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MICROECONOMICS

(Chapter 1 —> 6)

Chapter 1: the foundations of economics

- Microeconomics —>examines the behaviour of individual decision-making units in the economy
  —> uses consumers and firms
- Macroeconomics —> examines the economy as a whole to obtain a broad overall picture
  —> uses aggregates (collections of many individual units)

The four factors of production:
- Land —> all natural resource
- Labour —> the physical and mental effort that people contribute to the production of goods
- Capital —> physical capital —> a man-made factor of production used to produced goods
- Entrepreneurship —> organises the other three factors of production and takes on the risks

Other meanings of capital:
- Physical capital
- Human capital —> skills, abilities and knowledge acquired by people
- Natural capital —> refers to an expanded meaning of the factor of production "land"
- Financial capital —> investments in financial instruments

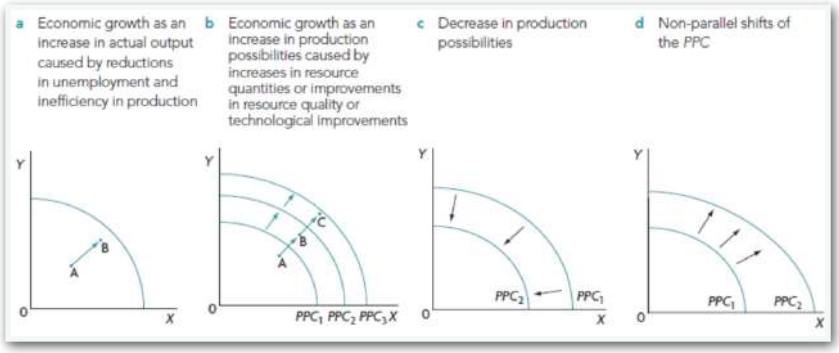
Opportunity cost and scarcity:
- Opportunity cost —> the value of the next best alternative that must be sacrificed for a good
- Scarcity —> resources are finite whereas wants are infinite
- Economics —> the study of choices leading to the best use of scarse resource to best satisfy the unlimited human needs and wants
- Sustainability —> the environment and the economy can produce needs and wants in the future
- Free good —> a good that is not scarce and so has zero opportunity cost
- Economic good —> any good that is scarse and has an opportunity cost bigger than zero

The basic economic questions:
1) What / how much to produce
2) How to produce
3) For whom to produce

- Resource allocation —> assigning resources to specific uses, chosen among many alternatives
- Government intervention changes the allocation of resources

Production Possibilities curve:
- Represents all combinations of the max. amounts of two goods that can be produced by an economy (production possibilities —> points on curve)
- All resources must be fully employed to be on the line
- All resources must be used efficiently

- Because of scarcity the economy cannot produce outside the PPC
- The economy must make a choice on what combination of goods will be produced
- Choices involve opportunity costs



- Economic growth —> increase in the quantity of output produced in an economy over a time
- Actual growth —> caused by a reduction in unemployment and increases in the efficiency of production

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Chapter 2: competitive markets (demand and supply)

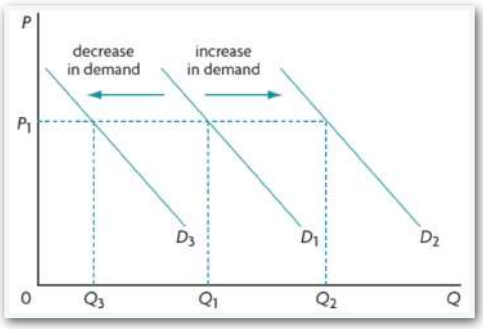
2.1 Introduction to competitive markets

Markets:

- market —> where buyers and sellers of goods, services and resources carry out an exchange
  —> can be local, national and international
  —> goods and services are sold in product markets while resources in factor markets
- Competition —> a process in which rivals compete in order to achieve some objective
- The greater the market power of a firm, the greater is the control over price
- Competitive market —> composed of large numbers of sellers and buyers acting independently
  —> no one individual seller has the ability to control the price of the product
  —> price determined by interactions of many sellers and buyers

2.2 Demand

The law of demand and the demand curve:



- Individual demand —> indicates the various quantities of a good the consumer is willing and able to buy at different possible prices, ceteris paribus
- Law of demand —> negative causal relationship between the price of a good and its quantity demanded (inversely proportional), ceteris paribus
- Market demand —> sum of all individual demands for a good

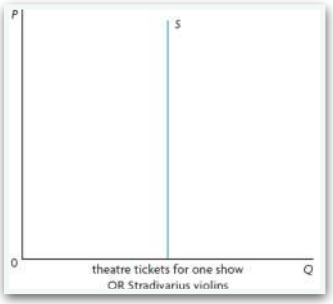
Non-price determinants of demand (shift) + price:

- Non-price determinants of demand —> the variables other than price that can influence demand and bring to a shift of the demand curve to the right or to the left
- Non-price determinants of demand —> income in the case of normal goods
  —> income in the case of inferior goods
  —> Preferences and tastes
  —> Prices of substitute goods
  —> Prices of complementary goods
  —> Number of consumers
- Price —> whenever the price of a good changes, ceteris paribus, it leads to a movement along the demand curve

2.3 Supply

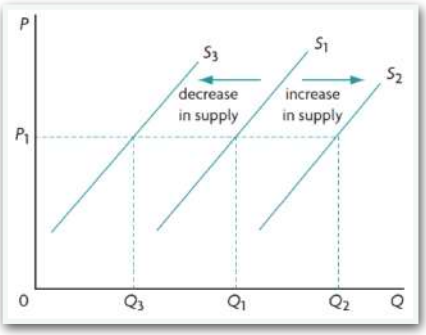
The law of supply and the supply curve:

- Individual supply —> the various quantities of a good a firm is willing and able to produce and supply to the market for sale at different possible prices, ceteris paribus
- Law of supply —> positive causal relationship between the price of a good and its quantity supplied (proportional), ceteris paribus
- Market demand —> sum of all individual supplies for a good
- The vertical supply curve (fixed quantity)
    —> no time to produce more of it
    —> no possibility of ever producing more of it



Non-price determinants of supply (shift) + price:

- Non-price determinants of supply —> the variables other than price that can influence supply and bring to a shift of the supply curve to the right or to the left
- Non-price determinants of supply
    —> Costs of factors of production
    —> Technology
    —> Prices of related goods: competitive supply
    —> Prices of related goods: joint supply
    —> Producer (price) expectation
    —> Taxes or subsidies
    —> Number of firms
    —> Shocks or sudden unpredictable events

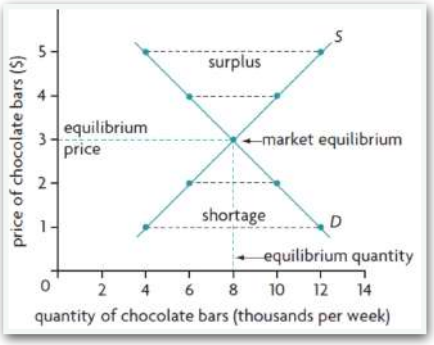


- Price —> whenever the price of a good changes, ceteris paribus, it leads to a movement along the supply curve

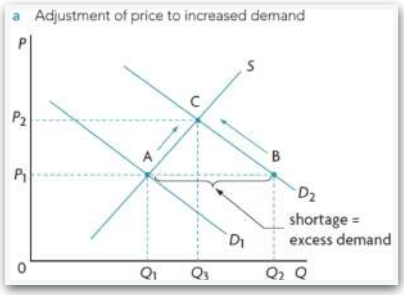
2.4 Competitive Market Equilibrium

Market equilibrium:

- Market equilibrium —> quantity demanded is equal to quantity supplied
- Equilibrium price —> the price at market equilibrium
- Equilibrium quantity —> the quantity at market equilibrium
- Market disequilibrium —> excess in supply or demand which cause the price to change until the market reaches equilibrium
- Excess in demand —> shortages
- Excess in supply —> surplus
- Changes in market equilibrium are due to shifts of the demand and the supply curve

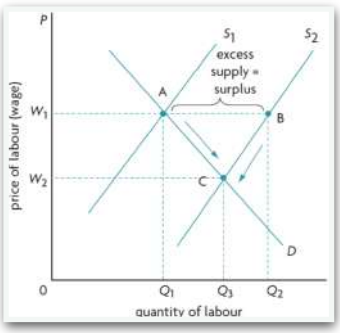


2.5 The role of the price mechanism and market efficiency



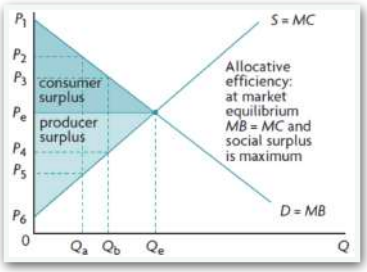
Functions of the price mechanism:

- Signals —> prices communicate information to decision-makers
- Incentives —> prices motivate decision-makers to respond to the information
- Market demand and market supply determine equilibrium prices and quantities for goods
- What to produce —> firms produce only those goods consumers are willing and able to buy
- How to produce —> factors of p. that the firm is willing and able to pay
- Price rationing —> wether or not a consumer will get a good is determined by the price of it
- Non-price rationing —> planned economies or non-price rationing systems



Allocative efficiency in competitive markets:

- Allocative efficiency —> producing the quantity of goods mostly wanted by society
- Marginal benefit —> the extra benefit that you get from each additional unit of something bought
- Demand curve = Marginal benefit curve
- Marginal cost —> the extra cost of one more unit of output
  —> typically increases as units of output produced increase
- MB = MC —> allocative efficiency
- MB > MC —> greater value on the last unit of the good produced than it costs to produce it
- MB < MC —> costing society more to produce the last unit of the good than the value it has



Consumer and Producer surplus:

- Consumer surplus —> the highest price consumers are willing to pay for a good minus the price actually paid (the area)
  —> **(**(P intercept of D curve - P of consumers) * Q purchased) / 2
- Producer surplus —> the price received by firms for selling their good minus the lowest price that they are willing to accept to produce the good (the area)
  —> **(**(P of producers - P intercept of S curve) * Q sold) / 2
- Social/community surplus —> sum of consumer and producer surplus
- Welfare —> the amount of consumer and producer surplus (when MB = MC)
- Governments should intervene because:
  —> efficiency can only arise under a number of very strict and highly unrealistic conditions
  —> competitive market is unable to answer the *for whom question*
  —> to counteract the failing of markets —> helps realise their potential advantages

Chapter 3: Elasticities

The use of percentages for elasticities:

- Independent of units (cars, oranges, …)
- Independent of currencies (different currencies across countries)
- Allows to express elasticities in common terms
- Allows to put responsiveness into perspective

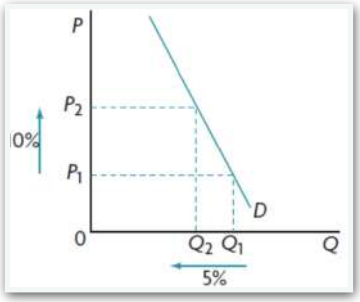
3.1 Price elasticity of demand

Price elasticity of demand:

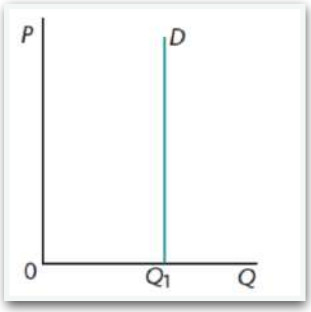
- A measure of the responsiveness of the quantity of a good demanded to changes in its price
- The minus sign is always dropped
- Steeper the demand curve, the less elastic the demand. Flatter the demand curve the more elastic
- Price elastic —> quantity demanded is highly responsive to a change in price
- Price inelastic —> quantity demanded is not very responsive to a change in price
- The formula for PED —> (% change in Quantity)/(% change in Price)
  —> (change in quantity / initial quantity) / (change in price / initial price)

Ranges of value of PED:

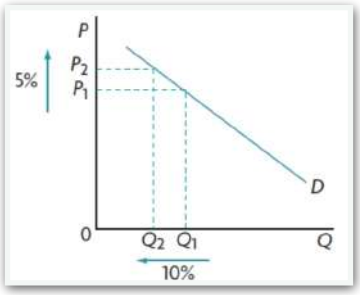
- PED < 1 —> Price inelastic



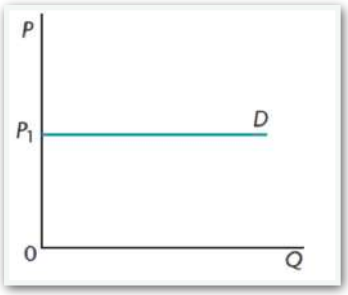
- PED = 0



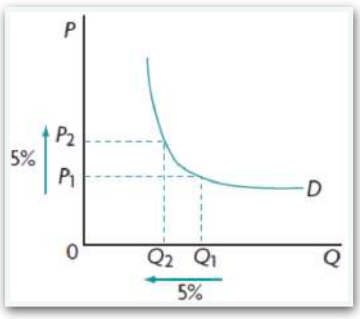
- PED > 1 —> Price elastic



- PED = infinity



- PED = 1 —> Unitary elastic



Determinants of PED:

- Number and closeness of substitutes —> the more substitutes, the more elastic is the demand
  —> the closer the substitute, the greater the elasticity
- Necessities versus luxuries —> the more necessary a good, the less elastic the demand
  —> the greater the degree of addiction, the more inelastic the demand
- Length of time —> the longer the period, the more elastic the demand

PED and total revenue:

- Total revenue —> the amount of money receive by firms when they sell a good (Price * Quantity)
- When PED > 1 —> total revenue increases if there is a price decrease
- When PED < 1 —> total revenue decreases if there is a price decrease
- When PED = 1 —> total revenue remains constant to changes in price

PED and firm pricing decisions and taxes:

- Business must take PED into account when considering changes in the price of their product
- If governments are interested in increasing their tax revenues, they must consider the PED because the lower the PED for the taxed good, the greater the tax revenue.

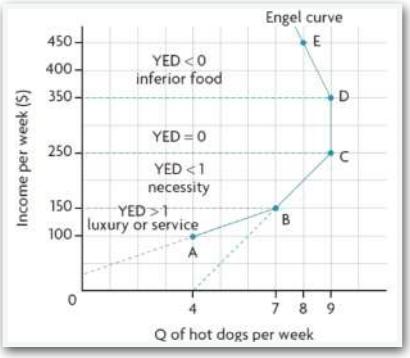
3.2 (YED) income elasticity of demand

Income elasticity of demand:

- A measure of the responsiveness of demand to changes in income, involves demand curve shifts
- Formula for YED —> (change in quantity / initial quantity) / (change in income / initial income)
- YED —> can be both positive or negative

Ranges of value of YED:

- YED > 0 —> normal good
- YED < 0 —> inferior good
- YED < 1 —> Necessities good
- YED > 1 —> Luxuries and services



Engel curve:

- If the lines' projection touches the vertical axis (luxury or service)
- If the lines' projections doesn't touch the vertical axis (necessity)
- At very low incomes a good may be luxury, as income increases it becomes necessity, and at high income level it becomes inferior

3.3 Price elasticity of supply (PES)

Price elasticity of supply:

- PES —> is a measure of the responsiveness of the quantity of a good supplied to changes in price
- Steeper the demand curve, the less elastic the demand. Flatter the demand curve the more elastic

- Price elastic —> quantity supplied is highly responsive to a change in price
- Price inelastic —> quantity supplied is not very responsive to a change in price
- The formula for PES —> (% change in Quantity)/(% change in Price)
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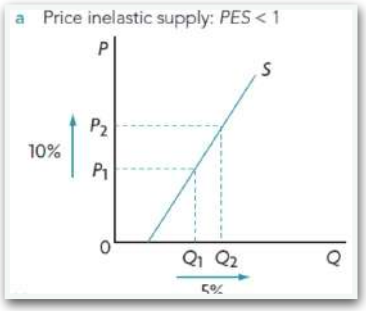
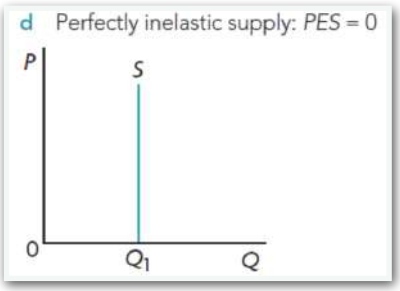
Ranges of value of PES:

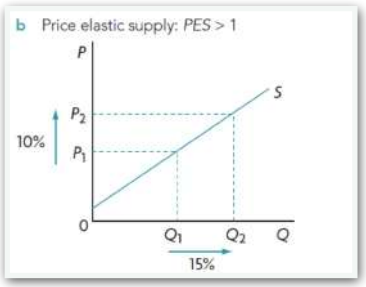
- PES < 1 —> Price inelastic



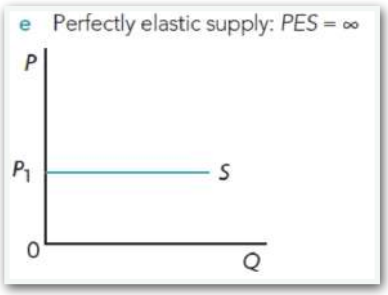
- PES = 0



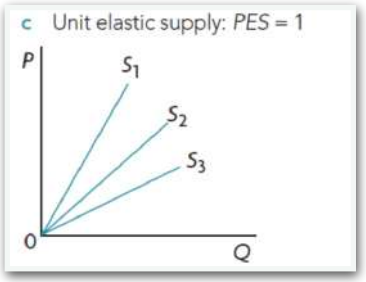
- PES > 1 —> Price elastic



- PES = infinity



- PES = 1 —> Unitary elastic



Determinants of PES:

- Length of time —> over a very short time, the firm may be unable to increase or decrease any of its inputs to change the quantity it produces
- Mobility of factors of production —> the more easily and quickly resources can be shifted out of one line of production and into another, the greater the PES
- Space capacity of firms —> the greater the spare capacity, the higher the PES
- Rate at which costs increase —> if the costs of producing extra output increase rapidly, the supply will be inelastic and viceversa

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Chapter 4: Government intervention in microeconomics

4.1 Government intervention in markets

Why governments intervene in markets:
- Earn revenue for the government —> indirect taxes
- Provide support to firms —> with subsidies, trade protection measures (tariffs, quotas,…)
- Provide support to households on low incomes —> subsidies, price ceilings, direct provision
- Influence the levels of production of firms
- Influence levels of consumption of consumers
- Correct market failure (failures to achieve allocative efficiency in markets)
- Promote equity

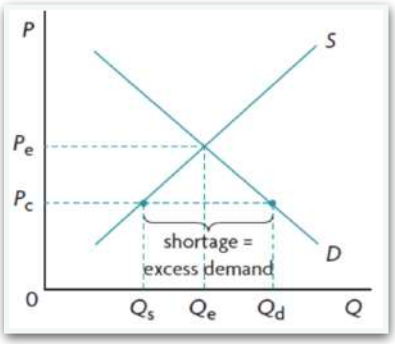
How governments intervene in markets:
- Price controls —> price ceilings and price floors
- Indirect taxes
- Subsidies
- Direct provision of services
- Command and control regulation and legislation
- Consumer nudges

4.2 Price controls

Fixed prices —> prices are fixed at a particular level (ticket prices, …)
Price controls —> the setting of minimum or maximum prices by the government

Price ceilings:
- Legal maximum price set below the equilibrium price, in order to make goods more affordable to people on low incomes
- Used to make certain goods more affordable to people on low incomes

Consequences for markets:
- Shortages
- Non-price rationing of goods and services
- Underground (or parallel) markets
- Underallocation of resources and allocative inefficiency
- Negative welfare impacts

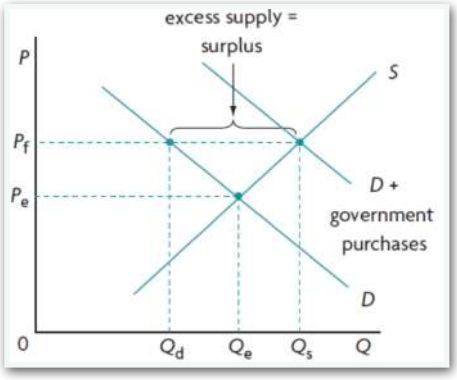


Consequences for stakeholders:
- Consumers —> partly gain and partly lose (some buy at lower price, some can't buy, not enough)
- Producers —> sell a smaller quantity at a lower price
- Workers —> some workers are likely to be fired
- Governments —> may gain political popularity

Price floors:
- A minimum price set below the equilibrium price, in order to provide income support to farmers or to increase the wages of low-skilled workers

Consequences for markets:
- Surpluses —> the government will buy the excess supply generates by price floors
- Government measures to dispose of surpluses —> store it or export the surplus
- Firm inefficiency —> firms with price floors do not face incentives to cut costs
- Overallocation of resources to the production and allocative inefficiency
- Negative welfare impacts

Consequences for stakeholders:
- Consumers —> must now pay a higher price for the good
- Producers —> gain as they receive a higher price and produce a larger quantity
- Workers —> gain as employment increases
- Government —> less government funds to spend on other desirable activities in the economy
- Stakeholders in other countries —> waste of resources



Minimum wages:
- the minimum price of labour that an employer must pay
- Labour surplus and unemployment
- Illegal workers at wages below the minimum wage
- Misallocation of labour resources (they cost more)
- Misallocation in product markets (increase in costs of production)
- Workers —> some gain because higher wage, some lose because they lose their job
- Consumers —> leads to a decrease in supply of products

4.3 indirect taxes

- are imposed on spending to buy goods and services and are paid partly by consumers, but are paid to the government by producers
- Excise taxes —> imposed on particular goods and services (specific taxes —> fixed amount of tax per unit, or ad valorem taxes —> fixed percentage of the price)

Why governments impose indirect taxes:

- Are a source of government revenue
- Are a method to discourage consumption of goods that are harmful for the individual
- Can be used to redistribute income —> can focus on luxury goods
- A method to improve allocation of resources by correcting negative externalities

Consequences of indirect taxes for various stakeholders

- Consumers —> are receiving less of the good and paying more for it
- Producers —> fall in price they receive and fall in the quantity of output they sell
- Government —> positive for the government budget as more revenue
- Workers —> a lower amount of output means that fewer workers will be needed
- Society —> underallocation of resources to the production of the good

4.4 Subsidies

- Refers to assistance by the government to individuals or groups of individuals
- Specific subsidies —> consist in payments by the government to firms

Uses of subsidies:

- Can be used to increase revenues of producers
- Can be used to make certain goods affordable to low-income consumers
- Can be used to encourage production and consumption of goods that are desirable for consumers
- Can be used to support the growth of particular industries in an economy
- Can be used to encourage exports of particular goods
- A method to improve the allocation or resource by correcting positive externalities

Consequences of subsidies for various stakeholders:

- Consumers —> fall in price and increase in quantity
- Producers —> they receive a higher price and produce a larger quantity
- Government —> government's budget is negative as it pays the subsidies
- Workers —> firms are likely to hire more worker to produce the extra output
- Society —> overallocation of resource to the production of a good
- Foreign producers —> negative for producers of other countries as may be unable to compete

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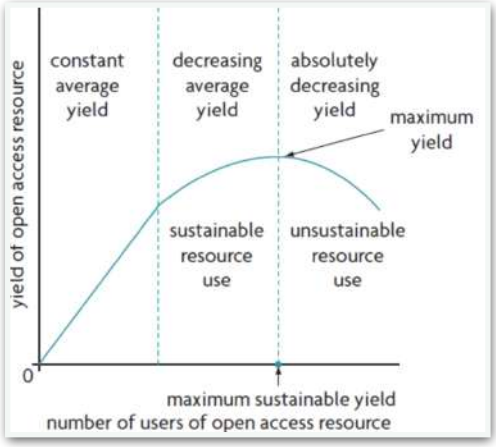
Chapter 5: Common pool resources and negative externalities

5.1 The meaning of common pool resources

Common pool resources:

- Resources not owned by anyone, do not have a price and are available for anyone to use without payment or any other restriction. They are rivalrous and non-excludable
- Rivalrous —> its consumption by one person reduces its availability for someone else
- Excludable —> it is possible to exclude people by using the good or charging a price
- Unsustainable production —> using resources unsustainably, depleting or degrading them
- Non-renewable resources —> resources that do not last indefinitely as they have a finite supply
- Renewable resource —> resources that can last indefinitely if they are managed properly



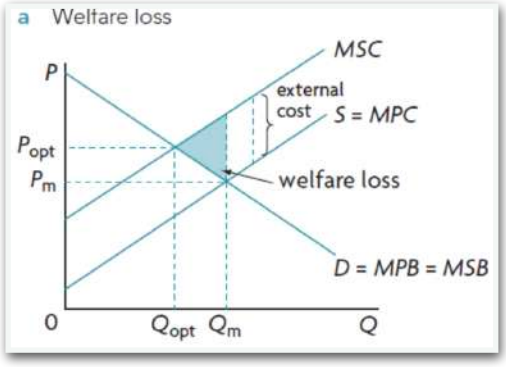
5.2 Diverging private and social benefits and costs

Externalities:

- Occurs when the actions of consumers or producers give rise to negative or positive side-effects on third parties, and whose interest are not considered
- Positive externality —> benefits to third parties
- Negative externality —> negative side-effects to third parties
- Consumption externality when results from consumption activities, and production externalities when results from production activities
- Marginal private cost (MPC) —> the costs to producers of producing one more unit of a good
- Marginal social cost (MSC) —> the costs to society of producing one more unit of a good
- Marginal private benefits (MPB) —> benefits to consumers from consuming one more unit
- Marginal social benefits (MSB) —> benefits to society from consuming one more unit of a good

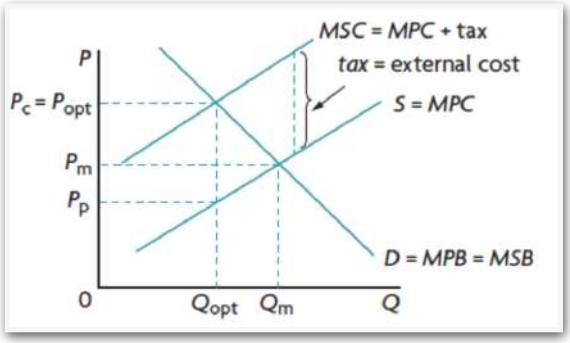
5.3 Negative production externalities

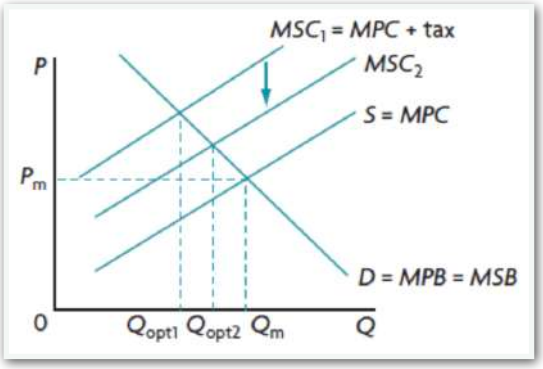
- the external costs created by producers
- It causes a welfare loss, involving a reduction in social benefits due to misallocation of resources
- Qm > Qopt and MSC > MSB



Market-based policies 1 - Indirect (Pigouvian) taxes:

- Work by changing the incentives firms face
- The optimal tax policy is to impose a tax that is exactly equal to the external cost
- In this way the MPC curve shifts upward until it overlaps with the MSC curve





Market-based policies 2 - Carbon taxes

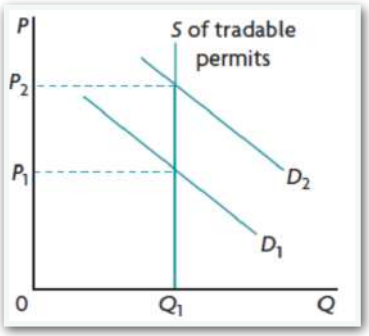
-Is a tax per unit of carbon emissions of fossil fuels

-The more carbon emitted, the higher the tax

-As a result firms switch to alternative, less polluting resources

Market-based policies 3 - Tradable permits:

- A policy involving permits to pollute issued to firms by a government or an international body
- They can be bought and sold among interested firms
- Provide incentives to producers to switch to less polluting resources for which is not necessary to buy permits



Advantages of market-based policies:

- Both taxes and tradable permits have the effect of internalising the externality
- Taxes on pollutants emitted provide incentives to firms to economise on the use of polluting resources and use production methods that pollute less
- Taxation leads to lower pollution levels at a lower overall cost to society

Disadvantages of market-based policies:

- Taxes —> Designing a tax equal in value to the amount of the pollution is very difficult
  - —> Usually set to low to make a significant impact
  - —> What production methods produce pollutants?
  - —> Which pollutants are harmful?
  - —> What is the value of the harm?
  - —> What is the appropriate amount of tax?
  - —> How will consumers be affected?
- Tradable permits —> Face the technical limitations as for taxes
  - —> governments has to set a maximum acceptable level of pollutants “cap”
  - —> Political favouritism may come into play and unlikely to achieve

Government legislation and regulation:

- Legislations and regulations intended to reduce the effects of production externalities and limit environmental damage typically involve emissions standards, quotas, license, …, restrictions
- Maximum level of pollutants permitted
- Install smokestack scrubbers to reduce emissions
- Banning the use of harmful substances

Advantages:

- Simple to put into effect and oversee
- Easier to implement compared to market-based polices and with no technical difficulties
- Quite effective

Disadvantages:

- Do not offer incentives to reduce emission by using alternative fuels
- Pollution is reduced at a higher overall cost
- Lack of sufficient technical information on types and amount of pollutants emitted
- Possible violations, and possible problems with enforcement
- Can only attempt to partially correct the problem

Collective self-governance:

- An approach to manage resources undertaken by communities of resource users by themselves, as they realise that it is in their own best interests to work collectively for the preservation of res.
- Concept by Elinor Ostrom
- Advantages —> people do not always act in the self-interest
  —> solutions can be achieved in the absence of private ownership of resources
- Disadvantages —> people must be able to communicate with each other to create rules
  —> difficult to apply to vast resources such as the oceans

Education and awareness creation:

- Education of the public and provision of information —> firms are forced to take consumers' opinions into consideration and change their production methods to reduce the externality
- Advantages —> firms are very much influenced by the opinions of their costumers
- Disadvantages —> only make a small difference as only on one industry (needed a broader scale)

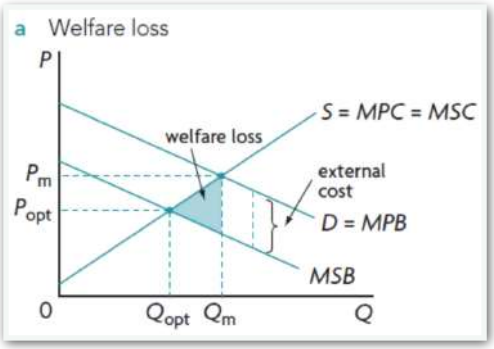
International agreements:

- Co-operation among governments and international agreements are crucial to control and prevent negative consequences on certain resources
- Important as for development and diffusion of new technologies to deal with global environmental issues

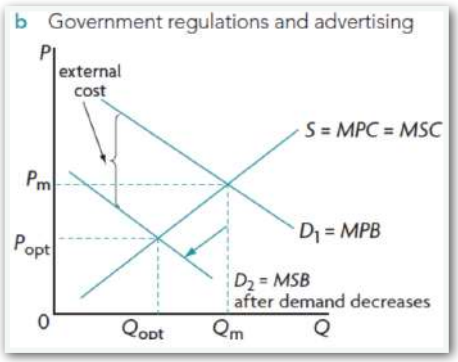
5.4 Negative consumption externalities

- The external costs created by consumers
- There is welfare loss because of the reduction in benefits for society due to the overallocation of resources to the production of the good
- MSC > MSB and Qm > Qopt
- Demerit goods —> goods considered to be undesirable for consumers, but are overprovided by the market (alcohol,…)

Market-based policies:



- Indirect taxes can be imposed on the good whose consumption creates external costs
- When such a tax is imposed, there is a decrease in supply
- The tax therefore permits allocative efficiency to be achieved
- Advantage —> the good that is taxed becomes relatively more expensive so consumption is less
- Disadvantages —> difficulties in measuring the value of the external costs
  —> difficulties involved in trying to asses who and what is affected
  —> some goods have an inelastic demand, so tax won't change consumption



Government legislation and regulation:

-Regulations can be used to prevent or limit consumer activities that impose costs on third parties

-Advantages —> regulation can be very effective —> restricting smoking in public places

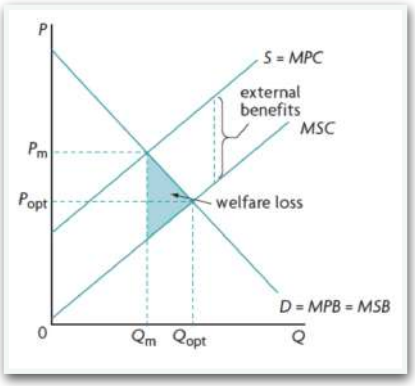
-Disadvantages —> difficult to regulate consumption of certain good such as fuel

Education and awareness-creation:

- Educating the public and creating awareness by the government can be used to try to persuade consumers to buy fewer good with negative externalities
- Advantages —> simpler than other methods
- Disadvantages —> government campaigns founded with tax funds, so less funds available for use elsewhere in the economy

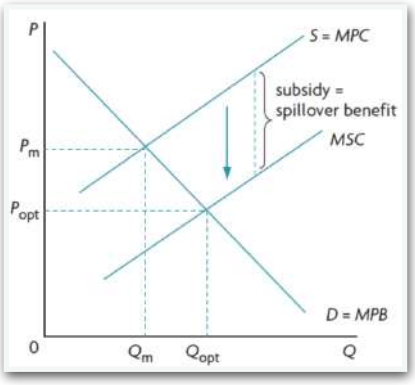
Chapter 6: Positive externalities and public goods

6.1 Positive production externalities



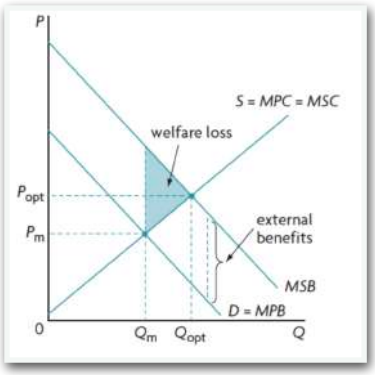
- Refer to external benefits created by producers
- Qm < Qopt and MSC < MSB
- Welfare loss —> the underallocation of resources to the production of a good with a positive production externality leads to welfare loss

Correcting positive production externalities:



- Shifting the MPC curve downward toward the MSC curve
- Quantity produced and consumed must increase to Qopt as price falls to Popt
- **Direct government provision** —> government provides goods and service by itself
- **Subsidies** —> price of good falls from MPC to MSC
- Direct government provision and subsidies have the same outcome

6.2 Positive consumption externalities



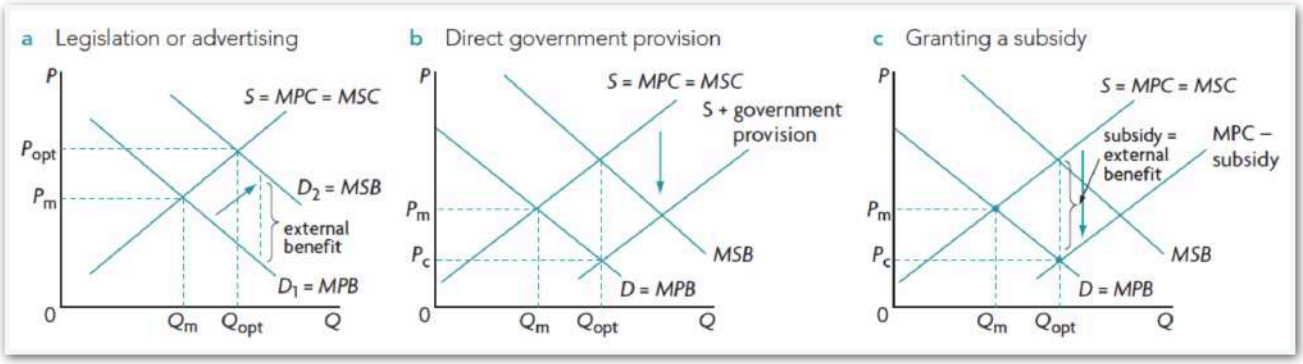
-External benefits are created by consumers
-The free market underallocates resources to the production of the good so too little of it is produced relative to the social optimum
-MPB < MSB and Qm < Qopt
-Loss of welfare due to the underproduction of the good

Merit goods:

- goods that are held to be desirable for consumers, but which are under provided by the market
- Many reasons for which underprovision could happen:
  - The good may have positive externalities —> too little is provided
  - Low levels of income and poverty —> people cannot afford to buy them
  - Consumer ignorance —> people ignorant of the benefits

Correcting positive consumption externalities:

- Government legislation and regulation —> legislation can be used to promote greater consumption of goods with positive externalities (ex. Education)
- Education and awareness creation —> persuade consumers to buy more goods with positive ext.
- Direct government provision —> Government provides certain goods and services (ex. Health)
- Subsidies —> has the same effects as direct government provision
- Problems —> use of government funds (opportunity costs), which goods should be supported and how much, high political nature



6.3 Market failure and public goods

- A public good is non-excludable and non-rivalrous
- Free rider problem —> when people can enjoy the use of a good without paying for it
    - A type of market failure because private firms do not produce these goods so the market fails to allocate resources to their production

Government intervention:

- Direct government provision
- Contracting out to the private sector:
    —> when a gov. makes an agreement with a private firm to carry out an activity
    —> financed out of tax revenues
    —> accompanied by detailed specifications on the activity, so better quality control
    —> provides access to a border range of skills and technology
    —> private firm may be more flexible and innovative than the government
    —> better quality and less costly

    —> gov. becomes less accountable for the public goods it provides
    —> gov. loses control over the services it has contracted out
    —> risk of making a poor contract so higher costs and lower quality
    —> contracting out needs to be monitored by the gov. so adds costs

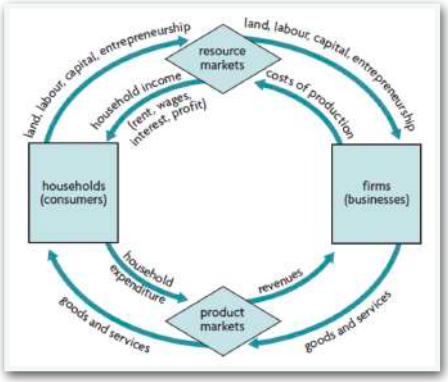
MACROECONOMICS

(Chapter 8 —> 13)

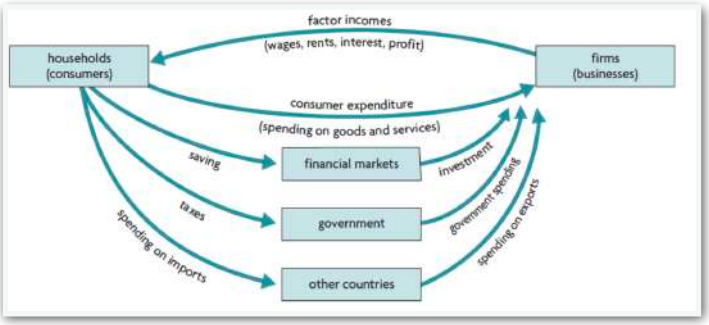
Chapter 8: The level of overall economic activity

8.1 Economic activity

The circular flow of income model:



Adding leakages and injections:



- If leakages are greater than injections, the size of the circular flow becomes smaller —> this results in fewer services purchased, firms cutting back on their output and unemployment
- If injections are larger than leakages, the opposite happens

8.2 / 8.3 Measures of economic activity and calculations

- national income accounting —> an economy's national income or the value of output
- National output —> the output of an economy (aggregate output)
- Knowing this two values allows to —> assess an economy's performance over time
  —> compare income and output performance with others
  —> have a basis for making policies to meet econ. objectives
- GDP —> the market value of all final goods and services produced in a country over a period

Measuring the value of national output

Expenditure approach:

- Measures the total amount of spending to buy final goods and services in a country
- Includes only purchases of final goods + serv. and allows to see contribution of each component
- C + I + G + (X - M) = GDP (Gross domestic product)
- C —> consumption spending —> all purchases by households on final goods and serv. in a year
- I —> investment spending —> spending by firms on capital goods + spending on constructions
- G —> Government spending —> spending by governments within a country
- X - M —> the value of all exports minus the value of all imports of a country

Income approach:

- Adds up all income earned by the factors of production within a country over a time period
- National income —> when all factor incomes are added up
- This approach allows economists to see the relative income shares of the different factors of p. and how these might change over time and across countries

Output approach:

- Measures the value of each good and service produced in the economy over a particular time period and then sums them up to obtain the total value of output produced
- It includes only the value of all final goods and serv. to avoid double counting
- It calculates the value of output by economic sector (agriculture, …) and then adds all up
- This approach provides economists the opportunity to study the performance of each sector

GDP and GNI:

- GNI —> the total income received by the residents of a country, equal to the value of all final goods and services produced by the factors of p. supplied by the country's residents regardless where the factors are located
- GNI —> Gross National Income —> GDP + net income from abroad

Nominal and real:

- Nominal if the measure is in terms of current prices, so not accounting the changes in prices
- Real if the measure of economic activity has eliminated the influence of changes in prices
- It is important to use real values when comparing a variable over time
- Nominal GDP measures the value of current output valued at current prices
- Real GDP measures the value of current output valued at constant (base year) prices

Total and per capita values:

- Per capita —> per person —> useful as a measure of standard of living in a country
- Needed because of —> differing population sizes across countries
  —> population growth

Purchasing Power Parity (PPP):

- Buying power equivalence
- The amount of a country's currency that is needed to buy the same quantity of local goods and services that can be bought with US $1 in the United States
- It makes comparisons across countries far more accurate

GDP deflator:

- Price index —> a measure of average prices in a period relative to average prices in a base year
- Real GDP = (Nominal GDP / price deflator) * 100

8.4 The business cycle

The business cycle:

- Short-term fluctuations in the growth of real output, which are alternating periods of expansion and of contraction
- Expansion —> when there is a positive growth in real GDP
- Peak —> the cycle's maximum real GDP
- Contraction —> when the economy begins to experience falling real GDP
- Trough —> the cycle's minimum level of GDP
- Potential output / GDP —> the output represented by the long-term growth trend
- Natural rate of unemployment —> only when in a point on the long-term growth trend line

Macroeconomic objectives:

- Reducing the intensity of expansions and contractions to make output gaps as small as possible
- Increasing the steepness of the line representing potential output to achieve a more rapid economic growth over long periods of time

8.5 National income statistics and alternative measures

Accuracy of national income statistics: (GDP and GNI)

- Do not include non-marketed output (which is likely to be far greater in developing countries compared to developed ones)
- Do not include output sold in underground (parallel) markets
- Do not take into account quality improvements in goods and services. Technological advances often permit improved products to be sold at a lower price giving benefits to consumers
- Do not account for the value of negative externalities such as pollution and toxic wastes
- Do not take into account the depletion of natural resources used to produce the output
- May not take into account differing domestic price levels (PPP)

Measure of economic well-being measuring issue: (GDP and GNI)

- Make no distinctions about the composition of output (not taking into account the degree to which they contribute to standards of living (military, …))
- Cannot reflect achievements in levels of education, health and life expectancy
- Provide no information on the distribution of income and output only of the average
- Do not take into account increased leisure —> average number of hours worked per week
- Do not account for quality of life factors —> non-economic factors (crime rate, stress levels, well-functioning institutions, …)

Alternative measures of well-being

OECD Better Life Index:

- It is based on a number of factors that the member countries themselves selected as factors that make better life
- Purpose —> provide a more accurate representation of well-being and form the basis of policies intended to improve the quality of life and well-being more generally

Happiness Index:

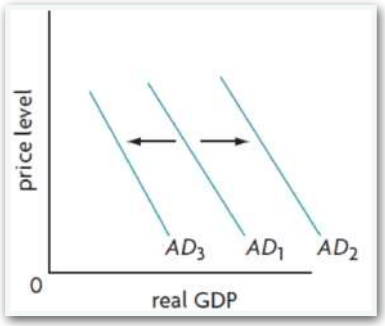
- Tries to address the interdependent economic, social and env. challenges faced by the world
- Based on —> Real GDP per capita, social support, healthy life expectancy, freedom to make life choices, generosity and perceptions of corruption
- Happiness is difficult to quantify and measure making this ranking less reliable for comparisons

Happy Planet Index:

- A measure of sustainable well-being
- HPI = (Life expectancy * well-being * inequality of outcomes) / ecological footprint

Chapter 9: Aggregate demand and supply

9.1 AD and the AD curve



- Aggregate demand —> the total quantity of aggregate output, or real GDP, that all buyers in an economy want to buy at different possible price levels, ceteris paribus
- It consists of all components of GDP

Causes of changes in consumption spending:

- Changes in consumer confidence —> the more optimistic consumers are about their future the more they will spend
- Changes in interest rates —> because some consumer spending is financed by borrowing, and the lower the interest rate, the more consumers will spend
- Changes in wealth —> wealth is the value of assets that people own. The more people feel wealthier, the more consumer spending
- Changes in income taxes —> the lower the income taxes, the higher the disposable income
- Changes in the level of household indebtedness —> the lower the level of dept, the higher the spending by consumers
- Expectations of future price levels —> if lower prices expected in future, spending is postponed

Causes of changes in investment spending:

- Changes in business confidence —> the more optimistic firms are about their future sales and economic activity, the higher the investment
- Changes in interest rates —> decreasing in interest rates lowers costs of borrowing, making firms able to invest more money
- Changes (improvements) in technology —> they stimulate investment spending
- Changes in business taxes —> firms profits after taxes fall, therefore decreasing investment
- Level of corporate indebtedness —> high levels of dept will make the firm less willing to invest
- Legal / institutional changes —> increasing access to credit and securing property rights would result in increases in investment spending

Causes of changes in government spending:

- Changes in political priorities
- Changes in economic priorities —> gov. can use its own spending to influence AD

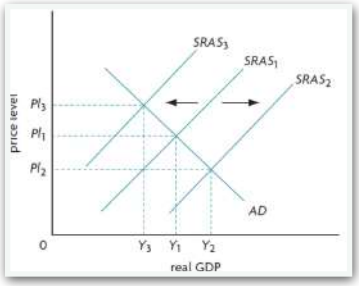
Causes of changes in X / M spending:

- Changes in national income abroad
- Changes in exchange rates
- Changes in trade policies, or the level of trade protection

9.2 Short-run AS and equilibrium in AD-AS

- Aggregate supply —> the total quantity of goods and services produced in an economy over a particular time period at different price levels
- Short-run AS (SRAS) —> shows the relationship between the price level and the quantity of real output produced by firms when resource prices (especially wages) do not change

Causes of shift of SRAS curve:



- Changes in wages
- Changes in non-labour resource prices
- Changes in indirect taxes
- Changes in subsidies offered to businesses
- Supply shocks such as wars and violent conflicts

- In the AD-AS model, the equilibrium level of output occurs where AD intersects with AS

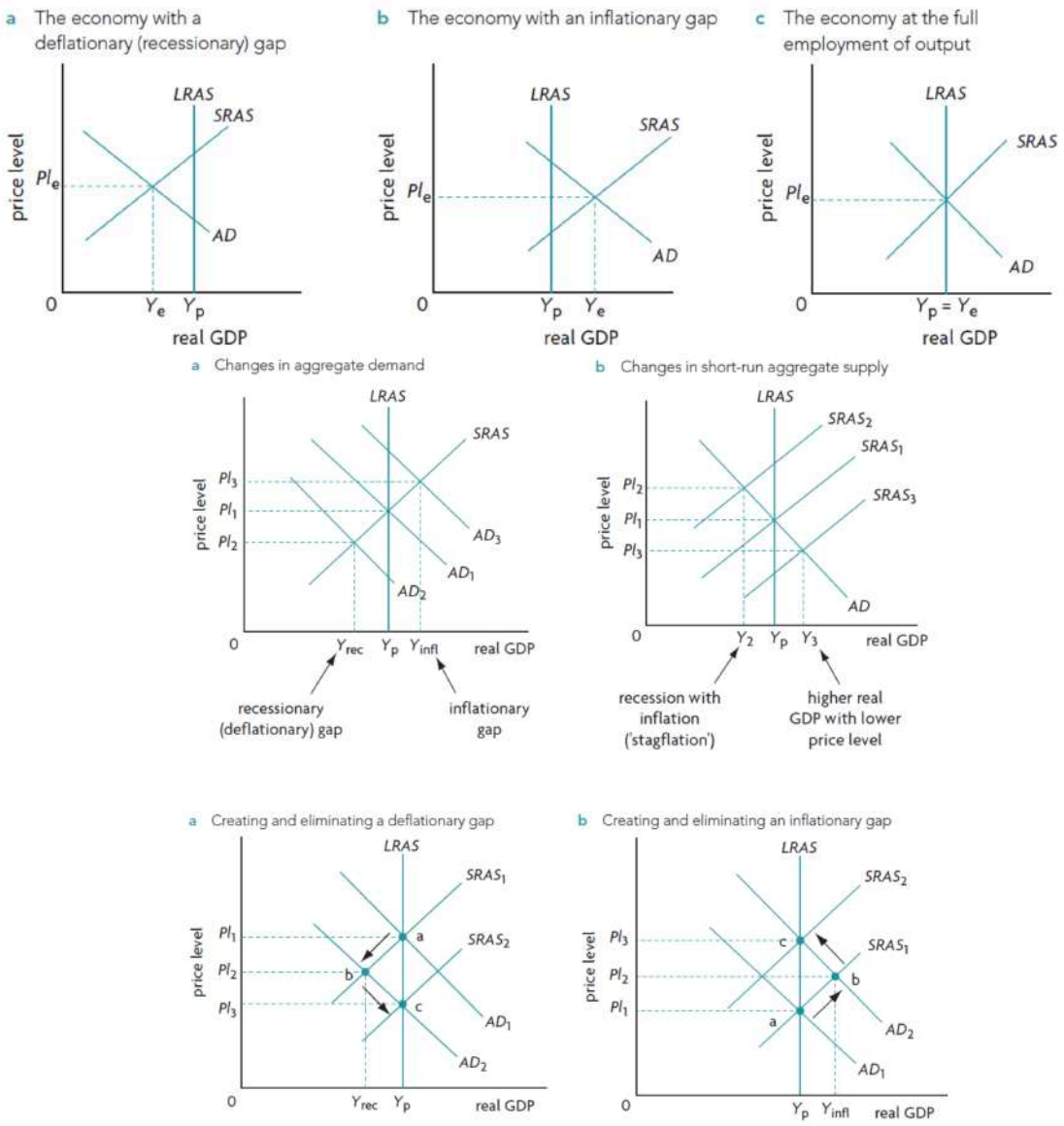
9.3 Long-run AS and equilibrium

The monetarist / new classical model:

- Importance of the price mechanism in co-ordinating economic activities
- Concept of competitive market equilibrium
- The economy as a harmonious system that automatically tends towards full employment
- The LRAS curve is vertical at the full employment level of output
- Long-run equilibrium occurs when the SRAS and AD curves intersect on the LRAS curve
- LRAS curve is vertical because with constant real costs, firms' profits are also constant, and firms no longer have any incentive to increase or decrease their output levels
- Governments should try to make markets work as freely as possible, to let it adjust alone

Short-run equilibrium:

- Deflationary gap —> unemployment is greater than the natural rate of unemployment
  —> not enough total demand in the economy to make it worthwhile for firms to produce potential GDP, so requiring less labour
- Inflationary gap —> real GDP is > than potential GDP and unemp. is less than the natural rate
  —> to much total demand in the economy and firm produce a greater quantity
- Full employment of output —> real GDP = potential GDP
  —> unemp. is = to the natural rate and no deflation or inflation gap
- The economy has a built-in tendency towards full employment equilibrium

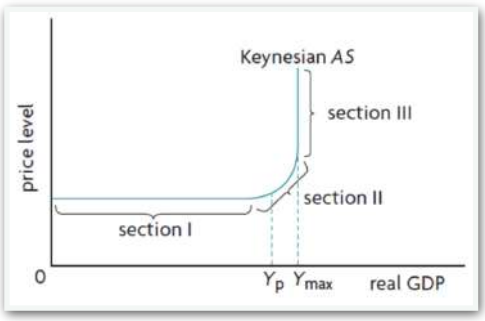


9.4 AS and equilibrium in the Keynesian model

- Inflexible wages and prices in the downward direction mean that the economy cannot move into the long run when experiencing a deflationary gap (can be seen in the Keynesian AS curve)
- If wages and prices do not fall easily, this means the economy may get stuck in the short run
- The gov. must intervene in the economy with policies to help it come out of deflationary gap

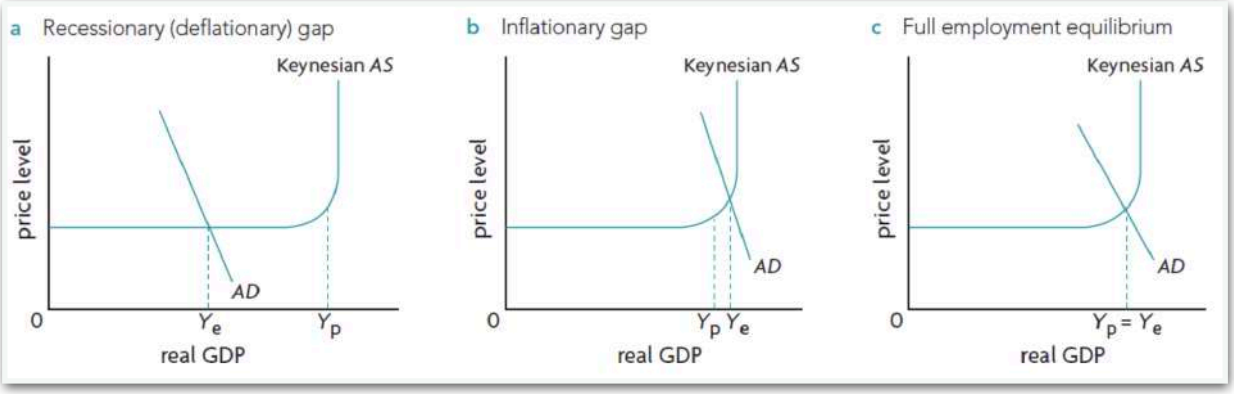
Keynesian AS curve:

- Section I —> real GDP is low —> a lot of unemployment of resources and scarce capacities
- Section II —> real GDP increases with the price levels and output increases, so increasing also employment of resources
- Section III —> real GDP reaches a level beyond which it cannot increase anymore —> firms are using the max. amount of labour and all other resources in the economy



The three equilibrium states:

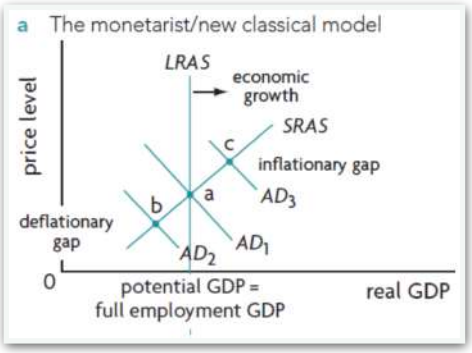
- The economy in the Keynesian model can remain indefinitely stuck in a deflationary gap
- Increases in AD does not necessarily result in increases in the price level

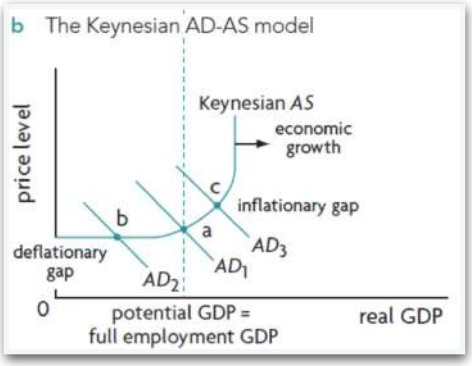


9.5 Shifting AS curve over the long term

Influences on AS over the long term:

- Increases in quantities of the factors of production
- Improvements in the quality of factors of production
- Improvements in technology
- Increases in efficiency
- Institutional changes —> how efficiently resources are used
- Reductions in the natural rate of unemployment





Chapter 10: Macroeconomic objectives I

10.1 Low unemployment

Unemployment:

- Unemployment —> people of working age actively looking for a job but who are unemployed
- Labour force —> the number of people employed + the number of people of working age who are unemployed
- Measured in two ways —> numerical —> total number of unemployed people in the economy
  —> unemp. rate —> (number of unemployed / labour force) x 100

Difficulties in measuring unemployment:

- Official statistics underestimate true employment because of hidden unemployment
  —> discouraged workers who gave up looking for a job are not excluded
  —> do not make a distinction between full-time and part-time employment
  —> do not make a distinction on the type of work done
  —> do not consider people on retraining programmes and early retired people
- Official statistics may overestimate true unemployment because of:
  —> do not include people working in the underground economy
- A disadvantage of this calculation is that it is an average over the entire population —> for this reason the calculation is done on different population groups in a society (region, gender, age …)

Costs of unemployment:

Economic costs:

- A loss of real output (real GDP)
- A loss of income for unemployed workers
- A loss of tax revenue for the government —> larger budget deficit or smaller budget surplus
- Costs to the government of unemployment benefits
- Costs to the government od dealing with social problems resulting from unemployment
- More unequal distribution of income
- Unemployed people may have difficulties finding work in the future (lose the skills)

Personal and social costs:

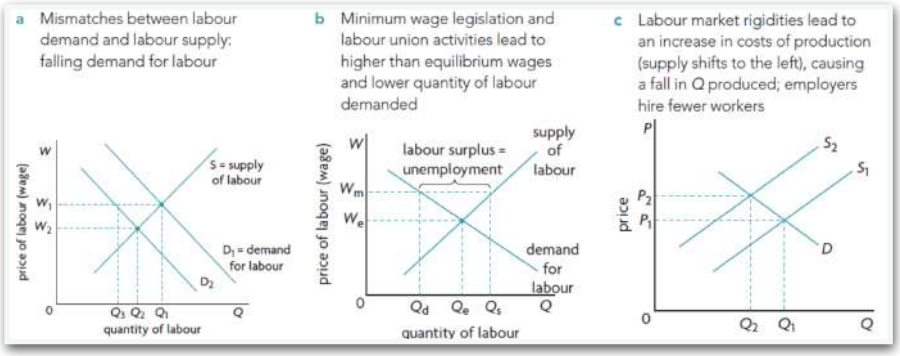
- Personal problems —> indebtedness and loss of self-esteem
- Greater social problems —> increased crime and violence, drug use and homelessness
- Arising levels of poverty

Types and causes of unemployment:

- Natural rate of unemployment —> the sum of Structural, Frictional and seasonal unemployment

Structural unemployment:

- Caused by changes in demand for particular labour skills
- Caused by changes in the geographical location of jobs —> firms may move …
- Caused by labour market rigidities —> factors preventing the forces of supply and demand from operating in the labour market
  —> minimum wage legislation
  —> labour union activities and wage bargaining
  —> employment protection laws
  —> generous unemployment benefits



Frictional unemployment:

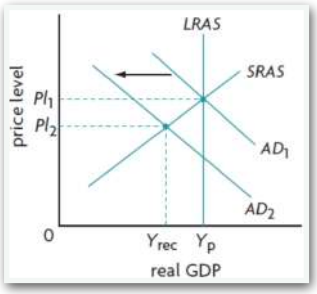
- Occurs when workers are between jobs —> have been fired, are in search of a better job or
- Tends to be short term —> does not involve a lack of skills that are in demand

Seasonal unemployment:

- Occurs when the demand for labour in certain industries changes on a seasonal basis because of variations in needs

Cyclical unemployment:

- Occurs during the downturns of the business cycle in a deflationary gap
- The downturn arises from low aggregate demand (demand-deficit unemployment)

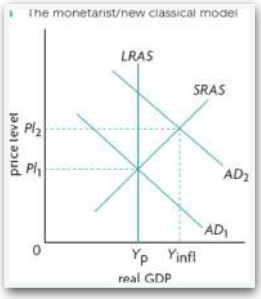


10.2 Low and stable rate of inflation

- Inflation —> a sustained increase in the general price level
- Inflation indicates that prices of goods and services are increasing on average
- Deflation —> a sustained decrease in the general price level
- Disinflation —> a decrease in the rate of inflation
- Consumer price index —> a measure of cost of living for the typical household —> compares the value of a basket of goods and services in one year with the value of a base year
  —> ((Final value of A- initial value of A) / initial value of A) x 100
- Real income —> (nominal income / CPI) x 100

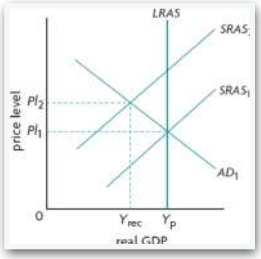
Problems with CPI:

- Different rates of inflation for different income earners
- Different rates of inflation depending on regional and cultural factors
- Changes in consumption patterns due to consumer substitutions when relative prices change
- Changes in consumption patterns due to increasing use of discount stores and sales —> prices are lower than those indicated in the CPI calculations
- International comparisons —> types of goods included, weights used and methods of calculation
- Changes in consumption patters due to introduction of new products
- Changes in product quality
- Comparability over time —> revising CPI baskets and changing the base year



Causes of inflation:

- Demand-pull inflation —> increases in aggregate demand shift right of AD)
- Cost-pull inflation —> increases in costs of production or shocks (AS to left)



Impact of inflation:

Negative impacted by inflation:

- People who receive fixed income or wages
- People who receive income that increase less rapidly than the rate of inflation
- Holders of cash
- Savers —> interest rates must be greater than inflation
- Lenders —> (lend money to people) —> money will lose a bit of its value over time

Positive impacted by inflation:

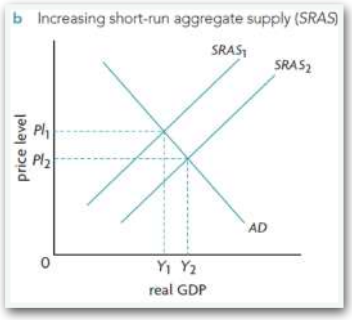
- Borrowers
- Payers of fixed incomes or wages
- Payers of incomes or wages that increase less rapidly than the rate of inflation

- Uncertainty —> cannot predict future changes in purchasing power —> fewer investments
- Savers —> lowered incentive to save money
- Export —> become more expensive to foreign buyers and imports become cheaper —> ability to compete with foreign centuries is reduced
- Economic growth —> lowered economic growth for the country
- Resource allocation —> prices rise rapidly so the signalling and incentive functions not effective
- Social and personal costs are unequally distributed —> poor people more affected by inflation

Hyperinflation:

- When there are very high rates of inflation
- Results from very significant increases in the supply of money
- Inflationary spiral —> inflation sets in motion a series of events that worsen inflation
- A low and stable rate of inflation between 2-3% if preferred overall

Causes of deflation:



- Deflation occurs very rarely because:
  —> wages of workers do not ordinarily fall
  —> large oligopolistic firms may fear price wars
- It is caused by decreases in AD and increases in AS

Costs of deflation:

- Falling price levels —> individuals on fixed incomes, holders of cash, savers and lenders gain
  —> borrowers and payers of individuals with fixed incomes lose
- Increases in real value of debt
- Uncertainty —> firms unable to forecast their costs and revenues due to declining price levels
- Deferred consumption —> consumers postpone spending —> deflationary spiral
- Risk of bankruptcies and a financial crisis
- Inefficient resource allocation —> signalling and incentive functions are not effective
- Policy ineffectiveness —> people won't be willing to spend

- Exports may increase as prices will be lower —> not enough to sustain all other negative effects

10.3 The relationship between unemployment and inflation

- An increase of one percentage point in unemployment lowers well-being nearly six times more than a one percentage point increase in inflation
- Misery index —> the sum of the unemployment rate and the inflation rate of a country
  —> the higher the index, the greater the misery of a population
  —> does not distinguish between the separate effects of unemployment and inflation on the well-being of the population

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Chapter 11: Macroeconomic objectives II

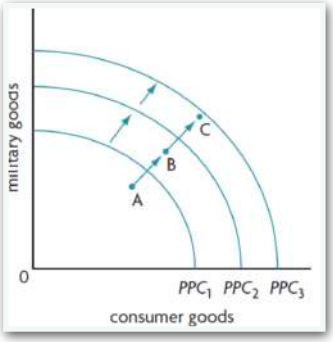
11.1 Economic growth

Economic growth:

- Refers to an increase in real GDP, or the real quantity of goods and services produced over a period of time
- Percentage change in real GDP or in real GDP *per capita*
- % change in real GDP = ((final value of real GDP - initial value of real GDP)/initial value) x 100
- % change in real GDP per capita = % change in real GDP - % change in population

Short term growth vs long term growth:

- Economic growth occurs as a result of:
  - —> increases in aggregate demand (short-term growth)
  - —> increases in short-run aggregate supply (short-term growth)
  - —> increases in long-run aggregate supply (long-term growth)
- In the Keynesian model, short-term growth does not involve an increase in potential output
- Short-term growth is affected far more by increases in aggregate demand rather than in short-run aggregate supply
- Short-term growth is shown in the expansion phase of the business cycle
- Usually long term growth needs an extended period of time to take effect



	***AD-AS* model**	***PPC* model**
Short-term growth	• increases in *AD* • increases in *SRAS* (less important)	• reduction in unemployment • improvement in efficiency
Long-term growth	• increased resource quantity • improved resource quality • technological change	
	• improvements in efficiency • institutional changes	–

Why economic growth occurs:

- Increase in the quantity and improvements in the quality of physical capita, due to investments
- Increased quantities of labour are unlikely to be a source of economic growth over long periods, but improvements in the quality of labour effects greatly economic growth
- Marketable commodities (minerals, metals, ecological resources, …) can contribute to growth but are not essential
- Common pool resources are crucially important to long-term growth —> as ability of countries to maintain them

Impact of economic growth on living standards:

- Greater potential for people to increase their consumption of goods and services, and improve their standards of living —> require policies to make effective use of the resources available
- Distribution of income —> greater income going to poorer household means greater living stand.
- Household spending —> greater income spent on food, education, health is greater living stand.
- Share of income controlled by women —> the greater, the stronger the impact
- Government spending on merit goods —> budget allocated to areas such as education or health
- Contributions by non-gov. organisations —> poverty oriented that reach more poor people

Impact of economic growth on the environment:

1) Some environmental damage is irreversible
2) Growth justifies government inaction on the environment
3) Growth is not bad for the environment but how it is pursued
4) Growth based on unsustainable resources use may threaten future growth

To pursue growth ecofriendily:

—> governments implement market-based policies that internalise the externality
—> Governments pursue more env. regulations that encourage pollution-free tech. change
—> Increased emphasis on human capital in production (which is pollution-free)
—> increased emphasis on green investments
—> changes in the structure of the economy towards more pollution-free services

Inappropriate gov. policies:

—> introduction of capital-using technologies (labour-saving)
—> low levels of government investment in human capital
—> services and infrastructure to urban areas ignoring rural sector with most people
—> concentrating investments in rich people and ignoring the urban slums

11.3 Potential conflict between macroeconomic objectives

Demand-pull inflation and economic growth:

- In the Keynesian model —> as long as AD increases along horizontal part of AS curve —> economic growth with no inflation —> no conflict between low inflation and growth
- New classical model —> when in a deflationary gap, increases in AD result in both growth and increase in price level —> possible conflict

Cost-push inflation and economic growth:

- Caused by decreases in SRAS due to factors such as high prices of factors of production
- Stagflation —> negative economic growth (not possible to have positive growth in cost-push)

Chapter 12: Economics of inequality and poverty

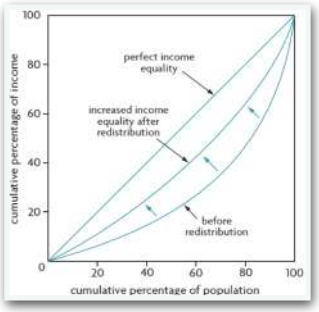
12.1 Inequality

Economic inequality:

- Refers to the degree that people in a pop. differ in their ability to satisfy their economic needs
- It results mainly from differences in income and wealth
- Income inequality —> differences in how evenly income is distributed in a population
  —> income includes interest from saving, bonds and share in stock markets
- Wealth inequality —> arises from differences in the amount of wealth people own

Measurements of economic inequality:

- Income is distributed in a quintiles of the population (20% of the whole)



Lorenz curve:

- Is used to show the degree of income inequality in an economy
- The closer a Lorenz curve is to the diagonal representing perfect income equality, the greater is the equality in income distribution

Gini coefficient:

- Is a summary measure of the information contained in the Lorenz curve of an economy
- (Area between diagonal and Lorenz curve / Entire area under diagonal)
- Has a value between 0 and 1
- The closer the value to 1 the greater the income inequality

Wealth inequality:

- The Lorenz curve and the Gini coefficient can be used in the same way to show wealth inequality
- Reasons behind greater wealth inequality:
  —> Limited growth in wages makes it difficult for low-income people to accumulate wealth
  —> High-income people consume a smaller fraction of their income —> can save more
  —> Income and wealth inequalities feed on each other

