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Emrah Ismail Cevik, Sel Dibooglu, Ali M. Kutan

PII: S0147-5967(14)00044-4
DOI: http://dx.doi.org/10.1016/j.jce.2014.05.001
Reference: YJCEC 2393

To appear in: *Journal of Comparative Economics*

Received Date: 4 February 2013
Revised Date: 19 January 2014

MONETARY AND FISCAL POLICY INTERACTIONS: EVIDENCE FROM EMERGING EUROPEAN ECONOMIES

Emrah Ismail Cevik

Bulent Ecevit University

Sel Dibooglu

University of Missouri St. Louis

Ali M. Kutan (akutan@siue.edu)

Southern Illinois University Edwardsville and The William Davidson Institute

Abstract

This paper examines the interactions between fiscal and monetary policy for some former transition, emerging European economies over the 1995Q1-2010Q4 period by using a Markov regime-switching model. We consider the monetary policy rule proposed by Taylor (1993) and the fiscal policy rule suggested by Davig and Leeper (2007) in accounting for monetary and fiscal policy interactions. Empirical results suggest that monetary and fiscal policy rules exhibit switching properties between active and passive regimes and all countries followed both active and passive monetary policies. As for fiscal policy, the Czech Republic, Estonia, Hungary, and Slovenia seem to have alternated between active and passive fiscal regimes while fiscal policies of Poland and the Slovak Republic can be characterized by a single fiscal regime. Although the policy mix and the interactions between monetary and fiscal policy point a diverse picture in our sample countries, the monetary policy seems to be passive in all countries after 2000. This finding is consistent with the constraints imposed by European Union enlargement on monetary policy.

JEL Classifications.: E52, E62, E63, C22, P52
Keywords: Monetary policy, fiscal policy, monetary-fiscal interactions, time series models, transition economies

Acknowledgement: We would like to thank the editor (Gerard Roland) and two anonymous editors for useful comments and suggestions. The usual disclaimer applies.