**Government:**

* organizations of individuals
  + particular set of institutions and \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
* authorized by formal documents
  + legally empowered
* make binding decisions on behalf of a particular community
  + Externally: war, trade, border control...
  + Internally: tax, education, health, welfare...

**Good Governance:**

* Rule of law
  + government can take \_\_\_\_\_\_ action that has not been authorized by law
  + citizens can be punished only for actions that violate an existing law
* Property rights
* Regulatory regime
* Macroeconomic policies
* Absence of corruption

**Government’s Power:**

* Power
  + ability to get people or groups to do what they otherwise would not do
* Government’s power
  + to develop institutions
  + to carry out policies
  + sometimes unpopular
  + has to be sufficiently strong
* sufficient power
* constrained power
* Madison: oblige the government to control itself
* restraints to check arbitrary and corrupt behavior by the government
* Key: building \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ political institutions

**Political Institutions:**

* Organizations, individuals, and agencies
* Electoral rules
  + single-member district and first-past-the-post
  + \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ representation system
* Constitutional rules
  + division and limit of power
  + between branches of government
  + between central and local governments
* Constrain arbitrary exercise of power by politicians and bureaucrats
  + delineate property rights between state and private sector
  + enforce property rights
  + influence competition in political process
  + hold public officials accountable for their actions

**Economic Policy Outcomes:**

* Political institutions play important role
* Resolve \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_conflict from economy policies
* Three examples of policy choices
  + budget deficit
  + financial market
  + trade policy

**Budget Deficit:**

* Difference \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ revenue and expenditure
* Government influence on budget
  + muster political support for taxation
  + resist demands for expansion of spending
* Political institutions of budget procedures
  + balanced budget rules
  + power of finance ministry

**Balanced budget rules in U.S.:**

* All U.S. states but Vermont have constitutional (41) or legal (8) requirement for balanced budget
* Gramlich (1995:180) holds that all real-world balanced budget amendments have significant enforcement problems
* even with the “\_\_\_\_\_\_\_\_\_\_\_”, constrained state fiscal policy is more responsible than unconstrained state fiscal policy

**Balanced budget rules:**

* are more likely to be effective if
  + voluntarily adopted
  + impose hard constraints
  + difficult to reverse
  + effectively enforced by
    - a credible third party or
    - higher level government

**Influence of Electoral Rules:**

* Minority (coalition) governments tend to have higher budget deficit than majority government
* States with systems of proportional representation tend to have higher budget deficit than states with majoritarian systems.
* Budget deficit tends to \_\_\_\_\_\_\_\_\_\_ in election year

**Financial market regulation:**

* Influence of political institutions
  + independent financial regulatory agencies
    - central bank independence
  + checks and balances in political process
* Among developing countries, central bank independence doesn’t seem to \_\_\_\_\_\_\_\_\_\_\_\_\_ inflation outcomes

**International trade liberalization:**

* Government’s trade policy influenced by domestic political conflict between gainers and losers from trade liberalization
* Industries that tend to have tariff protection
  + industries in decline
  + industries that are highly unionized
  + make substantial campaign contributions
  + more geographically dispersed

**Corruption:**

* Exercise of public power for private gain
* has large costs for economic development
* undermines well-functioning markets
  + a \_\_\_\_\_\_\_\_\_\_ that distorts competition & lower returns
  + a barrier to new entries in market competition
  + subvert state’s legitimacy
  + weakens state capacity to provide institutions to support markets

**Causes of corruption:**

* Distorted policy environment (opportunity)
* Weak judiciary (credible threat to punish)
* Poor civil service management
* Low public sector pay (not evident)
* Other factors
  + Openness to international trade
  + Complexity of regulatory environment
  + High and variable inflation

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**Political institutions:**

* Political institutions can help reduce the opportunities and incentives for corruption
  + Restrain politicians from arbitrary actions
  + Hold politicians accountable for their action
* Decentralization
* Electoral rules
* Press freedom
* Civil society

