What the Clinton administration got right and wrong about the '90s economy

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Bill Clinton is in some ways a strange historical figure. He wasn't really a transformative president in the mold of Ronald Reagan or Barack Obama. But he didn't leave office unpopular like George W. Bush or Jimmy Carter.

On the contrary, Clinton left office as the most popular president in the history of modern opinion polling, with a 66 percent approval rating that left the likes of Reagan and Dwight Eisenhower in the dust.

And the reasons are not fundamentally mysterious. Life was good during the latter part of the Clinton years. The share of American adults who held a job reached an all-time high, and wages rose rapidly while poverty fell rapidly.

Clinton's wife, Hillary Clinton, has become a major political figure in her own right after eight years as a senator and four as secretary of state but her career is still inextricably linked to his. All of which raises the question of whether Clinton *deserves* the credit for the good economic times.

The reality is that no president deserves as much credit or blame as he gets from the mass public for growth trends during his administration. But the case that Clinton-era macroeconomic policies — the mix of deficit reduction and restrained interest rates that his administration coordinated with the Federal Reserve — was a crucial part of the story is pretty strong. The Clinton administration marked the only time in the past 45 years when the federal government consistently practiced sound countercyclical stabilization policy, and it worked very well.

At the same time, Clinton left behind a much more simplistic political legacy, one that fetishized not correct countercyclical policy but balanced budgets and debt reduction — a legacy that's been deeply influential in the Democratic Party since he left office, and not in a good way.

The economy of the late 1990s was great

The '90s are often remembered in press primarily as a period of stock market mania that also featured absurd valuations for technology startups with dubious business models. And those things did, in fact, happen.

But it was also a time of widespread, broadly based prosperity.

The unemployment rate got really low.

But even this understates the strength of the labor market. Since many more women worked in the 1990s than had been the case in the also-prosperous 1960s, the total share of American adults who had jobs reached an all-time high.

Consequently, by conventional measures median household income reached a peak from which it never recovered (how you value new smartphone-related inventions will impact whether you really think this is true), and the poverty rate reached an all-time low.

Under the circumstances, it's not surprising that Clinton reflexively turns to his economic growth record when facing criticism. After protestors slammed a 1996 welfare reform law he signed, he retorted: "They say the welfare reform bill increased poverty. Then why did we have the largest drop in African American poverty in history when I was president? The largest in history."

There's no serious reason to believe the 1996 welfare law *caused* the large drop in black poverty, but the drop did happen — one reason Clinton is much more fondly remembered among working class African Americans than among white liberal intellectuals.

The case for Clintonism

Conversations with people involved in making economic policy during the Clinton years make a case that they deserve credit for the strong growth that is a little too nuanced for a stump speech. The basic idea is that intelligent countercyclical budgeting creating the space for monetary policy to work as intended, generating an investment boom and full employment, both of which spurred productivity growth and broad prosperity.

To understand this, you need to understand the context of economic history as it looked in the mid-1990s.

The past two American recessions started around the time of the popping of an asset bubble — stocks in 2001 and houses in 2007. This also happened way back in 1929, but when Clinton was in office it hadn't happened since the end of World War II. Recessions happened in the back half of the 20th century because the Federal Reserve raised interest rates to slow investment and the economy to keep inflation in check. In the 1950s and '60s this had worked well, but over the course of the 1970s inflation got out of control even as unemployment stayed stubbornly high.

Ronald Reagan and Federal Reserve Chair Paul Volcker succeeded in taming inflation with a brief but vicious recession in 1982.

But Reagan's "supply-side" revolution focused on tax cuts, and rolling back elements of the Great Society did not succeed in bringing back the high growth rates that prevailed before the

1970s. The economy shrugged off a huge stock market crash in 1987, but inflation reared its head in the early 1990s, prompting interest rate hikes and a new recession.

The Clinton team took action to reverse the structural budget deficits that Reagan had created. This, they believed, would give Volcker's successor, Alan Greenspan, the running room he needed to keep interest rates low and encourage unemployment to fall. At the same time, by reducing the amount of private sector savings that was channeled into buying federal debt, it would increase the amount of private sector savings that was channeled into private sector investment.

And, in fact, both of these things happened. Greenspan allowed unemployment to keep falling, and private business investment soared. Increased private investment helped push labor productivity up, which, combined with labor scarcity, pushed wages up. Median incomes rose, and poverty fell. Deficit reduction isn't always the right economic strategy, but it appeared to be the right economic strategy for the circumstances of the time.

The Greenspan factor

One prominent line of argument offered by conservatives at the time was to give all the credit to Greenspan, as then-Sen. Phil Graham did in a typical February 2000 speech. Indeed, the partisan imperative to find someone other than Clinton to credit with the strong economy of the 1990s is one of the main reasons Greenspan's reputation was so high around the turn of the century.

One can make simpler or more complicated versions of this case, but a nice simple version is this. Back in 1996, current Fed Chair Janet Yellen was serving on the Federal Reserve Board of Governors, and so was Larry Meyer. Meyer recalls that at one point during that year, he and Yellen went into Greenspan's office and "told the Chairman that we loved him but could not remain at his side much longer if he continued, as he had been doing for some time, to push the next tightening action into the next meeting, and then not follow through."

Greenspan resisted this pressure from inside the Fed to raise rates early, and that's why unemployment got so low in the 1990s.

Be all this as it may, it amounts to a strange argument against Clinton. Greenspan endorsed the 1993 deficit-reducing budget proposal that Clinton championed and Democrats passed over unanimous GOP objections. The proposal was intended to induce the Fed to maintain a low interest rate policy, which is what happened. And Clinton reappointed Greenspan as Fed chair twice.

