CofFEE

Centre of Full Employment and Equity

CofFEE

Centre of Full Employment and Equity

Macroeconomic risk assessment of the CAREC countries in the context of the global financial crisis

Professor William Mitchell
Centre of Full Employment and Equity
University of Newcastle
Australia

Professor L Randall Wray
CFEPS
University of Missouri-Kansas City
Levy Economics Institute

Linguistics introduction

- WAGE
- EXCHANGE RATE

- What to you hear?

- American person saying **W<u>A</u>GE**
- Australian person saying **W<u>A</u>GE**

When an American says:

wAGE

You hear two sounds

a + e

which is a diphthong

When an Australian says:

wAGE

↓

You hear three sounds

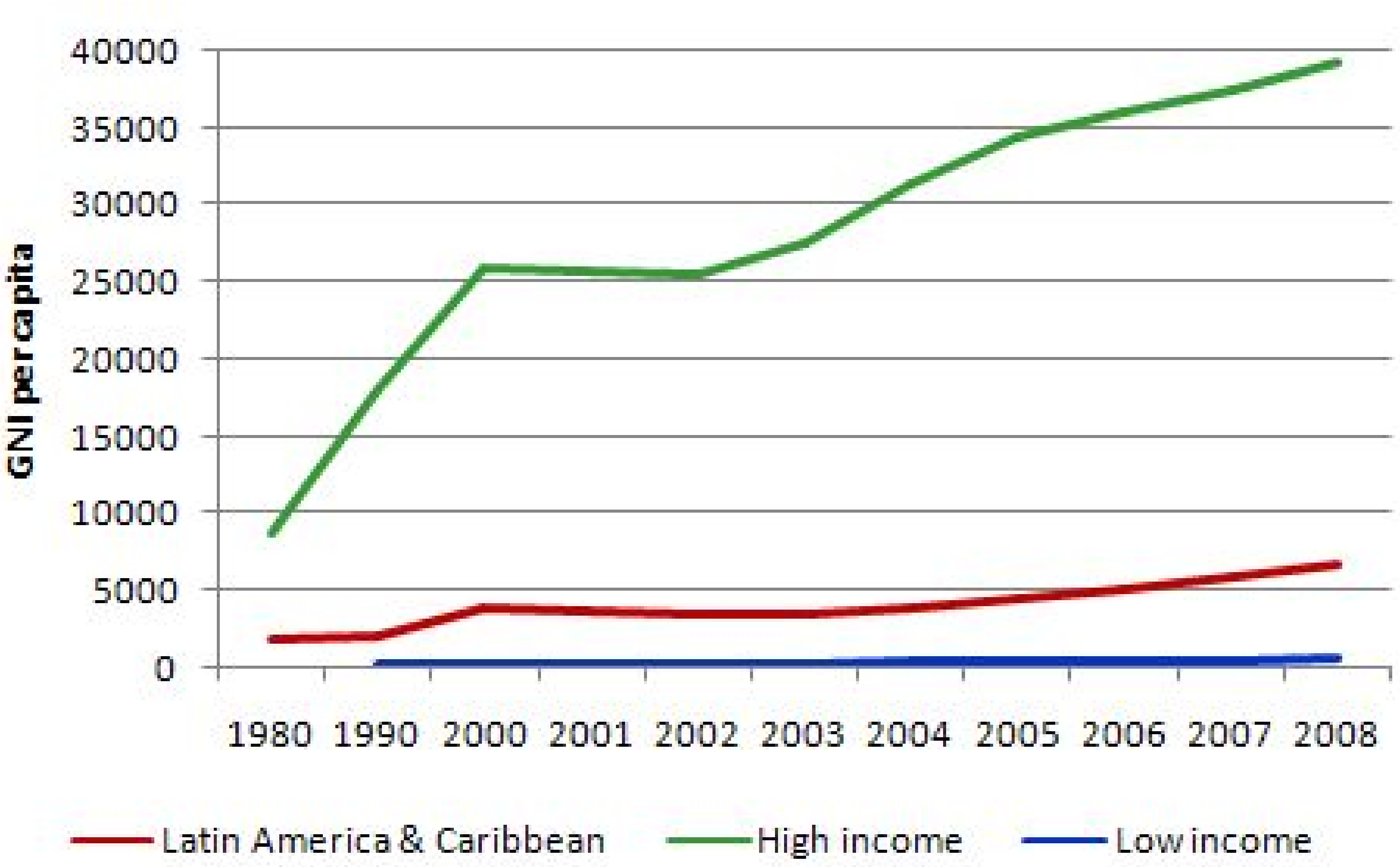
a + i + e

which is a triphthong

Basic principles of development

- Maximising the potential of a nation's human resources is the exemplar of development.
- Fiscal and monetary policy settings that wastes the potential of the nation's human resources is the antithesis of development.
- Unemployment is always a waste of resources