12.2 Poverty

- Refers to an inability to satisfy minimum consumption needs
- Absolute poverty —> a situation where a person does not have enough income to meet basic human needs

- Poverty line —> minimum income level before absolute poverty
- World bank poverty lines —> living on less than 1.90 $ a day is extreme poverty
  —> living on less than 3.20 $ a day for lower-middle income countries
  —> living on less than 5.50 $ a day for upper-middle income countries

- Relative poverty —> compares the income of individuals in a society with median incomes
- Poverty rates differ widely among social groups in a society
- Measures for absolute and relative poverty are useful to governments as guides to policies providing income support as well as measures intended to combat poverty

Minimum income standards (MIS):

- Method to measure poverty
- Consists of ongoing research on what people in a population believe are the essentials for a minimum acceptable standard of living that allows people to participate in society
- It calculates the minimum income that is required for different family types to be able to buy the essentials in the basket
- This measure reveals info on —> number of people living under minimum income
  —> the relative contribution of each item in the basket
  —> how these factors change over time

Composite indicators:

- Measures of complex phenomena that cannot easily be described by a single indicator
- Multidimensional poverty index (MPI) —> measures poverty in three dimensions —> health, education and living standards —> each dimension is intended to reflect deprivations
- MPI of the world bank —> as noted by the bank, the standard monetary measure of poverty does not capture important aspects of well-being, such as access to health care or a secure community

Difficulties in measuring poverty:

- Poverty has different meaning and different approaches to measurement
- Measurement problems —> do not take wealth or savings into consideration
  —> in some cases poverty is measured based on household surveys
  —> is subjective
  —> do not include homeless people
  —> freelance work or income from investments not included
- Overestimation or underestimation of the national poverty line

12.3 Causes of economic inequality and poverty

Causes of inequality:

- Circumstances that affect life opportunities and are beyond one's control include:
  —> parents' level of education, occupation and income
  —> place of birth
  —> gender
  —> race and ethnicity

- Different levels of human capital —> differences in skills, education and good health possessed
- Different levels of resource owned —> some people inherit, or accumulate through savings from high incomes, financial capital or other forms of property which gives both income and wealth
- Discrimination —> some social groups often face discrimination in the job market, with the result that they may receive lower wages or may find greater difficulty finding work
- Unequal status and power —> people in positions of power may sometimes use this to influence government policies favouring their own interests, rather than policies favouring redistribution
- Government tax and benefits policies —> people on low income must often rely heavily on transfer payments and social services and merit goods provided by the government
  —> tax policies that favour the rich and do not favour redistribution of income
- Technological change —> it has eliminated some jobs by replacing human labour with machines
- Globalisation —> economic integration on a global scale —> foreign direct investment involves greater demand for skilled rather than unskilled workers + economies may offshore certain jobs
- Market-based supply-side policies —> such as discouraging trade unions and reducing bargaining power of labour, or reducing the minimum wage
- Increases in pay of certain occupations —> certain occupations increased much more than others
- Unemployment —> if long-term then an individual is more likely to become poor
- Geography —> people may live in remote regions with limited possibilities for employment
- Age —> older people may receive pensions that are barely enough to cover minimum needs
- Poverty —> low incomes leads to low human capital, and so further low income

12.4 Impacts of income and wealth inequality

Economic growth:

- Greater inequality lowers growth by reducing the ability of lower income people to invest
- Children of low-income families are likely to also have low incomes in future
- Savings of wealthy people often leave the country (reduces resources available domestically)
- Income and wealth in a few hands results in significant political control —> influence policies
- Significant political control by the rich may result in less government provision of merit goods
- Improved income distribution increases the demand for locally produced goods and services —> encourages local production and promotes local employment and investment
- High income inequality means that the poor are unable to obtain credit so can't make investments
- High income inequality leads to social dissatisfaction, unrest and political instability

Low living standards:

- Lack of access to health care and education
- Higher infant, child and maternal mortality
- Higher levels of preventable diseases
- Social problems (crime rates, drug use, …)
- Inability to realise one's full potential —> waste of human capital

Social and political instability:

- High income and wealth inequalities create societies that are polarised and divided —> different interests created so interactions between groups are difficult
- The groups at the top begin to have a stronger political influence
- Rise in sense of dissatisfaction

12.5 Policies to reduce income and wealth inequalities and poverty

Taxation:

- It can lower inequalities by taking more taxes from the rich than from the poor
- Are the most important source of government revenues
- Divided in two types —> direct taxes and indirect taxes

Direct taxes:

- Taxes paid directly to the government tax authorities by the taxpayer
- Personal income taxes —> taxes paid by individuals on all forms of income
- Corporate income taxes —> taxes on the profits of corporations
- Wealth taxes —> taxes on ownership of assets (property taxes or inheritance taxes)

Indirect taxes:

- Taxes on spending on goods and services
- General expenditure taxes —> VAT for Europe and sales taxes for USA
- Excise taxes —> taxes paid on specific goods and services such as cigarettes and petrol
- Customs duties (tariffs) —> tax applied on imports of foreign goods into a country
  —> it keeps imports out of the country and it raises tax revenue
- Indirect taxes are inconsistent with the objective of a more equal distribution of income

Taxation types:

- Proportional —> as income increases, the tax rate remains constant
- Progressive —> as income increases, the tax rate increases
- Regressive —> as income increases, the tax rate decreases

Evaluating taxes as a policy for redistribution:

Transfer payments:

- Payments made by the government to individuals specifically for the purpose of redistributing income away from certain groups and towards other groups (vulnerable groups)
- Conditional cash transfers if they are granted with conditions to meet certain requirements
- They use a big part of the government budget and create incentives for people not to work

Targeted gov. spending:

- Governments spend to provide merit goods that are under provided by the market
- Uses tax revenue to provide the good in larger quantities and at very low or zero prices

Universal basic income:

- A method intended to provide residents in a country with a sum of money that they would receive regardless of any other income they may have

Polivies to reduce discrimination:

- Countries around the world usually have legislation that forbids discrimination in the workplace
- It is essential to ensure that discrimination does not occur

Government intervention in markets:

- Minimum wage legislation —> sets a legal minimum wage
- Price controls such as food price ceilings or price floors for farmers

- 25% of redistribution occurs through the tax system while 75% occurs through benefits

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Chapter 13: Demand-side and supply-side policies

13.1 Macroeconomic policies

Demand-side policies:

- Also called demand management —> focus on changing AD to achieve macroeconomic goals
- Try to counteract the effects of short-term fluctuations in real GDP and bring full employment level of real GDP, or potential GDP
- Two types of stabilisation policies —> either monetary policies or fiscal policies —> try to minimise the short-run fluctuations of the business cycle

Supply-side policies:

- Focus on the production and supply side of the economy (specifically the LRAS curve)
- Aim to increase potential output and achieve long-term economic growth
- Focus on increasing the quantity and quality of factors of production (LRAS curve factors)
- Two major categories of supply-side policies:
  —> market-based (rely on the working of the market)
  —> interventionist (rely on government intervention)

13.2 Demand management and monetary policy

The role of central banks:

- Monetary policy is carried out by the central bank of each country
- Commercial banks are financial institutions whose main functions are to hold deposits for their costumers, loans, transfer funds and to buy government funds —> cannot be central banks
- Are responsible for: —> Banker to the government (as commercial banks for costumers)
  —> Banker to commercial banks —> holds deposits for them and for loans
  —> Regulator of commercial banks —> regulates and supervises them
  —> Monetary policy —> controls the supply of money and interest rates
- It has a degree of independence from government interference in the pursuit of monetary policy

The goals of monetary policy:

- Low and stable inflation
- Low unemployment (specifically cyclical unemployment)
- Reduce business cycle fluctuations
- Promote a stable economic environment for long-term growth —> needed to be able to plan and carry out economic activities
- External balance —> country's revenues from exports are balanced by spending on imports over an extended period of time

Inflation targeting:

- The public announcement of medium-term numerical targets for inflation with an institutional commitment by the monetary authority to achieve these targets
- Between 1.5% and 2.5% usually
- Advantages —> achievement of a low and stable rate of inflation
  —> improved ability of economic decision-maker to anticipate future inflation
  —> greater co-ordination between monetary and fiscal policy
- Disadvantages —> reduced ability of the central bank to pursue macroeconomic objectives
  —> conflict between a low rate of inflation and low unemployment
  —> reduced ability of CB to respond to supply-side policies —> leads to cost-push inflation and stagflation
  —> a too low inflation target may lead to higher unemployment
  —> a too high inflation target may lead to problems resulting from high inflation

Real vs Nominal interest rates:

- Real interest rate = nominal interest rate - rate of inflation

The role of monetary policy:

- The point of changing the money supply and changing interest rates is ultimately to influence AD
- Changes in interest rates affect —> Investments and consumption in the GDP
- Higher interest rates —> lower spending so AD to the left
- Lower interest rates —> higher spending so AD to the right
- Expansionary monetary policy —> An increase in the money supply by the central bank
  —> aim to expand AD and the level of economic activity
  —> easy money policy
- Contractionary monetary policy —> A decrease in the money supply by the central bank
  —> aim to contract AD and the economy
  —> tight money policy
- Ratchet effect —> the price level moves up when there is an increase in AD and then remains at the same level until there is a further increase in AD

Evaluating monetary policies:

Strengths:

- Interest rate changes can be incremental
- Interest rates changes are reversible
- Monetary policy is flexible
- Relatively short time lags (time delays)
- Central bank independence
- Limited political constraints (no changes in government budget)
- No crowding out

Constraints:

- Possible ineffectiveness in recession —> rates cannot fall when approaching zero
  —> low consumer and producer confidence
  —> banks may be fearful of lending
- Conflict between government objectives
- May be inflationary
- Problematic when dealing with stagflation or cost-push inflation as they are supply-side issues

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13.3 Demand management and fiscal policy

The government budget:

- Type of plan of a country's revenues and expenditures over a period of time (usually one year) that the government makes to plan its activities
- Sources of gov. revenue —> taxes of all types
  —> from the sale of goods and services
  —> from the sale of government-owned assets or properties
- Types of gov. Expenditures:
  —> Current expenditures —> spending on day-to-day items that are recurring (wages, …)
  —> Capital expenditures —> include public investments or spending to produce physical capital (roads, airports, …)
  —> Transfer payments —> payments to vulnerable groups (for income redistribution)

Goals of fiscal policy:

- Refer to manipulations by the gov. of its own expenditures and taxes to influence AD
- Can affect G, C and I components of the GDP
- Equitable distribution of income
- Low and stable rate of inflation
- Low unemployment
- Reduce business cycle fluctuations
- Promote a stable economic environment for long-term growth
- External balance (Imports - Exports)

Expansionary fiscal policy:

- Increasing government spending
- Decreasing personal income taxes
- Decreasing business taxes (taxes on profits)
- Combination of the above

Contractionary fiscal policy:

- Decreasing government spending
- Increasing personal income taxes
- Increasing business taxes
- Combination of the above

Evaluating fiscal policy:

Strengths:
- Pulling an economy out of a deep recession
- Ability to target sectors of the economy
- Direct impact of government spending on AD
- Dealing with rapid and escalating inflation
- Ability to affect potential output

Constraints:
- Problems of time lags —> problem must be recognised, appropriate policy must be decided, policy takes effect in the economy
- Political constraints —> as numerous political pressures
- Sustainable dept
- In a recession, tax cuts may not be effective in increasing AD
- Inability to "fine tune" the economy —> cannot be used to reach a precise target as general
- May be inflationary —> if it lasts to long
- Unable to deal with cost push inflation or stagflation as it is a demand-side policy

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13.6 Supply-side policies

Goals of supply-side policies:
- Promote long-term growth by increasing the productive capacity of the economy
- Improve competition and efficiency
- Reduce costs of labour and reduce unemployment through greater labour market flexibility
- Increase incentives of firms to invest in innovation by lowering costs of production
- Reduce inflation to improve international competitiveness

Market-based supply-side policies:

Encouraging competition:
- Privatisation —> increases efficiency due to improved management and operation of private
- Deregulation —> elimination or reduction of government regulation of private sector activities
- Contracting out to the private sector
- Anti-monopoly regulation —> assures fair competition
- Trade liberalisation

Labour market reforms:
- Abolishing minimum wage legislation
- Weakening the power of labour unions
- Reducing unemployment benefits
- Reducing job security (against being fired)

Incentive-related policies:
- Lowering personal income taxes
- Lowering taxes on capital gains and interest income
- Lowering business taxes

Strengths:
- Improved resource allocation
- May not burden the government budget
- Ability to create employment
- Ability to reduce inflationary pressure (LRAS to right)

Constraints:
- Time lags as effects over the long term
- Possible unfavourable impact on unemployment (competition may increase unemployment)
- Possible negative effects on equity
- Negative impact on the government budget (policies in the form of tax cuts)
- Possible interference of vested interests (strong personal interests) —> oppose and may prevent the policies from being implemented
- Possible negative effects on the environment

Interventionist supply-side policies:

- Presuppose that the free market economy alone cannot achieve the desired results in terms of increasing potential output —> so gov. intervention is required
- Investment in human capital —> training and education
  —> improved health care services and access to these
- Investment in new technology —> research and development
  —> results in new or improved capital goods
  —> gov. usually provides incentives to firms for this
- Investment in infrastructure —> can lead to more efficient transport of goods …
- Industrial policies —> gov. policies designed to support the growth of the industrial sector
  —> Support for small and medium-sized enterprises of firms (SMEs)
  —> tax exemptions, grants, low-interest loans and business guidance
  —> support for infant industries (as SMEs but also protection against exports)

Strengths:

- Direct support of sectors important for growth
- Ability to create employment
  —> enabling workers to acquire the skills…
  —> providing assistance to workers to relocate
  —> providing info that reduces unemployment when workers are between jobs/season
- Potential ability to reduce inflationary pressure —> by increasing potential output
- Possible positive effects on equity —> skilled workers are more likely to be employed and be an active and productive part of the society

Constraints:

- Time lags —> time needed is long
- Negative impact on the government budget as heavily based on gov. spending

Overlaps between demand-side and supply-side policies:

- Interventionist supply-side policies involve an increase in government spending —> more AD
- Market-based supply-side policies encourage firms to invest more in R&D —> it is an investment so leads to an increase in AD

- Demand-side policies can contribute to long-term growth of potential GDP by providing a stable macroeconomic environment
- Fiscal policies —> gov. spending for provision of physical capital improves also quality of goods
  —> gov. spending for instruction also improves the quality of the labour force
  —> lower business taxes also promote technological innovations
- Monetary policies —> a fall in interest rates encourages more spending by firms on capital goods, so increasing their quantity —> this affects potential output

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THE GLOBAL ECONOMY

(Chapter 14 —> 20)

Chapter 14: International trade Part I

14.1 The benefits of international trade

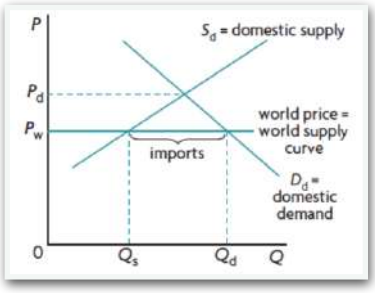
- Free trade —> the absence of gov. intervention of any kind in international trade (no barriers, …)

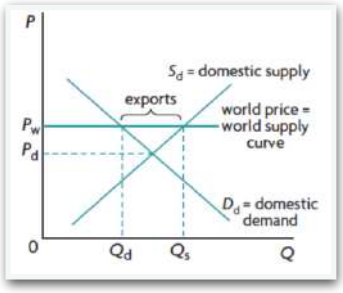
Benefits:

- Increased competition
- Greater efficiency in production
- Lower prices for consumers
- Greater choice for consumers
- Acquiring needed resources —> need for their domestic production a variety of natural resources or capital goods that are not available domestically
- Source of foreign exchange —> acquiring foreign exchange from exports —> < ability to import
- Access to larger markets —> world market
- Economies of scale in production —> access to larger markets allows firms to grow beyond the limits of national boundaries —> produce more output and take advantage of economies of scale
- Increases in domestic production and consumption as a result of specialisation —> countries concentrate production on one or a few goods and services
- More efficient allocation of resources —> due to specialisation
- Trade makes possible the flow of new ideas and technology
- Trade makes countries interdependent —> reduced possibility of hostilities and violences
- Trade as an "engine for growth" —> contribute to increases in domestic output, so growth

Export or import:

- Autarky (self-sufficiency) —> self-sufficient country in all the goods it produces and consumes
- Export —> if the domestic price of the good without trade is lower than the world price
- Import —> if the domestic prices of the good without trade is higher than the world price



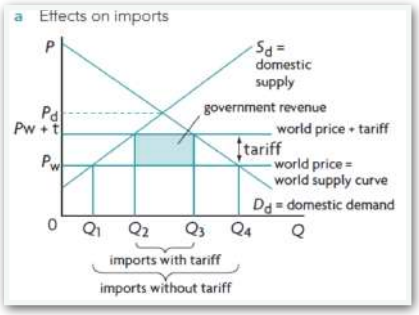


14.3 Types of trade protection

- Trade protection —> involves gov. intervention in international trade through the imposition of trade restrictions (barriers), to prevent the free entry of imports into a country
- To protect the domestic economy (domestic firms and their workers) from foreign competition

Tariffs:

- "Custom duties" —> most common form of trade restriction —> are taxes on imported goods
- Protective tariff —> protect a domestic industry from foreign competition
- Revenue tariff —> raise revenue for the government
- Effects on the economy are the same

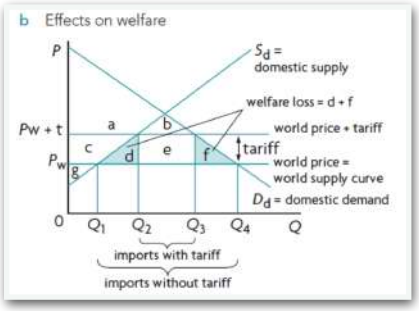


Winners:

- Domestic producers —> producers surplus increases
- Domestic employment in the protected industry increases
- The government gains tariff revenues

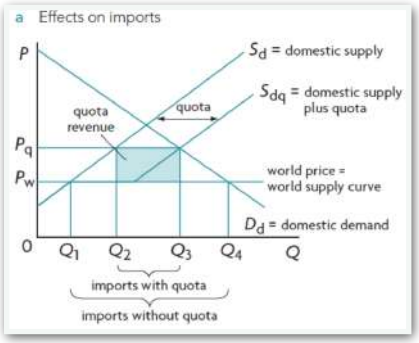
Losers:

- Domestic consumers —> consumer surplus drops
- Domestic income distribution worsens —> is a type of regressive tax as people on lower incomes proportionately pay more than people on higher incomes
- Increased inefficiency in production
- Foreign producers are worse off
- Global misallocation of resource results



Import quotas:

- Legal limit to quantity of a good that can be imported over a particular time period —> effects of quotas are similar to effects of tariffs, except that they do not create revenue for the gov.