Republicans claimed credit for themselves

Lawrence Kudlow and Stephen Moore, in a op-ed for the Washington Times and the Cato Institute, say the credit truly belongs to Ronald Reagan, whose "supply-side economic ideas ... unleashed a great wave of entrepreneurial-technological innovation that transformed and restructured the economy, resulting in a long boom prosperity that continues to throw off economic benefits to this day."

This aligns well with partisan politics but accords poorly with the chronology.

Clinton *raised* marginal tax rates on the highest-income Americans, in a move that was roundly denounced by supply-siders as economically ruinous and was uniformly opposed by Republicans in Congress. But the economy was much more prosperous *after* this happened than it was during the years Reagan was actually in office and taxes were lower.

A more chronologically plausible version of events notes that the economy was doing nothing special in 1993 and 1994 and only really took off after Republicans took Congress in the midterms. Defenders of this theory struggle, however, to name exactly what it is that they did that sparked growth.

Part of Ohio Gov. John Kasich's 2016 campaign says that "[a]s chairman of the U.S. House Budget Committee, John Kasich led the historic effort to balance the federal budget for the first time in a generation," referring to a 1997 budget deal that he was a key player in. But this mischaracterizes the events surrounding the deal.

What happened is that because the economy was growing faster than expected, the deficit was smaller than expected, which led Republicans to push for enormous tax cuts. Clinton forced them to settle for small ones and got them to agree to some modest new spending commitments. Republicans of the 1990s, in short, took advantage of the fruits of prosperity more than they contributed to it.

They also set the stage for a change in political dynamic. Seeking counterarguments to the GOP push for tax cuts, the Clinton team began to elevate the idea that it was important to preserve the budget surplus per se — an idea that carried over into the 2000 presidential campaign and beyond and that was really quite different from the specific conclusion that deficit reduction was a good idea given the circumstances of 1993.

Clinton and the stock bubble

What one makes of this period, in retrospect, is naturally colored by the knowledge that the stock market valuations of the final couple of years of Clinton's presidency were absurd. These high prices clearly lifted the economy to some extent, and Clinton may have simply been fortunate in his timing.

Zach Carter of the Huffington Post recently offered a very strong version of this argument, informed by the work of left-wing economists:

Poverty dropped during the Clinton years not because of welfare reform, but because the entire American economy was being juiced by a massive stock market bubble. No credible economist even disputes this. The Clinton bubble was fueled by the aggressive financial deregulatory policies of Clinton and his Federal Reserve chairman, Alan Greenspan.

This ties the left-wing case against Clinton into a neat bow. But it's difficult to see how the main financial deregulation of the Clinton years — a move to allow a single company to engage in both commercial banking and investment banking — contributed to high stock market valuations. If anything, the causal arrow points the other way. The extraordinarily large sums investment banks were earning from IPO underwriting helped persuade some members of the administration that they should open up that market to new competition from commercial banks.

But it is clear that high stock prices helped bolster the economy. People who owned stocks (mostly affluent people) felt richer and spent more money, which supported economic activity.

To cite this as *the cause* of 1990s growth, however, is largely anachronistic. For the past eight or nine years, the United States and many other rich countries has suffered from a persistent shortfall in aggregate demand — a situation in which even very low interest rates do not induce either full employment or inflation.

But at the time Clinton took office, the United States had not suffered from any such situation since the 1930s. Instead, interest rate cuts had been sufficient to spark growth, but fears about inflation had served as a curb on low interest rates and thus growth. Clinton-era economic policy tackled such fears through a variety of channels (trade agreements, a big shift in telecommunications regulation, efforts to get more welfare recipients to join the formal workforce, investments in child care), the most important of which was tackling the Reagan-era structural deficit.

Soaring stock prices is where much of the demand came from, but economic policy at the Treasury Department and the Fed allowed that demand to translate into job creation.

The mixed legacy of Clinton-era economic management

Even if you accept the pro-Clinton narrative on the '90s economy, it's a somewhat ambiguous narrative that has had two different main interpretations:

1. The 1990s show that maintaining appropriate Keynesian countercyclical fiscal and monetary policies is very important.
2. The 1990s show that deficit reduction is very important and/or that budget deficits are very bad.

In terms of their specific applications to the period between 1982 and 2001, these two ideas support the same conclusion: Reagan should not have cut taxes so deeply as to create a large structural budget deficit, and Clinton and congressional Democrats were right to push for deficit reduction.

But over the past 15 years they have tended to push in opposite directions.

Interest rates and inflation stayed subdued during the soft economy of the early/mid-aughts, even as George W. Bush brought budget deficits back with a vengeance. According to narrative 1, these deficits were bad in the sense that they were poorly targeted as fiscal stimulus and it would have made more sense to use the deficit in a different way. But most Democrats pushed some version or other of narrative 2, according to which it was simply bad of the Bush administration to have squandered the Clinton budget surplus.

When Obama took office in 2009, he initiated a substantial fiscal stimulus per narrative 2, but when the size of the stimulus proved inadequate to the scale of the economic problem he was unable to induce Congress to do any more stimulating. Obama then rather swiftly adopted the rhetoric of narrative 1.

"All across America, families are tightening their belts and making hard choices," he said as early as April 2009. "Now, Washington must show that same sense of responsibility."

This kind of balanced budget fetishism does not reflect the most rigorous account of what it is that Clinton-era economic policy got right, but it is certainly one of Clinton's most powerful legacies in the political domain. And it's one that's caused enormous consternation over the years from more progressive wonks who feel that the emphasis on fiscal discipline has damaged the economy and the Democratic Party in the 21st century and who resent worship of the Clinton economy for contributing to it.