SOME ISSUES IN MACROECONOMIC POLICY COORDINATION
PRESENTATION
by
DR. COMPTON BOURNE, O.E.
PRESIDENT
CARIBBEAN DEVELOPMENT BANK
at the
SEMINAR ON MONETARY COOPERATION IN THE CARIBBEAN
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Policy coordination may be defined as "supranational rules or norms agreed upon by all Member States which leave primary responsibility for the policy area with the national authorities, but sets limits on their discretion." (Begg, Macleod).

In relation to macroeconomic policy coordination, the policy range includes monetary policy, fiscal policy, investment policy, and a gamut of policies which influence the structure and overall performance of national economies. To emphasize, monetary cooperation is just one component, albeit a very important one, of a vector of other no less important macroeconomic policies. I say so not to offend the high priesthood of central banking (some of my best friends are central bankers), but to remind us that there are other macroeconomic policy instruments of consequence. Which components matter more, depend greatly on the economic circumstances of individual countries and on the economic objectives set for the CSME. For instance, a country already on a stable economic growth path would attach more significance to monetary policy which is primarily assigned responsibility for general price level stability. In contrast, a country trying to engender economic growth would place greater emphasis on public sector budgetary policy and on sectoral/industrial policy.

Several reasons may be advanced for macroeconomic policy coordination.

1. Improvement of allocative efficiency by removing or minimizing policy distortions affecting commodity and factor movements within the single market and economy.

2. The prevention or avoidance of negative spillovers from one national economy to other national economies:

   a. the concern more usually is with the effects of expansionary fiscal policy on aggregate demand and on commodity and factor markets elsewhere in the economic union as well as on the economic variables such as foreign currency exchange rates through which the economic union interacts with the rest of the world;

b. it is also recognized that excessive debt exposure in one or more member country may have contagion effects on others;
c. negative spillovers can ensue from macroeconomic policies other than monetary policy or fiscal policy. Among the more important is labour market policy where aggressive national wage policies could disturb wages or labour supply equilibria in other member countries if labour markets are fully integrated in the CSME; and
d. it is also worth noting that the emergence of huge fiscal surpluses in a member country could have negative spillover effects on other members of the CSME so that the management of those surpluses could be seen as a subject for macroeconomic policy coordination.

3. To facilitate orderly adjustment to asymmetric economic shocks to individual countries. The surge in international petroleum prices is an example of an asymmetric economic shock within the CSME. It induces deficit financing in oil importing countries and budgetary surpluses in oil exporting countries within the economic union.

TECHNICAL PROBLEMS WITH MACRO-ECONOMIC POLICY COORDINATION

1. It is easier to reach a consensus when the problems are short-term in nature than when they are medium to long term. Monetary policy and monetary cooperation can be assigned price stability objectives. Fiscal and labour market policies, however, will tend to be heavily influenced by the long-term adjustment and economic growth objectives of individual countries. It would therefore be sensible to place these considerations at the forefront of CSME objectives when designing a framework for macroeconomic policy coordination.

2. Further obstacles to coordination are presented by differences in the understanding of the workings of individual economies and of the linkages between them. In earlier work, I have pointed to the problem of model identification in central banking policy within the framework of a national economy. The problem is not limited to this component of macroeconomic policy. The additional point I make here is that national policymakers may have a model identification problem not only in respect of their own economy but also in respect of partner economies and that moreover they may be less than fully knowledgeable of the regional economic model. I would venture the opinion that in some countries economic policy is made with implicit economic models rather than explicit models and that at the regional level there is a multiplicity of unstated or unarticulated models informing the search for consensus on all major macroeconomic policy areas.

3. Differences in knowledge of the economic models could lead to macroeconomic rules reached by consensus but which nonetheless are not

sensible for all member countries and therefore are not sustainable or enforceable.

THE FORMAL FRAMEWORK FOR COORDINATION

The experience with policy coordination in Europe suggests a few pointers to regions entering into economic unions:

i. It is not sufficient to establish institutional arrangements for monetary policy coordination. Attention has to be paid to the other areas of policy and to the coordination between the major policy areas.
ii. The existence of policy rules expected to be binding on member states lack credibility if there is not an effective regime for enforcement and sanctions. As Begg notes “soft processes cannot be enforced and it will be all too easy for member states to opt out of coordination precisely when it becomes most necessary.”

References

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