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SYLLABUS

University of Chicago Harris School of Public Policy Studies

Macroeconomic Policymaking

PPHA 39530

Monday and Wednesday: 10:00 to 11:20 pm

March 28 – June 3, 2022

Harris School

INSTRUCTOR:

Carlos Fernandez Valdovinos

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Course Description

This course is about economic policymaking, with a focus on fiscal and monetary policies. It is structured around six topics. For each session, we will begin with a review of some materials that give the student a broad perspective on the state-of-the-art knowledge in the particular topic, before turning to the specific and practical policy issues. The course aims to give students two things:

1. A good understanding on what policymakers should do in each policy area covered (the normative aspects)
2. A sound explanation on why policies are not always optimal and, many times, deviate from the desirable course of action, emphasizing the obstacles for achieving optimality (for example, political).

Course Structure

The course is organized in different topics. I have compiled a list of readings for each topic, some of which we will cover in class and others which are for your own reference. Before the lecture for each topic, in order to help your participation in class, you may want to:

1. Read the paper with the recommended reading marker (*).
2. Skim the other papers if you are interested.

Exams and Grading

There is a mid-term exam where you are going to be able to exercise your ability as a policymaker. The final project involves a practical case of financial programming, where the particular country will be assigned. The final work should be done in groups.

Grade Distribution:

5% Attendance
15% In-Class Participation and discussion
30% Short Paper
50% Final Project

Grade Ranges:

A…….90-100
B…….80-89
C…….70-79
D…….60-69
F…….<60

Attendance and Participation:

Attendance is highly important to your success in the class. Students will be graded for the quality and quantity of their participation while attending class. Excused absences will be granted but only in advance.

Professor:

C. Fernández Valdovinos is a part-time lecturer at the University of Chicago with vast experience as a policymaker. He earned his degree in economics from Universidad Federal de Paraná, Brazil (1990). He received his M.Sc. in economics from the University of Illinois at Urbana–Champaign (1994) and his Ph.D. in economics from University of Chicago (1999). He was Governor of the Central Bank of Paraguay between 2013 and 2018, having received several awards and recognitions for his work. Previously he served as an economist at the World Bank and the IMF, where he was appointed as the IMF Resident Representative for Bolivia and Brazil.

Required Texts:

Selected articles and reports will be assigned, as indicated below. These will be posted to Canvas. Additional articles and reports may be assigned and discussed based on timely topics.

Guest Speakers:

I will also be scheduling one or two guest speakers that have deep experience in policy implementation.

Schedule:

Week 1: Frameworks for implementing monetary policy: the case of inflation targeting.

Inflation targeting involves the public announcement of medium-term numerical targets for inflation with an institutional commitment by the monetary authority to achieve these targets. In recent years, a number of central banks, both in industrialized and emerging markets countries, have adopted this strategy for monetary policy. The framework allows a central bank "constrained discretion," rather than as an ironclad policy rule in the Friedman sense. Still, the adoption of a numerical target for inflation poses many operational questions (challenges) that policymakers must address. In this session we will discuss the potential of the inflation-targeting approach for making monetary policy more coherent and transparent and for increasing monetary policy discipline. We will also review one case study of successful IT Implementation in an emerging market economy.

1. Central Bank of Chile (2020). "Chile’s Monetary Policy Within an Inflation-Targeting Framework".
2. Svensson, Lars (2010). "Inflation Targeting." NBER Working Paper No. 16654. (*)
3. Hofman D.; Chamon M.; Deb P.; Harjes T.; Rawat U. and Yamamoto I. (2020) "Intervention Under Inflation Targeting-When Could It Make Sense?" International Monetary Fund Working Paper 20/9.
4. Adler G.; Chang K.S. and Wang Z. (2020). "Patterns of Foreign Exchange Intervention under Inflation Targeting." International Monetary Fund Working Paper 20/69. (*)
5. Carriére-Swallow Y.; Jácome L.; Magud N. and Werner A. (2016). Central Banking in Latin America: The Way Forward. IMF Working Paper 16/197. (*)
6. World Bank (2015). “The Emerging Markets Monetary Policy Dilemma”. LAC Semiannual Report. World Bank, Washington, DC. Chapter 2.
7. Hammond, Gill. (2011). "State of the Art of Inflation Targeting". Centre for Central Banking Studies Handbook-No. 29. London: Bank of England.
8. Roger, Scott. (2010). "Inflation Targeting Turns 20". Finance & Development. March: 46-49.
9. Bank of International Settlements (2019). "Monetary policy frameworks in EMEs: inflation targeting, the exchange rate and financial stability". BIS Annual Economic Report. (*)
10. Sarwat Jahan S. (2017). "Inflation Targeting: Holding the Line". Finance & Development. Back to basics: Economic concepts explained. 72-73. (*)

Special Topic: Current Trends on Inflation Dynamics.