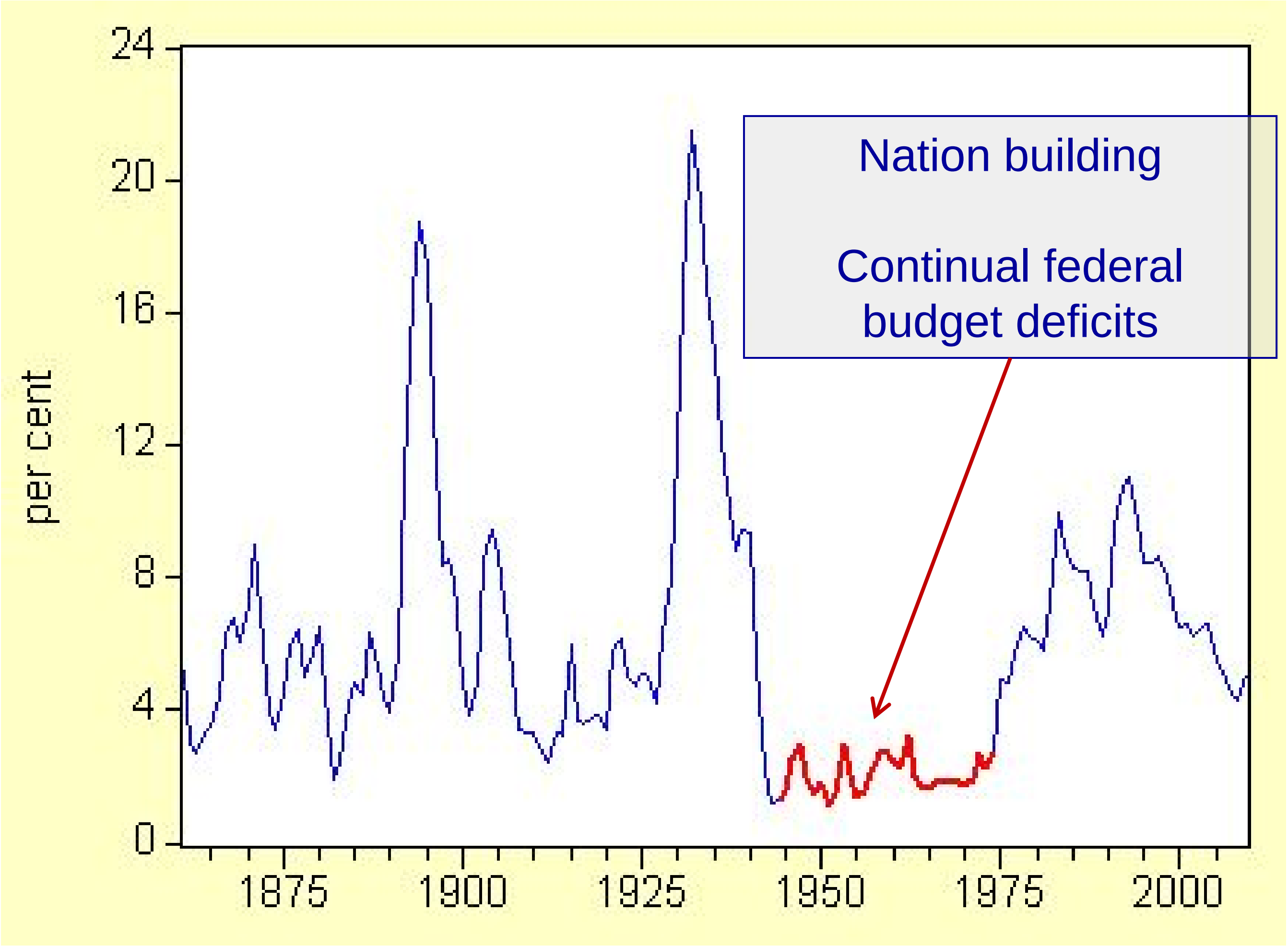
Per capita income trends since 1980



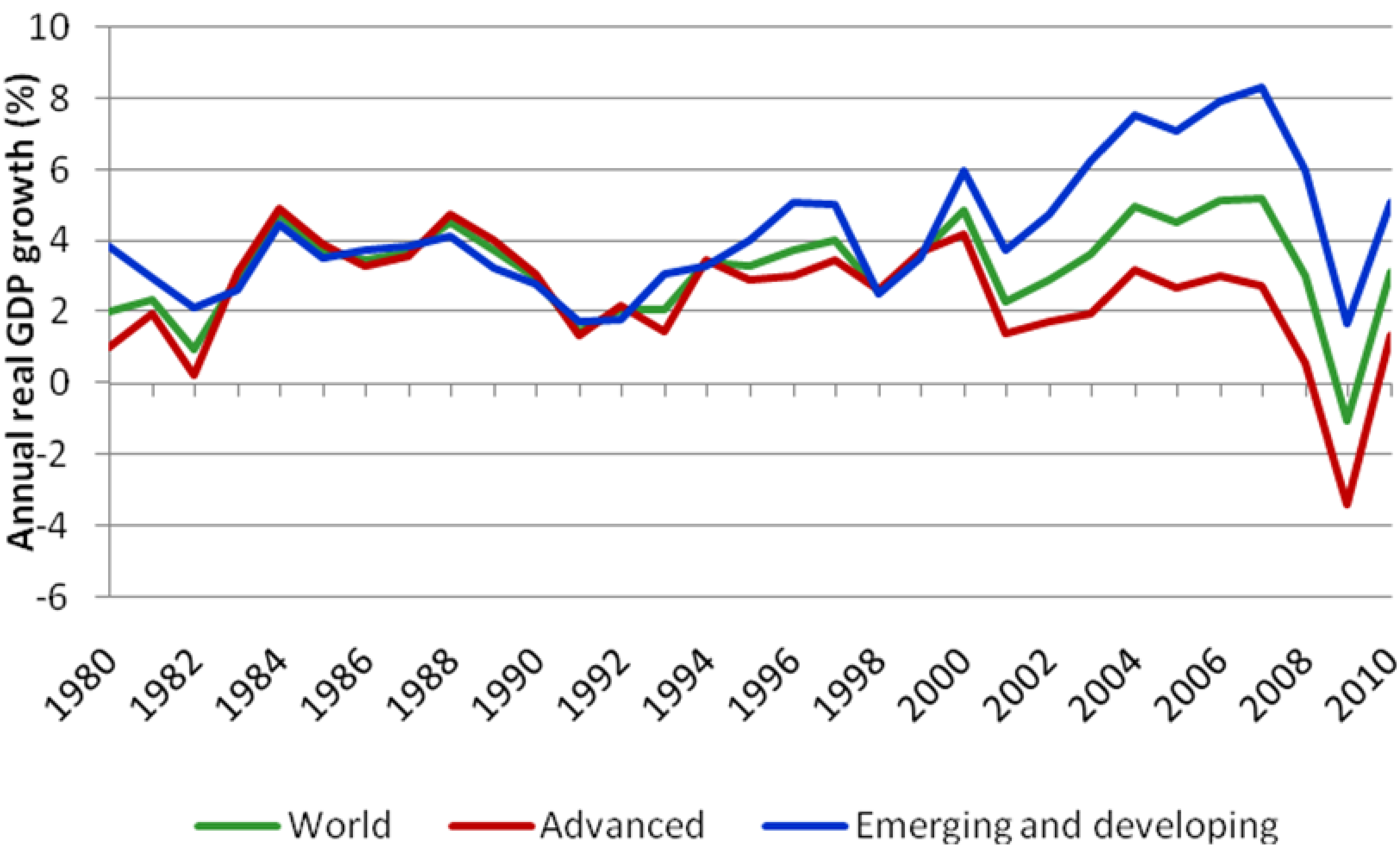
Outline …

- What caused the global economic crisis?
- How have governments responded to the crisis?
- What macroeconomic framework provides the best understanding of the crisis and its solutions?
- What are the implications for CAREC economies?

