, but his proposal was not adopted. In fairness to Mr. Clinton, the Republican's take-over of Congress in 1994 prevented him from pursuing a legislative agenda of his own. The Clinton administration would have liked to have done more to address the long-run problems of America *but "was stymied by lack of resources- sacrificed […] in the name of deficit reduction- and lack of cooperation in the Congress."* (Stiglitz, 2003, p.321).

Even in the budget-balancing nineties, the USA has been maintaining large **trade deficits**. The huge trade deficit was not solved during the Clinton's administration.

The Clinton's agenda dominating issues were trade liberalization, deregulation of the banking system, deficit reduction. Arguably, these policies could contribute to the collapse of the bubble at the beginning of the new millenium, the uncovering of the accounting scandals. Because America is the strongest country in the world, others are looking for it to follow.

6.5. Conclusion

"It should be evident that the president in fact generally deserves a share of credit for what happens on his watch that is neither zero not 100 percent."[105]

It would be irresponsible to judge Bill Clinton's economic policy solely by economic indicators. Moreover, it is difficult to speak about "Bill Clinton's policies," even "the Clinton administration's policies" is not quite appropriate, because there are several exogenous factors that has to be taken into account. Writing about U.S. in the 1990s, it is necessary to point out the Republican takeover of the Congress in 1994 (see Chapter 3), exogenous new technologies or the absence of any macroeconomic crisis. Moreover, the successful economic policy without strong support of Clinton's own party would have seemed to be impossible (See Chapter 3). Obviously, many steps had to be discussed with political rivals, the Republicans[106].

The European Union has to cope with similar problems as the U.S.. However, the EU seems to be rather blind when looking over the Atlantic Ocean. The question is whether the U.S. (or the EU) can repeat this economic miracle. The issue of regulation is irrelevant for the EU at the moment. What the EU needs is more deregulation of its rigid markets, more liberalism, and less social engineering; simply, it needs more U.S. socio-economic elements. However, liberalism might have different aspects, and there is a considerable difference between European and U.S. liberalism, which I personally favour. From the European perspective, the U.S. fiscal policy can draw much inspiration. The EU faces fiscal problems; some countries do not follow the so called Maastricht criteria. The EU is discussing the situation and the

[105]Frankel and Orzsag, 2002, p.12
[106] For a short analysis using the Median voter theory, see Chapter 3.2.

outcome is disappointing: they agreed to soften the fiscal rules, not to force EU members to follow fiscal discipline. The U.S. has shown how to solve an unsustainable fiscal situation within a decade. This lesson should not be forgotten by the EU leaders.

In terms of economic policy, the President Bill Clinton's economic policy does not deserve much criticism. I personally consider Clinton's era more successful than the Reagan's period of the 1980s. Even though they both were in office under different circumstances (for example, Reagan was still at the Cold War, while Clinton had the opportunity to lower defence spending substantially). Paul Volcker was a "known democrat" (Woodward, 2001) and Reagan reappointed him in 1983. Alan Greenspan was a Republican and Bill Clinton reappointed him in 1992 and 1996. Both Reagan and Clinton governed two terms (eight years), they both faced economic problems, they both gave a nickname for the kind of economic policy they made (reagonomics and clintonomics). On average, both Clinton and Reagan achieved similar economic growth (see Table 13). However in 1990s, the economic volatility was much lower. There was also less in unemployment, less inflation. Therefore in terms of economic stability, one of the most important factors for investment, productivity growth and healthy economy, 1990s proved to be more successful than 1980s.

The simplest overall **conclusion** one can draw from the 1990s is that the U.S. Economy runs well given a little luck and the avoidance of major macroeconomic policy mistakes. And Clinton had a piece of good luck; the end of Cold War, IT revolution, globalisation, that all contributed to unprecedented economic growth. It was suggested in Chapter 5 that among the most important signs of 1990s was a radical reduction on economic volatility. To sum it up, the Clinton's presidency brought about a significant economic growth, although many financial analysts argue that Mr Clinton's greatest contribution to the economy has been to leave its management to the chairman of the Fed. However, it would not be fair to say that the Clinton's administration did not contribute. We need to appreciate Clinton's cooperation with Fed and Alan Greenspan, Clinton's deficit reduction, and providing of a good investment climate. In terms of economic policy, Bill Clinton's era was very successful.

