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Chapter 1 : Fiscal Policy | Macroeconomic Analysis

The group Macroeconomics and Economic Policy focusses on the theoretical and empirical analysis of macroeconomic dynamics and the analysis of policy relevant research questions, mainly in the areas of economic growth, business cycles, macroeconomic forecasting and finanical markets.

Fiscal policy , often tied to Keynesian economics , uses government spending and taxes to guide the economy. The size of the deficit or surplus Tax policy: The taxes used to collect government income. Government spending on just about any area of government Monetary policy controls the value of currency by lowering the supply of money to control inflation and raising it to stimulate economic growth. It is concerned with the amount of money in circulation and, consequently, interest rates and inflation. Interest rates , if set by the Government Incomes policies and price controls that aim at imposing non-monetary controls on inflation Reserve requirements which affect the money multiplier Tools and goals[edit] Policy is generally directed to achieve particular objectives, like targets for inflation , unemployment , or economic growth. Sometimes other objectives, like military spending or nationalization are important. These are referred to as the policy goals: To achieve these goals, governments use policy tools which are under the control of the government. These generally include the interest rate and money supply , tax and government spending, tariffs, exchange rates, labor market regulations, and many other aspects of government. Selecting tools and goals[edit] Government and central banks are limited in the number of goals they can achieve in the short term. For instance, there may be pressure on the government to reduce inflation, reduce unemployment, and reduce interest rates while maintaining currency stability. If all of these are selected as goals for the short term, then policy is likely to be incoherent, because a normal consequence of reducing inflation and maintaining currency stability is increasing unemployment and increasing interest rates. For instance, unemployment could potentially be reduced by altering laws relating to trade unions or unemployment insurance , as well as by macroeconomic demand-side factors like interest rates. Discretionary policy vs policy rules[edit] For much of the 20th century, governments adopted discretionary policies like demand management designed to correct the business cycle. These typically used fiscal and monetary policy to adjust inflation, output and unemployment. However, following the stagflation of the s , policymakers began to be attracted to policy rules. A discretionary policy is supported because it allows policymakers to respond quickly to events. However, discretionary policy can be subject to dynamic inconsistency: This makes policy non-credible and ultimately ineffective. A rule-based policy can be more credible, because it is more transparent and easier to anticipate. Examples of rule-based policies are fixed exchange rates , interest rate rules , the stability and growth pact and the Golden Rule. Some policy rules can be imposed by external bodies, for instance the Exchange Rate Mechanism for currency. A compromise between strict discretionary and strict rule-based policy is to grant discretionary power to an independent body. Another type of non-discretionary policy is a set of policies which are imposed by an international body. This can occur for example as a result of intervention by the International Monetary Fund. Economic policy through history[edit] Main article: Economic history The first economic problem was how to gain the resources it needed to be able to perform the functions of an early government: Early governments generally relied on tax in kind and forced labor for their economic resources. However, with the development of money came the first policy choice. A government could raise money through taxing its citizens. However, it could now also debase the coinage and so increase the money supply. Early civilizations also made decisions about whether to permit and how to tax trade. Some early civilizations, such as Ptolemaic Egypt adopted a closed currency policy whereby foreign merchants had to exchange their coin for local money. This effectively levied a very high tariff on foreign trade. By the early modern age, more policy choices had been developed. There was considerable debate about mercantilism and other restrictive trade practices like the Navigation Acts , as trade policy became associated with both national wealth and with foreign and colonial policy. Throughout the 19th Century, monetary standards became an important issue. Gold and silver were in supply in different proportions. Which metal was adopted influenced the wealth of different groups in society. The first fiscal policy[edit] With the accumulation of private capital in the

Renaissance, states developed methods of financing deficits without debasing their coin. The development of capital markets meant that a government could borrow money to finance war or expansion while causing less economic hardship. This was the beginning of modern fiscal policy. The same markets made it easy for private entities to raise bonds or sell stock to fund private initiatives. Business cycles[edit] The business cycle became a predominant issue in the 19th century, as it became clear that industrial output, employment, and profit behaved in a cyclical manner. One of the first proposed policy solutions to the problem came with the work of Keynes , who proposed that fiscal policy could be used actively to ward off depressions, recessions and slumps. The Austrian School of economics argues that central banks create the business cycle.

Chapter 2 : What's the difference between macroeconomics and microeconomics?

Microeconomics is the study of individuals and business decisions, while macroeconomics looks at higher up country and government decisions.

Introduction Poverty is a multidimensional problem that goes beyond economics to include, among other things, social, political, and cultural issues see Box 1. Therefore, solutions to poverty cannot be based exclusively on economic policies, but require a comprehensive set of well-coordinated measures. Indeed, this is the foundation for the rationale underlying comprehensive poverty reduction strategies. Because economic growth is the single most important factor influencing poverty, and macroeconomic stability is essential for high and sustainable rates of growth. Macroeconomic stability by itself, however, does not ensure high rates of economic growth. In most cases, sustained high rates of growth also depend upon key structural measures, such as regulatory reform, privatization, civil service reform, improved governance, trade liberalization, and banking sector reform, many of which are discussed at length in the Poverty Reduction Strategy Sourcebook, published by the World Bank. Growth associated with progressive distributional changes will have a greater impact on poverty than growth that leaves distribution unchanged. Physiological deprivation involves the non-fulfillment of basic material or biological needs, including inadequate nutrition, health, education, and shelter. A person can be considered poor if he or she is unable to secure the goods and services to meet these basic material needs. The concept of physiological deprivation is thus closely related to, but can extend beyond, low monetary income and consumption levels. Social deprivation widens the concept of deprivation to include risk, vulnerability, lack of autonomy, powerlessness, and lack of self-respect. Poverty reduction strategies need first to be articulated i. The amount of finance, much of which will be on concessional terms, is, however, not necessarily fixed during this process: Nonetheless, in situations where financing gaps remain, a country would have to revisit the intermediate objectives of their strategy and reexamine their priorities. Except in cases where macroeconomic imbalances are severe, there will usually be some scope for flexibility in setting short-term macroeconomic targets. However, the objective of macroeconomic stability should not be compromised. Growth Matters Economic growth is the single most important factor influencing poverty. Numerous statistical studies have found a strong association between national per capita income and national poverty indicators, using both income and nonincome measures of poverty. Moreover, the study found that the effect of growth on the income of the poor was on average no different in poor countries than in rich countries, that the povertyâ€"growth relationship had not changed in recent years, and that policy-induced growth was as good for the poor as it was for the overall population. These studies, however, establish association, but not causation. In fact, the causality could well go the other way. In such cases, poverty reduction could in fact be necessary to implement stable macroeconomic policies or to achieve higher growth. Studies show that capital accumulation by the private sector drives growth. No magic bullet can guarantee increased rates of private sector investment. Cross-country regressions using a large sample of countries suggest that growth, investment, and productivity are positively correlated with macroeconomic stability Easterly and Kraay, Although it is difficult to prove the direction of causation, these results confirm that macroeconomic instability has generally been associated with poor growth performance. Without macroeconomic stability, domestic and foreign investors will stay away and resources will be diverted elsewhere. In fact, econometric evidence of investment behavior indicates that in addition to conventional factors i. Macroeconomic Stability Macroeconomic stability exists when key economic relationships are in balanceâ€"for example, between domestic demand and output, the balance of payments, fiscal revenues and expenditure, and savings and investment. These relationships, however, need not necessarily be in exact balance. Imbalances such as fiscal and current account deficits or surpluses are perfectly compatible with economic stability provided that they can be financed in a sustainable manner. There is no unique set of thresholds for each macroeconomic variable between stability and instability. Rather, there is a continuum of various combinations of levels of key macroeconomic variables e. While it may be relatively easy to identify a country in a state of macroeconomic instability e. Finally, macroeconomic stability depends not only on the macroeconomic management of an economy, but also on the structure of key markets and sectors. To enhance macroeconomic stability, countries need to support macroeconomic policy with structural reforms that strengthen and improve the functioning of these markets and sectors. Macroeconomic Instability Hurts the Poor In addition to low and sometimes even negative growth rates, other aspects of macroeconomic instability can place a heavy burden on the poor. Inflation, for example, is a regressive and arbitrary tax, the burden of which is typically borne disproportionately by those in lower income brackets. The reason is twofold. First, the poor tend to hold most of their financial assets in the form of cash rather than in interest-bearing assets. Second, they are generally less able than are the better off to protect the real value of their incomes and assets from inflation. In consequence, price jumps generally erode the real wages and assets of the poor more than those of the non-poor. Moreover, beyond certain thresholds, inflation also curbs output growth, an effect that will impact even those among the poor who infrequently use money for economic transactions. This phenomenon typically operates through shocks to the human capital of the poor. In Africa, for instance, there is evidence that children from poor families drop out of school during crises. Similarly, studies for Latin American countries suggest that adverse terms-of-trade shocks explain part of the decline of schooling attainment see, for example, Behrman, Duryea, and Szeleky, Composition and Distribution of Growth Also Matter Although economic growth is the engine of poverty reduction, it works more effectively in some situations than in others. If the benefits of growth are translated into poverty reduction through the existing distribution of income, then more equal societies will be more efficient transformers of growth into poverty reduction. A number of empirical studies have found that the responsiveness of income poverty to growth increases significantly as inequality is lowered. Others have suggested that greater equity comes at the expense of lower growth and that there is a trade-off between growth and equity when it comes to poverty reduction. Conventional wisdom has been that growth in sectors of the economy where the poor are concentrated will have a greater impact on reducing poverty than growth in other sectorsâ€"indeed, this is almost a tautology. For example, it is often argued that in countries where most of the poor live in rural areas, agricultural growth reduces poverty because it generates income for poor farmers and increases the demand for goods and services that can easily be produced by the poor. The links may be more complex over the long run, however. While faster growth in agriculture may address rural poverty in the short-term, reliance on agricultural activity may also intensify output variability, which, in turn, would contribute to increasing rather than decreasing poverty. A more diversified economy with a vibrant manufacturing sector might offer the best chances for a sustainable improvement in living standards in the long run. What are the implications of these empirical findings for macroeconomic policy? First, in light of the importance of growth for poverty reduction, and of macroeconomic stability for growth, the broad objective of macroeconomic policy should be the establishment, or strengthening, of macroeconomic stability. Policymakers should therefore define a set of attainable macroeconomic targets i. In cases where macroeconomic imbalances are less severe, a range of possible targets may be consistent with the objective of stabilization. Second, most developing countries will likely have substantial scope for enhancing the quality of growth, that is, the degree to which the poor share in the fruits of such growth, through policies aimed at improving income distribution. As these topics pertain more broadly to political economy, rather than exclusively to macroeconomics, they are beyond the scope of this pamphlet. But they reinforce the point that economic growth alone is not sufficient for poverty reduction and that complementary redistributional policies may be needed to ensure that the poor benefit from growth. Finally, while issues regarding the composition of growth also go beyond strict macroeconomics, several general policy observations can be made. There is a general consensus that policies that introduce distortions in order to influence growth in a particular sector can hamper overall growth. The industrial policies pursued by many African developing countries in the s have long been discredited World Bank, Instead, strategies for sector specific growth should focus on removing distortions that impede growth in a particular sector. In addition, policymakers should implement policies that will empower the poor and create the conditions that would permit them to move into new as well as existing areas of opportunity, thereby allowing them to better share in the fruits of economic growth. The objectives of such policies should include creating a stable environment and level playing field conducive to private sector investment and broad-based economic growth;