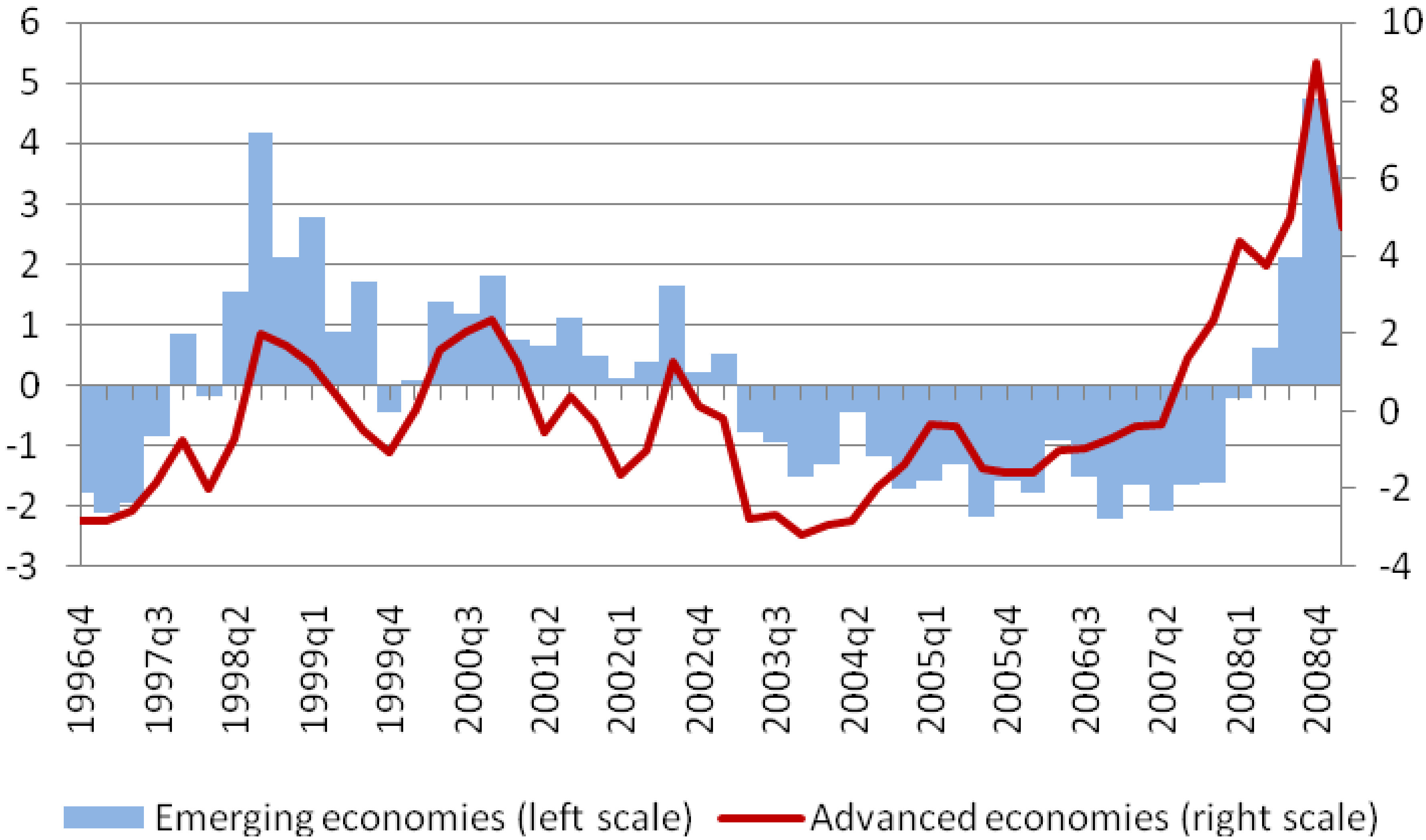
Some historical perspective …



Annualised global GDP growth, 1980-2010



Financial Stress Index in world economies ...



Why are we in crisis?

Why are we in crisis?

- The mainstream economic approach changed in the mid-1970s – a return to market liberalism.
- Massive deregulation and privatisations.
- Constrained real wages.
- Credit boom led to sub-prime etc.
- Monetary policy dominance – inflation targeting.
- Passive fiscal policy focused on budget austerity.
- Conclusion: unsustainable growth strategy which has now collapsed across the globe.

How have governments responded to the crisis?

The spending gap …

- Production levels are based on aggregate demand – spending.
- Employment is created to generate output to meet the demand for it.
- This generates income which is consumed or saved.
- Saving constitutes a “leakage” from the spending-output system.
- We call this a spending gap.
- If it remains unfilled then output and employment fall.

