Macroeconomic Objectives

Regardless of economies extent of development most countries strive to achieve following macroeconomic objectives:

1. High economic growth rate – high GDP
2. Low and stable rate of Inflation
3. Low Unemployment
4. Stable / favorable position on Balance of Payments

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5. Stable / favorable position of Exchange Rate

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Macroeconomic Policies

- Strategies used to achieve Macroeconomic Objectives are known as Macroeconomic Policies. Following Macroeconomic Policies are used to achieve previously mentioned Macroeconomic Objectives

1. Fiscal Policy
2. Monetary Policy
3. Supply Side Policies

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Macroeconomic Policies

- Unlike developing economies where government intervention is generally more prevalent, government involvement in developed economies is often just limited to legislation, regulation and formation of necessary institutions.

- Sometimes, governments use mix of Macroeconomic Policies to achieve their Macroeconomic Objectives.

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Macroeconomic Policies

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Fiscal Policy

- Fiscal Policy as devised through governments' annual budgets makes use of taxes and government spending to affect the national output.
- Governments run either budget deficits or surpluses or balanced budget. Unlike surpluses where taxation is greater than expenditure, for deficits government expenditure exceeds total taxation revenue.

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Gross Domestic Product

- GDP refers to the total value of all goods and services produced in an economy during one year.
- GDP is also national income for a country during certain time period, which means is sum of the incomes of all the people who were living in Pakistan during that year.

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Gross Domestic Product

- GDP is national income because the total value of any product is basically the sum of incomes earned by people including the business owner who were involved in manufacturing and sale of the product.

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How do we compare the size of economies?

- GDP is the sole basis to decide size of economies. Bigger economies produce goods / services worth more value so they have higher GDP and vice versa
- GDP Per Capita is an indicator of average income levels of any country.

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Ways to Calculate GDP

1. **Income Approach**: calculates GDP by adding up the incomes of all the people who are living in a country during that time period.

2. **Expenditure Approach**: calculates GDP by adding the expenditure of all the people who were living in a country during that time period.

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Ways to Calculate GDP

3. Product Approach: calculates the GDP of the country by summing up the value added in all the different stages of the production process like in the case of car manufacturing how much was the value added and then how much was value added during the sale of car etc.

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National Income

- National Income of an economy is indicator of its national output generated using its local factors of production. Since market value of output produced in any economy is representative of its citizens' income hence GDP is one indicator of economies' national income.
- Very simply speaking, national income is summation of individuals' income residing in any economy.

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National Income

- There are number of different statistics used to gauge an economy's national output, Gross Domestic Product being one of them.

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Gross Domestic Product (GDP)

- Gross Domestic Product is measure of total value of output of an economy. The market value of output produced in any economy during certain period of time is basically the income earned by it residents during a certain time period generally one year.
- There are three different ways of calculating GDP namely
- Product / Output Approach
- Income Approach
- Expenditure Approach

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Ways of Measuring GDP

- Product Approach: Summation of Value Addition that takes place during any production process allows economists to calculate economies' GDP using Product Approach.
- Income Approach: Summation of individuals' income of any year allows economists to calculate any economy's GDP using Income Approach.

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Ways of Measuring GDP

- Expenditure Approach:
  Summation of individuals' expenditure allows economists to calculate any economy's GDP for that year using Expenditure Approach. Since entire stock of output of goods produced in any year might not be sold hence unsold stock of goods is considered as producers' expenditure.

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Product Approach

Value Addition = Selling Price – Cost of Components

- If we calculate value addition for different production processes and add them up for different industries operating in an economy then we will be able to calculate economy's GDP using Output Approach.

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Product Approach

- For instance if any car manufacturer sells its final output of cars for Rs 100,000 and had incurred cost of components for Rs 50,000 then the production process would have value addition of Rs 50,000.

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GDP Estimation Techniques

- These three different GDP estimation techniques yield same results given there is complete information and no calculation discrepancies.

Why should Income and Expenditure Approach yield similar results?

- One individual's income is another individual's expense and therefore summation of citizens' income and expenditure should give similar results.

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GDP

Why should Product Approach yield same result as Income and Expenditure Approach?

Since Value Addition represents compensation paid to factors of production therefore technically this calculation is indicator of income received by different market participants

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GDP

For instance if for any production process the value addition is Rs 30,000 then it will be either compensation paid to labor, or to capital or to land or to entrepreneur

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Monetary Policy

- Alteration of economy's money supply and / or interest rates to manipulate its economic outcome is known as Monetary policy. Monetary Policy is solely determined by economies' Central Banks.

- Expansionary Monetary Policy is used to combat economies' low economic growth. Increased aggregate spending due to low interest rates is expected to boost economic growth. On the contrary Contractionary Monetary Policy is used to reduce economics activity by increasing interest rates.

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Monetary Policy

- Interest rates are also expected to affect portfolio / indirect investment flows between countries and so affect their exchange rates.
- Higher interest rates are expected to appreciate country's exchange rate due to higher cash inflows and with lower interest rates the exchange rate is expected to depreciate due to cash outflows.
- However the relationship explained between monetary policy and economy's exchange rate might not be very strong.

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Supply-Side Policies

- Policies aimed at enhancing economies' production potential are known as Supply-Side Policies.
- Enhanced production potential is important for economy to increase its growth rates.

1. Increased investment in human capital through availability of better educational and health care services can improve labor productivity and so is one possible supply-side policy.

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Supply-Side Policies

2. Similarly provision of economic incentives and more equal access to capital is expected to boost economy's investment levels.

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Supply-Side Policies

- Unlike Demand Side Policies namely Fiscal and Monetary Policy that are generally easier to implement and have shorter time lags. Supply-Side Policies often involve more complexities and have longer time lags.

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Supply-Side Policies

Effects of investment in human capital just like other type of investment generally take **longer** time to work through the economy as compared to changes in tax rates, government spending and interest rates.

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