7. Graphs

FIGURE 1:Government Consumption Expenditures As a Contributor to a Percentage Change in Real GDP (Source: Bureau of Economic Analysis, author's calculations)

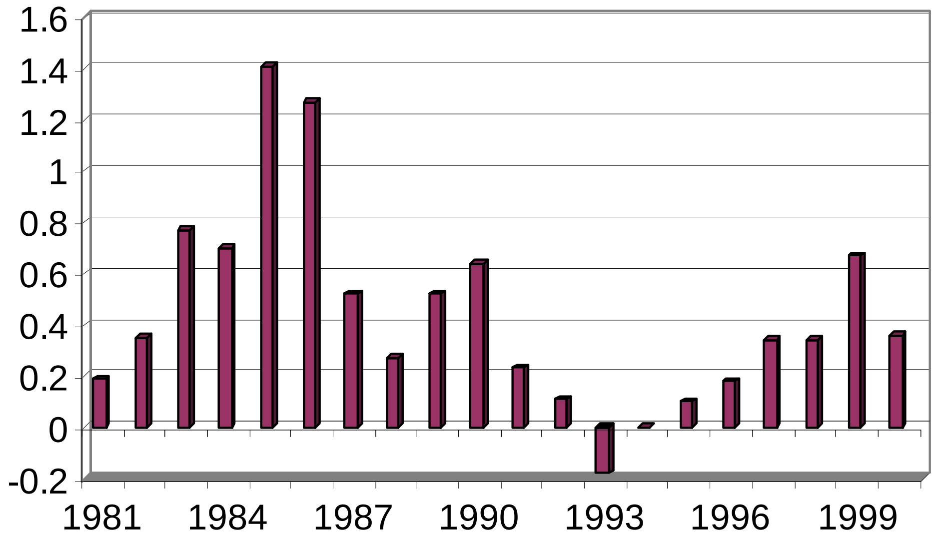
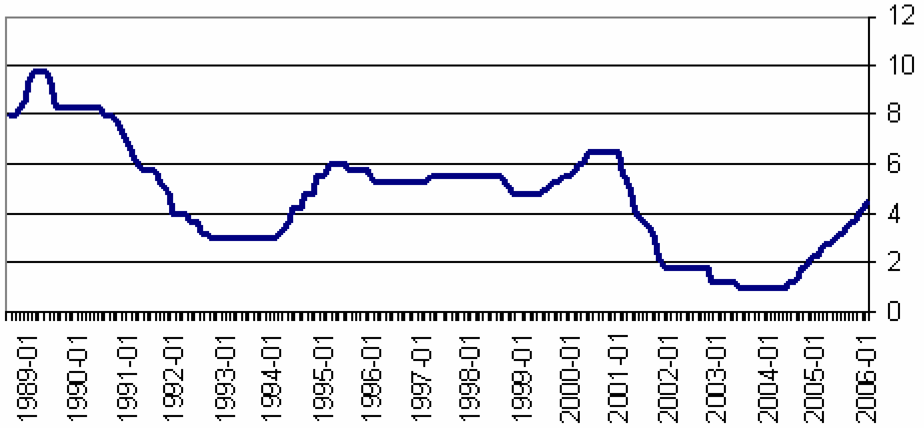


