

# Macroeconomic policies for development

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# Introduction

- The pre-crisis orthodoxy on macroeconomic policies – fiscal consolidation and inflation targeting
- The revival of fiscal policy in face of recession with reliance on automatic stabilisers plus some discretionary policy

# Fiscal policy

- The two schools
- Fiscal consolidation – forms of balanced budget, reliance on Say's Law and Ricardian equivalence
- 'Functional finance' – the oft need for budget deficits based on differences between savings intentions and investment intentions.

# Fiscal policy

- Fiscal policy and fine tuning
- The (ir)responsibility of fiscal policy
- The hostility to fiscal policy

# Numerical rules

- The arguments for numerical policy rules (e.g. balance budget over cycle) have relied on number of arguments
- Governments have to balance budget (intertemporal budget constraint)
- Governments do not need to unbalance budget
- Governments will be 'irresponsible'

# Fiscal policy and the crisis

- Fiscal policy in the financial crisis : the suspension of 'numerical rules' and the role of automatic stabilisers
- The intensification of the operation of 'numerical rules' for balanced budgets

# Fiscal policy

- The role of intellectual arguments against the need for fiscal policy
- The fall of those arguments

# Fiscal policy

- Budget deficit = Private Savings – Private Investment + (Imports – Exports)
- $BD = S - I - CA$
- $BD = S - I + FA$
- $BD = (S_h - I_h) + (S_f - I_f) + FA$

# The endogeneity of fiscal policy

- Budget deficit (or surplus) to be viewed as a 'residual' endogenous in two senses.
- Governments may fix tax rates and spending plans but the resulting budget deficit depends on private decisions
- Governments should seek to achieve budget position which achieves high level of economic activity but that depends on saving, investment and foreign trade intentions

# Savings--investment

- The scale of the required budget deficit depends on savings and investment behaviour
- Savings and inequality
- Investment
- Remembering the other side of the equation and the consequences of budget deficit reduction

# Functional finance

- The need to establish rules for budget deficits which optimise economic activity whilst retaining fiscal responsibility
- The role of functional finance: aim for budget deficit  $BD = S(Y^*) - I(Y^*) - CA(Y^*)$
- Issues of funding – not of the budget deficit though perhaps of current account deficit

# Functional finance

- Current account deficit issues and international co-operation
- Budget deficits and the interests of financial markets

# Functional finance

- Codifying functional finance
- Monitoring functional finance
- The constraints on budget deficit spending
- Budget deficits and sustainability of private debt

# Monetary policy

- What should be the objectives of monetary policy ?
- Has inflation targetting run its course ?

# Monetary policy

- What objective for the rate of interest ?
- Rate of interest and the exchange rate
- Rate of interest aligned with aligned with rate of growth

# Monetary policy

- Financial stability as the prime objective of the Central Bank
- Monetary policy would be more accurately termed financial policy

# Inflation

- The generally low inflation of the past 15 years or so seen as more a matter of 'luck' than of policy success
- Inflation as a global rather than national problem
- The end of the 'China effect' ?
- Commodity and agricultural prices : 'true inflation'?

# Concluding comments

- Fiscal policy addresses imbalances in the private economy: the need to develop other policies which address those imbalances
- Monetary policy to become financial (stability) policy
- The lack of an effective policy to address inflation