Chapter 37

Using macroeconomics policies

Key terms

1. Fiscal policy : the use of taxation and government spending by the government to achieve its policy objectives.
2. Monetary policy : The changes to monetary variables by central banks, such as interest rates and the money supply, to achieve their objectives.
3. Exchange rate policy : The manipulation of the exchange rate to achieve policy objectives.
4. Direct controls : Government measures that are imposed on the price or the quantity of a single product or factor of production.
5. Supply side policies : Government policies designed to increase the productive potential of the economy.
6. Bailout: when financial support is provided to a company or a country facing a potential bankruptcy threat.
7. Deflationary policies: fiscal or monetary policies aimed at reducing aggregate demand.
8. Reflationary policies: fiscal or monetary policies aimed at increasing aggregate demand.
9. Demand management: government use of fiscal or other policies to manipulate the level of aggregate demand in the economy.
10. Fiscal austerity: tax rises or government spending cuts designed to reduce a government budget deficit.

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1. **Macroeconomic policies used by government include :**

- **Fiscal policy** : the use of taxation and government spending by the government to achieve its policy objectives.
- **Monetary policy** : The changes to monetary variables by central banks, such as interest rates and the money supply, to achieve their objectives.
- **Exchange rate policy** : The manipulation of the exchange rate to achieve policy objectives.
- **Direct controls** : Government measures that are imposed on the price or the quantity of a single product or factor of production. Examples of direct controls include
  - Imposing a maximum price on a good such as bread, petrol or electricity.
  - Setting in minimum or maximum wage
  - Fixing a quota on imports of beef
  - Limiting the amount of foreign currency a citizen can buy during a year
  - Fixing a maximum interest rate that payday lenders can charge their borrowers for small loans
  - Limiting the amount an individual can borrow for a mortgage
- **Supply side policies** : Government policies designed to increase the productive potential of the economy.

The focus of this chapter is to discuss how macroeconomic policies are used to

- Reduce fiscal deficits and national debt
- Control the rate of inflation
- Respond to external shocks in the global economy
- Reduce poverty and inequality

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1. Policies to reduce fiscal deficits and national debts

Fiscal austerity

- Tax rises or government spending cuts designed to reduce a government budget deficit.
- Having a fiscal surplus will cut the debt in money term.

2. Policies to control the rate of inflation

Policies to reduce demand full inflation

1. Contractionary fiscal policy / Deflationary fiscal policy

1. **Reducing government spending**

   ⇒ Aggregate Demand(AD=C+I+G+NX) decreases.

   ⇒ Inflation rate decreases.

2. **Increasing income tax**

   ⇒ People have lower disposable income.

   ⇒ Consumption falls

   ⇒ Aggregate Demand(AD=C+I+G+NX) decreases.

   ⇒ Inflation rate decreases.

2. contractionary monetary policy

1. **Increasing interest rate**

   ⇒ People would like to save rather than spend, resulting in a fall in consumption.

   ⇒ Firms do not want to borrow money to invest, resulting in a fall in investment.

   ⇒ Aggregate Demand(AD=C+I+G+NX) decreases.

   ⇒ Inflation rate decreases.

Evaluation

1.) It depends on consumer confidence/business confidence. If consumers have high confidence, they still consume even interest rate is very high.

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To reduce cost-push inflation by supply-side policy

1. **Providing education and training**

   ⇒ It improves labour productivity.

   ⇒ Supply of output increases.

