
Macroeconomic policies in a global context

Chapter 82 – May, 2017

MACROECONOMIC POLICIES

- ▶ Fiscal policy
- ▶ Monetary policy
- ▶ Exchange rate policy
- ▶ Supply-side policy
- ▶ Direct controls

FISCAL POLICY

- ▶ *Instruments:*
 - ▶ taxes
 - ▶ government spending
 - ▶ government borrowing
- ▶ *Objectives:*
 - ▶ complete goods and services that are not provided in sufficient quantities by *private sector* markets (i.e., education, health care)
 - ▶ reallocation to affect the *distribution of income and wealth*
 - ▶ correct *market failure* at microeconomic level (i.e., environmental tax)
 - ▶ improve macroeconomic performance (i.e., ↑ GDP, ↓ unemployment)
 - ▶ control *fiscal deficit* and the size of *national debt*

FISCAL POLICY

DEMAND MANAGEMENT

- ▶ *Demand management*: Fiscal policy used to affect *aggregate demand*
- ▶ *expansionary fiscal policy*: policy that leads to larger budget deficit or smaller budget surplus
- ▶ *deflationary fiscal policy*: policy that reduces budget deficit or increases budget surplus
→ reduces level of AD
- ▶ *automatic or built-in stabilizers* (see p.534!)

FISCAL POLICY

MEASURES TO REDUCE FISCAL DEFICITS

- ▶ Fiscal deficits $> 3\%$ → growing national debts as %-age of GDP
- ▶ Debt may become impossible to finance in long-term (i.e., Greece). In this case a country may:
 - ▶ default
 - ▶ be bailed out by other countries or the IMF
- ▶ There are 2 ways to tackle fiscal deficits that are too large:
 1. *fiscal austerity*: cut public spending or raise taxes
 - reduces welfare of citizens!
 - reduces GDP even more (during a recession)
 - reduces AD, unemployment increases
 2. wait and let *automatic stabilizers* to work

MEASURES TO REDUCE THE NATIONAL DEBT

- ▶ *Fiscal surplus* will cut the debt (in monetary terms)
- ▶ *Balancing government finances + economic growth* will reduce national debt (as a percentage of GDP)
- ▶ *Inflation* will reduce real value of debt
- ▶ *quantitative easing* will reduce national debt (held outside the central bank)
- ▶ Governments can *default* on their debts

MONETARY POLICY

- ▶ *Instruments:*
 - ▶ interest rate (controlled by central bank): exchange rate may affect interest rate
 - ▶ control money supply
- ▶ *Different scenarios:*
 - ▶ Other central banks raise their *bank rates*:
 - ▶ *higher interest rates in foreign country*
 - demand for foreign currency ↑
 - price of foreign currency ↑
 - exchange rate = $\frac{\text{domestic currency}}{\text{foreign currency}}$ ↓
 - AD ↑ → inflation ↑
 - domestic central bank will raise *bank rates* to avoid ↓ of exchange rate
 - ▶ World commodity prices ↑
 - ▶ inflation in domestic country ↑
 - ▶ domestic central bank ↑ interest rates to ↓ AD
 - ▶ ↓ AD → inflation ↓
- ▶ read page 536 (money supply, quantitative easing)

EXCHANGE RATE POLICIES

- ▶ central bank ↓ interest rates
 - capital flow to foreign country (higher return to investment)
 - exchange rate ↓
 - imports more expensive & exports cheaper
 - AD ↑
- ▶ countries may *manipulate exchange rates* to:
 - ▶ improve *current account positions* on the balance of payments
 - ▶ affect *fiscal deficits*
 - ▶ affect *national debt*
 - ▶ encourage *FDI flows*
 - ▶ stimulate *exports*
 - ▶ drive *economic growth*

SUPPLY-SIDE POLICIES

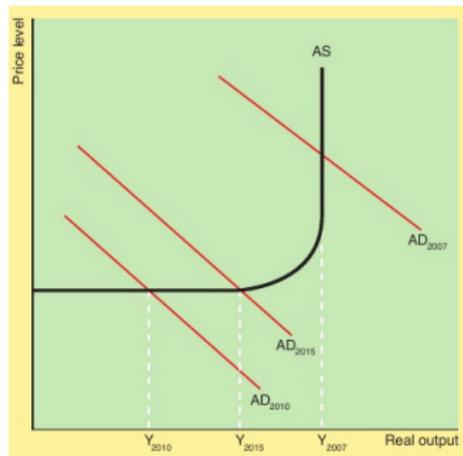
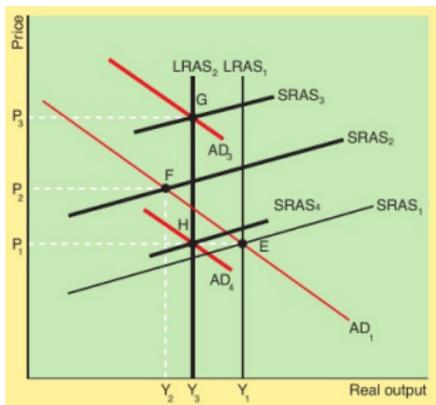
- ▶ improve education and human capital
- ▶ improve health care
- ▶ facilitate entrepreneurship
- ▶ reduce discrimination