**Taxation institutions & policies:**

* \_\_\_\_\_\_\_\_\_provides the state with resources to build market-supporting institutions
* Weak tax collection institutions lead to disproportionate reliance on tax revenue from more visible and easier sources
  + international trade
  + large firms

**Tax collection institutions:**

* Poor countries tend to have \_\_\_\_\_\_\_\_\_\_\_ tax administration & higher reliance on tariffs

**Conclusions:**

* Political institutions matter
* Good governance is essential to economic development
* Effective State
  + plays a catalytic, facilitating role
  + encourage and complement the activities of private businesses and individuals

**Macroeconomic Policies**

**Monetary Policy:**

* Attempts to influence the level   
  of economic activity (the amount   
  of buying and selling in the economy) through changes to the amount of money in circulation and the price   
  of money – short-term interest rates.
* Interest rates the key area   
  of Monetary Policy
* Short-term interest rates set by the Monetary Policy Committee (MPC)   
  of the Bank of England
* Meets for 2 days each month   
  to decide on rates
* The ‘official rate’ is the rate at which the Bank of England will lend to the financial system and influences the structure of all other interest rates
* Basis of Monetary Policy is that there is a long run relationship between the amount of money and inflation
* Demand for Money – the amount people wish to hold as cash as opposed to other assets
* The Supply of Money – the amount   
  of money in circulation in the economy
* Supply of Money:
  + \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ – notes and coins   
    in circulation (M0)
  + \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ – Notes and coins plus money held in bank and building society accounts (M4)
* A rise in either (*ceteris paribus*) might signal a rise in aggregate demand (AD)
* The Interest Rate Transmission Mechanism
  + The process by which a change in interest rates feeds through to AD

**Supply Side Policy:**

* Intention is to shift the aggregate supply curve to the right, increasing   
  the long term productive capacity   
  of the economy
* Tend to be long-term policies
* Arguments about how effective they are – e.g. lowering taxes increases incentives, reducing welfare dependency increases the urge   
  to find work

**Supply Side Policies:**

* Policies aim to influence productivity and efficiency   
  of the economy
* Key feature – open up markets and de-regulate to improve efficiency in the working of markets and the allocation   
  of resources
* Main areas of policy:
  + Labour Market – reduce impediments to free market, reduce bureaucracy and ‘red tape’ –   
    flexible labour markets
  + Reduce power of trade unions – legislation   
    of the eighties still has an impact in this respect
  + Short term contracts
  + Flexible working arrangements
  + Hiring and firing
  + Contracts, terms and conditions, pay
  + Criticism of such policies is that they put the needs of employers above those of workers which can lead to exploitation
* Tax and Welfare Reform:
  + More stringent benefit regime
  + Tax reform to encourage people   
    to work
  + Improving access to training   
    and education
  + ‘\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_’ scheme

**Fiscal Policy:**

* Influencing the level of economic activity though manipulation   
  of government income and expenditure
* Associated with Keynesian Demand Management Policies
* Now seen in wider terms:
* Influence Aggregate Demand –
  + Tax regime influences consumption (C) and investment (I)
  + Government Spending (G)
* Influences key economic objectives
* Acts as an ‘automatic stabiliser’
* Also used to influence non-economic objectives and provide framework for supply side policy
* e.g. education and health, poverty reduction, welfare reform, investment, regional policies, promotion of enterprise, etc.

**The Golden Rule!**

* Fiscal policy framework

The Government's fiscal policy framework is based on the five key principles set out in the Code for fiscal stability - transparency, stability, responsibility, fairness and efficiency.

The Code requires the Government to state both its objectives and the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ through which fiscal policy will be operated. The Government's fiscal policy objectives are:

* over the medium term, to ensure sound public finances and that spending and taxation impact fairly within and between generations; and
* over the short term, to support monetary policy and, in particular, to allow the automatic stabilisers to help smooth the path of the economy.
* These objectives are implemented through two fiscal rules, against which the performance of fiscal policy can be judged. The fiscal rules are:
* the golden rule: over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
* the sustainable investment rule: public sector net debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level. Other things being equal, net debt will be maintained below 40 per cent of GDP over the economic cycle.