removing the cultural, social, and economic constraints that prevent the poor from making full use of their existing asset base and accessing markets; and increasing the human capital base of the poor through the provision of basic health and education services. Macroeconomic Stability and Economic Growth Broadly speaking, two considerations underlie macroeconomic policy recommendations. First, there needs to be an assessment of the appropriate policy stance to adopt in a given set of circumstances i. Second, there is the choice of specific macroeconomic policy instruments that would be beneficial for a country to adopt e. In practice, these two considerations are closely linked. Adjusting a policy stance is often done via the adoption of a new instrument or the modification of an existing one. These situations can be put into three broad classes: This Section briefly discusses how macroeconomic policies can contribute to stability. For countries that enjoy stable macroeconomic conditions, there is somewhat greater flexibility in the choice of appropriate stance for macroeconomic policy. The central issue for these countries will be to ensure that the financing of their poverty reduction strategies does not jeopardize macroeconomic stability, which will be discussed in the last section of this pamphlet. Sources of Instability There are two main sources of economic instability, namely exogenous shocks and inappropriate policies. For example, many low income countries have a narrow export base, often centered on one or two key commodities. Even diversified economies, however, are routinely hit by exogenous shocks, although, reflecting their greater diversification, shocks usually need to be particularly large or long-lasting to destabilize such an economy. At times, economic crises are the result of both external shocks and poor management. Stabilization In most cases, addressing instability i. However, if the source of instability can be clearly identified as a temporary shock e. Since there is often a considerable degree of uncertainty surrounding such a judgment, it is usually wise to err somewhat on the side of caution by assuming that the shock will largely persist and by basing the corresponding policy response on the appropriate adjustment. In most circumstances where adjustment is necessary, both monetary or exchange rate and fiscal instruments will have to be used. In particular, successful adjustment to a permanent unfavorable shock that worsens the balance of payments will often require a sustained tightening of the fiscal stance, as this is the most immediate and effective way to increase domestic savings and to reduce domestic demandâ€”two objectives typically at the center of stabilization programs. Adjustment policies may contribute to a temporary contraction of economic activity, but this contingency should not be used to argue against implementing adjustment policies altogether, as the alternative may be worse. Attempting to sustain aggregate demand through unsustainable policies will almost certainly aggravate the long-run cost of a shock, and could even fail in the short run to the extent that it undermines confidence. In the long run, greater benefits to the poor are to be had as a result of the restoration of macroeconomic stability. The appropriate policies to protect the poor during adjustment are to maintain, or even increase, social expenditures and to adopt, where feasible, compensatory measures that would insulate or offset temporary adverse impacts to the fullest extent possible. In some cases, a lack of financing will drive the pace of stabilization. Where financing is not a constraint, however, policymakers will need to assess and carefully weigh various factors on a case-by-case basis in choosing the most appropriate pace of stabilization. Elements of Macroeconomic Stability Macroeconomic policies influence and contribute to the attainment of rapid, sustainable economic growth aimed at poverty reduction in a variety of ways. By pursuing sound economic policies, policymakers send clear signals to the private sector. The extent to which policymakers are able to establish a track record of policy implementation will influence private sector confidence, which will, in turn, impact upon investment, economic growth, and poverty outcomes. Prudent macroeconomic policies can result in low and stable inflation. Inflation hurts the poor by lowering growth and by redistributing real incomes and wealth to the detriment of those in society least able to defend their economic interests. High inflation can also introduce high volatility in relative prices and make investment a risky decision. Unless inflation starts at very high levels, rapid disinflation can also have short-run output costs, which need to be weighed against the costs of continuing inflation.