DIRECT CONTROLS

- ▶ government measure imposed on the price/quantity of a single product or factor of production
- ▶ Examples:
 - ▶ maximum price (i.e., bread, petrol, electricity)
 - ▶ minimum/maximum wage
 - ▶ quota on imports
 - ▶ limit on foreign currency that can be bought
 - ▶ maximum interest rate
 - ▶ limit on size of mortgage

MACROECONOMIC POLICIES AND EXTERNAL SHOCKS

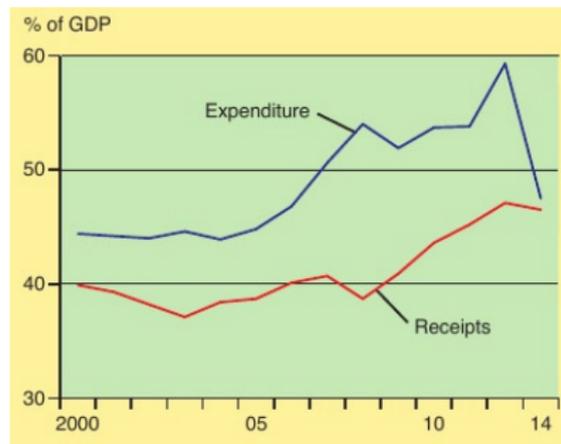
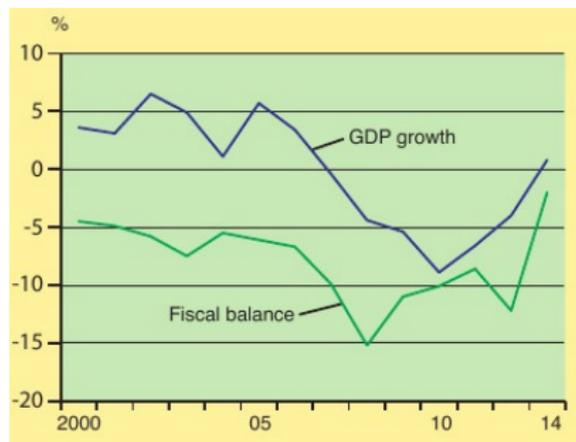
- ▶ commodity price shocks
- ▶ a major financial crisis



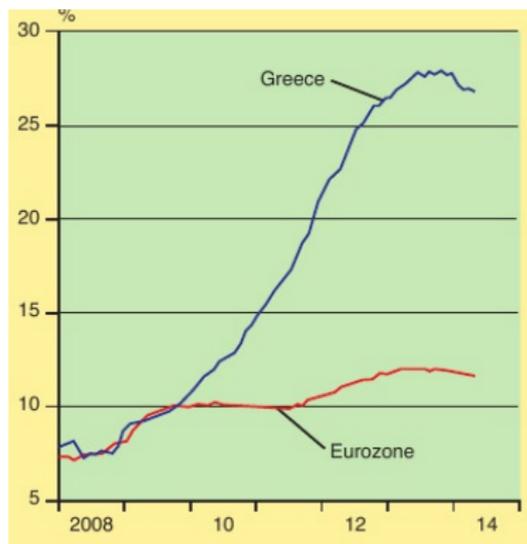
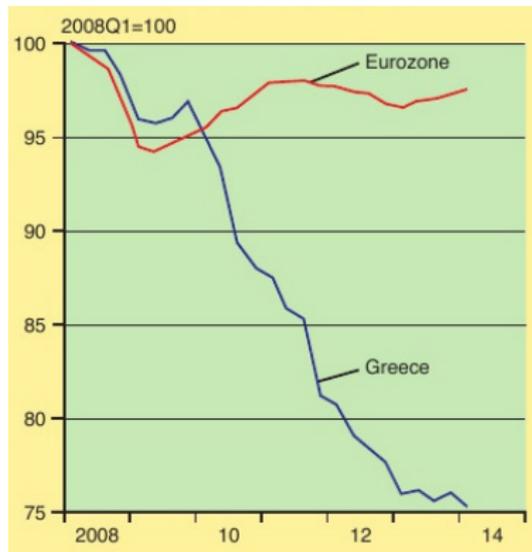
PROBLEMS FACING POLICY MAKERS

- ▶ inaccurate information
- ▶ risks and uncertainties
- ▶ external shocks

EXTRACT 1: ECONOMIC GROWTH IN GREECE



EXTRACT 1: ECONOMIC GROWTH IN GREECE



EXTRACT 2: ARGENTINA



KEYTERMS

- ▶ active or discretionary fiscal policy:
- ▶ automatic or built-in stabilisers:
- ▶ demand management:
- ▶ direct control:
- ▶ fiscal austerity: