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Can we avoid another Global Recession?

Introduction:

Since the Great Recession came to an end in 2009, the global economy has been going through a time of growth. There are worries that a new crisis may be on the horizon for the world economy. This term paper examines macroeconomics ideas to see if we can prevent another global recession.

Speaking in Davos, the IMF's Managing Director, Kristalina Georgieva, told the World Economic Forum Annual Meeting that the world needs to stay focused and strive for peace in Ukraine to avoid a global recession.

"They need to work hand in hand with fiscal authorities, with the finance ministries. Central banks are independent, this is a huge advantage. But fiscal policy and monetary policy in this environment really need to go hand in hand."

Economic growth:

An economy's ability to produce more products and services over time is known as economic growth, which is a crucial macroeconomic concept. Economic growth is a crucial element in preventing a global recession and a key indicator of an economy's strength and health.

The rate of economic development typically slows or even reverses during a global recession. This is because of a decline in the demand for goods and services, which also affects output and employment. Businesses unable to sell their goods or services may be compelled to reduce production, fire employees, or cease operations. This may result in a decline in economic activity that lowers demand and forces more companies to close their doors.

To avoid a global recession, it is important to maintain economic growth.

Another important macroeconomic term that is closely related to the possibility of a global recession is inflation. The rate at which the average price level of goods and services in a market rises over time is known as inflation. Money loses purchasing power when inflation is excessive, which can cause uncertainty and decrease economic activity.

Inflation:

Inflation typically declines or turns negative when the world is experiencing a recession. The decline in desire for goods and services is the cause of this. Businesses may be forced to lower their prices or go out of business when demand declines because they can no longer offer their products for the same price as before. This may result in a drop in the average cost of products and services, which in turn leads to deflation.

Because it can result in a downward spiral of economic activity, deflation can be a significant issue for the economy. Customers may put off purchases as the overall price level drops in the hopes of seeing even lower costs down the road. These further reduce demand, which results in lower output and jobs.

Unemployment:

A crucial socioeconomic idea that is intricately linked to the world economic downturn is unemployment. It describes the number of individuals who are actively looking for work but are having trouble doing so. As businesses reduce output, investment, and employment during a global recession, unemployment tends to rise.

A weak economy may be indicated by high unemployment, which can also result in decreased consumer spending, slower economic development, and societal unrest. There may be a decline in the desire for goods and services when people are unemployed because they have less money to spend. A downward spiral of economic activity could result from companies cutting back on employment and production, which would raise unemployment even further.

International Trade:

An essential macroeconomic idea, the danger of a global recession is closely correlated with international trade. The trading of products and services across international borders is referred to as international trade. International trade can lead to greater efficiency and innovation and is a significant driver of economic development. However, when there are imbalances in trade between nations, international commerce can also contribute to economic instability.

International commerce typically suffers during a global recession as nations impose import and export quotas to safeguard their domestic industries. As a result, there may be a slowdown in global economic activity, fewer jobs, and a decline in consumer desire for goods and services.

Measures:

Fiscal policy:

Governments use fiscal policy as a macroeconomic tool to affect the amount of overall demand in the economy. Increasing government expenditures and/or lowering taxes are examples of expansionary fiscal policy, which increases disposable income and consumption. In turn, this boosts overall demand and encourages economic expansion.

The Keynesian theory is one theoretical foundation for fiscal policy. In a recession, the economy, in Keynes' view, performs below its potential level of production, and there is a discrepancy between the economy's actual and potential output. Fiscal policy can be used in this case to increase government expenditure and/or reduce taxes to close the output gap.

However, some analysts contend that fiscal policy can result in budget deficits, which could have unfavorable long-term effects. In this situation, policymakers must find a balance between short-term fiscal stability and fiscal stimulus.

The possible effects of fiscal policy actions, such as government spending and taxation, on the economy can be examined using the IS-LM model. The LM curve in the IS-LM model represents the relationship between output and money supply, while the IS curve in the model depicts the connection between output and interest rates. When the government spends more, the IS curve is shifted to the right, which raises production and interest rates. This is so that a rise in government spending can increase output by increasing demand for goods and services. A rise in desire for money due to increased output causes an increase in interest rates.

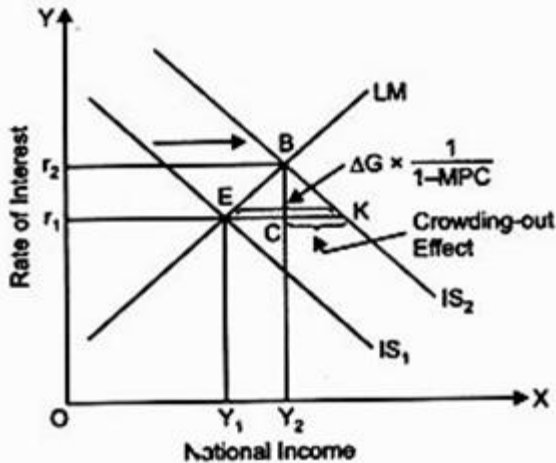


Fig. 20.6. Expansionary Fiscal Policy : Impact of Increase in Government Expenditure on Interest Rate and Income

