EEMR

Economics, Entrepreneurship and Management Research

Vol. 2 No. 1. 2023. e-ISSN:2955-9014 pp. 1-23

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Original scientific paper
UDC 338.23:336.74
336.02
COBISS.SR-ID 126813449
DOI:https://doi.org/10.62907/eemr230201001n

Monetary and Fiscal Policy in Solving the Global Economic Crisis

Abstract:

The global economy has been in a serious crisis for several years, which has deepened and accelerated in 2022 and 2023, so that a large number of countries are threatened with an economic recession with the possibility of transitioning into stagflation. The rise in energy, food, and other input prices has caused high inflation rates, both in developed and developing countries, regardless of their geographical location. The general impression is that some central banks that apply inflation targeting regime have reacted with delay, considering the rise in prices as a passing phenomenon of a temporary nature. Developing countries are in the most difficult situation and will have to borrow under unfavorable conditions to avoid a recession in their economies. The paper analyzes the possibilities and limitations of monetary and fiscal policy in preventing inflation and maintaining positive economic growth rates, with the aim of reducing unemployment, preventing a debt crisis, and reducing the standard of living of the population.

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Keywords: *monetary policy, fiscal policy, inflation, global economic crisis*

Introduction

The obvious imperfections of the market that manifest themselves at the micro and macroeconomic level justify the efforts of the state to limit or eliminate them through its actions in order to direct economic activities in the desired direction. Economic history has clearly shown that spontaneous action of market laws can lead to disturbances in the economy and the disruption of its balance, which leads to more frequent economic crises and their prolonged duration. Therefore, there is a necessity for correcting market movements through economic policy. Historically, economic policy measures have often been designed to protect the interests of the ruling class, and they have been improvised or spontaneous, which is why the results of their implementation have been very different.

The Great Depression of the 1930s emphasized the even greater importance of economic policy and the involvement of the state as an indispensable factor in economic movements.

The global financial crisis of 2008, the pandemic crisis since 2019, and up to the present day, when we are witnessing energy and other crises, accompanied by rising inflation, have led to a re-evaluation of the previous economic policy used to mitigate and overcome crises. It is becoming increasingly evident that it is necessary to act in coordination with monetary and fiscal policy measures, in order to stop negative trends in the business of most countries, which are very easily transmitted from one country to another due to the openness of their economies. Most developed countries have implemented inflation or price targeting policies in recent decades, but now double-digit inflation has affected numerous countries, from the US, through the EU, to developing countries. All these countries are facing an energy crisis, an increase in external debt, and a decline in the standard of living of their citizens.

Developed countries have started printing large amounts of money and lowering interest rates to and below zero since 2008. These measures were announced as temporary, but have lasted for more than a decade. Central banks initially assessed that the rise in prices was a passing phenomenon caused by the post-pandemic growth in demand and bottlenecks in production and

transportation. This was used to explain the policy of low interest rates in spite of increasingly obvious inflation. Today, inflation has reached levels that have not been seen in developed Western countries for the past 40 years. The economies of many countries are already facing recession and a major debt crisis. The biggest victims of such economic processes will be developing countries as their budgets are already in serious trouble due to the pandemic and are now further endangered by rising costs, primarily in energy and food. The only solution for them is new borrowing, but now at significantly higher interest rates, which leads to recession, rising unemployment and a real decline in wages.

1. Concepts of Monetary Policy in Modern Conditions

Classical economic policy theories assume the existence of at least one policy maker at the central level, with well-established preferences and an adequate set of instruments at their disposal. A necessary precondition for the success of economic policy is predetermined goals, relevant instruments, timely measures, and their coordination. Based on this, it can be concluded that economic policy is a complex but flexible system composed of several elements, representing a dynamic process of adaptation to new circumstances, which creates temporal inconsistency in the process of economic policy. The role of the policy maker belongs to government authorities and is oriented towards achieving predefined goals (Kydland and Prescott, 1997).

