Goals of Macroeconomic Policy I: Low Unemployment and Low Inflation (6)

0p0pI. Goals of Macroeconomic Policy

- Economic growth – ingredients
    - Aggregate supply
        - Inputs
            - Labor, machinery, other resources
            - Used to produce outputs
        - Output
            - Goods and services
            - Produced in economy
    - Aggregate demand
- Low unemployment
- Low inflation

II. Macroeconomic Policy

- Macroeconomic Policy
    - Growth policy
        - Make the economy grow faster in the long-run
    - Stabilization policy
        - Manage aggregate demand
        - Avoid high unemployment
        - Avoid high inflation

III. Unemployment

- Unemployment rate
    - Number of unemployed people
    - As percentage of labor force
- If GDP grows slower than the economy's potential
    - Unemployment rate rises
- If GDP grows faster than the economy's potential
    - Unemployment rate falls

Unemployment rate = # of unemployed / labor force** (labor force = unemployed + employed)

** Those who don't know qualify as labor force – children under 16, retired, discouraged workers, volunteers (working for non-profit company), disabled, people who don't want to works, convicts, institutionalized, military**

Population as of Jan 2015: 320 million
Civilians non-institutionalized: 248 million
Labor force: 157 million
Employed: 148 million
Unemployed: 9 million

IV. Counting the Unemployed

- Employed
    - Everyone currently at work, including part time workers
- Unemployed
    - People not currently working
        - Temporarily laid-off, expecting to return
        - Actively looking for a job (4 weeks)
- Out of the labor force
    - Nor looking for work

V. 3 Types of Unemployment

- Frictional unemployment
    - Due to normal turnover in the labor market
    - People who are temporarily between jobs
        - Moving or changing occupations
        - Unemployed for similar reasons
- Structural Unemployment
    - Due to structural unemployment
        - Due to structural change either on the demand side of the supply side
        - Their skills are no longer in demand
- Cyclical unemployment
    - The level of demand in the entire economy goes down
    - Rises during recessions
    - Falls as prosperity is restored

VI. Full Employment

- Full employment
    - Everyone who is willing and able to work can find a job
    - Unemployment rate is still positive
        - Positive frictional and structural unemployment
        - 0% cyclical unemployment

1. Rate at which the economy builds up its stock of capital
2. Rate at which technology improves
3. The rate at which workforce quality (or “human capital”) is improving

VIII. Macroeconomic Policy

- Growth policy
  - Economy sustains a high long-run growth rate of potential GDP
    - Not necessarily the highest possible growth rate
- Stabilization

IX. Levels, Growth & Convergence

- Levels, growth rates, and the convergence hypothesis
- Levels of productivity in a nation
  - Higher in rich countries
  - Depends on: its supplies of human and physical capital and the state of its technology
- Technological laggards
  - Can, and sometimes do, close the gap with technological leaders
  - By imitating and adapting existing technologies
  - “convergence club”
    - productivity growth rates are higher where productivity levels are lower
    - some of the world’s poorest nations are unable to join club

X. Growth Policy

- Growth policy encourages capital formation
- Nationals capital
  - Its available supply of plant, equipment, and software
  - The result of past decisions to make investments in these items
- Investment
  - The flow of capital
- Capital formation
  - Investment
  - Process of building up the capital stock
- Trade-off
  - More capital formation
    - Quicker growth and consume less today
  - More consumption today
    - Less capital formation and slower growth

    - Three B directors are prominent leaders from industry, labor, agriculture, or consumer sector
    - Three C directors appointed by the Board of Governors are not allowed to be officers, employees or stockholders
- Member banks elect six directors for each district; three more are appointed by the Board of Governors
- Functions of the Federal Reserve Banks
    - Clear checks
    - Issue new currency
    - Withdraw damaged currency from circulation
    - Administer and make discount loans to banks in their district
    - Evaluate proposed mergers and applications for banks to expand their activities
- Act as liaisons between the business community and the Federal Reserve System
- Examine bank holding companies and state-chartered member banks

X. Federal Reserve Banks and Monetary Policy

- Directors "establish" the discount rate
- Decide which banks can obtain discount loans
- Directors select one commercial banker from each district to serve on the Federal Advisory Council which consults with the Board of Governors

XI. Member Banks

- All national banks are required to be members of the Federal Reserve System
- Commercial banks chartered by states are not required but may choose to be members
- Depository Institutions Deregulation and Monetary Control Act of 1980 subjected all banks to the same reserve requirements as member banks and gave all banks access to Federal Reserve System

XII. Board of Governors of Federal Reserve System/Duties of Board of Governors

- Seven members headquartered in Washington, DC
- Appointed by the president
- Votes on conduct of open market operations
- Sets reserve requirements
- Controls the discount rate
- Chairperson of the Board of Governors

XXI. Other Instruments of Monetary Policy

- Unconventional monetary policy
    - Unusual forms (or volumes) of central bank lending and to unusual types of open-market operations
        - Pushing the federal funds rate down to virtually zero
        - Lending to banks in unprecedented volume
- Quantitative easing
    - Open-market purchases of assets other than Treasury bills
    - Treasury bonds (longer dated)
    - Other assets – in 2008 and 2009, to stabilize the mortgage market

XXII. How Monetary Policy Works

- Expansionary monetary policy (more on PP)
- Sensitive to monetary policy
    - Investment
    - Net exports
- Contractionary monetary policy
    - Higher investment rates (r)
    - Lower investment spending (i)
    - Lower total spending (more on PP)
- Expansionary MP →
    - I increases → AD increases = C + I (increases) + G + (X-IM)
- Effect of monetary policy
    - On aggregate demand

XXIII. Money and the Price Level

- Expansionary monetary policy
    - Increases aggregate quantity (more on PP)

** Look at HW 3