FIGURE 2: Fed Funds rate (end of month)
Source: econstats, author's calculations



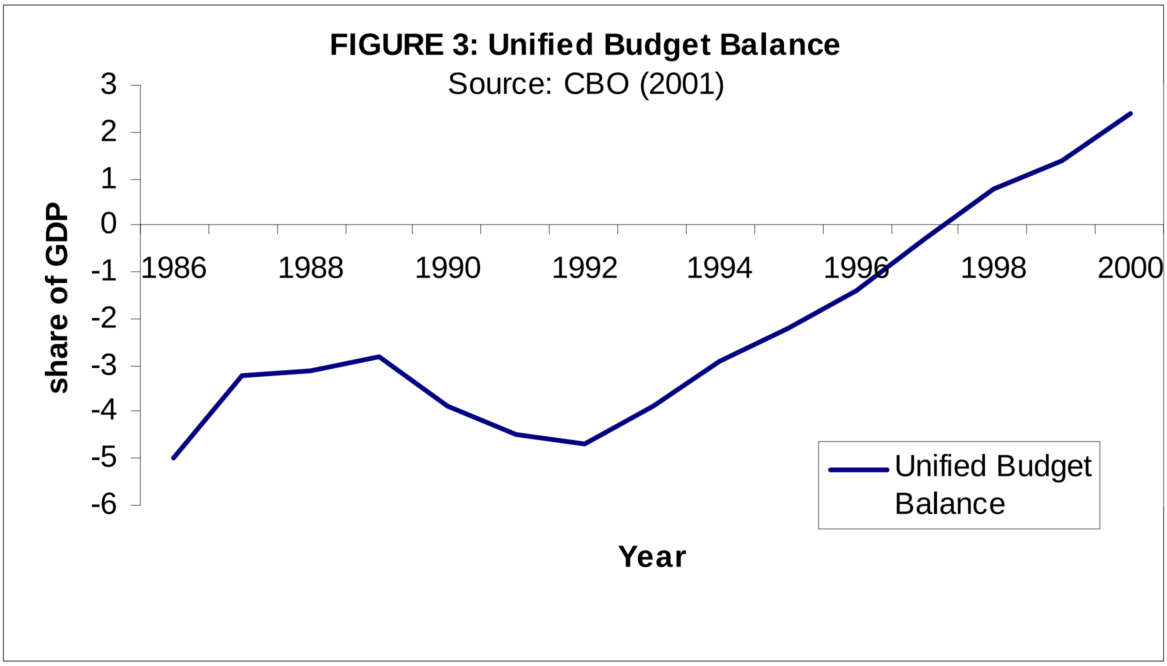


FIGURE 3: Unified Budget Balance
Source: CBO (2001)
share of GDP
3
2
1
0
-1
-2
-3
-4
-5
-6
1986
1988
1990
1992
1994
1996
1998
2000
Year
Unified Budget Balance

