Economic policy coordination in a regionally integrated area

Paper presented at the 52th RSA SIE, Roma 14-15/10/2011

*Massimo Cingolani – EIB**

ABSTRACT

Complete stock-flow consistent models (Godley and Lavoie, 2007) extend the debate on policy coordination in regionally integrated economies to the case of monetary production economies, illustrating the working of the monetary circuit (Halevi and Taouil, 2003).

Assuming an initially balanced situation (a full-employment one) in a single fiscal and monetary policy area, a shift in any of the key structural parameters, such as for instance one of the regional import propensities, can be offset by appropriate fiscal and monetary policies.

In case of a shock in a heterogeneous area composed of fragmented regional or sovereign economies, the four possible adjustment variables are the exchange rate, the interest rate, fiscal policy and the accumulation or disposal of external reserves. Used as autonomous domestic policy instruments, these are ineffective to restore full employment in the absence of economic policy coordination at the level of the whole area. In particular the exchange rate is ineffective for small regional economies, for which it impacts severely on the domestic price level.

Full employment can only be pursued through active fiscal policy coordination, particularly on the expenditure side, in such a way as to replicate the working of a regionally differentiated closed economy. The effectiveness of fiscal policy can be restored because the effects of the Kaleckian multiplier are reinforced through the working of the Harrod trade multiplier. The paper thus follows Parguez (2011), arguing that in a regionally integrated area, policy coordination should aim at full employment, to be pursued through increased ex ante public deficits, in a context of fixed, but partially revisable, exchange rates.