J.O.N. Perkins

A General Approach to Macroeconomic Policy

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Also by J.O.N. Perkins

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A General Approach to Macroeconomic Policy

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To all those econometricians who are asking, and trying to answer, the right questions about the relative effects of different instruments on the various macroeconomic objectives

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Preface

This book complements earlier studies by the present author by extending the analysis of macroeconomic policy from the need to deal with two problems (inflation and unemployment) to include also either the state of the current account of the balance of payments, or a broader objective that includes the level of investment as well as the state of the balance of payments.

It draws upon the results of a number of macroeconometric models to throw light on the relative effects of a number of different macroeconomic policy instruments on each of these objectives; and suggests a framework that is broader than that usually adopted, in which to consider macroeconomic policy decisions to deal with these various objectives simultaneously.

The work was begun during a period spent in University College, London, whose hospitality is gratefully acknowledged. I benefited considerably from discussions with economists at the European Economic Community (EEC), the Organisation for Economic Cooperation and Development (OECD) and the University of Warwick; and also from the comments of participants in seminars and conferences at the University of Adelaide, the Australian National University, Helsinki University, the University of Oslo, the University of Stockholm and the University of Melbourne. My colleagues, especially Bob Jones and Ian McDonald, provided much helpful discussion and useful comments. The usual caveat of course applies.

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1 Introduction

The current macroeconomic problem of the world economy is to reduce unemployment and restore and maintain a healthy rate of economic growth without making inflation worse.

This need to raise growth without unduly increasing inflation is a far more urgent matter for primary-exporting countries, especially those with a high level of international indebtedness, than it is for the main industrialised countries, whose policies have the principal role in determining the world economic situation – many of which may be reasonably satisfied with the prevailing rate of economic growth. One reason why the more industrialised countries have much less incentive to look for policies that increase growth than do other countries is that a relatively low rate of economic growth in the industrialised countries to some extent actually helps to maintain the living standards of those people in them with jobs, by holding down the prices of primary commodities. On the other hand, the countries that suffer most from a low rate of world economic growth include not only most of the countries with relatively low living standards, but also primary-exporting countries with higher living standards, such as Australia and New Zealand.

But the external economic problems of high and rising indebtedness, from which many of those countries are suffering, present problems also for the more industrialised countries, especially for their financial systems. In the long run, all countries would benefit by having low unemployment and a high rate of growth.

However, policy makers in the richer and more industrialised countries fear that a high rate of growth and low unemployment could be restored only by measures that would increase the upward pressure on the price level.

But it seems likely that there are combinations of macroeconomic instruments that could increase the rate of economic growth without increasing the upward pressure on the price level (and even with some downward pressure on prices). The difficulty is that the approaches to the discussion of macroeconomic policy that have become widely accepted assume – implicitly or explicitly – that measures that stimulate growth by reducing unemployment are bound to make inflation worse. But this is not necessarily so. For there are a number of reasonable