Since the early 1960s, three monetary policy systems have been applied (Heron, 2003): Keynesian (until 1973-74), monetarist (until the end of the 1980s), and the system of the so-called new consensus (since the 1990s). Economic policy has been improving over time and is still improving, but it also bears the stamp of the time in which it existed, and therefore must be studied in that context. The theoretical approach and theoretical shaping of monetary and fiscal policy arose from the fact that it was necessary to practically solve some issues in its domain. The development of theoretical concepts of monetary and fiscal policy has shown that there are individual ideas that are equally relevant and practically applicable, even in present conditions.

Keynes emphasized the possibility and obligation of regulating economic cycles by the state, thereby highlighting the importance of economic policy and opening the door wide to state

interventionism. Keynes rejected the power of the market as a self-regulating mechanism and demonstrated that there is no way for the invisible hand of the market to lead to full employment. Therefore, he promoted the need for government intervention aimed at restoring effective aggregate demand, in order to return the economy to full employment, and at the same time, he believed that this goal was achieved through fiscal rather than monetary policy (Boettke, Smith, and Snow, 2010, p. 8).

Although fiscal policy is the main instrument of economic policy in Keynesian theory, monetary policy also plays a significant role because it must also be aimed at stimulating economic activity. It indirectly affects the ultimate goals of economic policy through its impact on interest rates, and one of the main effects of money on income and employment is achieved by affecting interest rates, thus putting into operation the connection between the monetary and real sectors.

The monetarist attempt to restore the link between money and spending began with Friedman's revision of the quantity theory of money in 1956 (Howells, 2010, p. 6). This direction, the so-called "Chicago School," began to emerge through criticism of Keynesian macroeconomic theory and economic policy relating to the configuration of the IS-LM model, rejecting the theory of liquidity preference and introducing a stable money demand function. The key contribution of this criticism was the introduction of the concept of permanent income, on the basis of which an individual's consumption and demand for money are determined, as well as the replacement of Keynes's stable consumption multiplier with a stable velocity of money, which is the foundation of economic policy (Laindler, 2006, p. 11). Palley (1993, p. 11) emphasized in his research that fluctuations in the money supply are the cause of changes in nominal income, and adequate monetary policy is one that adheres to a rule of constant stable money supply growth rate.

Fiscal policy is of secondary importance compared to monetary policy, which arises from the monetarist proclamation that the ultimate goal of economic policy is price stability, assuming economic stability and full employment. Since the achievement of this goal depends on the money supply, which is otherwise exogenous and determined by the central bank, it follows that the importance of fiscal policy depends mainly on its impact on monetary policy, that is, on the movement of the money supply.

The School of Rational Expectations, which emerged as a response to stagflation that occurred in the 1970s, did not fit into the existing Keynesian and monetarist theories. It showed that the discretionary fiscal policy advocated by Keynes was unable to provide an adequate response to the disturbed general equilibrium. On the other hand, the monetarist model, which relied on managing monetary aggregates, was not applicable to the new situation. Therefore, a new macroeconomic theory developed, entirely based on the neoclassical framework established by the works of Lucas (1972) and Sargent and Wallace (1975, 1976), in which a model based on individuals whose behavior is determined by microeconomic theory was developed.

Taylor (2000, p.2) states that the rational expectations revolution established by Lucas led to the emergence of several schools of thought in macroeconomic theory, such as the new classical economics school, the real business cycle school, the new Keynesian school, and the new political macroeconomics school.

Representatives of the supply-side economics school insist on reducing the numerous constraints that arise as a result of the application of economic policy tools developed under the influence of the state. Therefore, they advocate a return to the principles of the free market and deregulation of the economy, thereby eliminating obstacles to additional initiative, which is crucial for stimulating production. The main instrument of economic policy is fiscal policy, which has priority over monetary policy, not to stimulate demand that would increase production, but to stimulate production to increase its yields. In this sense, the key task of fiscal policy is to lower tax rates to stimulate savings, increase the tax base according to the Laffer curve, but also investment and labor.