Chapter 3 : Economic policy - Wikipedia

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Outside of macroeconomic theory, these topics are also important to all economic agents including workers, consumers, and producers. Output and income[edit] National output is the total amount of everything a country produces in a given period of time. Everything that is produced and sold generates an equal amount of income. The total output of the economy is measured GDP per person. Output can be measured or it can be viewed from the production side and measured as the total value of final goods and services or the sum of all value added in the economy. Economists interested in long-run increases in output study economic growth. Advances in technology, accumulation of machinery and other capital , and better education and human capital are all factors that lead to increased economic output over time. However, output does not always increase consistently over time. Business cycles can cause short-term drops in output called recessions. Economists look for macroeconomic policies that prevent economies from slipping into recessions and that lead to faster long-term growth. The relationship demonstrates cyclical unemployment. Economic growth leads to a lower unemployment rate. The amount of unemployment in an economy is measured by the unemployment rate, i. The unemployment rate in the labor force only includes workers actively looking for jobs. People who are retired, pursuing education, or discouraged from seeking work by a lack of job prospects are excluded. Unemployment can be generally broken down into several types that are related to different causes. Classical unemployment theory suggests that unemployment occurs when wages are too high for employers to be willing to hire more workers. According to these more recent theories, unemployment results from reduced demand for the goods and services produced through labor and suggest that only in markets where profit margins are very low, and in which the market will not bear a price increase of product or service, will higher wages result in unemployment. Consistent with classical unemployment theory, frictional unemployment occurs when appropriate job vacancies exist for a worker, but the length of time needed to search for and find the job leads to a period of unemployment. Structural unemployment is similar to frictional unemployment as both reflect the problem of matching workers with job vacancies, but structural unemployment also covers the time needed to acquire new skills in addition to the short-term search process. Over the long run, the two series show a close relationship. A general price increase across the entire economy is called inflation. When prices decrease, there is deflation. Economists measure these changes in prices with price indexes. Inflation can occur when an economy becomes overheated and grows too quickly. Similarly, a declining economy can lead to deflation. Raising interest rates or reducing the supply of money in an economy will reduce inflation. Inflation can lead to increased uncertainty and other negative consequences. Deflation can lower economic output. Central bankers try to stabilize prices to protect economies from the negative consequences of price changes. Changes in price level may be the result of several factors. The quantity theory of money holds that changes in price level are directly related to changes in the money supply. Most economists believe that this relationship explains long-run changes in the price level. For example, a decrease in demand due to a recession can lead to lower price levels and deflation. A negative supply shock, such as an oil crisis, lowers aggregate supply and can cause inflation. The AD-AS model has become the standard textbook model for explaining the macroeconomy. The ADâ€"AS diagram can model a variety of macroeconomic phenomena, including inflation. Changes in the non-price level factors or determinants cause changes in aggregate demand and shifts of the entire aggregate demand AD curve. When demand for goods exceeds supply there is an inflationary gap where demand-pull inflation occurs and the AD curve shifts upward to a higher price level. When the economy faces higher costs, cost-push inflation occurs and the AS curve shifts upward to higher price levels. The ISâ€"LM model represents all the combinations of interest rates and output that ensure the equilibrium in the goods and money markets. The Solow model assumes that labor and capital are used at constant rates without the fluctuations in unemployment and capital utilization commonly seen in business cycles. An increase in the savings rate leads to a temporary increase as the economy creates more capital, which adds to output. However, eventually the depreciation rate will limit the expansion of capital: Both forms of policy are used to stabilize the economy , which can mean boosting the economy to the level of GDP consistent with full employment. Monetary policy Central banks implement monetary policy by controlling the money supply through several mechanisms. Typically, central banks take action by issuing money to buy bonds or other assets , which boosts the supply of money and lowers interest rates, or, in the case of contractionary monetary policy, banks sell bonds and take money out of circulation. Usually policy is not implemented by directly targeting the supply of money. Central banks continuously shift the money supply to maintain a targeted fixed interest rate. Some of them allow the interest rate to fluctuate and focus on targeting inflation rates instead. Central banks generally try to achieve high output without letting loose monetary policy that create large amounts of inflation. Conventional monetary policy can be ineffective in situations such as a liquidity trap. When interest rates and inflation are near zero, the central bank cannot loosen monetary policy through conventional means. An example of intervention strategy under different conditions Central banks can use unconventional monetary policy such as