Responding to the Global Fiscal Crisis with ‘Credibility’: An Assessment of the Macroeconomic Policy Frameworks of the Inter-Governmental Organisations

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Abstract: Following the severe impact of the Global Financial Crisis on output and unemployment in most developed economies since 2008, policymakers have been subjected to a greater than usual flow of macroeconomic and labour market policy advice from the major Inter-Governmental Organisations, including the OECD, IMF, World Bank and the European Union.

The objective of this paper is to critically assess the evolution of this policy advice from the broad consensus about the need for modest fiscal stimulus measures in selected countries to general agreement that virtually all OECD countries must now adopt strategies of fiscal consolidation in the medium term in the pursuit of long term fiscal sustainability. It is concluded that the policy advice is severely compromised by the failure of these organisations to differentiate between those countries that can conduct independent fiscal and monetary policy, and those subject to voluntary policy constraints, notably the Eurozone countries.

1. Introduction

The Global Financial Crisis (GFC) is considered to have caused the worst recession since the Great Depression (IMF, 2009). Most developed economies have been adversely affected through sustained below trend or even negative growth accompanied by rising unemployment. Budget deficits have grown significantly mainly due to the operation of automatic stabilisers, but also as a consequence of fiscal stimulus measures in some countries, notably Australia, the USA, Japan, Korea and China.

Since the advent of the crisis there has been a flood of policy documents concerning the conduct of macroeconomic and labour market policy from key Inter-Governmental Organisations (IGOs), notably the OECD, IMF, World Bank and the European Union. By 2009, these institutions had acknowledged that a fiscal stimulus was appropriate in some countries, albeit with qualifications, but sound public finance was advocated through the medium term (MT) pursuit of fiscal consolidation (ECB, 2009; Freedman et al, 2009; OECD, 2009a,b,c; 2010a,b; IMF, 2010a,b,c; Price, 2010).

In principle, the sharp recession should provide a major challenge to the neo-liberal orthodoxy1 advocated by these IGOs. Accordingly we shall carefully assess the policy advice offered by these bodies, which will be informed by the principles of modern monetary theory. Our particular focus is on how their advice has evolved over the past two years or so, the rigor of their underlying research and whether a deep-seated policy consensus persists.

There are serious flaws in their policy advice, which in part reflect their collective failure to differentiate in their theoretical and empirical work between countries in the Eurozone and those (sovereign) countries which operate with their own fiat currency and flexible exchange rates, and face no ex ante fiscal budget constraint. Eurozone countries are subject to fiscal
budget constraints through the Stability and Growth Pact and are required to borrow Euros to fund deficits. Consequently, member countries are forced to adopt pro-cyclical fiscal policy (FP). Also individual countries have limited capacity to influence monetary policy (MP) and the nominal exchange rate is insensitive to the circumstances of small countries, in particular.

Notwithstanding the seriousness of the GFC for the long term welfare of citizens of developed and developing countries, the conduct of FP and, in particular, the imperative for fiscal consolidation is viewed as an accounting exercise by these international organisations, rather than being guided by clearly defined principles of public purpose (Mitchell, 2010a). The broader policy framework remains largely unchallenged by the international academic literature, although Stiglitz advocated further fiscal stimulus, and warned of the risk of austerity measures producing a ‘Japanese-style malaise’ (CEDA, 2010).

The remainder of this paper mainly focuses on the policy recommendations of the IMF and OECD, as arguably the most well-established IGOs. In Section 2 we summarise the respective policy frameworks developed by these IGOs prior to the GFC, with a particular focus on how the neo-liberal paradigm shift affected these macroeconomic and labour market frameworks. Section 3 details the evolution of the policy responses of these organisations to the ongoing GFC, with first the advocacy of temporary fiscal stimulus, at least for some countries, which was rapidly followed by the pursuit of widespread fiscal consolidation. Section 4 provides a robust critique of the IGO’s policy prescriptions and the underlying neo-liberal framework. Section 5 offers some concluding remarks.

2. Neo-Liberal Policy Framework

To understand the pre-GFC policy stance of these IGOs we will briefly outline their origins, and the decisive economic events that have shaped the development of their neo-liberal orientations which have strongly influenced their policy responses to the GFC. Neo-liberal policies are designed to facilitate the unfettered operation of the market, based on the belief that a private sector dominated economy is the most efficient (see Williamson, 1990 for a list of policies consistent with the Washington Consensus).

