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The Policy Mix in Emerging Countries: the Case of Tunisia

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Abstract

The Policy Mix is often defined as the interaction between monetary policy and fiscal policy. These two policies are instruments of economic policy with the main objectives; full employment and lute against inflation. In this context, this paper will be devoted to the study of the interaction between monetary policy and fiscal policy in Tunisia, in order to clear the optimal policy mix for the Tunisian economy that would be able to solve the issues of unemployment and economic growth witnessed by Tunisia in recent years and especially bring our country out of the economic situation of "liquidity trap". Thus, from the Structural VAR model, we were able to identify the effectiveness of expansionary fiscal policy in Tunisia. Indeed, an expansionary fiscal policy is accompanied instantly by a monetary policy to control inflation and by a short-term increase in the level of production due to the low mobility of capital in our country. The results also show that monetary and fiscal policies in Tunisia are crossed, indeed expansionary fiscal policy led to an intervention by the monetary authorities to increase the interest rates and consequently to implement a restrictive monetary policy.

Keywords: Fiscal policy, liquidity trap, monetary policy, structural VAR.;

1. Introduction

The issue of the policy mix is now the subject of debate and discussion among economists and economic policies experts in developed countries and emerging countries. In theory, the problem of policy mix, defined as the interaction between monetary policy and fiscal policy, has known two different approaches reflecting the conceptual changes affecting these same economic policies.

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In a first approach, the policy mix is seen as a problem of optimal allocation of instruments to goals from Mundell's article (1962), which, in conjunction with the main remarkable fact at the time, namely open economies and capital mobility, recommends the assignment of monetary policy to external balance and allocation of fiscal policy to internal balance. In addition, the famous debate between Monetarists and subsequent Keynesians concerning the proper allocation resulting assumptions underlying the calculation of monetary and fiscal multipliers as the degree of openness of the economy, capital mobility, the nature of expectations and price flexibility. In contrast, the second theoretical approach to the question of policy mix studies the interaction between monetary and fiscal policy as a problem of coordination between the authorities of economic policy.
We will limit our study to the section of the first theoretical approach. Indeed, in our country, the central bank is not fully independent[†]; as a result, Tunisia does not present a problem of coordination between monetary and fiscal authorities. Therefore, it is necessary to properly address the issue of the policy mix in Tunisia from a theoretical concept with this problem as the assignment of instruments to targets.
How then can we characterize the Tunisian policy mix? The Fiscal shocks that have hit the Tunisian economy did it really influence the course of the monetary policy? In addition, monetary shocks have they in turn caused any effects on the public finances? Is there in Tunisia any complementarities or substitutability between monetary policy and fiscal policy? What is the ultimate future of monetary and fiscal policies in Tunisia after the revolution?

2. Modeling strategy

By drawing extensively from the article and C.Bruneau O.De Bandt (2003)[‡] addressing the interaction between monetary and fiscal policies in the context of transition to monetary union from a Structural VAR model, we will try in this section to estimate a Structural VAR for the case of Tunisia. The objective of this study is to identify the impact of monetary and fiscal policies in our country and whether the monetary and fiscal policies are complementary or substitutable in Tunisia
Estimations taken from a VAR model with four variables: GDP at constant prices (PIB), the inflation rate (INF), the money market rate (TMM) and the budget deficit (DB).
Stationary tests used time series allowed us to identify the variables in the model are non-stationary and that all four are integrated of order 1[§].
The dynamics of the model is represented by a vector autoregressive variables transformed to be expressed in actual values, logarithms and first differences. Our annual VAR model with four variables is of order 1. This order was determined by reference to the Akaike Information Criterion (AIC), confirmed by the criterion FPE (Final Prediction Error) and the criterion LR (sequential modified LR test statistic).
Once the order of the VAR is determined (equal to 1), we can now proceed to a cointegration test to see if many cointegrating relationships between the four variables in the model. If this is the case, it is essential to estimate an error correction model, if not, we continue to work with the VAR model but take all variables integrated of order 1. The Trace test indicates that there is no cointegration relationship between the four variables in the model. As a result, it is not required to estimate an error correction model; it also means that in what follows, we will work with a SVAR not a SVECM.If we will continue to work with the standard VAR model, our model will certainly contradict the theory in which the modeler can do without any economic theory to model the dynamic behavior of economic variables. For this, it is necessary to find an estimated underlying structural VAR model. Thus, we have to articulate finely the variables used in the VAR model, the underlying theoretical framework, the chosen identifying constraints and the frequency of data used.

Theoretical framework

To develop Structural VAR constraints and interpret the results of the modelling, it is important to define the

[†]See the work of A. Siala (2006), Ben Abdallah M and H. Mehri (2006).
‡ Bruneau C. et De Bandt O. (2003) « Monetary and fiscal policy in the transition to EMU, what do SVAR models tell us », Economic Modelling, 20 (2003), 959-985.
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