Week 2: Fiscal budget restrictions at work

In this part, we will develop a conceptual framework for analyzing the interactions between aggregate fiscal policy and monetary policy. The framework draws on existing models that analyze sovereign debt crises and balance-of-payments crises. This framework will serve as a guide for analyzing the monetary and fiscal history of a set of major Latin American countries from the 1960s until now.

1. Esquivel C., Kehoe T. and Nicolini J.P. (2019) "Lessons from the Monetary and Fiscal History of Latin America". University of Chicago, Becker Friedman Institute for Economics Working Paper No. 2019-47. (*)
2. Buera F and Nicolini J.P. (2019). "The Monetary and Fiscal History of Argentina". University of Chicago, Becker Friedman Institute for Economics. Working Paper.
3. Ayres J., Garcia M., Guillen D. and Kehoe P. (2019) "The Monetary and Fiscal History of Brazil". University of Chicago, Becker Friedman Institute for Economics. Working Paper.
4. Charotti J., Fernández Valdovinos C. and González Soley F (2019). "The Monetary and Fiscal History of Paraguay". University of Chicago, Becker Friedman Institute for Economics. Working Paper.

Week 3: A primer on capital flows

Open economies are always subject to shocks. The novel coronavirus, which is taking a huge toll across the world, is just the latest example. Other examples include changing global financial conditions, large drops in commodity prices and severe recessions in major trade partners. These global factors are usually associated with cyclical movements of capital flows. Under certain conditions, foreign financing available to borrower countries could unexpectedly dry up ("sudden stop"). What are the main drivers of capital flows? Are these flows mainly driven by global ("push") factors or rather by country specific ("pull") factors? How should policy react to these events? What are the implications of monetary policy normalization in advanced economies after the pandemic for emerging markets?

1. Hannan, Swarnali (2018). "Revisiting the determinants of capital flows to emerging markets - A survey of the evolving literature". IMF Working Paper 18/214. (*)
2. Gallagher, Kevin P. "From managing the trilemma to stability-supported growth." In Ruling Capital: Emerging Markets and the Reregulation of Cross-Border Finance, 49-70. ITHACA; LONDON: Cornell University Press, 2015. Accessed August 17, 2020.
3. IADB (2019). "Building opportunities for growth in a challenging world." Latin American and Caribbean Macroeconomic Report. Chapter 2 and 3.
4. IADB (2014). "Global Recovery and Monetary Normalization: Escaping a Chronicle Foretold?" Latin American and Caribbean Macroeconomic Report. Chapter 4, 5 and 6.
5. IMF (2016). "Understanding the Slowdown in Capital Flows to Emerging Markets". World Economic Outlook. Chapter 2. April. (*)
6. IMF (2017). "Drivers of Capital Flows and the Role of the Investor Base in Latin America" Western Hemisphere Region, Regional Economic Outlook. Chapter 4. April.
7. IMF (2017). "The Role of Foreign Exchange Intervention in Latin America's Inflation-Targeting Countries". Regional Economic Outlook: Western Hemisphere Background Paper No. 4. October.
8. IMF (2020). "Toward an Integrated Policy Framework". IMF Policy Paper. October.

Week 3 and 4: Fiscal adjustment. Challenges when implementing fiscal austerity.

When is it necessary to reduce the fiscal deficit and when should governments increase it? This is a perennial theme in the economic policymaking debate with very little consensus. Standard textbooks say that deficits are desirable when the economy needs an expansion, but advocates of austerity claim that under some circumstances fiscal contractions can be expansionary if they generate credibility. A lot depends on initial conditions —especially the level of public debt—a topic that we will discuss.

1. IMF (2010). “Recovery Risk and Rebalancing” World Economic Outlook. Chapter 3. October.
2. Alesina, A., Favero, C. and Giavazzi, F. (2019) Austerity: When It Works and When It Doesn’t, Princeton University Press. Chapters 1, 7, and 11.(*)
3. Alesina, A., F. Campante, and G. Tabellini. 2008. "Why is Fiscal Policy often Procyclical." Journal of the European Economic Association 6: 1006-1036. Sections 1 and 4.(*)
4. Vegh, C., C. Lederman, D, and F. Bennett, F. 2017. "Leaning Against the Wind: Fiscal Policy in Latin America and the Caribbean in a Historical Perspective." LAC Semiannual Report. World Bank, Washington, DC. Chapter 2. (*)
5. Chapter 4 of the IMF’s Regional Economic Outlook, April 2014 (pp. 49-62) also discusses fiscal adjustment in Latin America in response to the commodity shock.
6. Martin Ardanaz & Alejandro Izquierdo "Current Expenditure Upswings in Good Times and Capital Expenditure Downswings in Bad Times?: New Evidence from Developing Countries. IADB Department of Research and Chief Economist, DISCUSSION PAPER No IDB-WP-838, September 2017.(*)
7. Izquierdo,A., Pessino, C. & Vuletin, G. (2018). “Better spending for better lives: how Latin America and the Caribbean can do more with less.” Inter-American Development Bank, Department of Research and Chief Economist.
8. David, A., Guajardo, J., & Yépez, J. (2019). “Sovereign Spreads and Fiscal Consolidations.” IMF, REO Background Paper, October, 2019.