Along with the OECD, the International Monetary Fund (1944) was one of many international institutions, which were established immediately after World War 2. A consensus emerged that an international clearing union be established to support the development of the post-war global economy. Since countries were moving away from the gold standard, the main objectives for Keynes and White, the key drafters of the IMF documentation, ‘was to engender postwar economic growth by establishing an institution that would prevent a relapse into autarky and protectionism, not just to avoid a recurrence of the depression’ (Boughton, 2004:5).

The OECD emerged because the USA was prepared to contribute to the Marshall Plan, but wanted the European countries to take responsibility for its implementation (Bainbridge, 2000). The OECD in its present form originated in Paris in December 1959. Its aims ‘are to promote policies to secure the highest sustainable economic growth and employment, and thereby a rising standard of living, in member countries; to contribute to the expansion of world trade on a multilateral, non-discriminatory basis; to promote social and economic welfare in the OECD area by coordinating member countries’ policies’ (Bainbridge, 2000). The IMF and OECD initially espoused Keynesian economics.

The shift to a neo-liberal policy agenda followed the inflation breakout initiated by the oil price shocks of the early 1970s and the subsequent stagflation. The OECD commissioned the McCracken Report which followed the policy shift already underway in macroeconomics led
by Friedman and Phelps. McCracken (1977) argued that demand management be used to fight supply-side inflation, despite its origins, and also that government regulation be reduced through supply-side reforms. The Report contributed to the OECD’s shift towards more market oriented policies (Henderson, 1993:28). Also, Friedman’s seminal work on floating exchange rates and monetarism had a profound impact on the IMF’s policy orientation.

The influential role of the OECD in the design and dissemination of labour market and macroeconomic policy started in the early 1990s when member states commissioned it to explain their persistently high unemployment. The proposed reforms were based on the imperative to remove the institutional fetters allegedly inhibiting the operation of markets, in particular labour markets (LaJeunesse et al, 2006). Unemployment was seen as mainly structural, so it was redefined as an individual problem, arising from poor skills and motivation, rather than a systemic failure of macroeconomic policy (Watts, 2010).

Consequently supply side policies were advocated, including greater wage price flexibility; reform of employment security provisions; introduction of active labour market policies; and reform of unemployment and related benefit systems and their interaction with the tax system (OECD, 1994). Likewise, IMF staff also ‘gradually abandoned the view that persistently high unemployment was due to weak demand and increasingly focused on rigid labor markets and other supply side issues as the source of the problem’ (Boughton 2004:17).

The policy stance of the IMF leading into the GFC can be summarised as follows. There were concerns over the conduct of FP due to lead-lag times and the general operational constraints, and its link with the political process. MP ostensibly should be geared to the achievement of low and stable inflation, although in practice, central bankers considered other factors when setting the rate. The inflation objective would override concerns about the level of economic activity, per se, because low inflation was regarded as the most effective means for reducing the output gap (Blanchard and Gali, 2007; Blanchard et al. 2010). The primacy of MP, and concerns over the efficacy of FP raised by supply side economics (Canto, Joines and Laffer, 1983) and Ricardian equivalence theory (Barro, 1974), thus marginalised the role of FP within the IMF’s agenda. Financial regulation was considered a microeconomic intervention which was conducted at the institutional level, with little regard for the broader macroeconomic environment.

Thus prior to the GFC both IGOs remained wedded to a neo-liberal policy framework, reaffirming the importance of sound budget balances for the conduct of macroeconomic policy, which gave greater prominence to MP and the need to remove obstacles to participation and job creation via supply side initiatives.