On the other hand, the importance of monetary policy is not so significant, because it is accepted that inflation is a monetary phenomenon, based on which the conclusion is drawn about the need for strict or restrictive monetary policy, which, in combination with fiscal policy aimed at increasing productivity, should affect the reduction of inflationary pressure.

One of the most important reasons why the suggestions of the supply-side economics school are not accepted is the lack of firm evidence of a strong connection between tax cuts and economic growth, as well as the lack of convincing evidence that the result of lower taxes will be an

increase in investments (Freeman, 2005, pp. 4-5). Also, by monitoring indicators that measure the effects of supply-side economics, such as the level of investment, productivity, gross domestic product, average hourly earnings, unemployment, budget deficit, and public debt, it can be proven that the movement of most of these indicators does not confirm the assumptions of the mentioned school of economic thought (Ettlinger and Irons, 2008, pp. 7-14).

Kydland and Prescott demonstrated back in 1977 that conducting economic policy based on rules can increase prosperity. Woodford presented a modern variant of using rules in theoretical analyses of monetary policy in 1997. However, some authors have shown through their analyses that under certain circumstances, choosing rules over discretionary economic policy can cause greater losses.

Macroeconomists credited themselves with significant achievements during the period from the early 1990s to the onset of the economic crisis in mid-2007, which related to positive trends such as relatively low and stable inflation and significantly milder income fluctuations. Therefore, Bernanke (2004, p. 1) refers to this period as the "Great Moderation," whose emergence he explains through structural changes in the economy, improvements in economic policy, and favorable conditions due to smaller and less frequent shocks that affected the economy. The impression was created that the consensus that emerged as a result of theoretical and empirical research in the areas of monetary and fiscal policy was an indicator that the mentioned part of economic theory is relatively rounded and confirmed in practice. Therefore, the new consensus represented a framework that provides adequate answers to numerous questions related to the components and strategies of individual economic policy instruments, with a special focus on monetary policy.

Mishkin (2006, p. 1) defines the new consensus in monetary policy as accepting the following postulates:

1. There is no long-term "trade-off" between output (employment) and inflation;
2. Expectations are of fundamental importance for the outcomes of monetary policy;
3. Inflation has high costs;
4. Monetary policy is subject to the problem of time inconsistency;

5. Central bank independence helps improve the efficiency of monetary policy;
6. A strong nominal anchor is a key factor in creating good outcomes for monetary policy.

On the other hand, Goodfriend (2007, pp. 24-31) identifies four key elements of the new consensus recognized by monetary theory and applied in practice: (1) Priority is given to price stability; (2) Targeting of core inflation rather than total inflation; (3) The importance of credibility for low inflation; and (4) Preventive interest rate policy supported by transparent goals.

Blanchard, Dell'Ariccia, and Mauro (2010, p. 10) argue that during the consensus period, stable and low inflation was the primary, if not exclusive, goal of central banks. This is due to the fact that, on the one hand, central bank reputations required their commitment to inflation over economic activity, as well as theoretical support, on the other hand, stemming from the models of New Keynesians. The Federal Reserve System recognizes high employment and economic growth, price stability, and low inflation as the basic goals of monetary policy, which it strives to achieve while also taking into account the stability of financial markets and interest rates. Lavrač (2002, p. 4) suggests that if there are alternative goals, such as stabilizing the rate of economic growth or unemployment, in addition to price stability, they should be subordinate to the primary goal.

In the literature, there are typically four goals set for fiscal policy makers, relating to optimal allocation of resources, fair distribution of income and welfare, economic stabilization, and economic growth. Musgrave (1959, pp. 4-24) classified all non-fiscal goals into three groups: (1) Allocative goals; (2) Redistributive goals; and (3) Stabilization goals.

