

Comments on “Three World Wars: Fiscal-Monetary Consequences” by Hall and Sargent

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Who once said the following?

“Chase did not capitalize on the emotion of the people, yet it was there and he might have put it to work.”

- A) Donald J. Trump
- B) Harry Truman
- C) William G. McAdoo
- D) Ulysses S. Grant

For the answer see Hilt, Eric. and Rahn, Wendy. M. (2016)

Introduction

- How does the US government fund big “wars”?
 - World War I, World War II, Covid-19
- The authors carry out a careful, illuminating accounting exercise.
- Method: decompose growth in spending into taxes, new bond issues, money creation, “other”
- This paper is part of series, now its own franchise, which, like the *Star Wars* saga, continues to grow.
 - I love *Star Wars*!

Findings/Results

- A significant fraction of the Covid-19 “war” was financed by printing money
 - money creation covered 91.7% of the rise in spending
 - or maybe it was borrowing that covered 67% and money creation covering 18.5% under the assumption that Fed pays interest on reserves and RRP
- N.B. Rises in taxes during Covid-19 are a very low share compared to WWI and WWII
 - 3.5% compared to 20.8% and 30.2%
 - Civil War: 6.8%
 - Harry Truman would be much displeased!

3 issues to highlight

- Lessons and learning from history
- Wars vs depressions vs pandemics vs natural disasters vs existential threats (climate change, alien invasion, fungal outbreaks)
- Maturity structure
 - The future of debt/ fiscal space
 - “Our first decomposition implies that all of the COVID-era increase in privately held debt would have occurred in the absence of the pandemic.
 - This leaves a lot of debt that was *NOT* purchased by the public. (\$3.7 tn. = rise in Fed’s holdings)

Learning from the past

- “To finance World War I, Secretary of the Treasury William Gibbs McAdoo studied how the Union had during the Civil War.”
- “Secretary of Treasury Henry Morgenthau Jr. sought to avoid a recurrence of the deep post-World War I losses incurred by savers who had participated in Secretary McAdoo's ‘borrow and buy’ program.” Hall and Sargent (2021)
- “ ‘ During World War II, taxes were not high enough, and the Government was forced to borrow too much. As a result, when controls were taken off after the war, prices skyrocketed and we paid in inflation for our failure to tax enough.’ ” Harry S. Truman, cited in Hall and Sargent (2021)

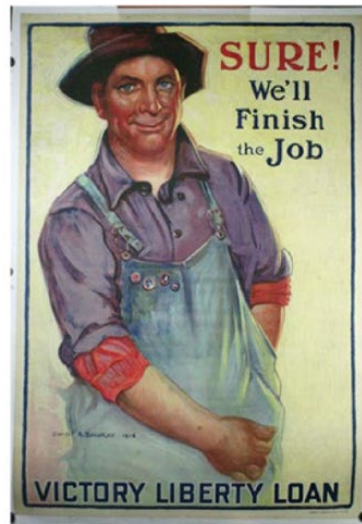
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Marketing campaign for debt: WWI

Figure 1. Liberty Bond Posters



Marketing campaign for debt: COVID-19

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Marketing campaign for debt: COVID-19



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Covid-19 as a war?

- Covid-19 was a large un-anticipated shock
- But was it like WW1 or WW2?
 - US enters these “world” wars years after they began and significant planning had already occurred.
 - Foreign markets & international K markets were mostly in disarray
 - Labor supply for civilian production may have shrunk in all 3 cases but in both WWs there was an economic/production boom
- Financing the Covid-19 shock from taxation would have been tantamount to countercyclical fiscal policy unlike during the wars.

The Future of US Debt

- “Our first decomposition implies that all of the COVID-era increase in privately held debt would have occurred in the absence of the pandemic.”
- “The maturity of federal debt outstanding is much shorter today than it was after World War II.”
 - But maybe not since the 1970s
- How much of the short end of the debt outstanding is new since COVID?
 - There was a huge spike in demand for short-term assets as market participants exchanged LT debt for ST debt?
 - Why not cash? Interest on reserves?
- Big picture: Has the US lost fiscal space? Was COVID weird or is there a bigger issue with Fed Strategy?

Conclusion

- This is a clearly written, useful, and informative paper.
 - One wonders what will happen if WWII or another financial crisis does occur in the near future.
 - Have treasury secretaries forgotten how to learn from history?
 - Future work: Great Depression, hypothetical climate change shocks or other future international conflicts/shocks + MOAR comparative studies!
 - Caveat: this work only gets done when big negative shocks arise. So, I do hope we won't be seeing that much more of this work.
 - Conditional on new shocks, this is very useful, especially to understand aspects of past shocks and using the past to illuminate the present.