3. The Impact of the GFC on IGO Policy Frameworks

Fiscal Stimulus Measures

In 2008, the IMF directed policymakers to further ease MP, particularly in advanced economies. The use of FP was justified by its stabilizing role, but the emphasis remained on the operation of automatic stabilizers. ‘(S)timulus must be timely, well targeted, and quickly unwound’ (IMF, 2008a:xvi). By the end of 2008 the IMF was considering fiscal stimulus measures more seriously, by reviewing the output multiplier effects of discretionary measures. However, the multipliers were ‘found to be quite low’ and sometimes negative (IMF, 2008b: xiii). Thus the IMF continued to direct policy makers towards strengthening the cyclicality of automatic stabilisers. This was claimed to be justified by the level of public debt and hence the medium-term outlook for fiscal sustainability.
ECB (2009) cautioned that, while FP action was ‘largely justified’, EU countries had obligations under the Treaty and SGP to conduct FP ‘within a predictable, medium-term oriented framework’. OECD (2009b:10-11) differentiated between countries with ‘a weak initial fiscal position’ and those with ‘most scope for fiscal manoeuvre’, but ‘For others, action would only be warranted in case activity looks to turn out even weaker than projected’. ‘The scope for further stimulus depends on the degree of government indebtedness. ……. Evidence shows that adverse reactions in financial markets are likely in response to higher government debt and that such reactions may depend on the initial budget situation’ (quoted in Watts, 2010). The IMF echoed the OECD’s concerns about the likelihood of financial crowding-out, and stressed the imperative of fiscal space, fiscal credibility and long-run fiscal discipline to ensure that temporary stimulus did not compromise long term fiscal sustainability, particularly given the prospect of rising health and social expenditures in those advanced economies with ageing populations (Freedman et al. 2009). However fiscal stimulus measures in the U.S. and Asia were estimated to have contributed 1 percent and 1.75 percent respectively to GDP growth in 2009 (IMF, 2010a).

The World Bank also stressed the value of keeping fiscal sustainability a high priority within policy agendas, particularly with reference to developing/emerging economies (World Bank 2008; 2010b). Thus, it was widely claimed that if fiscal stimulus was not implemented with a credible plan for its eventual withdrawal, higher interest rates would exacerbate concerns over the sustainability of fiscal balances, and thus necessitate more severe consolidation measures (Freedman et al, 2009; Blanchard et al. 2010; IMF, 2010c).

As the GFC worsened, central banks continued to ease interest rates, in addition to ‘bail-out’ offers and deposit guarantees in an attempt to retain confidence and stem further contagion. Once nominal rates approached zero, the IMF started favouring unconventional monetary measures such as altering the size and composition of central banks balance sheets via quantitative or credit easing.

Despite its earlier opposition, the IMF (2009:xix) now maintained that ‘past experience suggests that fiscal policy is particularly effective in shortening the duration of recessions caused by financial crisis’. Further, ‘consolidation should not be launched prematurely’ and ‘it is now apparent that the effort [fiscal stimulus] will need to be at least sustained, if not increased, in 2010, and countries with fiscal room should stand ready to introduce new stimulus measure as needed to support the recovery’ (IMF, 2009:xix). World Bank (2010a:14) supported the IMF’s position arguing ‘[i]n most countries, it is still premature to withdraw the fiscal stimulus because of spare capacity and ample fiscal space’.

The fiscal stimulus measures adopted by advanced and emerging economies in response to the GFC were considered essential to the restoration of global demand growth, estimated at 5.25 percent in the first half of 2010 (Freedman et al. 2009; IMF, 2010b; World Bank, 2010a). Thus the major IGOs cautiously acknowledged the appropriateness of fiscal stimulus measures as a countercyclical device under conditions of severe economic contraction. Also the IMF continued to support international financial flows by advocating the avoidance of trade and financial protectionism, such as ‘beggar-thy-neighbour’ policies.

Notwithstanding qualified support for fiscal stimulus, little space was devoted by the IGOs in their policy documents to providing a rationale. At face value there was no scope for fiscal intervention in economies which are subject to cyclically invariant NAIRUs and exhibit strong equilibrating properties. OECD (2009a,b,c; 2010a,b) accepted the implementation of fiscal stimulus measures, particularly in countries with limited scope for MP, without justifying stimulatory policy, per se. The IMF (2010a:23) had a major concern about ‘the potential for temporary joblessness to turn into long-term unemployment and to lower
potential output growth’, which implies a cyclically sensitive (hysteretic) NAIRU. This is an important theoretical concession.

