Webnote 318 (330)

5 macroeconomic policy approaches to managing a macroeconomy for spending

Macro Economics 5 Policies to manage <u>spending</u> in a Macroeconomy: 3 Goals = Growth, Employment and Stable Inflation

Big Question: How does the macroeconomy work?

National Income – expenditure method – Aggregate Demand = C + I + G + (X-M)

Fiscal Policy (interventionist) → AD = C + I + G + (X-M)

Spending: short run expenditure
Current account (9)
annual spending on:

- **social welfare (5)**
- **government employees**
- **defence**
- **education (5)**
- **health (5)**
- **old age pensions (4)**
- **debt repayments**
- **transfer payments (9,4)**

Spending: long run expenditure
Capital spending: (9)
Infrastructure: (4)

- Airports
- Housing
- road+ rail
- schools
- telecommunications
- sustainability projects (6) (renewable energy projects with government support)

Revenue

- **Tax policy: (4)**

1. **Direct- progressive (4)**
2. **Indirect- regressive**

Tax revenue streams:

1. **Direct:**
   - **Income tax on households**
   - **inheritance-tax**
   - **corporation tax**
2. **Indirect:**
   - **vat /sales tax**
   - **tariffs**
3. **State firms**
4. **State Lottery**

Exchange Rate Policy

→ AD = C + I + G + (X-M)

Foreign Trade Policy

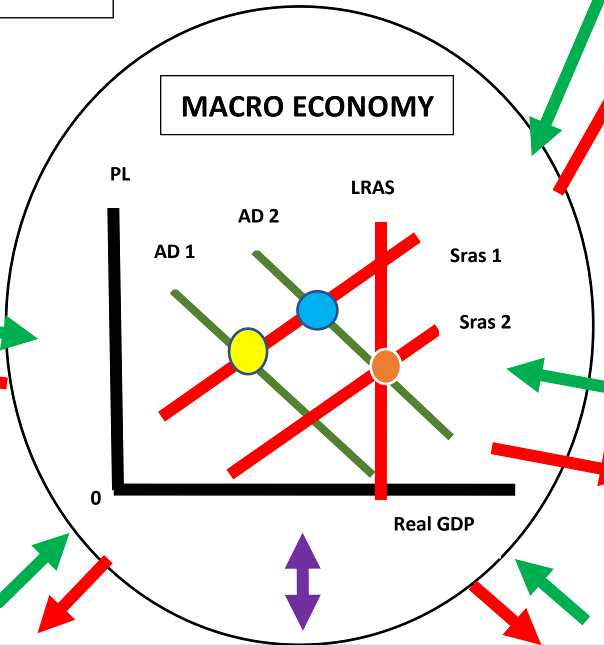
1 EXPORTS (j)

2 IMPORTS (L)

- Balance of Trade (x-m)

Key connecting issues:

- Balance of Payments
- Terms of Trade



Monetary Policy – (market based)

→ AD = C + I + G + (X-M)

Monetary Policy (4,8)
Monetary Policy is concerned with the control of the money supply and value of money:

- Interest rates
- Money supply
- Exchange rate (George Soros + ERM)
- National debt (see webnote 211. If there is a deficit in fiscal policy the government will need to borrow i.e. national debt rises.)

Below is a summary of the 2 schools of economics (syll 3.2) and how each school uses to policies above to manage the macro economy to achieve the key macro objectives i.e. growth, inflation (price stability) and unemployment (reduction). Note that each of the schools of economics use a combination of the policies i.e. fiscal + monetary.

Supply Side Policies (Neo Classical) (8)

(use short run as + ad measures to shift LRAS). (This involves markets being more competitive and efficient). Fiscal + Monetary policies as well as direct intervention (e.g.legislation) are used.

Supply Side Policies

(monetarist, neo-classical, Friedman, market/ Laissez Faire economics).
Strong reliance on market-based policies such as monetary policy or pro market measures such as fiscal tax cuts

Policies to adjust LRAS and increase Quantity and Quality of Factors of Production. Measures include:

1. Tax cuts
2. Reduce Welfare costs (transfer payments)
3. Encourage enterprise (risk taking culture)
4. Reform labour law
5. Privatization
6. Competitive markets

<u>KEY Concepts: Use these for evaluation</u>

1. scarcity, **(micro, macro and development)**
2. choice, **(micro, macro, trade + development))**
3. efficiency, **(micro)**
4. equity, **(macro)**
5. economic well-being, **(macro)**
6. sustainability, **(macro)**
7. Change, **(Time- LR vs SR, all sections of syllabus))**
8. Interdependence, **(micro, macro trade and development)**
9. Intervention **(micro, macro, trade + development)**

Demand Side Policies (Keynesian) (9)

(government uses fiscal + monetary + direct intervention policies (e.g. legislation) to shift AD to achieve the 3 macroeconomic goals – see goals above)

Demand Side Policies

(Keynesian, interventionist model)
Government intervention e.g. spending (G) designed to shift economy using AD as market unable to adjust due to sticky wages and remained below full employment in LR.
Measures include:

1. Fiscal Policy: Government spending on infrastructure projects to boost economic activity (4)
2. Direct Intervention: Reliance on fiscal policy and other methods of direct intervention where markets appear unable to function efficiently e.g. infrastructure spending (4)