The full employment era: 1945- 1975

- National governments aimed for full employment.
- Fiscal deficits – spending greater than taxation – closed the spending gap left by non-government saving.
- Fiscal deficits were the norm because the private sector desired to save.
- The deficits underwrote production and employment as they are doing now.
- Monetary policy played a support but secondary role.

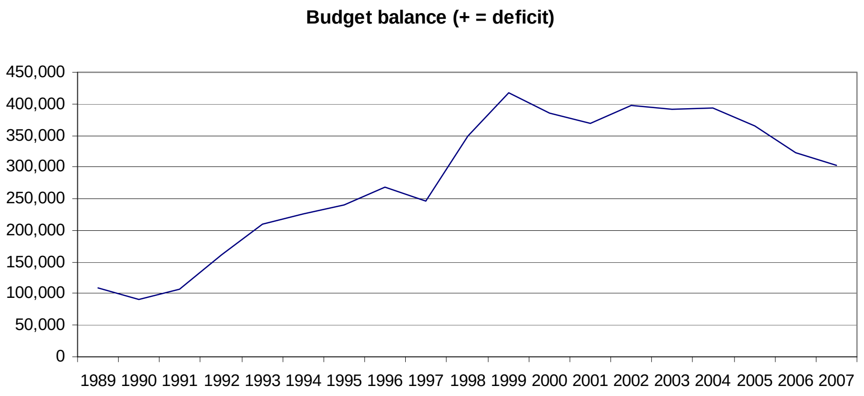
A modern monetary macroeconomics

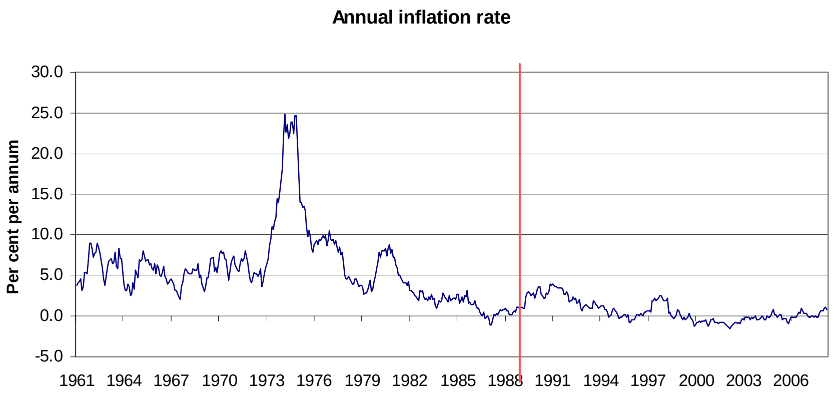
- What are the macroeconomic implications of the current policy reaction - rising deficits and low interest rates?
- A government that issues its own currency is **never** revenue-dependent.
- There is no such thing as the government 'running out of money'.
- This is not the same thing as saying the government should spend infinitely.
- Insolvency is not a risk … only inflation is the risk.

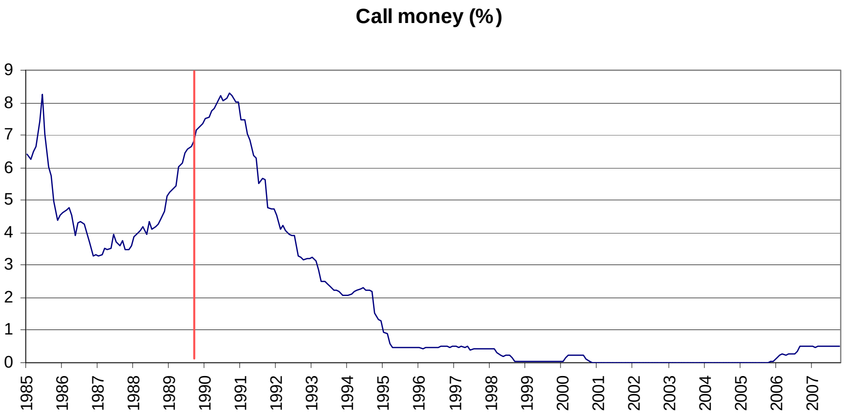
Will taxes and interest rates have to rise?

- Taxation revenue does not alter the government's capacity to spend.
- Issuing government debt does not alter the government's capacity to spend.
- Budget deficits put downward pressure on interest rates.
- For example, Japan.

Japan - a modern monetary economy …







- Budget deficits growing year by year
- Inflation rate negative
- Interest rates zero

What do budget surpluses mean?