**Fiscal Space and Consolidation**

While the limited role for MP in many countries and the uncertainty surrounding unconventional measures provided a rationale for short term fiscal stimulus, as noted, the latter always had to be guided by an imperative of *sound public finance*, through the medium term (MT) pursuit of *fiscal consolidation*. As long as enough fiscal space was available further fiscal stimulus could be considered ‘without endangering the sustainability of government debt’ (Freedman et al. 2009:16), but it became clear, due to rising risk premiums on some European government bonds, particularly Greek bonds, and the unprecedented growth of government debt, that fiscal space was diminishing rapidly (see IMF, 2010b; Kumar and Woo, 2010).

Fiscal space represents the available budgetary ‘room’ to provide resources or make desired expenditures without compromising the sustainability of a government’s fiscal position (Heller, 2005). Fiscal space is then the residual capacity a government has to respond to uncertainties within the economic environment within its intertemporally defined sustainable fiscal position. Greater fiscal space is achieved via fiscal consolidation which targets reductions in the level of public debt and deficits. Thus, fiscal space defines the economic limits of future fiscal stimulus measures.

Increased fiscal fragility could potentially ‘undermine financial stability gains and extend the crisis’, so that credible fiscal consolidation strategies were essential ‘to sustain the recovery of the global economy and financial system’ (IMF, 2010a:xii). Consequently, the adoption of fiscal consolidation measures was advocated for most advanced economies in 2011 (see IMF, 2010a,b)², whereas the OECD claimed that these measures should commence in 2010, with an earlier cessation of stimulus measures.

Thus both IGOs had a renewed emphasis on fiscal withdrawal and consolidation measures, justified by the need to regain fiscal space to buffer near term shocks and to achieve more sustainable public debt positions (ECB, 2009; Freedman et al, 2009; IMF, 2010a,b,c; OECD, 2009a,b,c; 2010a,b; Blanchard et al. 2010; Price, 2010). Deficit reduction plans now would achieve i) sustainable FP through the creation of ‘fiscal space to address future economic and financial shocks and to fund new priorities’; and ii) greater fiscal credibility, to improve the capacity to borrow, and relieve upward pressure on risk premiums (OECD, 2010a:5). Thus, putting aside the existence or otherwise of an intertemporal fiscal budget constraint, austerity measures were justified to enable discretionary net spending in the future, despite the acute short and longer term effects of the GFC on output and employment in many developed economies.

The OECD (2009a:124) acknowledges that the impact of *fiscal imbalances* (deficits) on long-term interest rates is ‘both mixed and controversial’. Their econometric work (Box 3.2) analyses the determinants of the interest rate spread and finds that ‘higher expected deficits increase long-term interest rates’ (see also Gale and Orszag, 2003; Baldacci and Kumar, 2010). Also, ‘[l]ong-term interest rates are assumed to increase by 4 basis points (1 basis point for Japan) for every additional percentage point increase in the government debt-to-GDP ratio above 75%’ (OECD, 2010b:3). Thus ‘a temporary fiscal injection may be more effective than a more sustained fiscal injection which is expected to significantly worsen the long-term fiscal outlook’. Barro (1979) and later Dotsey (1994) also argued against fiscal imbalances (deficits) due to Ricardian Equivalence, that is government expenditures would be offset by private consumption and investment decisions, but IGOs have tended not to embrace this argument.
IMF (2010b) found that, in the long-term, a reduction of 10 percentage point in the debt-to-GDP ratio would increase output by 1.4 percent and reduce real interest rates by 30 basis points. Consequently, lower real interest rates were expected to increase the stock of physical capital by 2.1 percent (Japan, Euro area, U.S.) and 1.6 percent in the rest of the world (IMF, 2010b).

In contrast, the outlook for the short-term effects of fiscal consolidation is bleak. ‘A fiscal consolidation equal to 1 percent of GDP typically reduces GDP by about 0.5 percent within two years and raises the unemployment rate by about 0.3 percentage points’ and consumption and investment falls by about 1 percent (IMF, 2010b:2). If rates are already low, so there is limited scope for stimulatory MP, IMF (2010b) finds that the output cost of consolidation is approximately 1 percent after two years. Comparing these estimates implies a high interest elasticity of investment demand. Moreover, this fiscal consolidation allegedly will promote a currency depreciation and contribute 0.5 percentage points to GDP via net exports (IMF, 2010b:3), despite a number of countries engaging in fiscal consolidation.

The OECD finesses the impact of fiscal consolidation on short-term output growth. Over the period, 2011-2017, ‘output gaps are closed as a result of sustained above-trend-growth (despite significant fiscal consolidation’) (OECD, 2009c:227, quoted in Watts, 2010). OECD (2010a:6, footnote 4) is more bullish ‘Even large fiscal contractions can be expansionary because they signal a permanent and decisive change in fiscal policy’, which is linked to greater public acceptance when ‘times are obviously precarious’.

The OECD outline three fiscal strategies. The most extreme, the structural reform scenario, ‘includes, in addition to fiscal consolidation, a set of reforms that ..... would gradually reduce savings in countries with large current account surpluses and discourage consumption in deficit countries’ (OECD, 2010b:3). Despite cuts in domestic expenditure in countries experiencing current account deficits, this scenario incorporates a cut in the structural unemployment rate in the Eurozone by 2 percentage points over eight years (OECD, 2010b:4). Thus, despite the adverse outcomes of the GFC, reforms can significantly reduce structural, and, by implication, actual unemployment rates.

The business-as-usual scenario is based on gradual fiscal consolidation. Higher government indebtedness would dampen MT growth for OECD countries, due to higher long-term interest rates, as outlined above, even though the underlying empirical work is based solely on Eurozone countries. OECD (2010b) concludes that the structural reform scenario outperforms the business-as-usual scenario with respect to growth, government indebtedness and the current account for the period 2021-2025. There is no analysis of the intervening decade, and the projected unemployment rates are not reported.

OECD (2010a:9) and IMF (2010b) maintain that spending cuts should be the main source of fiscal consolidation, since the impacts on GDP and unemployment are lower for equal changes in the budgetary position (Ardagna, 2004; Briotti, 2005). Also IMF (2010b) asserts that, in contrast to (indirect) taxes, spending cuts are typically supported by further monetary stimulus, although this argument is inapplicable in the current context. Expenditure cuts may also be ideologically driven to reduce the ‘size’ of the public sector. Transfer payments and government consumption expenditure, including public sector wages, are usually central to the austerity measures (OECD, 2010a; IMF, 2010b). Recent reforms in India, Indonesia and Mexico have been geared towards increasing revenues, whereas the U.K., Canada, Germany and Turkey have mainly targeted expenditure cuts (IMF, 2010c).
4. A Critique

In their espousal of universal policy principles, the IGOs fail to acknowledge that the conduct of FP is fundamentally different in Eurozone countries, because their governments are budget constrained, by choice, under the Stability and Growth Pact (SGP), albeit with a temporary relaxation due to the GFC. By contrast, countries, including Japan, the USA, UK and Australia, operate with their own fiat currencies under flexible exchange rates and are not budget constrained because, as monopoly suppliers of the currency, they are not required to borrow to finance their expenditure (Mitchell and Muysken, 2008). Thus the IGOs trivialise the conduct of FP by implying that, like prudent households, all national governments are budget constrained (Watts, 2010). The IGOs’ arguments for fiscal consolidation are driven by accounting imperatives, with no consideration of public purpose (Mitchell, 2010a).

Applying the principles of functional finance developed by Abba Lerner, and modern monetary theory (Forstater, 1999; Wray, 1998; Mitchell and Muysken, 2008), a country operating under a floating exchange rate (so that MP is freed from the need to defend foreign exchange reserves) and the monopoly provision of fiat currency by its national government, faces no formal constraints on government spending. This spending is the source of funds that the private sector needs to pay its taxes and to net save. Thus taxpayers do not fund government spending within such nations (cf. OECD, 2010a:5; Price, 2010).