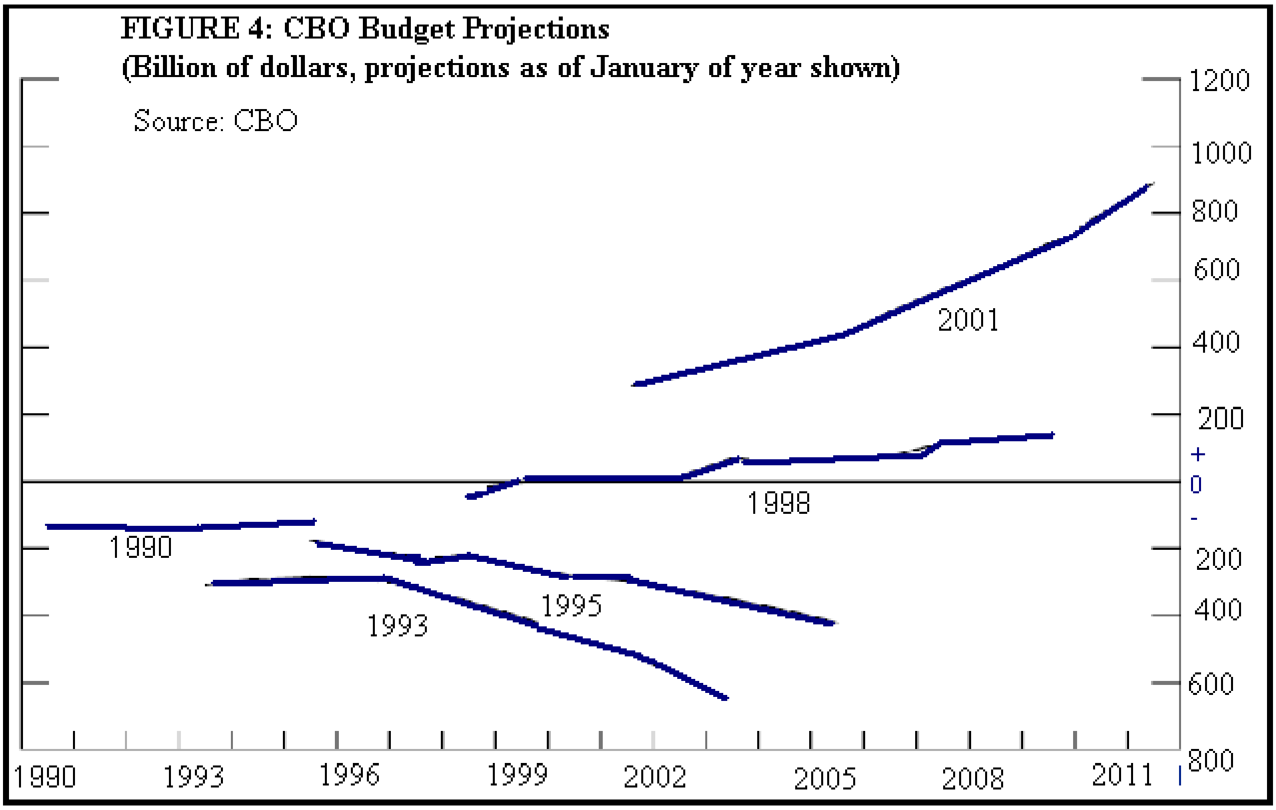


FIGURE 4: CBO Budget Projections
(Billion of dollars, projections as of January of year shown)
Source: CBO
1200
1000
800
600
400
200
+
0
-
200
400
600
800
2001
1998
1990
