Fordham University **Crises, adjustment & Poverty** **Economics 5450**

Some stylized facts regarding alternative stabilization policy strategies

	Money-Based *(Orthodox)*	**Exchange Rate Based** *(Heterodox)*	**Southern Cone** *(Neo-conservative)*
Inflation	Inflation falls due to demand restraint and unemployment	falls from high rates, but stays in low double digits. open trade/capital markets	Talked down ...via managed expectations, open capital Acc. and import competition
Output / Employment	Sharp recession typical "overkill" serious problem	Consumption boom but recession 3-5 yrs. later	Consumption/import boom ends in balance of payments crisis.
Real Wages	Sharp initial fall due to devaluation/ unemployment	Minimum Wage raised before wage freeze	Wages driven down by labor market reforms (anti-union?)
Exchange Rate (RER = ep*/p)	Sharp devaluation to restore competitiveness	Nominal exchange rate freeze often follows a quick devaluation leads	Pre announced ***Tablita*** (published slower rates of nominal exchange rate fall).
Monetary Policy	Sharp reduction in domestic Money supply falling mainly on public sector (lower deficit)	*Expansion of domestic credit* to accomodate remonetization and to avoid high interest rates.	Tight domestic credit with financial liberalization & opening capital markets to control interest rates.
Fiscal Policy	Fiscal cuts essential to avoiding crowding out private investment.	Budget cuts essential to reduce import demand & inflationary pressure; but transient Tanzi & Talvi effects reduce fiscal deficit as well.	Fiscal policy important for adding boosting credibility of government reforms creating a break with past.
Current Account	Quick improvement due mainly to recessionary fall in imports.	General deterioration in CA offset somewhat by budget cuts.	Deteriorates rapidly due to consumption boom.
Capital Account	Quick improvement via CA adjustment.	CA deteriorates, but official/private capital inflows compensate.	Improves rapidly due to very high domestic rates cum tabilita
Typical failure scenario:	Inflation falls only due to deep recession: political pressures for expansion then cause inflation to rise	Lack of fiscal adjustment undermines credibility or, a few years later a BofP crisis leads to a big devaluation.	Exch. rate appreciation cum import boom leads to capital flight/devaluation
works best in:	in low inflation economies with manuf. Exports and reasonable debt burdens. .	in high inflation middle income countries with fairly good domestic and open capital markets	nowhere as import competition does not prevent NT price inflation RER appreciation then leads to a BofP / financial crisis.
Additional Comments:	When devaluation is expansionary a stronger long term growth may follow favoring poor rural export crop producers in some cases.	Tanzi and Talvi effect can create "illusion" of fiscal adjustment. Quick fix attractive to countries with high inequality or fragile democracies	Often considered a variant of fx based stabilization programs but really failed precursor. Key differences include bank & capital market liberalization and domestic monetary policy.

Acronyms: NT nontraded, RER: real exchange rate; CA current account; fx foreign exchange rates;