Researching Interaction of Monetary and Fiscal Policy, Wijoyo Gained Doctoral Degree

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In order to overcome social losses due to inflation and output shocks, coordination of monetary and fiscal policy is much more beneficial than no coordination at all. The simulation proves that such coordination of monetary and fiscal policy (endogenous fiscal policy) resulted smaller loss than without coordination (exogenous fiscal policy).

"Therefore, monetary and fiscal policies need to be improved when experiencing shocks through institutional strengthening as the Monetary Board," Wijoyo Santoso, S.E., M.A said on Friday (29/4), conducting an open examination of his doctoral program in Faculty of Economics and Business UGM.

In facing inflation shocks, Wijoyo said, response of monetary and fiscal policy is not yet optimal. Simulation results show a greater loss in fiscal policy which is endogenous than when the fiscal policy is exogenous. Conversely, in facing output shock of interaction of monetary and fiscal policy (endogenous fiscal policy), there are smaller losses compared to when fiscal policy is exogenous to all variations of interest rates and outputs.

Meanwhile, monetary and fiscal policy response to shocks in inflation and output are jointly proven not optimal, either, because the value of loss function in the parameter of estimation result is absolutely still higher compared with the loss function in combined parameters. "Therefore, to achieve optimal interaction of monetary and fiscal policy, interest rate volatility or variance should be kept to a minimum relative to the variance of output. Simulation shows the smaller variant of relative interest rate to the output variable will produce smaller loss function," the main, senior researcher of Center for Strategy and Policy Studies at Bank of Indonesia said.

The interaction of monetary and fiscal policies in Indonesia to the substitution or complementary, according to Wijoyo, is influenced by various types of shocks. The simulation result concludes the interaction of monetary and fiscal policies in Indonesia during the observation period is complementary or assists each other in facing inflation shock. Instead, the interaction of monetary and fiscal policies is substitutive or replaces each other in facing output shock.

Wijoyo views inflation shock in the form of 1 percent increase in inflation would push the monetary authority to increase interest rate of policy to control inflation, whereas fiscal authority will reduce government spending or the budget deficit because output is considered as increasing.

"Output shock in form of 1 percent increase in output makes the monetary authority not raise rates of policy interest because the output increase will not cause significant inflation, whereas fiscal authority would reduce their spending because they think the output sufficiently increases," Wijoyo who passed very satisfactorily concluded.

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