Special Topic: *Fiscal Policy after the Pandemic*.

Week 6 and 7: The importance of fiscal rules

The convenience of rules versus discretion, of commitment versus flexibility, is a central issue of today’s fiscal policy debate. Why might governments want to surrender discretion? Which are different ways to tie their hands for the sake of fiscal responsibility? Fiscal rules have emerged as the favorite mechanism to ensure macroeconomic stability and to enhance the ability to access international financial markets at favorable rates. However, revenue volatility (associated with commodity dependence), expenditure pressures and rigidities, make fiscal adjustments (and compliance with fiscal rules) very hard. We will study fiscal rules and their effectiveness in a number of countries.

1. IMF (2018). Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability. IMF Staff Discussion Note SDN/18/04, April. (*)
2. Bova, Elva, et al. (2014), "Fiscal Rules and the Procyclicality of Fiscal Policy in the Developing World". IMF Working Paper, July. WP/14/122. (*)
3. Martin Ardanaz, Eduardo Cavallo, Alejandro Izquierdo, and Jorge Puig. Growth-Friendly Fiscal Rules? Safeguarding Public Investment from Budget Cuts through Fiscal Rule Design, IADB Department of Research and Chief Economist, DISCUSSION PAPER No IDB-DP-698, July 2019. (*)
4. Lledó V., Yoon S., Fang, Mbaye S., and Kim Y. (2017). "Fiscal Rules at a Glance". IMF Working Paper, July.

5. IMF (2018). "How to Calibrate Fiscal Rules. A Primer" IMF How-To-Note, International Monetary Fund, Washington, DC.
6. Pessino, Carola; Izquierdo, Alejandro; Vuletin, Guillermo. (2018). “Better spending for Better Lives: How Latin America and the Caribbean Can Do More with Less”. IADB Report. Chapter 9.

Week 8 and 9: Assessing the economy: An introduction to financial programming

Policy makers continuously need to evaluate the current state of the economy, forecast where it is heading, and identify economic policies that can change the course of the economy. The IMF uses its well-known "financial programming model" (FPM) for economic surveillance purposes. The institution also uses FPM to derive monetary and fiscal programs to achieve desired macroeconomic targets in countries undergoing crises and having an IMF-supported economic program. Financial programming is based on monetary, balance of payments, and fiscal accounting identities. In this part, the students will learn the basic skills required to conduct financial programming.

1. Mussa, M. and Savastano M. (1999). "The IMF Approach to Economic Stabilization", NBER Macroeconomics Annual 1999, Volume 14, pp. 79-128. (*)
2. Barth R. and Hemphill W. (2000). "Financial Programming and Policies: The Case of Turkey." IMF Institute.
3. Mikkelsen, Jan (1998). "A Model for Financial Programming." IMF Working Paper 98/80.
4. Karlik J., Bell M., Martin M., Rajcoomar S. and Sisson C. (1996). "Financial Programming and Policy: The Case of Sri Lanka." IMF Institute.
5. Mercedes Da Costa M. and Juan-Ramón H. (2011). "Programación financiera: Fundamentos teóricos y aplicación práctica al caso de Costa Rica." Interamerican Development Bank (IADB).

Optional (Week 8): Sovereign debt management and sustainability

This session will discuss sovereign borrowing and debt management issues, medium-term debt sustainability analysis; and debt crises and restructurings. It will discuss the policies that support sustainable debt; the keys to a successful restructuring; the particular challenges faced when dealing with domestic and external creditors. It will also look at the recent update of the IMF- WB Debt Sustainability Framework.

1. Reinhart, C. and Kenneth S. Rogoff K. (2010). "This Time is Different, Eight Centuries of Financial Folly." Princeton University Press. Chapters 2, 4, 5, and 17.
2. Reinhart, Carmen M., Rogoff K. and Savastano M. (2003). "Debt Intolerance." NBER Working paper 9908, August 2003.
3. International Monetary Fund (2017). "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries." IMF Policy Paper (Washington), December. (*)
4. International Monetary Fund (2017). "Review of the Debt Sustainability Framework for Low Income Countries: Proposed Reforms." IMF Policy Paper (Washington), August.
5. International Monetary Fund (2012). "A Survey of Experiences with Emerging Market Sovereign Debt Restructurings." Monetary and Capital Markets Department, June.

6. IMF-iBlog (2014). "Acting Collectively: A better Way to Restructure Government Debt." Sean Hagan, November 24, 2014.

Final Project – date TBD