quantitative easing to help increase output. Instead of buying government bonds, central banks can implement quantitative easing by buying not only government bonds, but also other assets such as corporate bonds, stocks, and other securities. This allows lower interest rates for a broader class of assets beyond government bonds. In another example of unconventional monetary policy, the United States Federal Reserve recently made an attempt at such a policy with Operation Twist. Unable to lower current interest rates, the Federal Reserve lowered long-term interest rates by buying long-term bonds and selling short-term bonds to create a flat yield curve. Examples of such tools are expenditure , taxes , debt. For example, if the economy is producing less than potential output, government spending can be used to employ idle resources and boost output. Government spending does not have to make up for the entire output gap. There is a multiplier effect that boosts the impact of government spending. For instance, when the government pays for a bridge, the project not only adds the value of the bridge to output, but also allows the bridge workers to increase their consumption and investment, which helps to close the output gap. The effects of fiscal policy can be limited by crowding out. When the government takes on spending projects, it limits the amount of resources available for the private sector to use. Crowding out occurs when government spending simply replaces private sector output instead of adding additional output to the economy. Crowding out also occurs when government spending raises interest rates, which limits investment. Defenders of fiscal stimulus argue that crowding out is not a concern when the economy is depressed, plenty of resources are left idle, and interest rates are low. Automatic stabilizers do not suffer from the policy lags of discretionary fiscal policy. Automatic stabilizers use conventional fiscal mechanisms but take effect as soon as the economy takes a downturn: Comparison[edit] Economists usually favor monetary over fiscal policy because it has two major advantages. First, monetary policy is generally implemented by independent central banks instead of the political institutions that control fiscal policy. Independent central banks are less likely to make decisions based on political motives. Central banks can quickly make and implement decisions while discretionary fiscal policy may take time to pass and even longer to carry out.

Chapter 4 : Economic Policy

Macroeconomics (from the Greek prefix makro-meaning "large" + economics) is a branch of economics dealing with the performance, structure, behavior, and decision-making of an economy as a whole.

There are two major branches of economics: Microeconomics Macroeconomics In short, microeconomics is the study of individual economic units of the economy, while macroeconomics is the study of the economy as a whole and its totality. There are two main schools of economic thoughts. These schools are 1. Classical economics or 2. According to classical economics: An economy as a whole always functions at a level of full employment, due to free play of market forces in a free economy. Supply creates its own demand. This classical doctrine of automatic full employment was largely accepted until the early s, when the Great Depression Occurred. The Great Depression of exploded the myth that an automatic working of market mechanisms would ensure an equilibrium level of income consistent with full employment of resources. There was a persistent fall in the level of output, income, and employment during the Great Depression, even though the United States and other western countries were highly industrialised, with well-developed basic industries, electric power, means of transport and communication, banks, and other financial institutions. The Classicals failed to explain this situation during The Great Depression. Keynes introduced his own theory and wrote his famous book The General Theory of Employment, Interest and Money, which birthed the Keynesian revolution, the second primary school of economic thought. Keynes criticised the Classical assumption of full employment and developed modern macroeconomics: The incentive for development of modern macroeconomics came from the Great Depression of the early s. Macroeconomics addresses the desire to control business cycles in advancing economies and the need to develop backward economies. The Meaning of Macroeconomics Macroeconomics is the study of the aggregates and averages of the entire economy. In microeconomics, we study the individual economic units like a household, a firm, or an industry. However, in macroeconomics we study the whole economic system like national income, total savings and investment, total employment, total demand, total supply, general price level. We study how these aggregates and averages of economy as a whole are determined and what causes fluctuations in them. The aim of the study is to understand the reason for the fluctuations and to ensure the maximum level of employment and income in a country. Microeconomics is the study of individual trees, whereas macroeconomics is the study of forest as a whole. Macroeconomics is also known as the theory of income and employment, since the subject matter of macroeconomics revolves around determination of the level of employment and income. At the time of the Great Depression, government participation through monetary and fiscal measures in the economy increased considerably. Since the study of millions of individual economic units is almost impossible, macroeconomics provided tools for the assessment of economic policy. Macro policies make it possible to control inflation and deflation, and moderate violent booms and recessions. The main functions of macroeconomics are the collection, organising, and analysis of data; determining national income; and formulating appropriate economic policies to maintain economic growth and full employment in a developing country. The scope of macroeconomics include the following theories:

Chapter 5 : The Meaning and Importance of Macroeconomics | Owlcation

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As the term implies, macroeconomics looks at the overall, big picture scenario of the economy. Put simply, it focuses on the way the economy performs as a whole. This includes looking at variables like unemployment, GDP and inflation. The government uses these factors and models to help develop its own economic policies. Through central banks, the government will come up with its fiscal and monetary policies to keep the economy in check. On the other hand, microeconomics looks at the behavior of individual factors in an economy like people, households, industries, etc. The Study of Macroeconomics Those working in the field of macroeconomics study aggregated indicators such as unemployment rates , GDP and price indices, and then analyze how different sectors of the economy relate to one another to understand how the economy functions. Macroeconomists develop models explaining relationships between a variety of factors such as consumption, inflation, savings, investments, international trade and finance, national income and output. Such macroeconomic models, and what the models forecast, are used by government entities to aid in the construction and evaluation of economic policy. Specific Areas of Research Macroeconomics is a rather broad field, but two specific areas of research are representative of this discipline. One area involves the process of understanding the causation and consequences of short-term fluctuations in national income, also known as the business cycle. The other area involves the process by which macroeconomics attempts to understand the factors that determine long-term economic growth , or increases in the national income. Keynes offered an explanation for fallout from the Great Depression , when goods remained unsold and workers unemployed, a feat that left classical economists stumped. This theory evolved throughout the 20th century, diverting into several macroeconomic schools of thought known as Keynesian economics, often referred to as Keynesian theory or Keynesianism. Factors studied in both microeconomics and macroeconomics typically have an influence on one another. For example, the unemployment level in the economy as a whole has an effect on the supply of workers from which a company can hire. Macroeconomics, in its most basic sense, is the branch of economics that deals with the structure, performance, behavior and decision-making of the whole, or aggregate, economy, instead of focusing on individual markets. Meanwhile, microeconomics looks at economic tendencies, or what can happen when individuals make certain choices. Individuals are typically broken down into subgroups, such as buyers, sellers and business owners. These actors interact with the supply and demand for resources, using money and interest rates as a pricing mechanism for coordination.

Chapter 6 : Macroeconomic Policy

Context. Macroeconomics is the branch of economics that deals with the overall functioning of the economy. Macroeconomic policies are critical in shaping the landscape within which factor markets (such as labor and capital) and product markets (such as shoes, cars, or bread) operate.