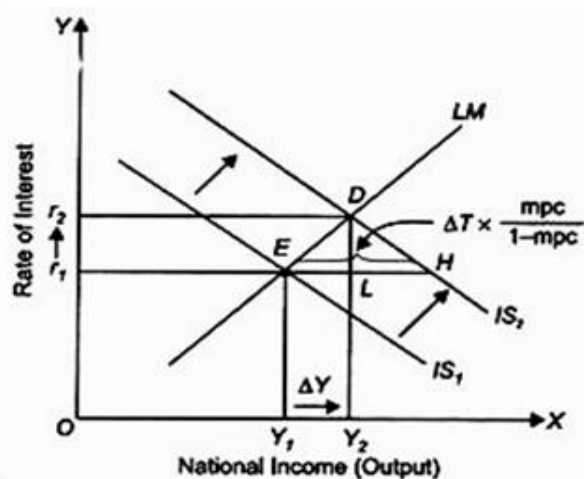


Fig. 20.7. Expansionary Fiscal Policy: Effect of Cut in Taxes

On the other hand, when the government cuts back on expenditure, the IS curve shifts to the left, causing output and interest rates to fall. This is because lower government spending lowers demand for products and services, lowering output. Interest rates drop due to the decline in output because there is less desire for money.

Similarly, when taxes are raised by the government, less money is available for spending, lowering production and reducing consumption. As a result, there is less desire for money, which lowers interest rates. Taxes are reduced by the government, which raises disposable income and boosts production and consumption. Because of this, there is more demand for money, which raises interest rates.

Policymakers can use the IS-LM model to determine the ideal amount of public spending and taxation to prevent another global recession. Policymakers can determine the ideal amount of taxation and spending by using the IS-LM model to prevent a new global recession. Government officials can stimulate demand and production and avert a recession by raising spending or cutting taxes. Conversely, policymakers can reduce demand and production by reducing spending by the government or raising taxes, which can aid in preventing inflation and an overheated economy.

The implementation of fiscal policy based on the Keynesian and IS-LM models has a long past. Here are a few illustrations:

1. To stimulate economic growth and generate jobs, President Franklin D. Roosevelt implemented the New Deal in the United States during the 1930s Great Depression. Along with tax reductions, the New Deal saw substantial government investment in social welfare and public works projects. Keynesian ideals, which emphasized the necessity of government intervention in the economy to advance full employment, served as the foundation for these policies.
2. Post-World War II: To encourage economic growth and stability, many nations adopted expansionary fiscal policies based on the Keynesian paradigm after the war. The Employment Act of 1946 set the goal of full employment in the United States, and the government enacted programs like the Marshall Plan, which helped European nations rebuild their economies. Keynesian ideas served as the foundation for the creation of the welfare state and social safety networks in Europe.
3. Stagflation, characterized by soaring prices and unemployment, occurred in many nations during the 1970s. The Keynesian model, which assumed that unemployment and inflation would advance in opposing directions, was put to the test during this time. In reaction, economists created the IS-LM model, which emphasized how important monetary policy is and how expectations play a part in how the economy performs.
4. The global financial crisis of 2008-2009: The global financial crisis of 2008–2009 saw the implementation of fiscal policies based on both the Keynesian and IS–LM theories in many nations. The American Recovery and Reinvestment Act, enacted by the US government in 2009, increased government spending on infrastructure projects, education, and other public goods significantly. The IS curve was moved to the right by this rise in government spending, which increased output and employment. Tax reductions were also adopted by the US government to increase demand and spending. Additionally, this caused the IS curve to shift to the right, increasing production and employment. These fiscal policy changes assisted in boosting economic expansion and averting a deeper and more protracted decline. The American Recovery and Reinvestment Act served to increase real GDP by between 0.1 and 4.1 percentage points between 2009 and 2012 and to create or save between 700,000 and 3.3 million jobs, according to a 2019 report by the Congressional Budget Office.

In many nations throughout history, the application of fiscal policy based on the Keynesian and IS-LM models has played a significant role in shaping economic policy. Even though these models have come under fire, they are still important in determining economic strategy today.

Monetary Policy:

Another macroeconomic instrument that central banks use to affect the level of aggregate demand in the economy is monetary policy. Lowering interest rates and/or expanding the money supply through an expansionary monetary policy encourages more investment and consumption. In turn, this boosts overall demand and encourages economic expansion. The possible effects of monetary policy actions, such as interest rates and the money supply, on the economy can be examined using the IS-LM model. Policymakers can aid in preventing a new global crisis by using the model to determine the ideal level of interest rates and money supply.

The relationship between the financial and real segments of the economy is depicted by the IS-LM model. The relationship between production and interest rates is represented by the IS curve in this model, whereas the relationship between output and the money supply is represented by the LM curve. The LM curve and/or the IS curve can shift when the central bank adopts monetary policy measures because they can influence both the interest rate and the money supply.