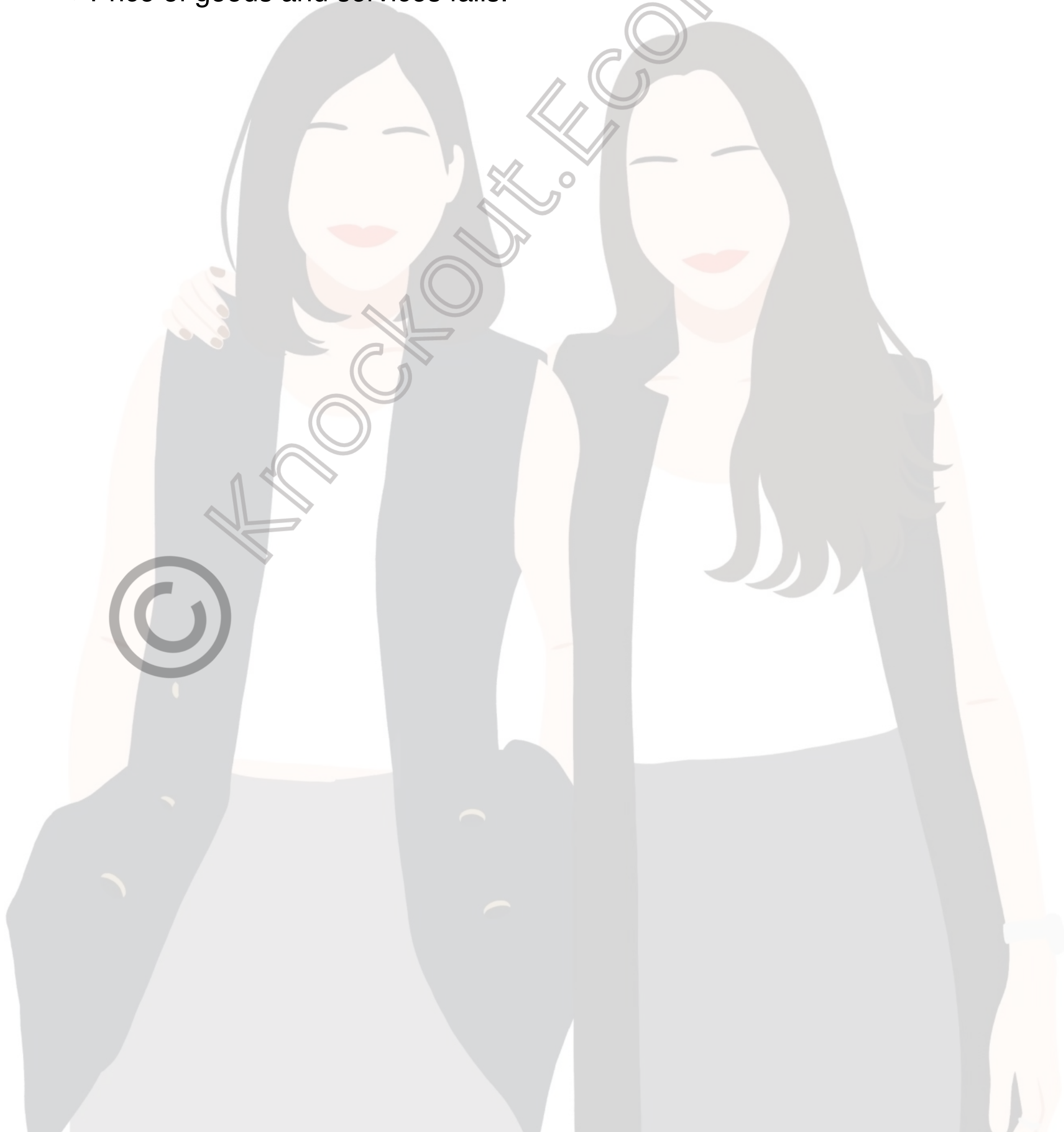
   ⇒ Price of goods and services falls.

2. **Reducing business regulation**

   ⇒ New firms can start up the businesses.

   ⇒ supply of output increases.

   ⇒ Price of goods and services falls.



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3. Policies to respond to external shocks in the global economy