Winners:

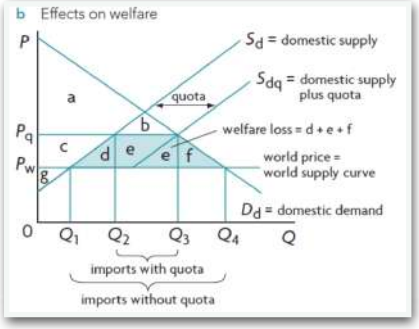
- Domestic producers —> greater producer surplus
- Domestic employment increases

Neutral impact:

- The gov. neither gains nor loses —> import licenses to foreign govs.

Losers:

- Domestic consumers —> loss of consumer surplus
- Domestic income distribution —> result in a higher price
- Increased inefficiency in production
- The exporting countries may be worse off or better off —> as they gain the quota revenues
- Global misallocation of resources



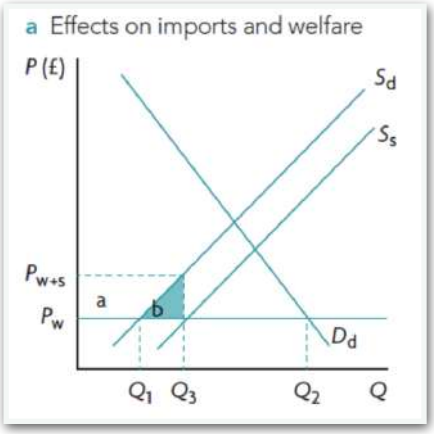
Production subsidies:

- Payments per unit of output granted by the gov. to domestic firms that compete with imports
- Are granted on goods that are produced for the domestic market —> entire quantity produced is sold domestically

Winners:
- Domestic producers —> loss of producer surplus as gov. has to pay
- Domestic employment increases

Neutral:
- Consumers are not affected

Losers:
- The government budget
- Taxpayers are worse off
- Increased inefficiency in production
- Exporting countries
- Global misallocation of resources

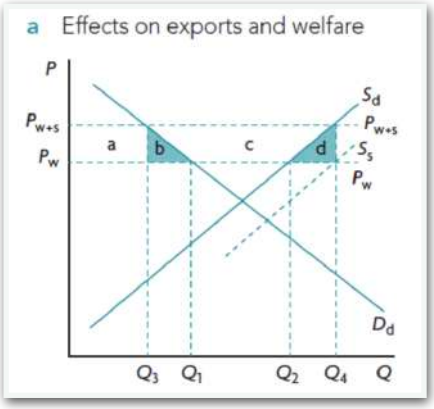


Export subsidies:

- Similar to production subsidies, but is a subsidy paid for each unit of the good that is exported

Winners:
- Producers —> loss of producer surplus as gov. has to pay
- Domestic employment increases

Losers:
- Consumers —> loss of consumer surplus
- Negative effect on the government budget
- Taxpayers are worse off
- Domestic income distribution worsens (increased price for them)
- Exporting countries are worse off
- Increase in global misallocation of resources



Administrative barriers:

- Whenever a good is imported form another country, it must go through a number of customs procedures (inspections, valuation, …) —> are time-consuming, costly and difficult
- Importing countries can impose requirements that imported goods must follow —> quantity of imports is reduced

Chapter 15: International trade Part II

15.1 Arguments for and against trade protection

Arguments for trade protection:

Infant industry argument:
- Infant industry —> is a new domestic industry that has not had time to establish itself and achieve efficiencies in production —> is unable to compete with more mature competitor firms
- They will need protection from imports until they grow —> to high cost of p. at the beginning
- Introduced in 1791 by Alexander Hamilton —> first UA secretary of the treasury
- A country may have a comparative advantage in the production of a particular industrial good, but can't specialise in it unless it first receives some protection
- The gov. must know which industries have the potential to become low cost producers, they could lead to inefficiency as no more a strong competition, and may be a to long protection

National security:
- Certain industries are essential for national defence (weapons, chemicals and minerals) —> should be protected so that country is self-sufficient
- In times of war the country should not have to depend on imports for its defence
- Excuse could be used by industries that have an indirect use in defence (steel) to have protection
- Decisions should be made on political and military —> not economic

Health, safety and environmental standards:
- Countries maintain health, … standards that all imported products must meet before they are allowed to enter —> may be used as a form of hidden protection to keep certain goods out

Efforts of a developing country to diversify:
- Diversification —> change involving greater variety
- Economically least developed countries (ELDCs) —> highly specialised in producing and exporting only few primary commodities —> can be dangerous
- Trade protection policies to keep out imports of goods they would like to produce domestically
- Gov. may not know which products are more appropriate to protect and positive diversification

Arguments which are questionable:

Anti-dumping:
- Dumping —> selling a good in international markets at a price below the cost of producing it
- Is illegal according to international agreements
- If a country suspects that a trading partner is practising dumping it has the right to impose tariffs or quotas —> to limit imports of subsidised or duped goods —> anti-dumping
- Govs. may use it as an excuse to offer protection to their domestic producers even if unjustified

Unfair competition:

- Practices that countries may use in order to gain a competitive advantage over other countries in order to unfairly increase their exports at the expense of other countries
- Countries use those reasons to impose protectionist measure even if not justifiable
- Dumping
- Subsidies to reduce costs of production
- Administrative barriers or hidden protection
- Undervaluing currencies —> exports are more competitive in foreign markets
- Violation of intellectual property —> ideas, trade secrets, inventions, …

Correcting a balance of payments deficit:

- When the outflow of money from a country is greater than the inflow
- Trade protection is a solution as a short-term emergency measure if there is a serious deficit
- Other solutions on the long-term even though

Tariffs as a source of government revenue:

- Frequent in developing countries —> even half or more of all gov. revenues
- Easy to tax imports —> goods that must pass though borders where they can be monitored
- Govs. may rely on tariff revenues as an excuse to delay tax system reforms
- Should be temporary and gradually phased out as countries grow and develop

Protection of domestic jobs:

- Restrictions on imports are needed to protect domestic employment
- If an industry uses imported inputs with restrictions, they will pay a higher price —> higher costs of production and so higher unemployment in the domestic country
- Unemployments increases in the countries that are forced to export less

Impact on stakeholders	Tariffs	Quotas	Production subsidies	Export subsidies	Administrative barriers
Producers	gain	gain	gain	gain	gain
Workers	gain	gain	gain	gain	gain
Government	gain	neutral	lose	lose	neutral
Taxpayers	neutral	neutral	lose	lose	neutral
Consumers	lose	lose	neutral	lose	lose
Domestic society Producer efficiency	lose	lose	lose	lose	lose
Domestic society Income distribution	lose	lose	neutral	lose	lose
Domestic society Resource allocation	lose	lose	lose	lose	lose
Foreign producers	lose	lose	lose	lose	lose
Global society Resource allocation	lose	lose	lose	lose	lose

15.2 Economic integration: trading blocs

- Economic integration —> economic co-operation between countries and co-ordination fo their economic policies —> increased economic links between them
- Countries expect to derive benefits from this
- Begins from agreements between countries to reduce or eliminate trade and other barriers between them + extend co-operation (on labour policies, the environment, monetary, …)

Trade agreements:

Preferential trade agreements (PTA):
- Agreement between two or more countries to lower trade barriers on particular products in trade
- Trade barriers remain on the rest of the products, and on imports from non-member countries
- Sometime involve co-operation between members on other issues (labour standards, env., …)
- Several forms —> free trade areas, customs unions or common markets
  —> bilateral or regional (several countries)

Bilateral, regional and multilateral trade agreements:
- Bilateral TA —> agreement between two countries
- Multilateral TA —> agreement between many countries —> World Trade Organisation
- Regional TA —> agreement between a group of countries that are within a geographical region
- All promote trade liberalisation
- WTO —> aim to reduce trade barriers —> fundamental principle is non-discrimination —> a country cannot impose higher barriers on imports from one country and lower ones from another

Trading blocs:

- A group of countries that have agree to reduce tariff and other barriers to trade to encourage free trade and co-operation between them

Free trade area agreement:
- Countries agree to gradually eliminate trade barriers between themselves
- The most common type of integration area
- Problem —> a product may be improved into the FTA by a country that has the lowest external trade barriers and then sold to countries within the FTA that have higher external trade barriers
- NAFTA (north American), ASEAN (Association of southeast asian nations), …

Customs union:
- Countries that fulfil the requirements of FTA + adopt a common policy towards all non-members
- Involves a higher degree of economic integration than an FTA

- Have the advantage that they avoid having to create complicated rules of origin for imports
- Problem —> coordination on policies toward non-members must be met
- CEFTA —> central European free trad agreement

Common market:

- Countries that have formed a customs union proceed further to eliminate any remaining tariffs in trade between them —> they agree to eliminate all restrictions on movements of any factors of p.
- Enjoy free trade and all its advantages
- Workers are free to move and work in any member country without restrictions
- Capital can flow from country to country without restrictions
- Result in better use of capital resources and improved allocation of resources
- Problem —> requires even greater policy coordination among members
  —> requires the willingness of member govs. to give up some of their policy authority
  —> it is lengthy to do all of this

Evaluating trading blocs:

- Increased competition
- Expansion into larger markets
- Economies of scale
- Lower prices for consumers and greater consumer choice
- Increased investments
- Better use of factors of p. —> improved resource allocation and more employment opportunities
- Improved efficiency in production and greater economic growth
- Stronger bargaining power
- Political advantages —> political stability
- Trading blocs may be a challenge to multilateral trading negotiations (as the WTO)
- Unequal distribution of gains and possible losses —> countries are unlikely to gain equally —> creates the potential for conflicts
- Economic integration involves a loss of sovereignty —> loss of decision-making power

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15.3 Economic integration: monetary union

- Involves a far greater degree of integration than a common market —> when members adopt a common currency and a common central bank responsible for monetary policy
- Example —> euro zone countries

15.4 World Trade Organisation

- Organisation fro liberalising trade

Functions:

- Administer WTO trade agreements
- Provides a forum for trade negotiations
- Handles trade disputes
- Monitors national trade policies —> periodic review of its members national trade policies
- Provides technical assistance and training for developing countries
- Facilitates cooperation with other international organisations

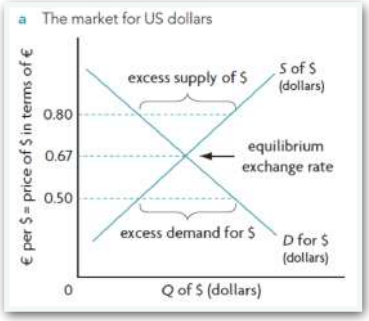
Criticisms:

- The WTO is accused of promoting trade rules that do not favour developing countries
    —> developed countries received greater tariff reductions than developing ones
    —> non-tariff and hidden barriers against developing countries wasn't addressed enough
    —> developed countries influence the agreements
    —> protection of intellectual property increased cost of acquiring new tech
- The WTO has been unable to reach an agreement on agricultural protection and services
    —> developed countries protect farmers through production and export subsidies —> has numerous negative effects on the farmers and economies of developing countries
- The WTO is accused of not distinguishing between developed and developing economies
    —> trade protection lowering was made the same for everyone
    —> developing countries need trade protections instead
- WTO members have unequal bargaining power
    —> decisions are based not the power of members in spite of the one vote per member rule
    —> powerful countries dominate agenda-setting and their opinions carry greater weight
- A key challenge faced buy the WTO: fragmentation of global trade
    —> global trading system may be facing a setback because of growing trade protection tendencies around the world
- Another key challenge faced by the WTO: the blocking of its powers to resolve disputes
    —> Appellate body —> seven judges committee
    —> the US blocked the appointment of new judges of the appellate body in 2019

Chapter 16: Exchange rates and the balance of payments

16.1 Floating exchange rates

- Foreign exchange —> international transactions involving the use of different national currencies
- Demand for foreign currencies generates a supply of domestic currency in a country
- Demand for the domestic currency generates a supply of foreign currencies in a country
- Exchange rates —> the value of one currency expressed in terms of another

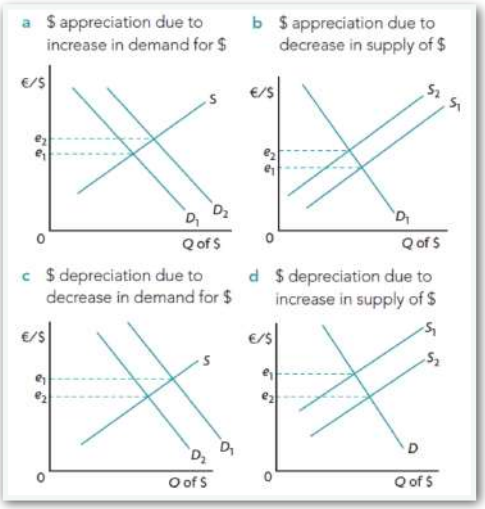


Floating exchange rate system:

- Exchange rates are determined by market forces (demand and supply)
- No government or central bank intervention in the market

Appreciation and depreciation:

- Once an exchange rate settles at its equilibrium value, it will remain there until a change in demand or supply of the currency
- Appreciation —> increase in the value of a currency
  —> all other currencies depreciate relative to it
- Depreciation —> a fall in the value of a currency
  —> all other currencies appreciate relative to it



Causes of changes in exchange rates:

Factors that affect currency demand Inflows of funds		Factors that affect currency supply Outflows of funds	
Increase in currency demand leads to appreciation Figure 16.2(a) D curve shifts right	**Decrease in currency demand leads to depreciation Figure 16.2(c) D curve shifts left**	**Decrease in currency supply leads to appreciation Figure 16.2(b) S curve shifts left**	**Increase in currency supply leads to depreciation Figure 16.2(d) S curve shifts right**
Increase in foreign demand for exports of goods and services	Decrease in foreign demand for exports of goods and services	Decrease in domestic demand for imports of goods and services	Increase in domestic demand for imports of goods and services
Lower inflation leading to increase in foreign demand for exports	Higher inflation leading to decrease in foreign demand for exports	Lower inflation leading to decrease in domestic demand for imports	Higher inflation leading to increase in domestic demand for imports
High growth rates of trading partners leading to increase in foreign demand for exports	Low growth rates of trading partners leading to decrease in foreign demand for exports	Low domestic growth rate leading to decrease in domestic demand for imports	High domestic growth rate leading to increase in domestic demand for imports
Increase in inward investment	Decrease in inward investment	Decrease in outward investment	Increase in outward investment
Higher interest rates leading to more inward financial investment	Lower interest rates leading to less inward financial investment	Higher interest rates leading to less financial investment by domestic residents in foreign countries	Lower interest rates leading to more financial investment by domestic residents in foreign countries
Increase in inflow of remittances	Decrease in inflow of remittances	Decrease in outflow of remittances	Increase in outflow of remittances
Speculators expect currency X will rise so they buy currency X	-	-	Speculators expect currency X will fall so they sell currency X
Central bank buys the domestic currency	-	-	Central bank sells the domestic currency

16.2 Consequences of changes in exchange rates: an evaluation

- Currency appreciation —> expected result in a decrease in net exports (X - M)
- Currency depreciation —> expected result in an increase in net exports (X - M)

Effects on the rate of inflation:

- Demand-pull inflation —> appreciation will work to reduce demand-pull inflationary pressure in an economy —> because it causes AD to fall due to less net exports
- Cost-pull inflation —> appreciation will work to lower cost-push inflationary pressures in the economy by making imports less expensive —> rightward shift of the SRAS curve

Effects on economic growth:

- Depreciation —> increases net exports —> thus increasing real GDP —> short-term growth
  —> increases cost-push inflation —> real GDP may fall due to lower SRAS

Effects on unemployment:

- Depreciation —> causes a fall in cyclical unemployment
  —> due to cost push-inflation —> less GDP —> increase in unemployment

Effects on foreign debt:

- Depreciation —> by lowering the value of the domestic currency it causes the value of foreign debt to increase —> governments try to avoid it for this reason