1995
1993
1990
1993
1996
1999
2002
2005
2008
2011

FIGURE 5: U.S. Unemployment Rate vs. Natural Unemployment Rate 1960-2000

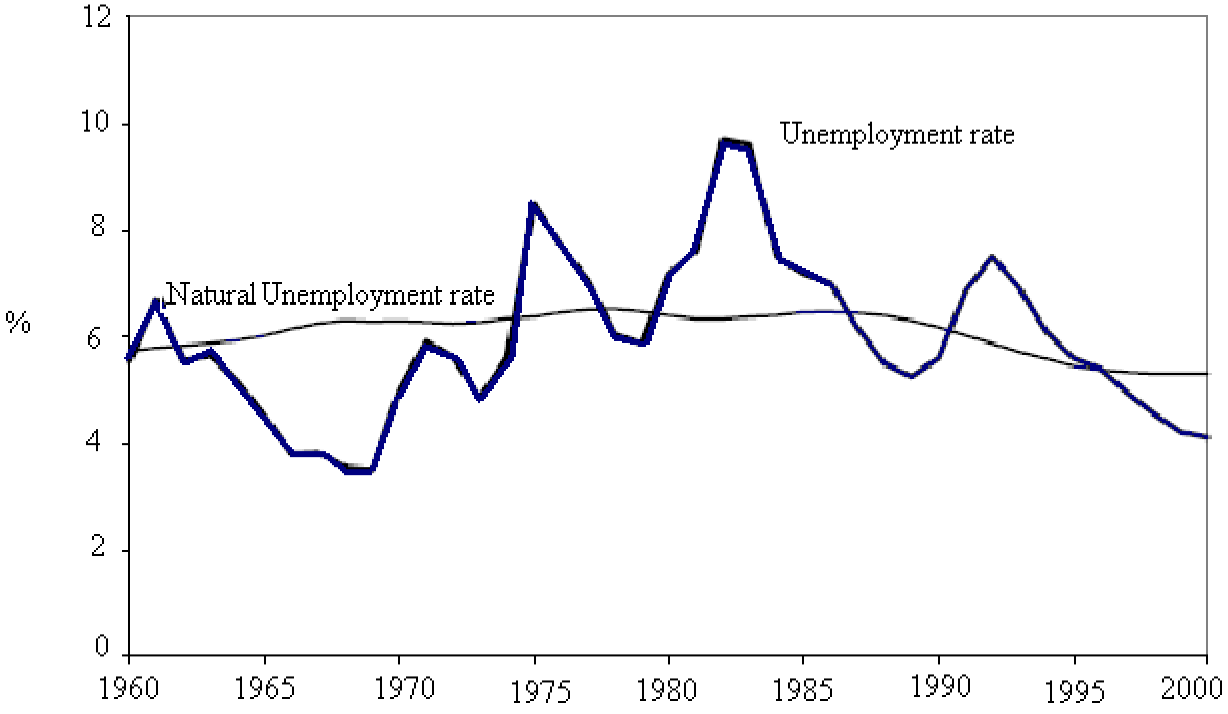
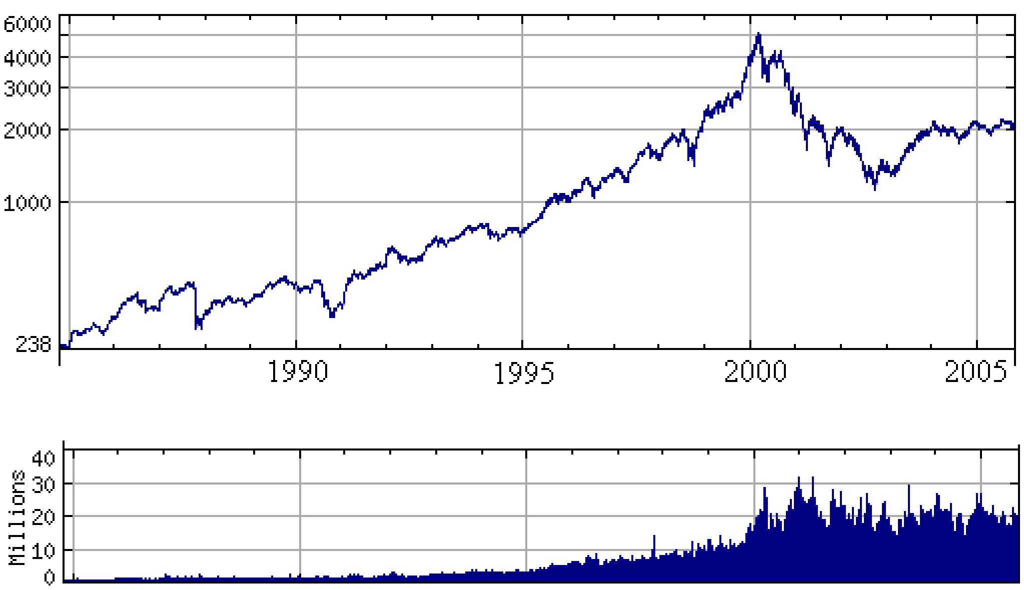