During the 1960s, it was widely accepted in literature that fiscal policy was useful because decision-makers were believed to have the ability to effectively stabilize the economy through discretionary fiscal policy. In the 1970s and 1980s, the effectiveness of the stabilization function of fiscal policy was extensively analyzed, leading to several elements related to this issue becoming part of a new consensus that emerged in the last decade of the 20th century (Gwartney, Stroup, Sobel, and MacPherson, 2009, pp. 252-253). Setterfield (2007, pp. 9-16) argues that

fiscal policy as a stabilization policy instrument is a sustainable alternative to monetary policy, and therefore proposes a reformulation of macroeconomic development models.

However, Blanchard, Dell'Ariccia, and Mauro (2010, p. 202) emphasize the limited role of fiscal policy, or the refusal to use it to achieve stabilization or countercyclical goals, particularly in academic circles, while the practice was different. In their analysis, they prove that discretionary fiscal stimuli were generally accepted and applied in response to more serious shocks arising from crises in more developed countries (e.g., the crisis in Japan in the early 1990s), as well as in developing countries due to the limited effect of automatic stabilizers.

However, after a period of great moderation, with the onset of the crisis in August 2007, which caused a financial collapse and the biggest economic contraction since the Great Depression of the 1930s, it became clear that previous understandings, strategies, effects, and the role of monetary and fiscal policy in the coming period needed to be reexamined. It became evident that there was serious distrust in the ability of those in charge of these two policies to manage them successfully in the direction of achieving the desired ultimate goals of economic policy.

2. Stabilization fiscal policy for sustainable growth

Fiscal measures are often used together with monetary policy to achieve certain objectives. The common goals of fiscal and monetary policy are to achieve or maintain full employment, achieve or maintain a high rate of economic growth, and stabilize prices and wages. Fiscal policy is a desirable tool of economic policy in the hands of the state, which is used to intervene in the economy in order to manage the economic activity of the national economy. In this sense, certain instruments of fiscal policy are used, such as public finance, government spending, taxes, and others.

The macroeconomic role of fiscal policy, according to (Carlin and Soskice, 2006), can be reduced to the following activities: 1) providing automatic stabilizers that protect the economy from the effects of shocks on the side of aggregate demand; 2) stabilizing the level of output around the equilibrium rate, using discretionary changes in government spending and/or taxes; 3) planning

the financing of government spending, in order to keep the level of public debt at a sustainable level.

Modern states take between one-third and half of gross domestic product from the economy and population through the instruments of tax policy, and use it to finance their social, political, social, and economic functions. The amount of taxes, as well as the way in which the state will realize tax revenues, depend on numerous aspects of economic behavior, which means that the design and structure of the tax system can also have a significant impact on the dynamics of economic growth (Randjelović, 2021).

Fiscal policy is a means by which the government adjusts the level of consumption in order to monitor and influence the national economy (Rena, 2006). Managing fiscal policy is a powerful tool for stabilizing the economy, and with its help, the amount and structure of taxes, expenditures, and debt management are controlled. Managing fiscal policy affects aggregate demand, distribution of wealth, and the economy's ability to produce goods and services. Effective management of fiscal policy is a generally accepted tool of macroeconomic policy. It provides efficient allocation of resources and serves as a precondition for economic growth (Lojanica, 2018).

When defining fiscal policy, the government has the freedom to design and implement it. However, in many countries, fiscal rules have been introduced, which provide a framework, and often quantitative constraints on basic fiscal aggregates (fiscal deficit, public debt, etc.) in order to ensure the long-term sustainability of public finances (Wyplosz, 2013).

The challenge is to create an institutional and legal framework that should improve the quality of political participation and promote fiscal responsibility. Developing countries should use fiscal policy as a means of maintaining public finances in the medium term based on strict rules. In the case of poor management, there is little chance of achieving fiscal policy goals, such as increasing employment.

The question of the optimal design of basic tax forms is one of the most complex issues in public finance theory. It is usually raised in the context of the need to achieve the targeted amount of tax

revenue with minimal negative impact on productive behavior (work, savings, investment, education, etc.), that is, to achieve the targeted amount of tax revenue with a minimal excess of tax burden (Hindriks and Myles, 2013).