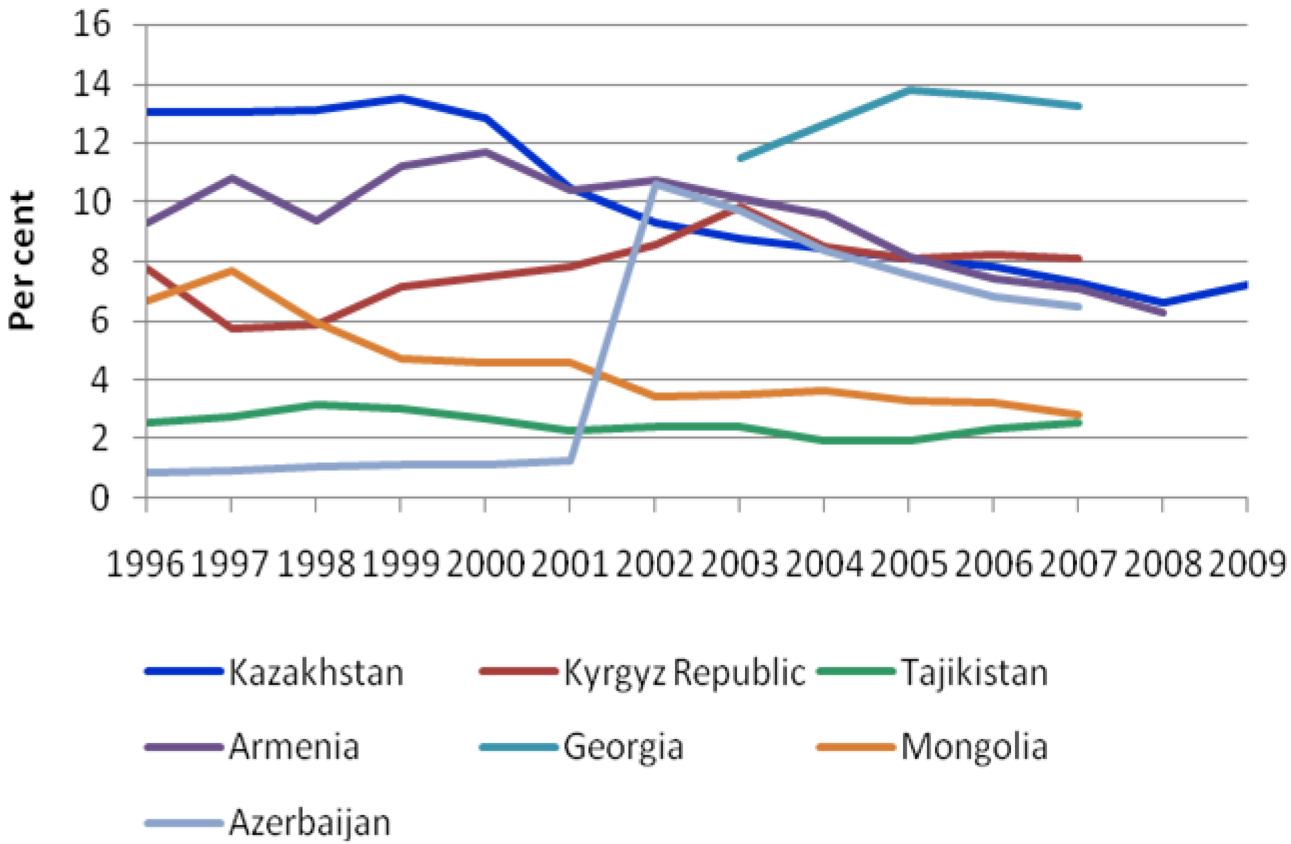
- Increases the spending gap (fiscal drag).
- Private sector has less to spend than otherwise.
- Less private employment.
- Less public employment.
- Less public infrastructure investment.
- Less education and training provided.
- Less public services.
- Less scope for income support.

What are the implications for the CAREC economies?

Risks to CAREC economies

- Denominating liabilities in foreign currencies.
- Excessive reliance on external debt.
- Pegging exchange rates to foreign currencies.
- Looking to exports as a major source of demand.
- Encouraging excessive growth of the financial sector.