FIGURE 6: Nasdaq Composite Index

Source: http://finance.yahoo.com



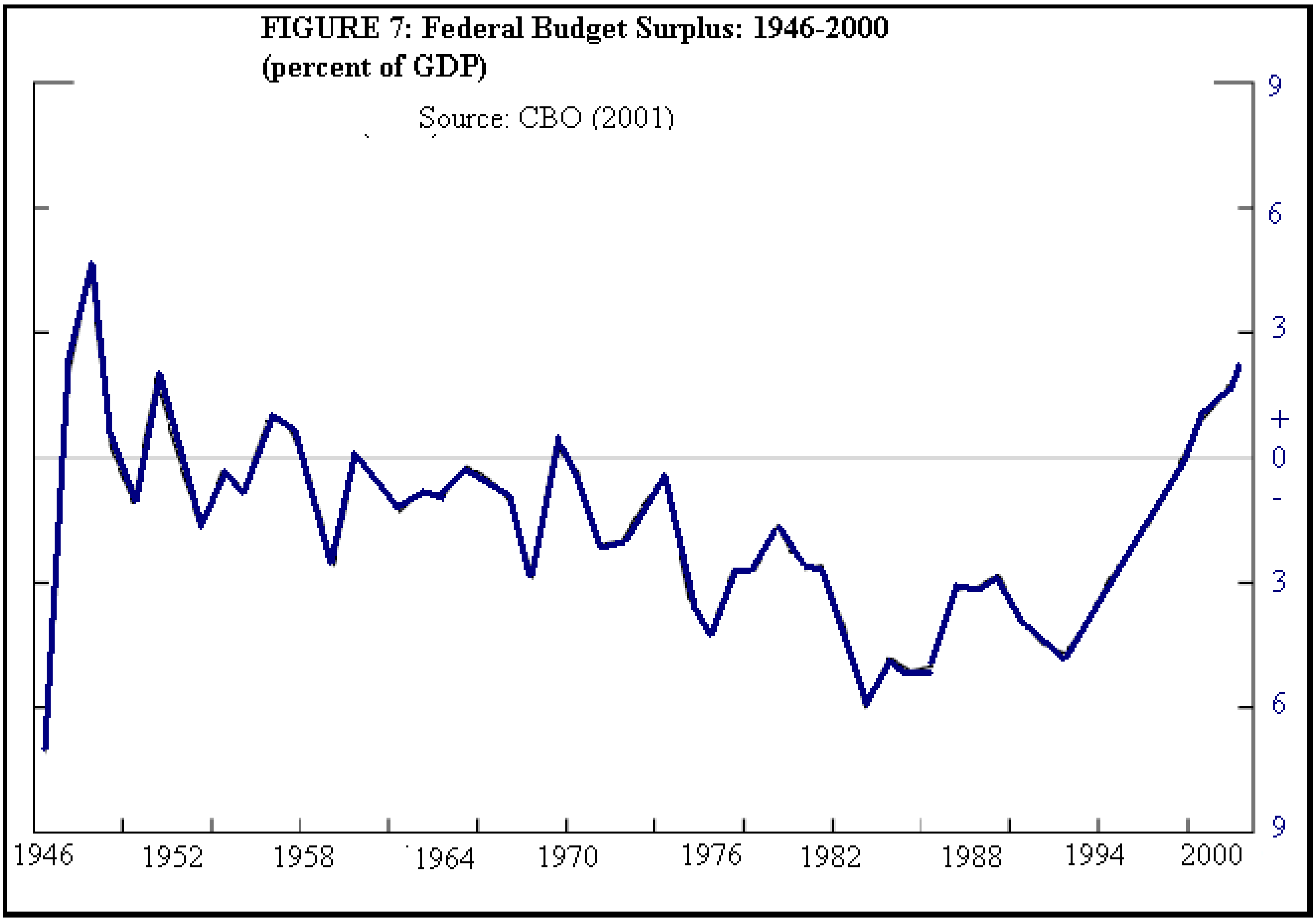


FIGURE 7: Federal Budget Surplus: 1946-2000
(percent of GDP)

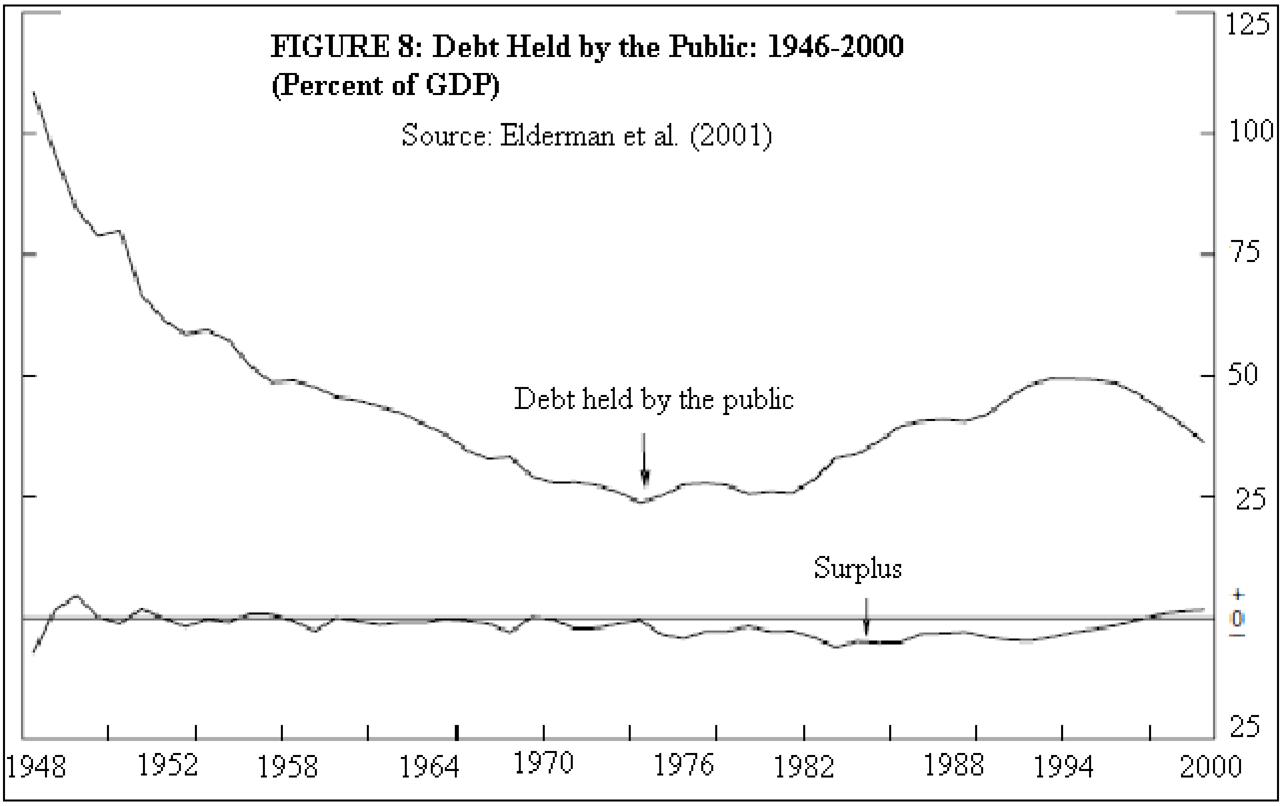


FIGURE 8: Debt Held by the Public: 1946-2000
(Percent of GDP)

