# ECONOMICS II
# MACROECONOMICS

BMEGT30A101
BMEGT30A103
Monday: 8.15–9.45 (QA240)

# ECONOMIC POLICY
## – Alternative Perspectives –
## CH 18

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Consulting hours: Tuesday 12–14

MŰEGYETEM 1782

Gazdaság- és Társadalomtudományi Kar • Közgazdaságtan Tanszék

közgazdaságtan tanszék

# CONTENTS

# 1. INTRUDUCTION

# The macro roles of the government

1. **Allocation** – market failures: public goods, externalities, imperfect information, monopolies
2. **Redistribution** – fairness, dignity
3. **Stabilization**
4. **Creating and functioning economic and political institutions**
   – Inclusive vs Extractive economic and political institutions **(see CH 9)**

# 2. WHICH POLICY?

# A. Stabilization policies: fiscal of monetary

How should policymakers respond to business cycle?

Which policy is more effective?

- Fiscal: $\Delta Y / \Delta G = ?$
- Monetary: $\Delta Y / \Delta M = ?$

# IS-LM model

- **Crowding out effect**: that rises in public sector spending drive down or even eliminate private sector spending
- Suppose P=1 (short-run):
- IS: $$Y = \frac{1}{1-\hat{c}}\left[C_0 + I_0 + G_0 - \hat{c}T_0 + \hat{c}TR - ai\right]$$
- LM: $$i = \frac{m}{k}Y - \frac{1}{k}\frac{M^S}{P}$$

# B. Active or Passive

- **Views of economists : *the economy…***

**as naturally stable ←→ is inherently unstable**

- **Unpredictable future**
- **Lags** **(inside, outside)**
- **Lucas critique –** **(need to know how people's expectations will respond to a policy change)**
- **Automatic stabilizers** **(income tax, u benefit)**

- **The economy is hit by frequent shocks**

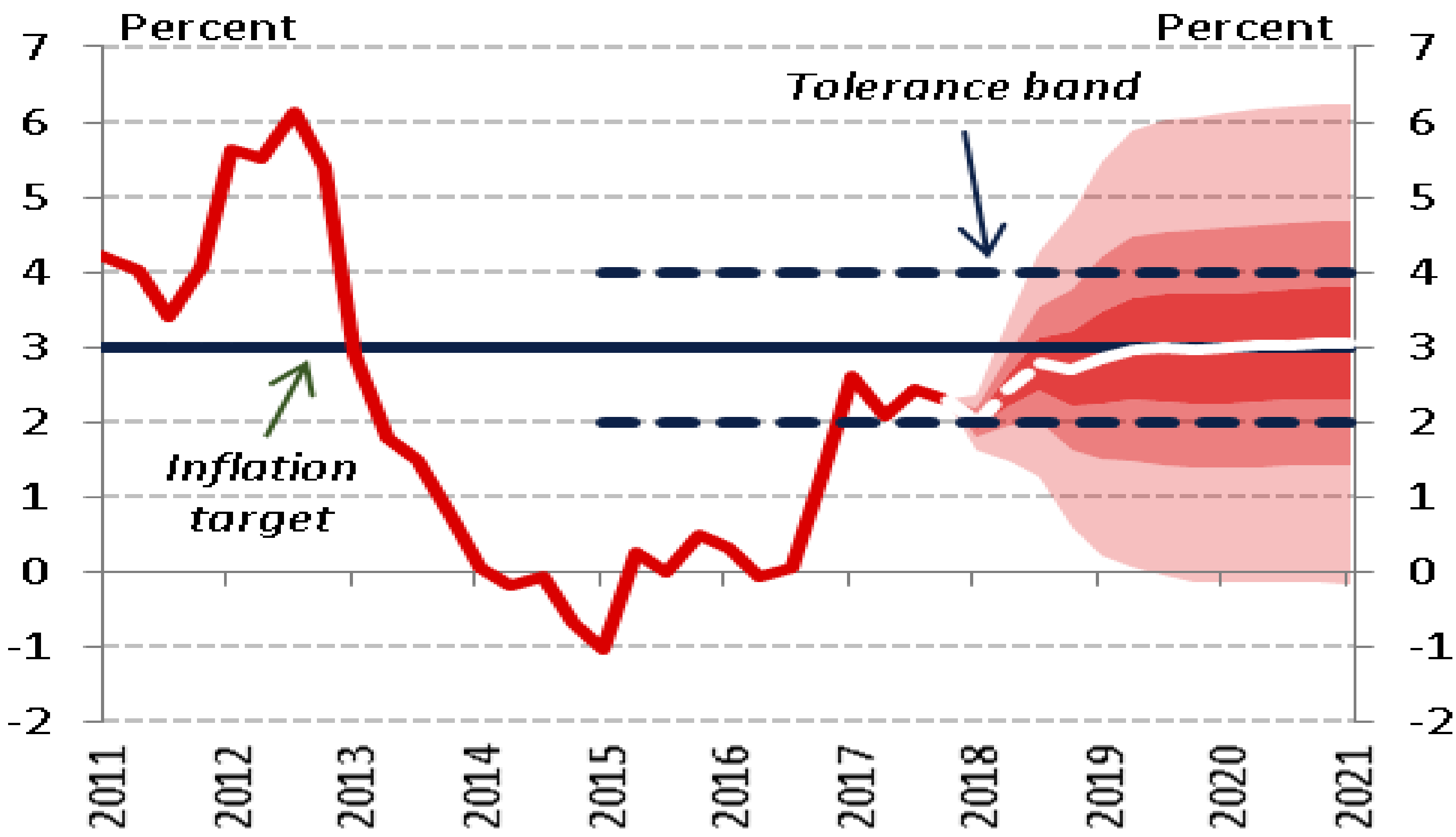
# C. Conducted by Rule or by Discretion

- **<u>By rule</u>**: policymakers announce in advance how policy will respond to various situations and commit themselves to following through on this announcement
  - Inflation targeting, Central- Bank independence

- **<u>By discretion</u>**: policymakers are free to size up events as they occur and choose whatever policy they consider appropriate at the time
  - More flexible in responding to various unforeseen situations

- **Time inconsistency** – unless credibility the announcement has little effect (No negotiation over hostages)

# Inflation targeting in Hungary




[2018. 03. 29. Inflációs jelentés]

# 3. FINANCING BUDGET DEFICIT

# Keynesian cross

- $Y=C+I+G= 100+0{,}5(Y–200–0{,}2Y)+500+1000$
- $Y^E=2500$
- **BD**$=G–T =1000–(200+0{,}2\cdot 250)=$ **+300**

- If BD=0 ➔ $G=T_0+tY= 200+0{,}2Y$
- $Y=C+I+G= 100+0{,}5(Y–200–0{,}2Y)+500+ 200+0{,}2Y$
- $Y^E=1750$ ➔ $G=T_0+tY= 200+0{,}2Y = 550$
- **ΔG**$= G – G =$ **–450**

# 4. CONCLUSION

- Economics is a young science, and there is still much that we do not know.
- Lessons from Lucas critique:
  - Need to consider how policy affects expectations and behavior
  - Economists must show requisite humility
- The economy is complex.