Economies around the world are suffering through a downturn that has a good chance of becoming the worst recession since the Great Depression. Monetary and fiscal authorities have responded aggressively. Central banks have cut policy interest rates dramatically and engaged in other non-standard efforts to increase liquidity and provide credit to financial institutions. In countries like Japan and the United States, short-term nominal interest rates are effectively zero, while in Europe rates are 2 percent or lower. The Federal Reserve System has doubled the size of its balance sheet in the course of two months, shifted the composition of its assets from mainly Treasuries to mainly claims on private entities, and acquired the right to pay interest on reserves.

Fiscal authorities have implemented or are planning to implement substantial fiscal stimulus packages that combine tax cuts with various kinds of spending increases. These packages are unprecedentedly large: in the United States, for example, President Obama’s package is over $800 billion, and this follows President Bush’s $117 billion tax rebate in the beginning of 2008 and the $700 billion Troubled Assets Relief Program in the latter part of 2008. Taken together, these debt-financed fiscal actions will raise federal government debt by more than 13 percent of GDP. Fiscal actions of this magnitude are sure to have long-lasting impacts on the economy.

Much of the policy discourse has focused on the relative sizes of multipliers—how much GDP rises following a given fiscal stimulus—associated with tax cuts and various kinds of government spending increases and on the need to front-load the stimulus in order to “jump-start” the economy. While these issues may be important, they are not ones on which there is a clear professional consensus. Moreover, estimates of multipliers are likely to be most credible during “normal” times and in response to “typical” fiscal actions. The estimates are least credible in the midst of a financial crisis to which fiscal policy is reacting on a grand scale.

Missing from the discourse is any serious connection between the policy initiatives and modern macroeconomic research. Expectations and dynamics, which play central roles in modern analyses, are almost completely absent from the discussion. Also missing is the recognition that the impacts of any policy initiative depends on the joint monetary-fiscal policy framework in place.
There are compelling reasons to believe that expectations and dynamics are important for the ultimate success of any monetary-fiscal plans. Large policy actions like those being implemented worldwide are likely to shift expectations in important ways. Economic theory predicts that a large expansion of government debt can have very different impacts on the macro economy, depending on how economic decision makers expect monetary and fiscal policies will adjust in the future. If taxes are expected to rise in the future, the stimulative effects of the fiscal expansion will be partially offset. If, instead, people do not believe future taxes will adjust, then fiscal expansion generates wealth effects that can serve to amplify policy’s ultimate impacts. Of course, whether people expect no adjustment in future taxes, and hence inflationary finance of the debt, depends critically on the behavior of monetary policy. Expectations and macroeconomic policy interactions are intricately linked and determine the eventual effects of policy actions. But these aspects have received no explicit treatment in the policy initiatives to date. Neither have they been an important part of governments’ communications to the public.

The conference aims to apply modern analyses of monetary and fiscal policy to the current economic crisis and to create a forum in which researchers can communicate their findings to the policy-making community. Leading academic economists whose research can shed light on the current economic problems will write papers about the current crisis. Papers may be either academic research or shorter, less technical papers focused on the current situation. The papers will draw out the practical implications for monetary and fiscal policy that emerge once forward-looking behavior and dynamics are explicitly examined.

Policy makers and advisors to policy makers are the target audience for the conference. This would include officials and staff from central banks, treasuries, international policy organizations, and economic think tanks.

Paper presenters include John Cochrane, Lawrence Christiano & Martin Eichenbaum & Sergio Rebelo, Troy Davig & Eric Leeper, Marvin Goodfriend, Tom Sargent, Chris Sims, Harald Uhlig, and Leopold von Thadden. The panel consists of Alan Blinder, Giancarlo Corsetti, Don Kohn, and Paolo Pesenti.

Princeton University’s Woodrow Wilson School of Public and International Affairs and Center for Economic Policy Studies and Indiana University’s Center for Applied Economics and Policy Research will sponsor the conference.