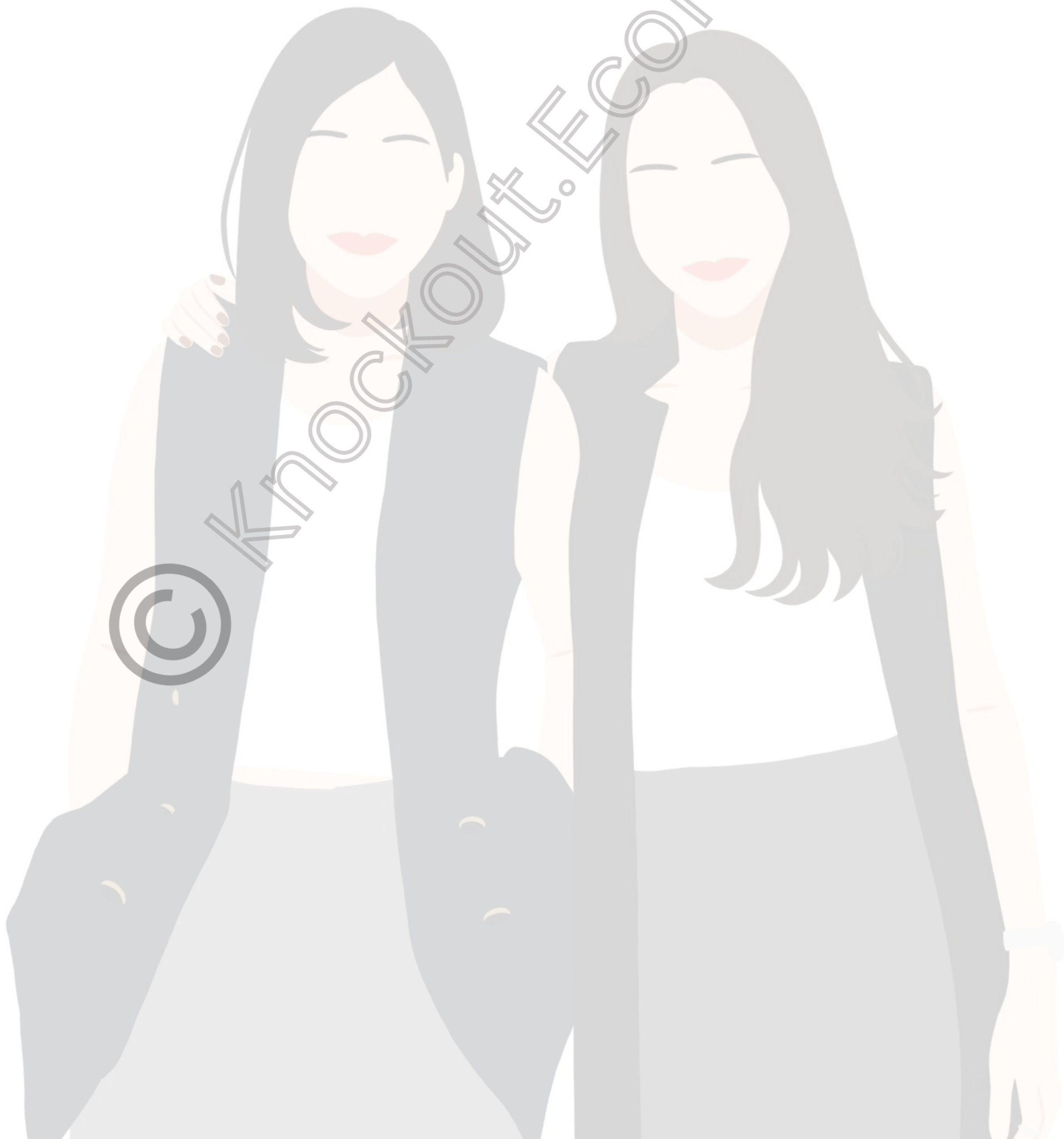
Macroeconomic policies can be used to address the effects of negative shocks to an economy such as a rise in commodity prices for commodity importers.

- **Commodity price shocks: a sharp rise in oil price**

  ⇒ Government tries to remove inflation from oil price by deflationary fiscal & monetary policy

  ⇒ This reduces AD and It can cause price to fall.

  ⇒ This policy can lead to unemployment in the short term and cuts in living standard of household.



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4. Policies to reduce poverty and inequality

Understanding the causes of changes in absolute and relative poverty will help governments implement policies to reduce poverty. Policies to reduce poverty and inequality include the following

4.1 Policies to increase economic growth

- Reflationary demand-side policies, both fiscal and monetary can be used to increase real GDP.
- Supply-side policies can also be implemented to achieve a long-term increase in real GDP. Both these will raise real GDP per capital.

