Chapter 38

Impact and problems of macroeconomic policies

Key terms

1. External shock: a demand-side or supply side shock to an economy which has been caused by factors outside the individual country's control.
2. Hyperinflation: large increase in the price level
3. Regulation on transfer pricing: rules made by governments on transfer pricing to ensure the amount of profits paid by MNCs is fair.
4. Tax avoidance: when an individual or firm deliberately manipulates the tax system to pay less than the fair amount
5. Transfer pricing: an accounting technique used by transnational companies to reduce tax on profits by selling goods at a low price internally from a high tax country to another part of the company in a low tax country.

1. Demand-side policies in response to the Global Financial Crisis of 2008

The Global Financial Crisis caused a demand-side shock to the global economy.

Monetary Policy

Following 2007-2008, governments in countries such as the UK and USA and their central banks, pursued expansionary monetary policies, cutting interest rates to almost zero. The objective of QE was to free up credit in financial markets in order to increase lending by commercial banks. QE also put down value of currency. The overall impact should be to increase AD.

However, Some argues that QE did not create the extra lending which might have been expected, since some financial institutions put aside the extra cash rather than increasing their lending. Rather it has fuelled an increase in the price of assets such as houses or shares. Low interest will make savers to be suffered while support people who invest in mortgage market.

Fiscal Policy

Fiscal policy was expansionary in order to response to the crisis including reducing VAT, Increase government spending on infrastructure and providing training program.

2. Measures to control TNCS

- TNCS can increase jobs, incomes, exports and tax revenues.
- Transfers of knowledge as well as FDI in building new manufacturing plants or opening new outlets can also benefit countries.
- TNCS; however; can also have a negative impacts

2.1 Reducing tax avoidance

↳ MNCs may avoid paying tax and host country cannot get tax revenue

↳ Government has to prevent tax avoidance

↳ Tax avoidance : when an individual or firm deliberately manipulates the tax system to pay less than the fair amount

2.2 The regulation of transfer pricing

↳ Transfer pricing; refer to the pricing policies adapted by groups of companies for transactions between companies in the group.

↳Transfer profit to a country with lower tax rate

↳ Tax authorities have strict rules to regulate transfer pricing to attempt to prevent companies from using it to avoid tax payment

2.3 Limits to government ability to control TNCS

1. It is for TNCs operating in EU or to use bribery or corrupt practice anywhere in the world.
2. Many developing countries do not allow TNCs to set up in their countries without setting up a joint company with local partner.
3. Government can negotiate deals where a proportion of the production is exported. This helps the country to earn foreign currency which can be used to pay imports.
4. TNCs has to manufacture at least some of the value of the order in the country e.g may order military aircraft.

3. The impact of policy changes on different economies

Sometimes, the impact might be more strongly felt on a region within the economy. For some countries, a policy change will have an impact on the global economy as a whole. For others, there is still likely to be impact on some other countries.

3.1 The impact of policy changes on local economies

↳ Policies designed to improve living standards in rural area.

3.2 The impact of policies on the national economies

↳ Policies designed to increase positive multiplier effect on economy, low and stable inflation

3.3 The impact of policies on the global economy

↳ Policies designed to increase export revenue.

↳ China is moving from growth based on exports towards consumption-led growth

4. Problems facing policymakers when applying policies

Policy makers such as governments face many problems when making decisions. These problems include the following.

1. Inaccurate information

- inaccurate data of GDP

2. Risk and uncertainty

- e.g. BREXIT and Covid

3. External shocks

- e.g. OPEC restricts production the price oil rises.

Exercise Chapter 37 & 38

Using macroeconomics policies &

Impact and problems of macroeconomic policies

1. (A) Assess the view that economic growth is the most important factor influencing economic development. Refer to examples of developing countries in your answer. (15 marks)

   (B) To what extent is monetary policy the most effective way of stimulating economic growth? Refer to at least one example of a developed economy in your answer. (25 marks)