Fiscal sustainability, the overarching principle driving fiscal consolidation, is based on the flawed principle that net government spending is confined within the limits of, at best, an inter-temporal budget constraint or at worst an ex-ante budget constraint in the face of growing risk premiums and/or institutional constraints. Thus the effects on the real economy of consolidation measures are usually overlooked by the IGOs. For instance, OECD (2010a:8-11) cites countries which ‘successfully’ undertook large multi-year adjustments to their fiscal positions. Spain implemented consolidation measures to gain access to the EMU in 1999. Over the period, 1993-1997, the deficit-to-GDP ratio was reduced by 4 percentage points through cuts in social transfers, government wages and health care spending (OECD, 2010a). The OECD fails to acknowledge that Spain’s period of consolidation coincided with average unemployment rates of between 16 and 19 percent (ILO, 2010). Likewise, Ireland reduced its public debt-to-GDP ratio from 120 to 107 percent from 1986 to 1989 (Alesina and Perotti, 1995), but registered unemployment averaged 18 percent over this period.

The targeting of a balanced budget over the cycle was once viewed as prudent by both orthodoxy and some Post Keynesian economists but this strategy is inconsistent with sustained full employment. Unless the economy can achieve persistently large trade surpluses, the required budget surplus at full employment means that the private sector has a net deficit (i.e. saving less than investment), which translates into increasing indebtedness, while full employment is sustained. Further, a balanced budget cannot be construed as a universal, prudent FP, because in aggregate there is necessarily balanced trade.

The SGP rules which were revised in 2005 (Alves and Afonso, 2006) limit public deficits and debt of Eurozone member countries to 3 percent and 60 percent of GDP respectively. During a downturn, automatic stabilisers typically drive a country’s budget into deficit, sometimes exceeding the chosen or statutory target. An attempt to re-align the deficit (and/or debt) to its target requires the imposition of fiscal austerity measures typically via expenditure cuts, even if the structural deficit (surplus) was consistent with a balanced budget over the cycle. Thus these rules promote pro-cyclical fiscal policy (e.g. Ireland and Greece) and represent a more extreme form of fiscal austerity, than the pursuit of a balanced budget over the cycle.
Thus a government following the SGP rules in a severe recession is shirking its responsibilities to advance public purpose by filling the spending gap and achieving full employment over the business cycle (Mitchell, 1998). Consequently breaches of the SGP requirements by members have been quite common (e.g. Germany and France in 2003, and Bulgaria, Cyprus, Denmark, Finland and Luxembourg in 2010).

The European Commission (2010) is developing proposals to achieve more effective economic governance in the EU and the euro area, with a particular focus on fiscal discipline, through a stronger SGP. IMF (2010a) supports the strengthening of fiscal rules by any nations facing limited fiscal space or fiscal sustainability pressures. Also, the World Bank advocates the implementation of fiscal rules, particularly to enhance the credibility of fiscal positions during economic downturns (see Perry, 2003).

Fiscal space, like fiscal sustainability is an elusive concept and irrelevant for a sovereign economy with its own fiat currency since the only constraint on its government spending is its access to real resources (Mitchell, 1998). Ostry et al. (2010) provides a detailed analysis, using a sample of 23 advanced economies (1970 to 2007). To quantify fiscal space the authors estimate the primary balance reaction function and the interest rate schedule in order to determine the debt limit. However given the uncertainty of the point estimates Ostry et al. (2010) classify countries, notwithstanding their operational heterogeneity, into those with high, medium and low likelihoods of fiscal space, which is closely aligned with their projected debt ratios.

Figure 1: Sovereign Long-Term Government Bond Yields: Q1 2000 to Q2 2010

Further, the IMF and OECD claim that creditors will bid up risk premiums associated with government debt, thereby undermining a recovery is fundamentally wrong. In contrast to countries with their own independent fiat currencies, Eurozone countries must formally borrow to finance budget deficits, and so are exposed to bond market pressures and rating agency antics. These propositions are illustrated in Figures 1 and 2 which show relatively stable long term bond rates for countries with their own fiat currencies (Australia, U.S., U.K., and Japan) and rising rates for those Eurozone countries facing rising debt ratios, such as
Greece, Spain, Ireland. Ostry et al (2010) claim that once a particular public debt ‘limit’ is surpassed, interest rates on government debt will begin to grow exponentially, although this will never eventuate for a sovereign government, as evidenced by Japan’s experience.

An emerging literature explores so called tipping points for the government debt to GDP ratio beyond which there is a deleterious impact on (per capita) GDP growth. Using a heterogeneous sample of 101 developed and developing economies, a World Bank study, Caner et al (2010) found a tipping point at 77 percent of GDP (see also Reinhart and Rogoff, 2010). However this literature often fails to differentiate between Eurozone countries and those with their own fiat currencies. Also, with the exception of Checherita and Rother (2010) whose study is confined to the Eurozone, causality and endogeneity are not adequately addressed.