The development of modern tax systems has been significantly influenced by broader processes such as globalization, which has affected the growth of international capital mobility, leading to active tax competition between countries in terms of their race to attract as much capital as possible by reducing taxes (Arsić, Randjelović, 2017).

Investment and tax reforms provide a foundation for stronger and more productive economies. In the long term, all countries may face the challenge of fiscal adjustment, particularly in response to unforeseen shocks, poor economic management, or long-term structural changes in the economy. Budgets need to adapt to rapid changes in economic reality, requiring a reorientation of the role of the state and improvements in resource allocation and efficiency through institutional and structural reforms (Campos and Pradhan, 1996).

Numerous studies suggest that the relationship between the total tax burden and economic growth is negative, differing in terms of the intensity of this negative effect (Koester and Kormendi, 1989). On the other hand, there are also numerous studies suggesting that the relationship between tax burden, or the size of the public sector, and economic growth is not stable and convincingly negative (Mendoza et al., 1997).

According to Bergman (2011), the quality of fiscal policy is particularly important for countries experiencing recessionary trends. When there is certainty in the economy, optimal tax rates are constant under certain assumptions. Conversely, when the economy is uncertain with imperfect bond markets, tax rates follow a random walk (Turan et al., 2014). In this sense, the idea of tax smoothing makes sense. Tax distortions and tax burdens grow disproportionately with the tax rate. In this case, the government can reduce tax distortions through tax smoothing. The idea is to use the budget deficit or surplus to maintain relatively stable tax rates. In this sense, the availability and use of debt instruments play a crucial role in tax smoothing and tax policy shaping. If there is permanent growth in government spending, the government can adjust tax rates accordingly.

The scope of fiscal policy concerns short-term fluctuations in unemployment around its equilibrium, resulting from price and wage rigidities that hinder the optimal use of available resources. Countercyclical fiscal policy can be an important economic policy instrument to keep unemployment close to its equilibrium level and output close to its growth trend (Burda and Wyplosz, 2012).

Important stabilization function of fiscal policy operates through so-called "automatic fiscal stabilizers." They act through the influence of economic fluctuations on the government budget and do not require any short-term policy maker decisions. The size of tax collection and transfer payments, for example, are directly linked to the cyclical position of the economy and are adjusted in a way that helps stabilize aggregate demand and private sector income. Automatic stabilizers have a number of desirable characteristics. First, they respond timely and predictably, helping economic agents form correct expectations and increasing their confidence. Second, they react with intensity that is adapted to the size of deviations of economic conditions from what was expected when budget plans were adopted. Third, automatic stabilizers act symmetrically during the economic cycle, dampening "overheating" in periods of growth and supporting economic activity during economic crises without affecting the fundamental stability of budget positions as long as fluctuations remain balanced (ECB, 2005).

The emphasis in studying fiscal policy is on providing practical solutions to individual issues that fall within its scope, which has been the basis for the development of this branch of economics. Fiscal policy encompasses all activities aimed at shaping taxes and public spending to reduce the gap in economic cycles and ensure full employment that is not burdened by inflationary or deflationary trends. The use of fiscal revenue (taxes, fees, excises, contributions, customs, etc.) and budgetary expenditure must always be subordinate to the achievement of goals defined by macroeconomic policy and its tasks. Fiscal policy defines ways in which funds will be collected into the state budget, as well as ways of spending budgetary resources.

The basic objectives set before fiscal policy fully coincide with the basic economic goals of any state. The most significant objectives of fiscal policy include (Ashima, 2002),

- Achieving full employment,

- Maintaining inflation at a low and stable level,
- Achieving a sustainable position in the balance of payments, and
- Achieving a high and stable level of economic growth.

In addition to these basic objectives, fiscal policy can have a large number of additional goals, such as: reducing differences between the levels of development of individual economic sectors, reducing differences between the levels of development of individual regions within the country, reducing levels of economic inequality among different population groups, protecting the environment, etc.

