

Week 13. Fiscal and Monetary Policy

- Causes of recessions and the GFC
- Fiscal and monetary policy

Macroeconomics and the Great Depression (Oct 1929)

Took 30 years until the share market reached its peak in nominal terms. From bank failure.

Causes of recessions

Mainstream view is that the proximate cause is from declines in aggregate demand (consumption expenditure and planned investment)

GFC (September 2008)

→ housing price bubble, large increase in household debt. Lehman Brothers bankruptcy influencing banks to become wary of lending to each other forcing the share market to fall \$1,600 → \$700 credit diminishing. Dramatic decline in employment, sharp decline in GDP, then gradual recovery.

Enormous implication for how economic policy should be used to prevent recessions, suggests to boost D. If private D falls, then the government can stimulate it (John Keynes Theory)

Shadow banking and fancy finance may have aided this, theory in which lending money is risky to those with bad credit ratings but if you pull all the loans together it makes a safe loan, yet diversification does not work as they went bad altogether.

Yet:

- Technology continue to progress
- Working-age population continues to rise
- Capital stock often growing, even if not as fast
- = Productive capacity of the economy usually rising
 - Actual production drops sharply, followed by gradual recovery

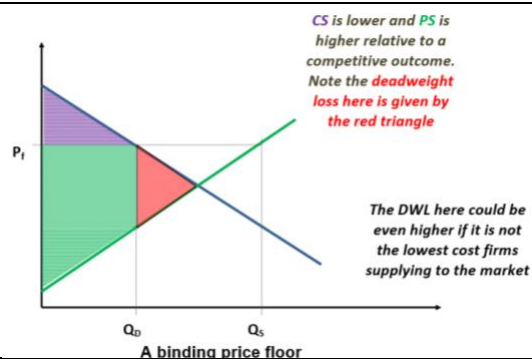
Fiscal Policy

Involves government spending and tax collection to reduce the volatility of the business cycle – automatic stabilisers and discretionary fiscal stimulus.

Other adverse effects/caveats

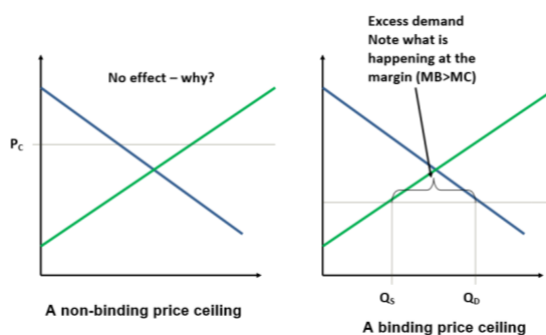
Lecture 9: Market intervention: Price regulation, taxes and subsidies

Price floor DWL
(diagram)



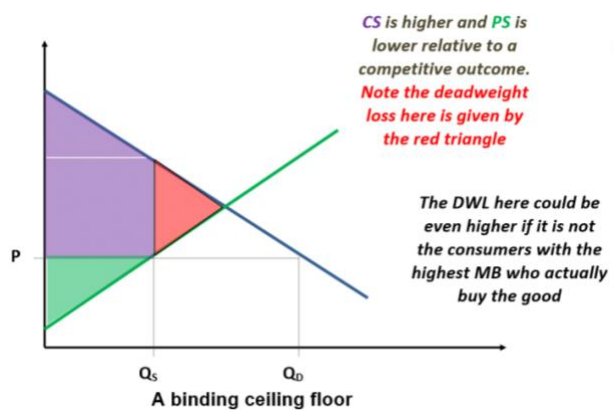
Lecture 9: Market intervention: Price regulation, taxes and subsidies

Price ceiling
(diagram)



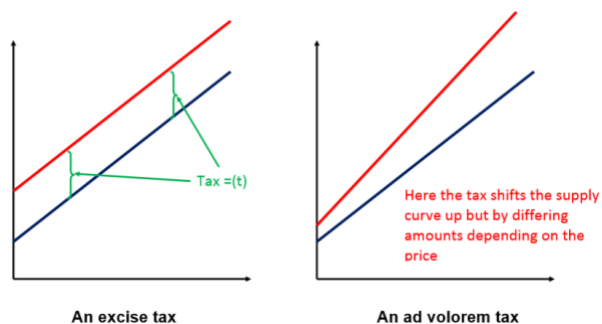
Lecture 9: Market intervention: Price regulation, taxes and subsidies

Price ceiling DWL
(diagram)



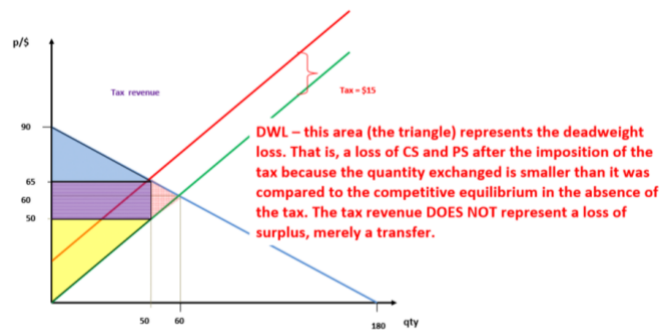
Lecture 9: Market intervention: Price regulation, taxes and subsidies

Excise Tax and AD Valorem tax
(diagram)



Lecture 9: Market intervention: Price regulation, taxes and subsidies

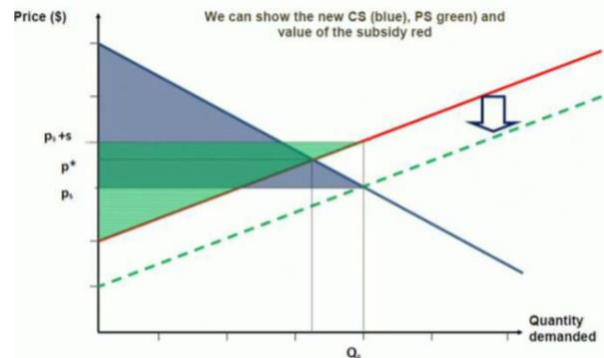
DWL with a tax



Lecture 9: Market intervention: Price regulation, taxes and subsidies

Subsidies

right

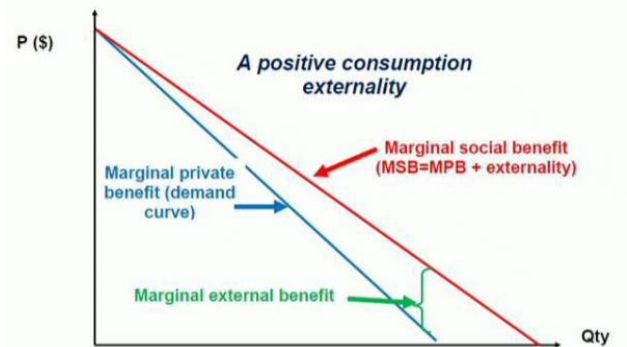


triangle represents net loss (DWL)

Lecture 10: Market failures: externalities & public goods

Positive consumption externality ft

- Marginal private benefit
- Marginal external benefit
- Marginal social benefit



Lecture 10: Market failures: externalities & public goods

Negative consumption externality ft

- Marginal private benefit
- Marginal external benefit
- Marginal social benefit

