

## SYLLABUS

### University of Chicago Harris School of Public Policy Studies PPHA 39530 Macroeconomic Policymaking

Monday and Wednesday: 9:00 to 10:20 am  
March 20 – May 19, 2023

#### INSTRUCTOR:

Carlos Fernandez Valdovinos  
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**TAs:** Maria Soledad Hurtado and Gabriel Angarita

### 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.

Given that the instructor is not based in the US, some lecture sessions will be remote, and others will take place on Fridays at 10:00am. All sessions will be recorded and available on the Canvas Zoom Main Account. Please refer to the Canvas main page for calendar details.

### Evaluations

There is a team take-home monetary policy exercise that will be explained by the end of week 3, and an in-person mid-term exam that will cover the main concepts reviewed until week 5. The final is an individual take-home project that involves a practical case of financial programming. For the final, collaboration between 2-3 people will be allowed, with the requirement that each student must include the names of the people they collaborated with.



## **Attendance, Participation, and Discussion**

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

Participation will also be evaluated discussion-based through reading checks. Students will have the option to post questions related to the weekly readings, or answers to the other students' questions (50 words max. for both the questions and answers). Points will be discounted if the content is not related to the corresponding week's readings or if exceeds the word limit. Canvas Discussions links will be provided by TAs before the reading check deadlines.

Note: there are 5 reading checks in total, but only 2 good questions and 2 answers from different reading checks will be required. This means that if one week your question or answer is not sufficiently good, or if you miss one discussion, you will still be able to get 100% points in this section. You can post as many questions and answers as you want. The objective of this evaluation is to encourage discussion among students and bring more pre-meditated content to the lecture sessions to continue discussing it in class.

## **Grade Distribution**

10% In-Class Participation  
10% Reading Checks Canvas Discussion (2 questions and 2 answers in total)  
10% Monetary Policy Exercise  
30% Midterm Exam  
40% Final Project

## **Grade Ranges**

A .....96-100  
A-.....90-95.9  
B+.....87-89.9  
B.....84-86.9  
B-.....80-83.9  
C+.....77-79.9  
C.....74-76.9  
C-.....70-73.9

## **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

There will also be one or two lecture sessions with guest speakers that have deep experience in policy implementation.

## Content Schedule:

### **Week 1 and 2: 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, several 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. Other topics covered in the lectures will be the role of the exchange rate in an IT regime and the crucial importance of an independent central bank to control inflation. We will also review one case study of successful IT Implementation in an emerging market economy.

1. Central Bank of Chile (2020). "Central Bank of Chile: Monetary Policy in 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 2020/69.
5. Carrière-Swallow Y.; Jácome L.; Magud N. and Werner A. (2016). Central Banking in Latin America: The Way Forward. IMF Working Paper 2016/197. (\*)
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. (\*)



11. Jácome, Luis and S. Pienknagura (2022). "Central Bank Independence and Inflation in Latin America—Through the Lens of History". IMF Working Paper 2022/186.

Special Topic: Current Trends on Inflation Dynamics.

## **Week 2: A primer on capital flows**

Open economies are always subject to shocks. The novel coronavirus, which has taken 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.
9. IMF (2022). "Spillovers of US Monetary Tightening to Latin America." *Regional Economic Outlook: Western Hemisphere Background Paper 1* (October), International Monetary Fund, Washington, DC.

## **Week 3: 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 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.
9. Alesina, Alberto ; Ciminelli, G. ; Furceri, D. & Saponaro, G. (2021). "Austerity and Elections." IMF Working Paper No. 2021/121, International Monetary Fund, Washington, DC.
10. Dabla-Norris, E., and F. Lima. (2018). "Macroeconomic Effect of Tax Changes." IMF Working Paper 18/220, International Monetary Fund, Washington, DC.

Special Topic: Fiscal Policy after the Pandemic.

### **Week 6 to 8: 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. Ardanaz, Martin; Cavallo, Eduardo; Izquierdo, Alejandro and Puig, Jorge (2019). "Growth-Friendly Fiscal Rules?". IADB Department of Research and Chief Economist, DISCUSSION PAPER No IDB- DP-698. (\*)
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.
7. Ardanaz, Martin; Cavallo, Eduardo and Izquierdo, Alejandro (2023). "Fiscal rules: challenges and reform opportunities for emerging markets". IADB Working Paper Series 1443.
8. Valencia, Oscar and Ulloa-Suarez, Carolina (2022). "Numerical compliance with fiscal rules in Latin American countries". IADB Working Paper Series 1345.

### **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 (2021). "Review of the Debt Sustainability Framework for Market Access Countries". IMF Policy Paper (Washington), January
6. International Monetary Fund (2012). "A Survey of Experiences with Emerging Market Sovereign Debt Restructurings." Monetary and Capital Markets Department, June.
7. International Monetary Fund (2014). IMF Debt Sustainability Analysis Background Chapter 8 in Financial Programming and Policy Manual.



8. IMF-iBlog (2014). "Acting Collectively: A better Way to Restructure Government Debt." Sean Hagan, November 24, 2014.
9. Abbas, S. Ali, Alex Pienkowski, and Kenneth Rogoff (eds) (2019). "Sovereign Debt: A Guide for Economists and Practitioners". Oxford Academic.
10. International Monetary Fund (2002). "Assessing Sustainability," SM/02/166. Available via the internet: <http://www.imf.org/external/np/pdr/sus/2002/eng/052802.htm>.
11. International Monetary Fund (2003). "Sustainability Assessments—Review of Application and Methodological Refinements," SM/03/206. Available via the internet: <http://www.imf.org/external/np/pdr/sustain/2003/061003.pdf>.
12. International Monetary Fund (2004). "Debt Sustainability in Low-Income Countries – Proposal for an Operational Framework and Policy Implications." Available via the internet: <http://www.imf.org/external/np/pdr/sustain/2004/020304.htm>.
13. International Monetary Fund (2004). "Debt Sustainability in Low-Income Countries: Further Considerations on an Operational Framework and Policy Implications." Available via the internet: <http://www.imf.org/external/np/pdr/sustain/2004/091004.htm>.

### **Week 9: Assessing the economy: An introduction to financial programming**

Policymakers 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).