Effects on living standards:

- Depreciation —> it causes imported goods to become more expensive in the domestic economy
  —> if goods are used as factors of production —> increased cost-push inflation and hence making the cost of living higher

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16.3 Government intervention

- Fixed exchange rate system —> exchange rates are fixed by the central bank of each country at a particular level and are not permitted to change freely in response to the market
- Requires constant intervention by the central bank or government —> in the form of buying and selling reserve currencies by the central bank

Intervention to maintain fixed exchange rates:

- Using official reserves to maintain the exchange rate
- Increases in interest rates for savings
- Borrowing from abroad
- Efforts to limit imports

Changing the fixed exchange rate:

- Devaluation —> if the currency value is higher than what can be maintained
- Revaluation —> if the currency has a lower value than what can be maintained by intervention

- Between 1879-1934 —> gold standard —> countries fixed their exchange rates relative to gold
- 1944-1973 —> Bretton Woods system —> permitted periodic devaluations or revaluations
  —> not against just one other currency but against all other currencies

Managed exchange rates:

- Since 1973 —> exchange rates are for the most part free to float to their market levels over long periods of time —> central banks periodically intervene to stabilise them over the short term
- It prevents large and abrupt fluctuations that may destabilise the economy
- Pegging —> a number of countries peg their currencies to other currencies and float together with it —> the pegged currency is allowed to fluctuate only within a narrow range above and below a target exchange rate relative to the dollar or the euro

Consequences of overvalued and undervalued:

- Often occurs in fixed and managed exchange rate systems
- Overvalued currencies —> imports become cheaper —> developing countries want it to speed up industrialisation
  —> exports become more expensive —> hurts domestic exporters
- Undervalued currencies —> developing countries use them to expand their export industries
  —> competitive advantage compared to other countries —> dirty float

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16.4 The balance of payments

- Balance of payments —> a record of all transactions between the residents of the country and the residents of all other countries
- Shows all payments receive (credits), and all payments made (debits)
- The sum of all credits must be equal to the sum of all debits
- Credits —> create a foreign demand for the country's currency
- Debits —> create a supply of the domestic currency
- Surplus —> when credits are larger than debits
- Deficit —> when debits are larger than credits

Current account components:

- Balance of trade goods —> is the exports minus the imports of goods
- Balance of trade services —> is the exports minus the imports of services
- Balance of trade in goods and services —> net exports —> by summing first two components
- Income —> all inflows (from rents, interests and profits from abroad), minus all outflows
- Current transfers —> inflows due to transfers from abroad (gifts, remittances, foreign aid, pensions), minus outflows
- Balance on current account —> when all items in the current account are added up

- A current account deficit means a country consumes more than it produces —> it pays for extra output consumed through a financial account surplus

Capital account components:

- Capital transfers —> inflows minus outflows for such things as debt forgiveness, non-life insurance claims and investment grants
- Non-financial assets —> the purchase or use of natural resources that are non-produced
- Is relatively small and unimportant compared to the other accounts

Financial account components:

- Foreign direct investment (FDI) —> investments in productive facilities by foreigners
- Portfolio investment —> investments in financial capital
- Reserve assets —> foreign currency reserves that the central bank can buy or sell to influence the value of the country's currency
- Official borrowing —> government borrowing from abroad
- Balance on financial account —> the sum of these items

Errors and omissions:

- It is extremely difficult to record every single transactions —> item called "error and omissions" to fill the gap

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Chapter 18: Understanding economic development

18.1 Sustainable development

- Sustainable development —> development that meets the needs of the present without compromising the ability of future generations to meet their own needs
  —> does not deplete or degrade natural resources
- Sustainable dev. goals —> developed by the United Nations Conference
  —> have one to three indicators per target

Goals:

- End poverty in all its forms and everywhere
- End hunger, achieve food security + nutrition, and promote sustainable agriculture
- Ensure healthy lives and promote well-being for all at all ages
- Ensure inclusive and equitable quality education and promote lifelong learning opportunities
- Achieve gender equality and empower all women and girls
- Ensure availability and sustainable management of water and sanitation
- Ensure access to affordable, reliable, sustainable and modern energy
- Promote sustained, inclusive and sustainable economic growth, employment and decent work
- Build resilient infrastructure, have industrialisation and foster innovation
- Reduce inequality within and among countries
- Make cities and human settlements inclusive, safe and sustainable
- Ensure sustainable consumption and production patterns
- Take urgent action to combat climate change and its impacts
- Conserve and sustainably use oceans…
- Protect terrestrial ecosystems, forests and halt land degradation and biodiversity loss
- Promote peaceful and inclusive societies, provide justice and build effective institutions
- Strengthen global partnership for sustainable development

18.2 Measuring development

- Economic growth —> the increases in output and incomes over time
- Economic development —> process that leads to improved standards of living for a population
- Human development —> Goulet —> life sustenance —> access to basic services
  —> self-esteem —> the feeling of self-respect
  —> freedom —> freedom from want, ignorance and squalor

Indicators:

- A measurable variable that indicates the state or level of something being measured
- Useful for —> monitoring how a country changes
  —> making comparisons between countries
  —> assessing how well a country is performing with respect to particular goals of dev.
  —> devising appropriate policy measures to deal with specific problems

Single indicators:

GDP per capita and GNI per capita:
- GNI per capita is a better indicator of the standards of living of a country —> it represents income per person received by the residents
- GDP per capita is a better indicator of the level of output per person produced in a country
- Must consider in terms of PPP in order to be correct across countries —> published by Organisation for Economic Cooperation and Development, European Union and World bank

Health indicators:
- Life expectancy at birth —> average number of year of life in a population
- Infant mortality —> number of infant deaths from the time of birth until the age one x1000
- Maternal mortality —> the number of women who die per year for pregnancy x 100000
- Influence by —> public health services and prevention of communicable diseases
  - —> adequate health care services with access
  - —> healthy environment (safe water, sanitation and pollution)
  - —> adequate diet and avoidance of malnutrition
  - —> high level of education of the entire population
  - —> absence of serious income inequalities and poverty

Education indicators:
- Adult literacy rate —> the percentage of people aged 15 or more who can read and write
- Primary school enrolment —> the percentage of school-age children enrolled in primary school
- Lower secondary school enrolment —> same as primary
- Can be achieved also with low per capita incomes

Economic inequality indicators:
- Lorenz curve, Gini coefficients, poverty lines, minimum income, Multidimensional poverty index

Social inequality indicators:
- Adolescent fertility rates, prevalence of undernourishment, inequality in life expectancy, education, gender, child malnutrition, infants lacking immunisation, child labour, homeless people due to natural disaster, birth registration

Energy indicators:
- Social —> share of households without electricity and income spent on fuel and electricity
- Economic —> energy use per capita and share of renewable energy
- Environmental —> air pollutant emissions from energy systems and deforestation for energy

Environmental indicators:
- CO_2 emissions per unit of GDP and emissions of hazardous substances
- Bird and fish species threatened
- Ozone layer depletion
- Waste generation + waste water treatment
- Intensity of water use

Composite indicators:

Human development index by UNDP:
- Measures average achievement in —> long and healthy life
  —> access to knowledge
  —> decent standard of living
- Useful to government wishing to devise policies focusing on economic and human dev. —> superior to single indicators as a measure of dev.
- Does not provide info. about income distribution, malnutrition, demographic trends…

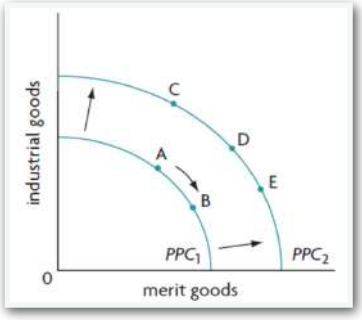
Inequality-adjusted HDI:
- Measures human dev. in the same three dimensions as the HDI, but each adjusted for inequality
- Attempts to measure losses in human dev. that arise from inequality

Gender inequality index:
- Measures inequalities between the genders in three dimensions:
  —> reproductive health —> maternal mortality and adolescent birth rate
  —> empowerment —> share of woman parliamentary seats and educated women proportion
  —> labour market participation —> proportion of women in the labour force

Happy planet index:
- Proposed as a measure of sustainable well-being adjusted for inequalities + ecological footprint
- Takes into consideration life expectancy, people's feeling about personal well-being

Strengths and limitations:
- Advantage —> useful as measures of different aspects of development
- Disadvantage —> based on statistical information
  —> some countries have a limited capacity to collect statistical data
  —> data are not fully available in many countries
  —> when data are not available agencies try to come up with estimates
  —> often agencies do not have access to recent data, incorrect comparison
  —> definitions of variables and methods vary from country to country

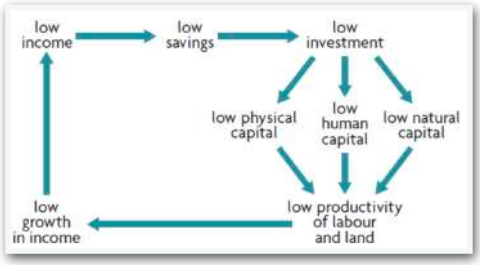
Economic growth and development:
- Economic growth can occur without economic development
- A —> B no economic growth with some development
- B —> C economic growth with no development
- B —> D or E economic growth with development



Chapter 19: Barriers to economic growth and economic development

19.1 Poverty cycles (or traps)

- Poverty is transmitted from generation to generation because:
  —> cannot afford to send their children to school
  —> cannot afford the necessary medical care and food —> physically disadvantaged
  —> large families —> income stretched to cover more people needs
- Banks do not lend to poor people —> no collateral
- To break cycle —> requires intervention of the gov.
  —> investments in capital (uses gov. revenues)
  —> foreign aid can help



19.1 Poverty cycles (or traps)

Economic inequality:

- Highly unequal distribution of income are a barrier to growth and development —> greater equality in income distribution may lead to more rapid growth and more development
- Asian Tigers —> Singapore, … adopted this strategy successfully
- In past it was thought of the opposite case instead
- Global trends show that inequalities in wealth are worsening in most developing countries

Infrastructure:

- Type of physical capital (roads, dams, power, telecommunications, …)
- Important for the effective functioning of any economy
- 20% of total investment in most developing countries —> mostly a government responsibility
- Developing countries perform poorly in it because:
  —> problems in financing
  —> inadequate maintenance + quality
  —> limited access by the poor
  —> misallocation of resources —> not enough demand for their services
  —> neglect of the environment

Access to technology:

- New technology contributes to improving the quality of physical capital
- Appropriate tech. —> satisfies economic, geographical, ecological and climate conditions
- Labour-using tech. —> uses more labour in relation to capital —> results in local employment and use of local skills and materials
- Capital-using tech. —> uses more capital in relation to labour —> in developing countries with large supplies of labour they displace workers and increase unemployment —> throw people into poverty and require skill levels + use of foreign exchange for imports
- Most tech. advances tend to be of the capital-using type
- Many of the technologies are inappropriate to the climates … of many developing countries
- Low R&D in developing countries —> no appropriate tech. produced

Human capital:

- Skills, abilities and knowledge acquire by people + good levels of health —> more productive
- Low levels of educational attainment and health in developing countries
- Barriers to education:

—> insufficient funding for education
—> insufficient teacher or untrained teachers
—> insufficient classrooms and basic facilities
—> lack of teaching materials
—> children with disabilities are excluded
—> gender discrimination
—> conflict or risk of conflict
—> distance of school from home
—> hunger and malnutrition
—> inability to pay for education

- Barriers to good health:

—> Insufficient funding for health care
—> insufficient access to health care services
—> private payments for health care
—> geographical access
—> insufficient numbers of trained medics
—> insufficient medical facilities and supplies
—> acceptability of modern medical practices
—> access to clean water + sanitation

Primary sector:

- Developing countries, especially the lower income ones, tend to specialise in the production of only a few goods, which usually are primary commodities
- Volatility of primary product prices has serious negative consequences for producers
- Consequences on efforts to plan for growth and development —> unable to determine future

International markets limited access:

- Tariff barriers —> products of interest to developing countries have high tariff barriers
  —> discourage the development of manufacturing and vertical diversification
  —> low tariffs on raw materials / higher tariffs on processed products (escalation)
- Non-tariff barriers —> administrative barriers
- Agricultural trade and rich country subsidies effects —>

—> Global misallocation of resources
—> Global inefficiency
—> Lower export earning for dev. countries
—> Increased poverty among affected people

The informal economy:

- Economic activities that are unregistered and legally unregulated
- International Labour Organization (ILO) —> work in the informal economy of developing countries is not undertaken to avoid payment of taxes or bypass labour as in developed countries
- Is necessary in the absence of other means of livelihood
- 61.2% of global employment is in the informal economy
- Correlated to the Human Development Index —> low HDI, high informal economy

Capital flight:

- Refers to the large-scale transfer of privately-owned financial capital to another country
- Caused by anything that may lead to the loss of value of the domestic current, the fear of loss of property through confiscation, increases in taxation, political instability, foreign debt problems, devaluation possibilities and balance of payments problems
- Involves a loss of financial capital that could have been invested domestically
- Forces governments to devalue the currency —> self-fulfilling prophesy
- Argentina's 61% and Mexico's 64% foreign debt accumulation was due to capital flight

Indebtedness:

- In 1973-1974 the Organization of the Petroleum Exporting Countries increased price of oil —> firms faced larger import expenditures and borrowed to cover their deficits
- In 1996 the World Bank began the Heavily Indebted Poor Countries (HIPC) Initiative —> provided debt relief to some highly indebted poor countries by cancelling $100 billion of it
- Debt situation has again deteriorated because of:

—> the global financial crisis in 2008
—> drop in global commodity prices in 2014
—> interest rates dropped to low levels —> easier to borrow for African countries
—> lower saving and large financing needs
—> poor governance
—> exchange rate depreciation —> value of debt increased
—> borrowing spent rather than invested
—> increase in borrowing from private sources

- Effects were:

—> debt servicing costs
—> poor credit ratings
—> increases in taxes and cut in gov. spending
—> increased income inequality
—> lower private investment as uncertainty
—> debt trap —> borrowing to pay debt
—> lower economic growth

Geography and landlocked countries:

- Transportation by sea is less expensive than by land
- Landlocked developing countries are disadvantages as export and import activities depend on their neighbouring countries —> may have poor relations, …
- Vienna programme of action aims to assist these countries

Tropical climates:

- Climate differences are key in determining types and methods of agricultural production, animal husbandry and labour productivity
- Developed countries have temperate climates, while developing countries have tropical climates

19.3 Political and social barriers

Weak institutional framework:

- Institution are rules organisations and social norms that facilitate coordination of human action
- Countries need to develop institutions relating to property rights, a well-functioning legal system, a transparent tax system, banking and credit institutions, protection against corruption + justice
- Justice is necessary to eliminate poverty as most is as a result of disempowerment and exclusion
- Developing country tax system features:

—> high dependance on indirect taxation
—> inefficient /highly bureaucratic tax systems
—> weak tax collection systems
—> political and economic power to wealthy

- Low levels of revenue —> the higher the level of GDP per capita, the higher the tax revenues as a share of GDP
  —> corruption in tax collection
  —> inefficiencies in tax collection
  —> tax exemptions and privileges of wealthy people
  —> low property tax rates
  —> elite influence government tax policies
- Inequities in tax systems —> not particularly progressive due to rely on indirect taxation
  —> very high income groups end up paying far less overall taxes

Banking:

- Banking services and access to credit are important to economic growth and development
- Lack of wealth typically means lack of access to credit
- Provides an incentive for people to save
- Provides businesses and farmers with credit
- Provides consumers with credit
- Access to credit is important for poverty alleviation

Property rights and land rights:

- Property rights —> laws and regulations that define rights to ownership, use, transfer of property
- The more secure the property rights (titling), the faster the economic growth
- Less investment when property rights are not secure + when borrowing property can be collateral
- Land rights —> the rights and rules to possess, occupy and use land

Land titling didn't work because:

- Titles were often capture by elites
- Once titles are established taxes may be imposed
- Land as collateral for poor and may lose it
- Economic hardship may force to sell
- Titling increases the market value of land

- Land grabs —> the buying or leasing of large pieces of lan by individuals and companies

—> can cause the risk of eviction and displacement of millions of poor farmers
—> food security is less as produced commodities are for export now

Gender inequality:

- Result in serious deprivations and limited access of women and girls to social, economic and political opportunities compared with men and boys
- Health and education are affected
- Labour market —> lower levels of education and skills disadvantage women as less qualification
- Inheritance rights and property rights —> in developing countries passed mainly to men
- Income, wealth and poverty —> women's income are on average substantially lower than men's

Appropriate governance:

- Better governance is related to more investment and greater economic growth
- Participation
- Decency
- Transparency
- Fairness
- Accountability
- Efficiency

Corruption:

- The abuse of public office for private gain
- Especially pronounced in countries where the legal system and mass media are weak
- Monitored by the Transparency International (TI)

—> tax to obtain something
—> bribes to be paid to obtain basic services
—> bribes going into the pockets of politicians
—> damages the people's trust in the state

—> misallocation of resources due to officials accepting bribes to pursue uneconomic projects / to bypass environmental regulations
—> restricts entry of new firms (competition)

Unequal political power and status:

- Difficult to carry out a dev. programme without the support of political elites —> poses difficulties for government undertaking policies
- Caste system —> social position determined by birth and cannot be changed
- Class system —> determined by factor over which there's is some control
- Race and ethnicity —> sometimes lead to prejudice, discrimination, intolerance and conflicts
- Political stability —> necessary for effective government decision making
  —> instability creates an environment of uncertainty
  —> instability often leads to an outflow of financial capital
  —> instability increases vulnerability to hunger —> resources to army
  —> *low levels of income per capita are associated with political instability*

Chapter 20: Strategies to promote economy growth and development

20.1 International trade strategies

Import substitution:

- A growth and trade strategy where a country begins to manufacture simple consumer goods for the domestic market to promote its domestic industry —> using protective measures
- Justified by the infant industry argument
- Latin American countries from the 1930s —> abandoned for export promotion in the 1980s
- Now only selective import substitution

Policies and consequences:

- High levels of protection of domestic firms —> inefficiency and resource misallocation
- Overvalued exchange rates —> capital-intensive production and unemp. + informal economy
- Too much government intervention in the economy —> inefficiency and resource misallocation
- Neglecting of agriculture —> more need for food imports
- Deterioration in the balance of payments —> imports of capital equipment and food + outflow of financial capital
- More capital-intensive production methods —> unemployment and income distribution worse
- Limited possibilities for growth over the long term

Export substitution:

- Strategy where a country attempts to achieve economic growth by expanding exports
- Asian tigers adopted it —> Singapore, China, Japan, …
- Included —> financial assistance to targeted key industries —> export industries and R&D
  —> strong government intervention —> state ownership of financial institutions
  —> large public investments in key areas
  —> requirements imposed on multinational corporations
  —> exchange rate management —> undervalued currencies to encourage exports
- Successful because —> expansion into foreign markets
  —> emphasis on diversification
  —> major investments in human capital
  —> increased employment
  —> appropriate technologies —> involving R&D
  —> no balance of payments problems
- Disadvantages —> overly dependent on exports —> recession can be dangerous
  —> may be efforts to maintain low wages to make exports more competitive
  —> possible trade deficits in trading partners —> could lead to trade protection

Regional free trade agreements:

- Will lead to increased growth and more development —> Latin America, Central America, …
- Help developing countries achieve growth and development when they involve:

—> regional agreements —> similar development
—> geographical closeness —> similar market sizes

Bilateral free trade agreements:

- Have the potential to provide a developing country with access to the developed country market
- UNCTAD —> BFTA threatens existing regional cooperation agreements of developing countries
- Need —> developing country must make equal and matching cuts in tariff and other barriers
  —> increases in exports are limited
  —> more imports and less propor. exports —> balance of payments problem, foreign debt
  —> developing countries have weaker bargaining power
  —> developing country must agree to other requirements —> may not be of interest
  —> weaken regional trade agreements when member country with a third country

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20.2 Diversification and social enterprise:

- Diversification —> reallocation of resources into new activities that broaden the range of goods and services produced —> primary sector share of GDP shrinks —> replaced by manufacturing
  —> characteristically of higher income developing countries
- Benefits: —> sustained increases in exports
  —> development of technological capabilities and skills
  —> reduced vulnerability to short-term price volatility
  —> use of domestic primary commodities
- Adding value to products is important because:

—> more varied production activities —> new firms to manufacture goods
—> employment opportunities —> higher skill and tech. levels created

- Overspecialisation —> in resource-rich countries —> become heavily dependent on primary commodities which have short-term volatility of export revenues —> balance of P difficulties
  —> resource-poor countries —> more labour-intensive manufacturing
- Social enterprise —> type of commercial organisation —> aims to achieve social goals to improve people's well-being and promote social change
  —> non-for-profit —> objective is to achieve their social goals not increase profit
  —> profits go back into the enterprise

20.3 Market-based policies

Washington Consensus:

- Washington Consensus —> free market approach to growth and development
  —> shared by World Bank, IMF and United States Congress
- Included —> trade liberalisation, privatisation of state enterprises and deregulation
  —> non exchange rate management, reduced restrictions to foreign direct investments
  —> limited borrowing by the government, restricting the use of industrial policies
- Effects —> limited benefits for export growth and diversification —> lost share in world exports
  —> limited effects on economic growth
  —> increasing income inequalities and poverty within developing countries (lower 40%)

Worse off —> —> —> less educated or illiterate people / —> poor people lack collateral
—> people in remote areas / —> people without exports
—> people in agriculture which now have volatile prices
—> people who lose their jobs due to cutbacks in the public sector
—> people affected by cuts on merit goods
—> people affected by lower levels of social protection (supply-side policies)
—> people forced into the informal economy

New consensus:

- Since late 1990s —> mix of markets with government intervention to support growth and dev.
- Governments support education, health, infrastructure and R&D
- Large budget deficits should be avoided —> does not involve reduction in the above
- Pursue policies that promote income equality and alleviation of poverty
- Provide a proper regulatory framework for markets to work effectively —> for competition, …
- Efforts to promote property and land rights, an effective tax system and banking
- Increase in foreign aid and access to markets from developing countries
- Developing countries should have a special treatment by the international trade agreements
- Help create the conditions for markets and trade to work to advantage developing countries

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20.4 Interventionist policies: redistribution + merit goods

Redistribution policies:

- Reduce inequality within and among countries —> objective of redistribution policies

Tax policies:

- Important that developing countries undertake reforms that will improve their taxation system
- IMF recommends —> increase in the progressively of the tax system
  —> expand the coverage of personal income taxes
  —> expand use of indirect taxes on luxury goods and on negative externalities
  —> increase taxation from capital income (profits)
  —> impose or increase taxes on real estate and land
  —> reduce tax evasion

Transfer payments:

- Universal social protection —> access by an entire population to social protection —> costly
  —> child benefits, pensions, disability, unemployment, …
- Transfer payments —> cash transfers or benefits in kind

—> reduce poverty and increase inclusion
—> empowers individuals
—> increases incomes
—> promotes economic growth (AD)
—> safety against sudden hardships
—> improves access to health care + education
—> reduces malnutrition and child mortality
—> introduces the poor in the formal economy
—> reduces child labour
—> political stability
—> do not reduce the incentive to work

- Conditional cash transfers —> money paid on condition that the households undertake activities related to education and health care
- Non-conditional cash transfers —> do not impose restrictions

Minimum wages:

- To support incomes of unskilled workers —> gives rise to unemployment
- Job losses do not occur unless minimum wages are set at very high levels
- Reduces income inequalities
- International Policy Centre for Inclusive Growth (IPC-IG):
  —> should be set after consulting with representatives of workers
  —> should consider the needs of workers and their families
  —> must ensure compliance and enforcement

Provision of merit goods:

- Merit goods are important for growth and development
- *Positive externalities of education:*

—> Economic growth (more productive)
—> more physical capital quality (education)
—> increased political stability
—> lower crime rate and better life quality

- *Positive externalities of health care:*

—> greater work productivity
—> no disease transmission

Combined benefits:

—> education of woman —> improved maternal health and less maternal mortality
—> healthier children due to better nutrition
—> basic principles of hygiene and sanitation
—> better health improves school attendance
—> longer lifespan to use skills learned

Services must be:

—> universal —> free —> public —> promote women

Infrastructure:

- Increases productivity and lower costs of production
- Facilitates modernisation and diversification of the economy
- Quantity and quality of infrastructure —> determine shipping costs
- Provides services essential for a basic standard of living

20.5 Foreign direct investment and MNCs

Multinational corporations:

- FDI —> investment by first based in one country in productive activities in another country
  —> control of at least 10% of the firm in the host country
  —> a firm taking FDI is called multinational corporation
- MNC —> mainly in developed countries in 20th century —> form 1980s also developing (50%)
  —> produce 33% of global output and half of world exports and imports
- *MNCs go in developing countries because:*

—> increases sales and revenues
—> bypass trade barriers
—> lower costs of production
—> use locally produced raw materials

- *MNCs search for:*

—> political stability
—> stable macroeconomic environment
—> favourable tax rules
—> weak labour protection laws
—> a liberalised economy and large markets
—> trade policy emphasising exports
—> rapid economic growth
—> well-function infrastructure
—> a well-educated labour force

- Advantages: —> MNCs can supplement insufficient foreign exchange earnings
  —> can improve local technical and management skills
  —> can supplement insufficient domestic saving and increase investment
  —> can lead to greater tax revenues in the host country
  —> can help promote local industry
  —> can increase local employment and higher economic growth

- Disadvantages —> may not always supplement insufficient foreign exchange earnings
  —> may not always improve local technical and management skills
  —> may not lead to greater tax revenues in the host country
  —> may not help promote local industry
  —> may not help lower unemployment in the host country
  —> environmental degradation
  —> promote inappropriate consumption patterns in developing countries
  —> may use government funds to build not needed infrastructure
  —> may use their economic + political power for policies that decrease growth
  —> competition between developing countries to host MNCs —> degrades them

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20.6 Foreign aid:

- The transfer of funds or goods and services to developing countries
- Objective —> to bring about improvements in their economic, social and political conditions
- 2 types —> concessional —> aid may involve grants
  —> non-commercial —>. Must not involve buying and selling or profit

Humanitarian aid:
- In regions where there are emergencies caused by violent conflicts or natural disasters
- Intended to save lives, ensure access to basic necessities and to assist in reconstruction
- Through grants or goods-in-kind (food, …)

Development aid:
- To help developing countries achieve their economic growth and development objectives
- May involve financial support for specific projects, to sector or technical assistance
- Are offered by ODA and NGOs

Official Development Assistance (ODA):

- Comes from government funds —> forms the largest part of foreign aid
- Three ways —> through bilateral aid —> funds go directly
  —> through multilateral aid —> funds go directly but from many countries
  —> through NGOs —> spend them in developing countries
- Provided because —> political and strategic motives
  —> economic motives
  —> humanitarian and moral motives

Private aid: Non-governmental Organisations:

- Second type of aid flowing into developing countries
- Are not party of any governmental structure
- Charitable organisations, non-profit organisations and nationally based groups
- Obtain their funds from private voluntary contributions and ODA funds
- Can perform functions that are not performed as effectively by national governance

Evaluating foreign aid:

- Countries can escape the poverty cycle if foreign aid provides the missing funds for these investments
- Aid can make resources available for investments in health, education, … —> helps poor people
- Contributes to improved income distribution
- Leads to economic growth
- Debt relief helps countries reduce their debt

Limits of ODA:

- Tied aid —> recipients forced to spend a portion of funds to buy goods and services of donor
  —> recipients cannot seek lower price and buy inappropriate capital-intensive tech.
  —> large firms in developed countries usually benefit from this
- Conditional aid —> recipient forced to pursue policies to achieve a greater market orientation
  —> recipient forced to accept particular projects that the donors decide on
- Aid volatility —> chaining volumes of aid in donor budgets —> difficult to implement policies
  —> governments cannot predict the future aid
- Uncoordinated donors —> aid-funded projects are many and un-coordinated and may overlap
- Substitution —> recipient government may use funds to substitute for domestic resources (taxes)
- May not reach the most in need
- Corruption
- Quantity of aid —> ODA funds are far less than the target amount

Advantages of NGOs:

- Strong anti-poverty orientation of activities
- Working closely with project beneficiaries
- Contribute to democratisation, advocacy and raising public awareness and support
- Offer expertise and advice
- Able to innovate in pursuit of solutions
- Enjoy the trust of beneficiaries

Criticisms to NGOs:

- Small size and weakness of many NGOs
- Possible loss of independence due to growing dependence on governments for funding
- May attract the best qualified personnel away from government
- Challenge to state authority —> must not be considered a replacement of government

Debt relief:

- Multilateral Debt Relief Initiative —> 100% debt relief for debts by the World Bank and IMF
- Heavily Indebted Poor Countries Initiative came before
- Countries had to —> have a GNI per capita below a certain level
  —> have a debt level that cannot be sustained
  —> show evidence that they are following WB and IMF policies
  —> have to commit themselves to pursuing a poverty reduction strategy
- Problems —> some bilateral creditors did not provide any relief
  —> programme takes effect too slowly
  —> some measures are too severe to follow
  —> many countries are highly indebted but have not been included

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20.7 Multilateral development assistance

- Involves lending to developing countries on non-concessional terms
- Rates of interest and repayment periods are determined by the market
- Lenders are —> multilateral development banks —> World Bank, Asian Dev. Bank, …
  —> the International Monetary Fund
- Lending for economic development or international financial stability —> not for commercial

World Bank:

- Development assistance organisation that extends long-term loan to developing country governments for the purpose of promoting economic development and structural change
- Formed in 1944 and has 189 member states
- Is a lender of funds to governments
- Two organisations —> International Bank of Reconstruction and Development (IBDR)
  —> non-concessional terms to middle income developing countries
  —> International Development Association (IDA)
  —> loans to low income countries on highly concessional terms
- Structural adjustment loans —> in past used to change the course of policy-making in developing countries by reducing government intervention and promoting competition —> strong criticism

- Current goals —> has committed to Sustainable Development Goals —> before was millenium
  —> poverty-oriented projects and require gov. intervention, access to credit by the poor, reforms for more equitable distribution, reverse environmental degradation

Evaluating the WB:

- Social and environmental concerns —> ensure that project objectives are consistent with SDGs
- World Bank governance dominated by rich countries —> voting power on financial contribution
- Excessive interference inn countries' domestic affairs
- Conditional assistance (lending) —> deprives countries of control
- Inadequate attention to poverty alleviation —> not doing enough
- Evaluating focus on market-based supply-side policies —> criticised for focusing on increasing flexibility in labour markets

International Monetary Fund:

- A multilateral financial institution that was established jointly with the World Bank
- Purpose —> lending to countries with balance of payments deficits
- Has 189 member countries and oversees the global financial system, follow macroeconomic policies of members, stabilising exchange rates and help countries with payment difficulties
- The loans provided usually come with a package of stabilisation policies that must be followed
- IMF may be rethinking its policies
- Activities —> contractionary monetary policies —> help with the balance of payments position
  —> contractionary fiscal policies —> to lower AD
  —> currency devaluation or depreciation
  —> cuts in real wages
  —> liberalisation policies —> to promote a free market and environment
- Criticisms —> IMF governance governance dominated by rich countries
  —> excessive interference in countries' domestic affairs
  —> conditional lending
  —> damaging effects on developing countries
  —> IMF stabilisation policies based on a flawed concept

20.8 Institutional change

Microfinance:

- Items that all men and women —> particularly the poor and vulnerable should have equal access
- Refers to credit (loans) in small amount to people who do not ordinarily have access to credit
- Short repayment periods involved

- Are delivered by Microfinance institutions —> credit unions, NGOs, informal savings, …
- Appeared in the 1970s and revealed that the poor were capable of excellent repayment rates
- Have a positive impact on poverty reduction
- Only reach only a very small proportion of poor —> not enough microcredit schemes
- Controversies —> microcredit schemes may become a substitute for anti-poverty policies
  —> microcredit schemes contribute to the growth of the informal economy
  —> interest rates in micro credit schemes are too high

Mobile banking:

- The use of mobile telephones to receive or send money and to pay bills
- Advantage included are:

—> payments with instant access + no delays —> easier to get loans, insurance, …
—> no need for travel with cash —> easier payments with no need to travel
—> reduced costs and easier to pay workers —> easier for poor people

- Disadvantages —> network problems cause delays, cost of the service, fraud chances

Women's empowerment:

- Improvements in child health and nutrition and lower child mortality
- Improvements in educational attainment of children
- Quality of human resources
- Lower fertility (lower birth rates)
- Reached through:

—> equal participation and representation —> eliminating violence and discrimination
—> promoting education + skill development —> making pregnancy and work possible

Reducing corruption:

- Develop high levels of transparency and independent external scrutiny —> provide supervision
- Reform institutions of tax administration
- Build professional civil service based on merit hiring
- Focus on areas where there is a higher risk
- Cooperate with other countries to make corruption more difficult to take place across boarders
- World bank —> establish institutions and incentives to prevent corruption
  —> mechanisms that discourage corruption —> penalties and sanction
  —> development of the type of government needed

Property and land rights:

- Contribute to food security —> improve access to credit and productivity of small farmers
- Lead to lower rates of deforestation
- Preserve diverse food cultures + biodiversity

- Support indigenous peoples
- Contribute to gender equality if to women
- Contribute to poverty reduction

20.9 Strengths and limitations of government intervention vs market-orientation

Market-oriented policies:

- Market-based supply-side policies —> encourage competition, labour reforms, incentive policies
- Trade liberalisation
- Freely floating exchange rates
- Strengths —> result in greater efficiency in production, lower prices and improved quality, better allocation of resources, economic growth and economic well-being
  - —> incentives to work, innovate and invest
  - —> markets much larger than they would be with trade barriers
- Weaknesses —> market failure —> environment, merit goods and public goods provision
  - —> weak institutional framework —> cannot improve institutions
  - —> income inequalities and poverty
  - —> inability to alleviate poverty
  - —> inability to empower women
  - —> informal economy
  - —> questionable effect on economic growth and development

Interventionist policies:

- Based on government intervention in markets intended to correct market deficiencies and create an environment in which markets can work more effectively
- Strengths —> correcting market failures
  - —> investment in human capital
  - —> provision of infrastructure
  - —> dev. of stronger institutions
  - —> redistribution of income
  - —> promotion of gender equality
  - —> industrial policies
  - —> provision of stable macro env.

- Weaknesses —> budget funds
  - —> excessive bureaucracy + inefficiency
  - —> possible protection of inefficient producers
  - —> excessive intervention leads to allocative inefficiencies
  - —> possible influence of elite groups exerting political pressures
  - —> corruption
  - —> poor governance