Fiscal policy objectives can be achieved in a large number of different ways. The most commonly used objectives through which fiscal policy activities are implemented are public revenues, public expenditures, fiscal deficits, and public debt. Fiscal policy, through its measures and activities, attempts to have an effect on the following elements of the economic system: increasing, decreasing or changing the structure of demand, increasing or decreasing liquidity of the economy, the crowding-out effect, and the intergenerational distribution of wealth and income, among others.

In the concept of fiscal policy, the starting point is usually lowering public spending in the social product, increasing public revenues and efficient collections, reducing and eliminating budget deficits, eliminating central bank money emission for financing budget deficits, introducing VAT, and paying off matured obligations and interest from the budget (Ristic, Komazec, 2012).

In the concept of modern anti-inflationary fiscal policy, a special place is given to budget stabilization policy that can be implemented expansively and restrictively, and budget deficit, i.e., deficit financing of investments and public debt. Expansive fiscal policy is implemented through an increase in budgetary expenditures above revenue growth, and a decrease in budgetary or tax revenues. Restrictive fiscal policy is implemented through a reduction in public expenditures, reduction, and repayment of public debt, and an increase in fiscal requirements, i.e., introducing new taxes or increasing old ones. At the same time, there must be synchronized and coordinated interaction of these anti-inflationary instruments of fiscal policy, as well as synchronization and coordination between expansive and restrictive fiscal policy.

3. The necessity of coordination between monetary and fiscal policy in curbing inflation

The global economy in 2022 faces numerous challenges and dangers, ranging from an energy crisis, high inflation, to the possibility of a recession and stagflation in many countries in different geographic areas. Inflation has affected most of the developed countries in the world, from the US to individual EU member states such as Germany, France, Italy, and others. At the same time, it is present in South American countries such as Mexico, Argentina, Brazil, and others, as well as in India, Australia, South Korea, Egypt, Russia, South Africa, etc. Signs of a recession are a slowdown in economic activity in two consecutive quarters, accompanied by a decline in GDP and industrial production and an increase in unemployment.

On the other hand, stagflation is a phenomenon when a recession is accompanied by a high price increase in the economy, i.e., inflation. Then problems arise because unemployment rises and GDP falls in a recession, and policies used to combat recession and unemployment simultaneously increase the inflation rate, i.e., price growth. Raising benchmark interest rates is a measure of central banks against inflation. However, if fiscal policy is also distributing money to various subsidies to companies and the population, then monetary and fiscal policy are in collision.

In the world, the prices of raw materials, especially energy, are rising, preceded by a long period of expansive monetary policy based on targeting inflation and the general price level. The significance of the so-called nominal anchor as a barrier to excessive inflationary growth has opened the way to various targeting regimes as monetary policy strategies (exchange rate targeting, money supply, price level, inflation targeting). Inflation targeting largely respects the views defined within the new consensus, making monetary policy a significant factor in establishing macroeconomic stability (Marjanovic, Mihajlovic, 2012).

The text discusses the importance of transparency and communication in the implementation of inflation targeting regime by the central bank. Four standards of transparency that the central bank should adhere to are mentioned, including clarity in addressing the public, disclosure of relevant information, openness to public control, and enabling wider public access to all central

bank activities. Adherence to these standards is crucial for building public trust and forming correct expectations of economic agents, which is an important condition for the success of monetary policy.

The optimal inflation rate in the context of inflation targeting is also discussed. It is often argued that the central bank should not target a 0% inflation rate, as a positive and low inflation rate (around 2%) can have more positive effects. For example, a positive inflation rate can facilitate market equilibrium, especially in the case of increased aggregate demand. In addition, the impact of reducing the nominal interest rate under the control of the central bank will have a greater effect on reducing the real interest rate at higher inflation rates since the nominal interest rate cannot be negative. This argument has gained importance, especially after the 2008 crisis, and there have been recommendations to increase the inflation target level to 4% to increase maneuvering space to reduce the real interest rate as a necessary response to the recession.