FIGURE 9: Unemployment Rate and GDP 1992-1996

Source: U.S. Bureau of Economic Analysis, Bureau of Labor Statistics

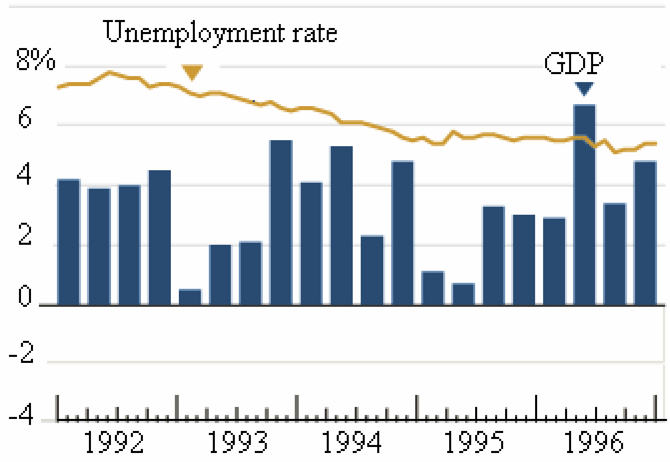


FIGURE 10: Unemployment Rate and GDP 1992-1996

Source: U.S. Bureau of Economic Analysis, Bureau of Labor Statistics

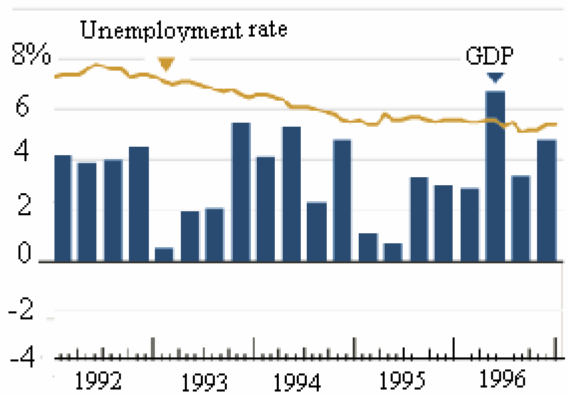


FIGURE 11: Unemployment Rate and GDP 1997-2000

Source: U.S. Bureau of Economic Analysis, Bureau of Labor Statistics

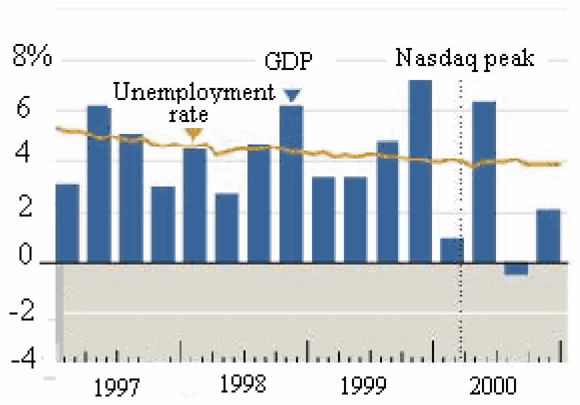
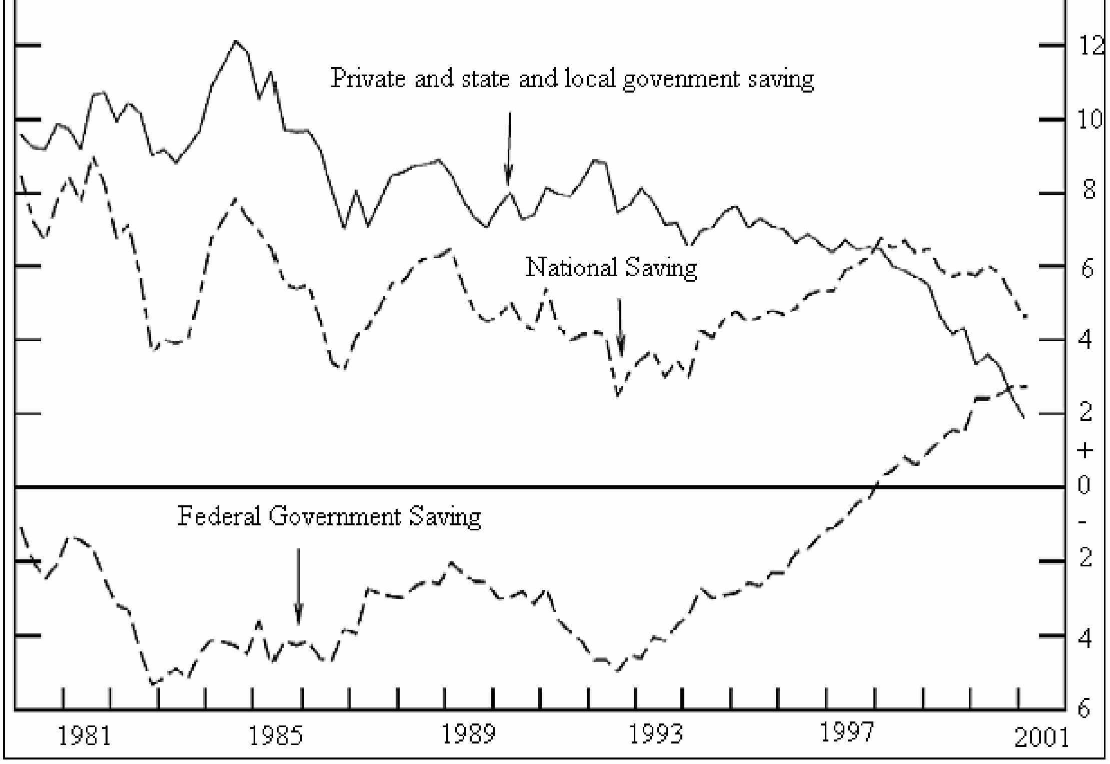


FIGURE 12: Net National Savings and its Components (percent of GDP)

Source: Elmendorf et al. (2001)



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Projekt bakalářské práce

Termín bakalářské zkoušky: **letní semestr 2005/2006**
Autor bakalářské práce: **Martin Pospíšil**
Vedoucí bakalářské práce: **Doc. Ing. Karel Půlpán CSc**.

Téma: Ekonomická politika prezidenta Billa Clintona

Cíl práce: Cílem je popsat americkou ekonomickou politiku v devadesátých letech pod vedením demokratického prezidenta Billa Clintona. Ten se při převzetí úřadu v roce 1993 musel potýkat s vysokým zadlužením své země, ekonomickou recesí. Tyto problémy řešil netradičně snížením výdajů a zvýšením daní. Cílem práce je mimo jiné popsat vliv Federálního rezervního systému (FED) a monetární politiky na výkon americké ekonomiky. Průvodní znaky 90. let v USA