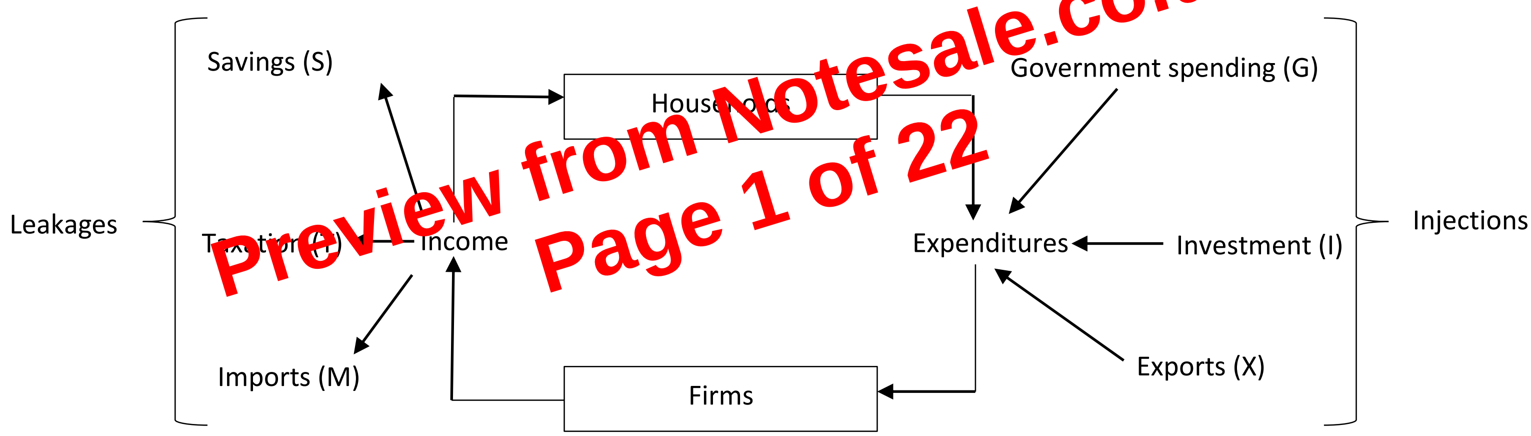
Macroeconomics

Macroeconomic objectives

Macroeconomy is so large it is difficult to measure its performance. To help the government assess the performance of the economy, they use objectives

- Key ones:
    - Trade – balanced trade
    - Inflation – low and stable
    - Growth – strong and sustained
    - Employment – low unemployment
- Minor ones:
    - Redistribution of income
    - Stability

Circular flow



- Consumer expenditure is not an injection as it is part of the flow
- Injections > leakages = rise in short term growth
- Leakages > injections = fall in short term growth
- Size of flow can increase if
    - There are more households
    - The quality and quantity of factors of production increases

Demand side ☹ – Deflationary spiral

1. Consumers delay consumption as they expect prices to be falling more in the future – causes AD to fall even more as consumer spending decreases → firms cut prices – makes it worse

2. Reduces the effect of interest rates – incentivises savings and not to borrow – effect of expansionary monetary policy to stimulate spending is negated
    a. E.g. if interest rates are 1% and inflation in economy is -2%, the real interest rate is 3% (1 – (-2) = 1 + 2 = 3)

3. Increases the real value of debt
    a. If you are a worker and firms are cutting their prices, your wages will fall
    b. You lose bargain power because goods are cheaper
    c. Thus, if you have a loan of £2000 and your wages fall, it becomes harder to pay back the debt – even more saving in the economy and less borrowing – continues the spiral.

Supply side ☺ –

- Reduction in cost of production for firms – could be tax cuts etc..
- Improvement in productive capacity in the economy – counters cost plus inflation

<u>Unemployment measures</u>

The unemployed consists of those (of working age) <u>registered as able, available and willing to work</u> but cannot find work despite <u>an active search</u>.

Those who do not fit this definition do not count as within the labour force

In UK (ways to measure):

1. Labour force survey
    a. Survey given out to about 60 000 households – these households tick a box to determine if they fit within the unemployment definition of the international labour organisation (ILO)
    b. Benefits:
        i. World-wide survey – allows for cross country comparison
    c. However:
        i. Sampling error

2. Claimant count
    a. Measure of people claiming unemployment benefits
        i. Benefits of this method:
            1. Cheaper way to measure
        ii. However:
            1. Does not include all people that fit within the ILO definition of unemployment

Depends on:

1. **Initial level of economic activity** – e.g. if AD is already very close to the level where all of the country's spare capacity is used, then expansionary fiscal policy will only increase AD by a little – the more spare capacity there is, the greater the effect of expansionary fiscal policy is going to be on growth and unemployment (by shifting AD)
2. **Size of the multiplier** – the bigger the size of the multiplier the less the government needs to spend money for there to be a large impact on growth – because initial government spending will lead to further and further spending, thus effect on AD will be very large
3. **Length of time lag** – the bigger the time lag, the less the effect will be in the short term
4. **Offset by other factors** – e.g. rise in exchange rates (or contractionary monetary policy) may offset some of the increase in AD caused by expansionary fiscal policy

<u>Automatic stabilisers</u>

- Governments can fall back on automatic stabilisers to negate the fluctuations in economic growth
- Part of fiscal policy that is 'automatic' – does not need to be actively changed by governments
- E.g. in the heart of a recession
    - High unemployment
    - A lot of spare capacity
        - Government spending rises naturally
            - Unemployment benefits for example

        - Tax revenue falls in recession as less people work
        - Corporation tax revenue falls as businesses make lower profits
    - These factors increase AD
- E.g. in a boom
    - Low unemployment
    - Little spare capacity
        - Government spending decreases naturally
            - Less unemployment benefits to pay

        - Tax revenue increases as more people work and pay income tax and firms earn higher profits and pay corporation taxes
    - These factors reduce AD and automatically stabilise the economy
- Allow economic growth and fall in growth not to fluctuate as much (less fluctuations of business cycle – smaller deviations from long term trend)