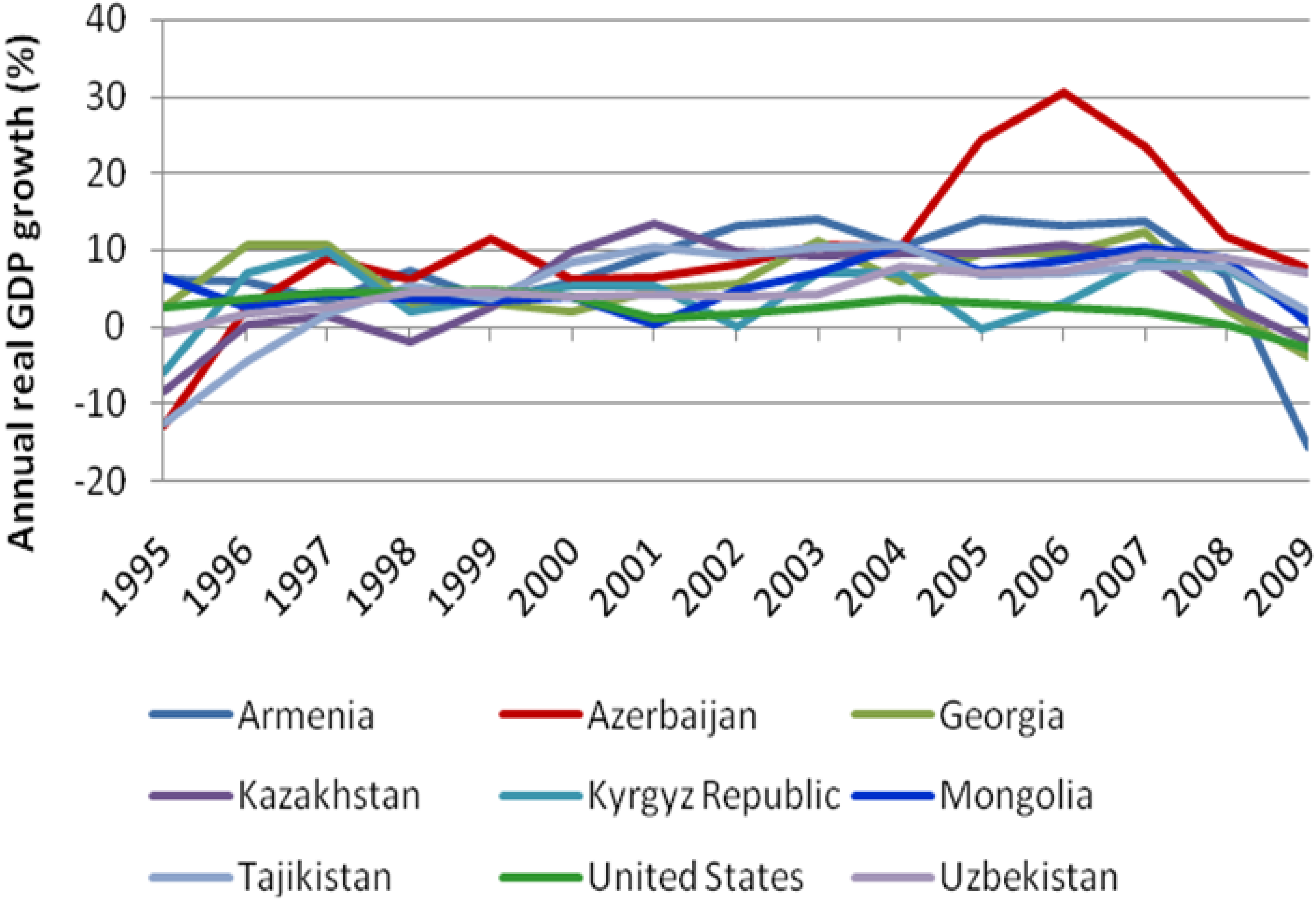
CAREC unemployment rates …



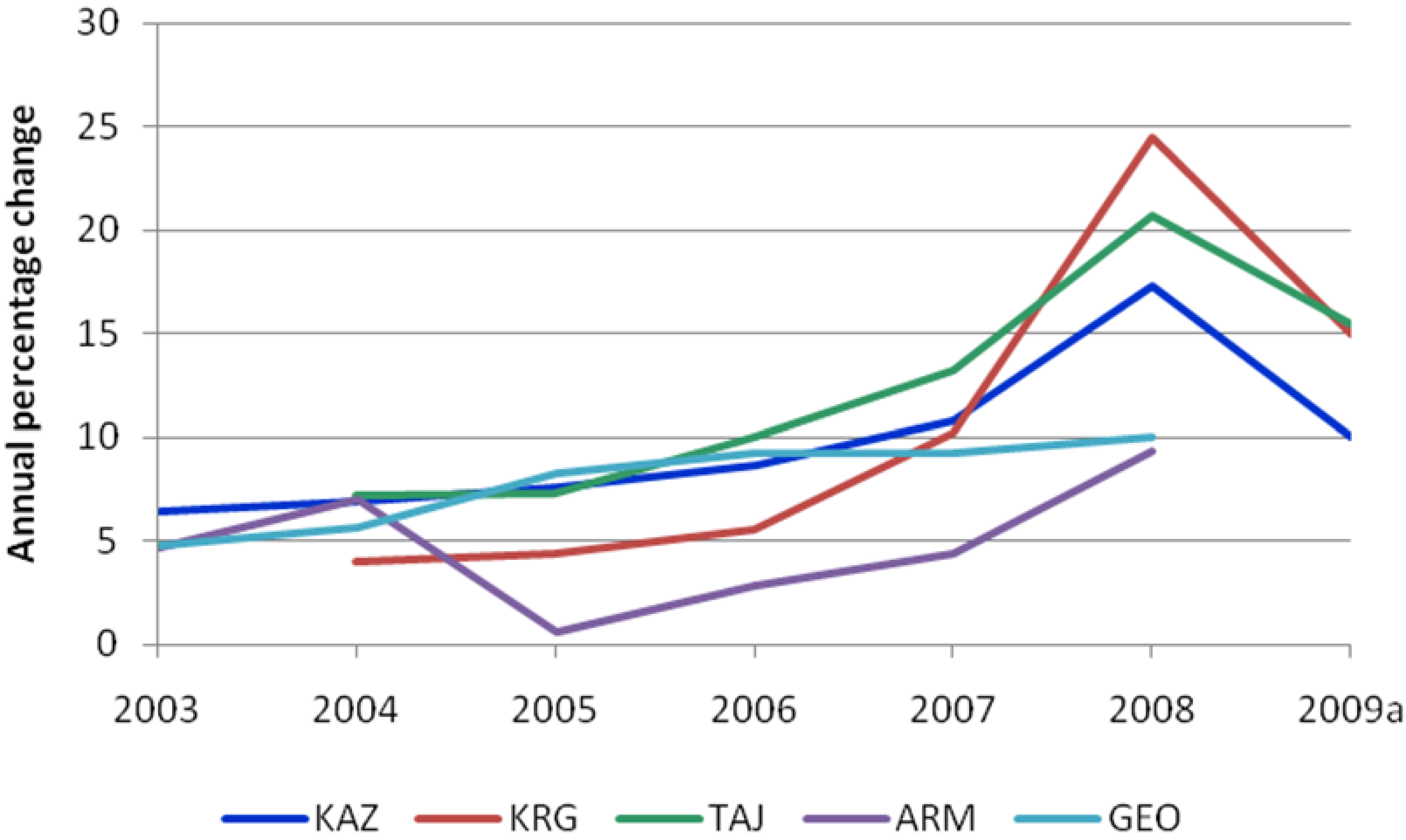
Priority should be employment and skills

- CAREC governments have capacity to promote domestic, demand-led regional development.
- Focus should be on employment and skills – next presentation will talk about this more.
- Unemployment is unacceptably high.
- Government has capacity to deploy the idle labour in public works.
- Always focus on the **real** costs of policy not the nominal costs.

CAREC GDP growth rates … export-led?



CAREC inflation rates … increase productivity?



Proposals to deal with the crisis

- CAREC economies are characterised by vastly underutilised resources
- Concentrating exclusively on the financial problems will not provide a long-term solution and a sustainable development path.
- Stabilisation and long-run growth are linked
- Support from international donors should not be conditional on the size of the deficit – as an end in itself.

Policy directions …

- Move toward exchange rate flexibility.
- Avoid foreign currency loans to government.
- Allow private debtors to default on foreign currency loans, rather than government assumption.
- Do not extend deposit insurance to any deposits denominated in foreign currency.
- Abandon inflation targets, formal and informal.

Policy directions …

- Maintain demand, employment and wages; avoid indexation.
- Introduce a system of employment and training guarantees.
- Work toward regional policy coordination among CAREC nations.
- Greater integration within the region in terms of infrastructure sharing and technology transfer.

Thank you