Financial Definition of macroeconomics What It Is Macroeconomics involves the study of aggregate factors such as employment, inflation , and gross domestic product, and evaluating how they influence the economy as a whole. How It Works The Great Depression and its resulting high unemployment rate greatly influenced the development of macroeconomics. In , John Maynard Keynes published The General Theory of Employment, Interest and Money , which theorized that government spending and tax policies could be used to stabilize economies. The Keynesian school of economic thought argues that an increase in government expenditures or a reduction in taxes will stimulate an economy ; likewise, a reduction in government expenditures or an increase in taxes will constrict an economy and reduce inflation. Although Friedman published several books on a variety of topics, his best-known work is Studies in the Quantity Theory of Money , published in Federal government has both fiscal and monetary tools at its disposal to help regulate the economy. The measures and topics of study most commonly associated with macroeconomics include: Macroeconomics also studies the interrelationships among the factors that shape the economy. Macroeconomics confers considerable importance to the role expectations play in an economy. It studies the effects of anticipated and unanticipated changes, as well as the impact caused when the changes are expected to be temporary versus when they are expected to be permanent. Why It Matters Macroeconomists look for ways to meet economic policy goals and create economic stability. In doing so, they often attempt to predict future levels of employment, inflation , and other key economic indicators. These predictions affect decisions made today by governments, individuals, and companies. It is important to note the distinction between macroeconomics and microeconomics. Whereas Macroeconomics looks at the "big picture," microeconomics delves into the study of supply and demand and factors that impact individual consumer decisions. However, the two are inherently interrelated, as small decisions at the microeconomic level will ultimately have an impact on larger economic factors that influence the entire economy. In the investing world, it behooves everyone to have at least a general familiarity with macroeconomic theory and the current state of the economy. It goes without saying that broad macroeconomic changes will inevitably be felt at both the corporate and the individual level. Furthermore, the markets themselves are often moved by the release of sensitive economic data, such as the latest GDP report or recent employment figures. Often, those most concerned with macroeconomics tend to adopt a top-down approach to investing. Rather than strictly focusing on company fundamentals, top-down investors first attempt to analyze which sectors of the economy are poised to benefit from current economic trends. Only when they have determined the areas with the most favorable economic outlooks do they begin to search for the most promising companies within those particular industries. The underlying rationale behind this philosophy is that even strong companies can struggle if the industry in which they operate is facing a stiff economic headwind. Meanwhile, the weakest firms in a booming industry can still thrive.

Chapter 7 : Macroeconomics and Economic Policy

In short, microeconomics is the study of individual economic units of the economy, while macroeconomics is the study of the economy as a whole and its totality. There are two main schools of economic thoughts. These schools are 1. Classical economics or 2. Keynesian economics. Macroeconomics before.

Fiscal Policy Fiscal Policy refers to the use of the spending levels and tax rates to influence the economy. The governing bodies use combinations of both these policies to achieve the desired economic goals. Thus, the essential tools of fiscal policy are taxing and spending. But as the recession deepened into the Great Depression and no correction occurred, economists realized that a revision in theory would be necessary. John Maynard Keynes developed Keynesian Theory, which called for government intervention to correct economic instability. At the same time, he recommended, it should decrease taxes in order to give households more disposable income with which they can buy more products. Through both methods of fiscal policy, the increase in aggregate demand stimulates firms to increase production, hire workers, and increase household incomes to enable them to buy more. Keynes advocated the opposite positions during times of rapid inflation. It varies from country to country. The individuals who have control over the budget are referred to as the fiscal authority. In the United States, it is held by the executive and legislative branches; whereas in Europe, there are varied models with the power, mostly, lying in the hands of the prime minister or the finance minister and the parliament with the degree of power of either bodies changing through time. Discretionary Fiscal Policy and Automatic Stabilizers The government exercises fiscal policy to prevent economic fluctuations from taking place. When actions are undertaken to minimize economic fluctuations, it is known as discretionary fiscal policy. Discretionary fiscal policy is employed when an increase in unemployment and inflation is observed. They are taxes and transfers that automatically change with changes in economic conditions in a way that dampens economic cycles. For example, at times of economic downturns, the amount of money spent on food stamps automatically rises as more people apply for it or the rules are eased. The additional spending generated by the food stamps helps to soften the downturn for the individuals receiving the help, and also benefits the businesses and employees where the money is spent. The objective of expansionary fiscal policy is to reduce unemployment. However, it can also cause some inflation. On the other hand, the objective of contractionary fiscal policy is to reduce inflation. However, it can also trigger some unemployment. By contrast, fiscal policy is often considered contractionary or tight if it reduces demand via lower spending. Effects of Fiscal Policy The objectives of fiscal policy vary with duration and economy of application. In the short term, governments may focus on macroeconomic stabilization with aims of stimulating an ailing economy, combating rising inflation, or helping reduce external vulnerabilities. In the longer term, the aim may be to foster sustainable growth or reduce poverty with actions on the supply side to improve infrastructure or education. Although these objectives are common among countries, their relative importance differs depending on the country circumstances. In the short term, priorities may reflect the business cycle or response to a natural disaster while in the longer term; the catalysts can be development levels, demographics, or resource endowments. Although they do have a negative effect on private investment, a varied effect on housing prices, lead to a quick fall in stock prices and depreciation of the real effective exchange rate. Reduced taxes have the inverse outcomes as they have positive although lagged effects on GDP and private investment; have a positive effect on both housing and stock prices; and lead to appreciation of the real effective exchange rate. However, putting them into practice is quite a difficult task because of various reasons. Thus, changes in expenditure generally must come from the small part of the budget that includes discretionary spending. This gives the government less leeway for increasing or lowering spending. Another inhibiting factor is working with estimations. When lawmakers put fiscal policies in place, they base their decisions partly on the past behaviors of individuals. It is risky to assume that people will, for example, respond the same way to a tax cut in the future as they have in the past. Although changes in fiscal policy affect the economy, changes take time. By the time the policy takes effect, the economy might be moving in the opposite direction. In these cases, fiscal policy would only add to the new trend, instead of correcting the original problem. The pressure that people in authority experience of pleasing the citizens hinders fiscal policy as well. It requires a coordinated effort from multiple pockets of the government which is very difficult to make happen. In addition, a problem prevalent in one part of the country may not be as troublesome in another or possibly the opposite of that. In addition, in order to be effective, the fiscal policy has to be in coordination with the monetary policies of the central bank as well.