jsou vysoká zaměstnanost, růst produktivity a investic, silný hospodářský růst, ale také rekordní deficit obchodní bilance. Práce se zaměří na zhodnocení těchto jevů, porovná úspěchy a selhání této ekonomické politiky a v závěru dojde k porovnání s Evropskou Unií.

V práci bude hledána odpověď na následující otázky:

- Jaké byly největší problémy amerického hospodářství na počátku devadesátých let?
- Jaký byl vliv FEDu na ekonomickou politiku USA v 90.letech?
- Jakou úlohu hrál přebytek rozpočtu?
- Byla míra deregulace v ekonomice adekvátní?
- Jaká byla specifika 90.let v USA i ve světové ekonomice?
- Jaké byly úspěchy a neúspěchy této ekonomické politiky?
- Je možné aplikovat podobnou politiku i mimo USA?

Osnova:

1.1.Reagonomika a George Bush st.
1.2.Zotavení ekonomiky v roce 1992
1.3.Bill Clinton-strategie
1.4.Globalizace a změny ve struktuře ekonomiky
1.5.Zvýšení daní a snížení výdajů=silný růst?
1.6.Pokles nezaměstnanosti, investice, růst produktivity
1.7.Redukce deficitu-rozpočtový přebytek
1.8.Schodek obchodní bilance
1.9.Role FEDu
1.10. Mezinárodní ekonomická politika USA
1.11. Pokles v roce 2001-příčiny
1.12. Úspěchy a nezdary
1.13. Hodnocení ekonomické politiky Billa Clintona
1.14. porovnání s Evropskou Unií

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http://www.whitehouse.gov/

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