Numerous studies have shown that inflation targeting provides good macroeconomic results, such as lower unemployment rates compared to exchange rate targeting, although this relationship largely depends on the degree of openness of the economy. Also, certain studies show that inflation targeting has a positive impact on economic growth, as well as on reducing output losses in the case of implementing the disinflation process.

On the other hand, it is argued that inflation has been significantly reduced in countries that have adopted this regime primarily because their initial inflation rates were high, and there was a global trend of declining inflation, not solely as a result of inflation targeting.

Since 2008, developed countries have started printing money and lowering interest rates to and below zero. Although these measures were announced as temporary, they have lasted for more than a decade. Cheap money has led to a huge increase in the debts of states, businesses, and citizens, and this process has been further intensified by the pandemic.

Central banks initially assessed that the price increase was a passing phenomenon caused by post-pandemic demand growth and bottlenecks in production and transportation - which explained the policy of low-interest rates despite increasingly evident inflation. It should also be added here

that the inflation calculation model does not reflect the real increase in prices - for example, the prices of real estate and financial "goods" do not enter into the calculation of inflation, although they significantly affect the standard of living.

Table 1: Reference interest rate in the USA (2018-2023.)

Period of validity (from)	(to)	Annual rate
20.12.2018.	31.07.2019.	2,25% - 2,50%
01.08.2019.	18.09.2019.	2,00% - 2,25%
19.09.2019.	30.10.2019.	1,75% - 2,00%
31.10.2019.	02.03.2020.	1,50% - 1,75%
03.03.2020.	15.03.2020.	1,00% - 1,25%
16.03.2020.	16.03.2022.	0,00% - 0,25%
17.03.2022.	04.05.2022.	0,25% - 0,50%
05.05.2022.	16.06.2022.	0,75% - 1,00%
17.06.2022.	27.07.2022.	1,50% - 1,75%
28.07.2022.	21.09.2022.	2,25% - 2,50%
22.09.2022.	03.11.2022.	3,00% - 3,25%
04.11.2022.	14.11.2022.	3,75% - 4,00%
15.12.2022.	01.02.2023.	4,25% - 4,50%
02.02.2023.	22.03.2023.	4,50% - 4,75%
23.03.2023.	02.05.2023.	4,75% - 5,00%
03.05.2023.	sada	5,00% - 5,25%

Source: https://www.kamata.rs/referentna-kamatna-stopa-sad (accessed 10.05.2023.)

The US central bank changed its concept of inflation targeting during this period and switched to a system of targeting price levels. It is not necessary for inflation to be within the target range every year, but it is important that the multi-year average of price growth does not exceed the target range. The European Central Bank, which had a ceiling of two percent inflation prior to

2008, decided to revise its monetary policy and allow inflation to exceed two percent without raising interest rates.

The explanation for the delay in raising interest rates was that the level of global debt was so high that raising rates would trigger a chain reaction in which a large number of debtors would be placed in an unfavorable situation. This would slow down or stop economic recovery, resulting in a recession accompanied by a major debt crisis.

On the other hand, it is argued that inflation has significantly increased the nominal level of GDP, making debts relative to such GDP relatively lower and more manageable. The problem, of course, is that this does not solve the crisis, but only postpones it. Today, inflation has reached levels not seen in developed western countries in the past forty years.

Table 2: Reference interest rate of the European Central Bank (2014-2023.)

Period of validity (from)	(to)	Annual rate
10.09.2014.	15.03.2016.	0,05%
16.03.2016.	26.07.2022.	0,00%
27.07.2022.	13.09.2022.	0,50%
14.09.2022.	01.11.2022.	1,25%
02.11.2022.	20.12.2022.	2,00%
21.12.2022.	07.02.2023.	2,50%
08.02.2022.	21.03.2023.	3,00%
22.03.2023.	sada	3,50%

Source: http://www.cekos.rs/referentna-kamatna-stopa-evropske-centralne-banke-0 (accessed 10.05.2023.)