4.2 Direct controls

- Government directly provide foods for poor.
- Setting maximum rate on interest is charge in loans and essential food.
- Setting minmum wage is paid for workers.

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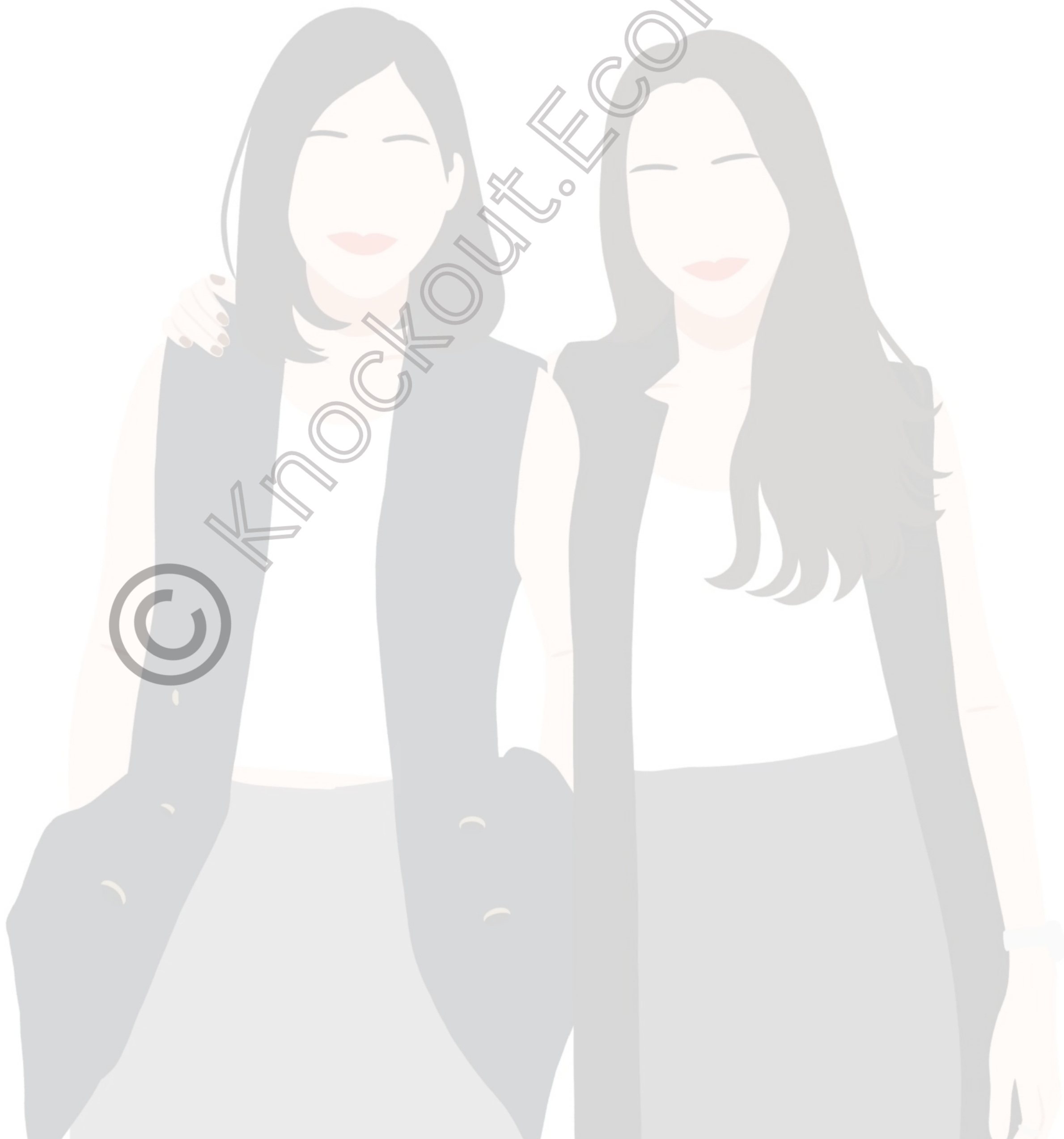
Exercise Chapter 37 & 38

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)



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