Kalecki insights on fiscal, monetary plans

PUBLIC INTEREST

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The coordination of fiscal and monetary policy is a difficult challenge for all economies. Coordinating fiscal and monetary policy involves specifying an analytical framework that is shared by the institutions responsible for these policies, namely, the government and the central bank. Without such a framework there is dissonance about individual policy actions, to the detriment of the national economic discourse.

Michal Kalecki provided a useful and relevant analysis of the issues involved 50 years ago, carefully characterising the problem separately for advanced and developed economies, and also considering the problem in the Indian context. Kalecki's contemporary relevance was brought to my attention by Niranjan Rajadhyaksha of the IDFC institute. The recently concluded Jackson Hole meeting of central bankers and economists focussed on two concerns central to Kalecki: The role of market power (impacting aggregate supply) and inequality(impacting aggregate demand) in fiscal and monetary decision making.

In the Indian context, the important Kaleckian question, different from Keynes, is not *how* growth is to be financed but at *whose* expense? Agreement on an inflation target is very important for a country focused on inclusive growth. Inflation can act as a tax on the poor, especially if it is driven by rising prices of necessities. Demand management therefore involves agreement that inflation must be controlled by targeting aggregate inflationary expectations using interest rates, but equally, using instruments of taxation and transfers to ensure that relative prices of non-essentials are at levels that do not result in an increase in luxury consumption, which would both reduce savings and increase imports. Policies to secure these objectives must be co-ordinated.

On the supply side, maximising growth requires the Indian economy to deliver public and private goods that cater to home market demand at affordable prices, and that grow exports. This is financed through taxation and the deployment of domestic and foreign savings. Ideally, a revenue surplus combined with borrowing from domestic saving would finance public investment, with private investment financed by domestic saving, and by foreign direct and portfolio investments. Monetary authorities have to make explicit their consideration of these questions in credit and inflation policy design. Equally, when the central government runs a revenue deficit, and the bulk of borrowing is used for consumption, fiscal prudence becomes important and the impact on inflation-and on imports — of such deficit financing becomes a legitimate question for consideration by monetary authorities.

There is disharmony between fiscal and monetary policy when the shared economic framework does not deliver agreement on the trade-offs. For example, if growth is seen to be generated by increases in demand for consumption, then it is necessary to agree when such growth will falter due to lack of supply response. Equally, if domestic public debt is being used to finance consumption, and not investment, then it is important to recognise that this would worsen the income distribution without corresponding benefit. This is because the interest paid on domestic debt accrues to savers and in a developing economy savers tend to be richer. If debt is used for investment, then we can live with the adverse distributional consequences. But if debt, and not taxes, pays for consumption, then there is no gain to balance the adverse distributional impact. This reason for fiscal prudence is extremely important for the practice of macroeconomic trade craft in India, but has been sidelined by those who practice the now discredited "crowding out" macroeconomics of the Thatcherite age, which has been abandoned even by the IMF and the central bankers at Jackson Hole.

Kalecki also paid careful attention to the role of finance in perpetuating the concentration of economic power. He had two important insights. First, investment may be limited not because of credit constraints (as in developed economies) but because of the unwillingness of entrepreneurs to finance investment. Second, finance maybe directed to activities (such as speculation) which would maximise individual gain, but not growth. A purely macro-prudential approach to credit policy is not adequate in these circumstances. Here, the coordination of fiscal and credit policy is of the first importance. Even if banks are publicly owned, (as in India) it may well be the case that credit flows are not availed by growth generating investments; if, in addition, the allocation of credit is dominated by a handful of large corporates, then an element of monopoly can enter the picture, and there could be a trade-off between fiduciary prudence and equity in credit disposition to important sources of growth like agriculture and SMEs.

I use the Kaleckian lens to make two points: first, as recognised at Jackson Hole, orthodox thinking about fiscal-monetary co-ordination is no longer adequate given country-specific circumstance. Second, the basis for discussion about differences in opinion regarding specific fiscal, monetary or credit policy decisions must be discussed within a shared (not necessarily Kaleckian) analytical framework. Invoking fear of market wrath or citing temporary benchmarks of economic health only serves as fodder to the commentariatfor damaging speculation about institutional acrimony. In conversations among policy makers with collective responsibility for coordinated action, differences in point of view will occur. Their collective resolution must be based on economic and political rationale, and not on considerations of turf or perceived differences in responsibility. Avoiding fiscal or monetary dominance is a shared institutional responsibility, and history will assign collective blame or credit for success or failure on this score.

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