The biggest victims of these economic processes will be developing countries, whose budgets are already in serious trouble due to the pandemic and are now further threatened by rising costs, especially of energy and food. Unlike developed countries, which can continue to print money,

developing countries do not have such an option, leaving them with the only possibility of new borrowing, but now at significantly higher interest rates. The danger is that the rise in interest rates could cause a recession, increase in unemployment, and a real decline in wages.

From the perspective of big capital, the key problem is not high inflation, but labor market trends, where for the first time in many decades, demand for labor is greater than supply, putting pressure to increase employee wages and thereby reduce corporate profits. Additionally, inflation is now controlled solely by monetary policy, while fiscal policy is not used to suppress it – taxes on corporate profits and wealthy layers of society are not increased, although they have a significant anti-inflationary effect.

The illusion of increasing purchasing power of citizens was maintained by a flood of cheap goods from the East and low inflation. On the other hand, housing, education, and healthcare costs have skyrocketed, causing the middle class, the pillar of societal stability, to slowly become impoverished. Those who responsibly saved lost income from interest, while the wealthiest continued to become richer through the growth of the value of their financial assets (stocks, etc.). During the pandemic, states printed money and distributed it to companies that were not working, and the newly printed money accumulated in the financial system. With the end of the pandemic, demand increased, which intensified the inflationary spiral.

The events on financial markets have long since separated from the real economy, and central banks, it seems, are much more concerned with the interests of the financial sector than the real economy. The Bank for International Settlements warns that half of the financial system is not in the hands of banks, but in the hands of financial houses and funds, known as "shadow banks." They perform similar functions as banks but are not subject to strict regulation by central banks.

In recent years, environmental issues and economic adjustment to the "green agenda" have become more relevant, directing investments into energy sectors that produce green energy, dominated by the strongest global players. Thanks to cheap money, 2021 saw historical records in the purchase, merger, and consolidation of companies, so global companies and monopolies are becoming more powerful, and wealth centralization is increasing (Katić, 2022).

The current situation in the world resembles the 1970s when stagflation was last a problem. Policymakers believe that the financial system is now much more resilient and that central banks have more tools to combat stagflation. Additionally, the EU has a common currency, which means that countries will not compete against each other in devaluing their national currencies. The European Central Bank has recognized the existence of high inflation later than all major central banks and is now lagging behind in the fight against it. Central banks are raising their reference interest rates to fight inflation. This also causes business banks and other financial institutions to raise their interest rates for companies and citizens, resulting in more expensive borrowing and less spending.

Conclusion

The major financial crisis of 2008, followed by the ongoing pandemic crisis, and the current energy and other crises and high inflation have led to a re-evaluation of the previous economic policy used to mitigate and overcome crises. Developed countries have responded to the crisis by printing money and lowering interest rates to and below zero. These measures were announced as temporary, but have lasted longer than a decade. Central banks initially believed that rising prices were a passing phenomenon, which they used to explain the policy of low interest rates despite high inflation. The economies of many countries are already facing recession and a major debt crisis, and the biggest victims of these economic processes will be developing countries because their budgets are further threatened by rising costs, primarily energy and food. In such a situation, their only solution is to take on new debt, but now at significantly higher interest rates.

The world economy in 2023 is facing numerous challenges and dangers, from the energy crisis, high inflation, to the possibility of a recession and stagflation in many countries, in different geographical areas. Inflation has affected most developed countries in the world, from the USA to individual EU member states, and is also present in South American, Australian, Indian, and other countries. Financial market events have long since separated from the real economy, and central banks are paying more attention to the financial sector than the real economy. An additional problem is that a large part of the financial system is not in the hands of banks but in

the hands of financial houses and funds, the so-called "shadow banks" that perform similar tasks to banks but are not subject to the strict regulation of central banks. In such conditions, greater efficiency of monetary policy in synchronized action with the fiscal policy of the most developed countries is necessary, which would be transferred to developing countries as well.

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