Thus, subject to an effective counter-inflation strategy (Mitchell, 1998), a sovereign government should run budget deficits to fill any spending gap at full employment. The failure to run deficits of sufficient magnitude means that either an economy does not achieve full employment or its private sector becomes increasingly indebted, which ultimately leads to a harsh correction via reduced spending when the private sector decides to restore its balance sheets. This has been graphically illustrated by the impact of the GFC on OECD economies.

Figure 2: Non-Sovereign Long-Term Government Bond Yields: Q1 2000 to Q2 2010

If a common currency is to be retained, addressing deficient aggregate demand in Eurozone countries would require scrapping the SGP and introducing a supranational fiscal authority that could spend like a sovereign government (Mitchell, 2010b). Under these circumstances macroeconomic policy could be geared to the achievement of full employment in member countries, although all policy sovereignty would be relinquished.

Mitchell (1998) argues that the lowest fiscal stimulus required to achieve full employment is to guarantee all unemployed workers a job at the minimum wage. In contrast to Keynesian pump priming, a Job Guarantee (JG) is perfectly calibrated to the level of unemployment, since a job is only created when an unemployed person seeks a job. Thus debates over the
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timing and magnitude of fiscal stimulus packages and when they should be phased out are redundant (Watts, 2010).

5. Conclusion

The emergence and consolidation of the neo-liberal paradigm had a profound impact on the policy agendas of the IMF and OECD which had initially espoused Keynesian economics. These IGOs, as well as the World Bank and the EC, supported the selective use of fiscal stimulus measures as the GFC deepened and monetary policy became constrained. While there have been minor differences between the IMF and the OECD with respect to timing, the consensus among the IGOs in favour of fiscal consolidation strategies in the pursuit of sound public finance has reasserted the ‘business-as-usual’ sentiment. In contrast to the OECD, however, the IMF recognizes the detrimental impact of fiscal consolidation on economic activity and employment at least in the short run.

The terminology which underpins this shared policy framework, includes sound public finance, fiscal consolidation and sustainability and more recently fiscal space. Such language ‘conveys a sense of authority and impartiality about policy design, despite these terms never being defined in an operational manner and the social and economic consequences of their implementation rarely being explained’ (Watts, 2010:3).

The fundamental problem with the IGOs’ policy documents and their underlying empirical work is their failure to differentiate between countries which operate with their own fiat currencies and conduct independent MP under flexible exchange rates and those which have voluntarily restricted their capacity to conduct independent macroeconomic policy. Sovereign governments which are willing to sacrifice the welfare of its citizens and hence the advancement of public purpose in order to pursue meaningless accounting imperatives, have disengaged from their electoral obligations.

The absence of competing discourses about macroeconomic principles can perhaps be expected within IGOs, even though they serve different, albeit overlapping, constituencies, because long term institutional survival may be threatened by fundamental changes in policy orientation (Dostal, 2004; Watts, 2010). However, the absence of meaningful debate in academic economics departments is a matter of serious concern.

References


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Here we are we confine our analysis to the neo-liberal economic policy agenda. Wacquant (2001, p.404) eloquently notes that there are 3 pillars of neo-liberalism. 'Erasing the economic state, dismantling the social state, strengthening the penal state: these three transformations are intimately linked to one another and all three result essentially from the conversion of the ruling classes to neo-liberal ideology.'

Among advanced economies, the IMF (2010c) project required fiscal adjustments in the cyclically-adjusted primary balance to stabilise the debt at the end-2012 level by 2030 for Australia to be 5.2 percent of GDP. In addition, to reduce the debt ratio to 60 percent in 2030 would require adjustments of 4 percent of GDP in Germany, 9.2 percent in Greece, 9.8 percent in Ireland, 13.1 percent in Japan, 9 percent in the U.K. and 12 percent in the U.S. (IMF, 2010c). However these estimates assume a zero interest-growth differential up to 2015 and 1 percentage point thereafter for all countries, thus must be interpreted with caution.