Chapter 8 : Difference between microeconomics and macroeconomics | Economics Help

1. Introduction. Poverty is a multidimensional problem that goes beyond economics to include, among other things, social, political, and cultural issues ().Therefore, solutions to poverty cannot be based exclusively on economic policies, but require a comprehensive set of well-coordinated measures.

Could you differentiate between micro economics and macro economics? Microeconomics is the study of particular markets, and segments of the economy. It looks at issues such as consumer behaviour, individual labour markets, and the theory of firms. Macro economics is the study of the whole economy. Micro economics is concerned with: Supply and demand in individual markets Individual consumer behaviour. Consumer choice theory Individual labour markets â€" e. Reasons for inflation and unemployment. Economic growth Reasons for differences in living standards and economic growth between countries. Government borrowing Moving from Micro to Macro If we look at a simple supply and demand diagram for motor cars. Microeconomics is concerned with issues such as the impact of an increase in demand for cars. This micro economic analysis shows that the increased demand leads to higher price and higher quantity. Macro economic analysis This looks at all goods and services produced in the economy. The macro diagram is looking at Real GDP which is the total amount of output produced in the economy instead of quantity. Instead of the price of a good, we are looking at the overall price level PL for the economy. Instead of just looking at individual demand for cars, we are looking at aggregate demand AD â€" total demand in the economy. Macro diagrams are based on the same principles as micro diagrams; we just look at Real GDP rather than quantity and Inflation rather than Price Level PL The main differences between micro and macro economics Small segment of economy vs whole aggregate economy. Microeconomics works on the principle that markets soon create equilibrium. In macro economics, the economy may be in a state of disequilibrium boom or recession for a longer period. There is little debate about the basic principles of micro-economics. Macro economics is more contentious. There are different schools of macro economics offering different explanations e. Keynesian, Monetarist, Austrian, Real Business cycle e. Macro economics places greater emphasis on empirical data and trying to explain it. Micro economics tends to work from theory first. Differences between microeconomics and macroeconomics The main difference is that micro looks at small segments and macro looks at the whole economy. But, there are other differences. If demand increases faster than supply, this causes price to rise, and firms respond by increasing supply. For a long time, it was assumed that the macro economy behaved in the same way as micro economic analysis. Great Depression and birth of Macroeconomics In the s, economies were clearly not in equilibrium. There was high unemployment, output was below capacity, and there was a state of disequilibrium. Keynes produced his The General Theory of Employment, Interest and Money; this examined why the depression was lasting so long. It examined why we can be in a state of disequilibrium in the macro economy. Keynes observed that we could have a negative output gap disequilibrium in the macro-economy for a prolonged time. For example, Irving Fisher examined the role of debt deflation in explaining the great depression. Since , macroeconomics developed as a separate strand within economics. There have been competing explanations for issues such as inflation, recessions and economic growth. Similarities between microeconomics and macroeconomics Although it is convenient to split up economics into two branches â€" microeconomics and macroeconomics, it is to some extent an artificial divide. Micro principles are used in macro economics. If you study the impact of devaluation, you are likely to use same economic principles, such as the elasticity of demand to changes in price. Micro effects macro economics and vice versa. If we see a rise in oil prices, this will have a significant impact on cost-push inflation. If technology reduces costs, this enables faster economic growth. If house prices rise, this is a micro economic effect for the housing market. But, the housing market is so influential that it could also be considered a macro-economic variable, and will influence monetary policy. There have been efforts to use computer models of household behaviour to predict the impact on the macro economy.

Chapter 9 : Macroeconomics - Wikipedia

American Economic Journal: Economic Policy publishes papers covering a range of topics, the common theme being the role of economic policy in economic outcomes.