In this model, a drop in interest rates causes the LM curve to move to the right, which raises production and aggregate demand. Additionally, a rise in the money supply causes the LM curve to slant to the right, which lowers interest rates and boosts aggregate demand and production.

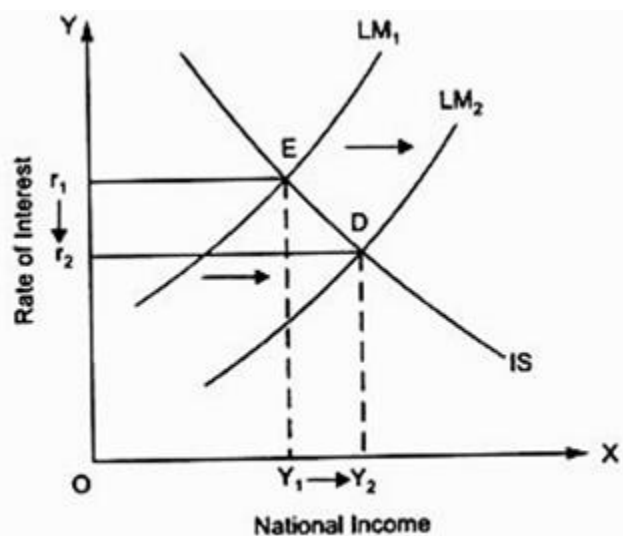


Fig. 20.8. *Effect of Expansion in Money Supply on Interest Rate and Income*

When the central bank lowers interest rates, for instance, the cost of borrowing decreases, investment and consumption rise, and production rises. Both production and interest rates rise because of the IS curve's rightward shift. Similarly, when the central bank expands the money supply, interest rates fall, boosting investment and consumption while increasing production.

Policymakers can identify the ideal level of interest rates and money supply to prevent a new worldwide recession by using the IS-LM model. Policymakers may decide to adopt expansionary monetary policy measures, such as lowering interest rates or expanding the money supply, to boost economic activity and increase output if the economy is in a downturn and aggregate demand is low.

On the other hand, policymakers may decide to adopt contractionary monetary policy measures, such as raising interest rates or reducing the money supply, if the economy is overheating and experiencing high inflation. This will reduce demand and prevent inflation.

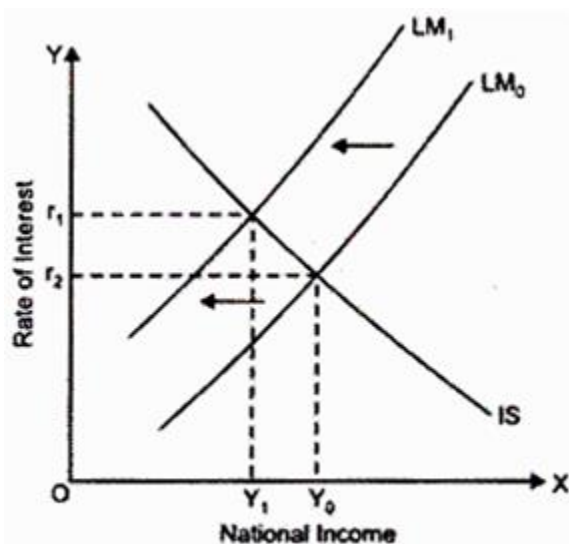


Fig. 20.9. Contractionary Monetary Policy to Fight Inflation

Overall, the IS-LM model gives decision-makers a helpful tool for analyzing the potential effects of monetary policy actions on the economy and figuring out the ideal level of interest rates and money supply to prevent a new global recession. Policymakers can encourage economic growth and stability by using the model to help them make choices about how to implement policies.

There are numerous instances of nations that have used the IS-LM model to inform their monetary policy decisions and reap the rewards. Japan in the 1990s is a prime illustration of this.

Japan went through a protracted era of deflation and economic stagnation in the 1990s known as the "Lost Decade." Policymakers adopted monetary policy measures based on the IS-LM model to address this downturn.

The Bank of Japan adopted a policy of zero interest rates in 1999, which brought down interest rates to almost zero levels. By increasing investment and consumption due to this policy change, the economy expanded and avoided a more severe and protracted recession. Quantitative easing, which raised the money supply and further reduced interest rates, was the policy's immediate successor.

These monetary policy adjustments aided in boosting economic expansion and averting a deeper downturn. A 2003 study by the Bank of Japan found that between 1999 and 2001, the zero-interest rate strategy contributed to real GDP growth increasing by 1.2 percentage points and the unemployment rate decreasing by 0.5 percentage points.

To promote economic growth during times of economic downturn, other nations, including the United States and the United Kingdom, have also adopted monetary policy measures based on the IS-LM model. These actions have supported economic recovery by assisting in preventing or reducing the impacts of a recession.

International cooperation:

The IS-LM model can be used to assess how the economy might be affected by international cooperation. To handle global economic challenges and advance economic growth and stability, countries must coordinate their efforts.

Policymakers can determine the ideal degree of international collaboration to avert another global recession using the IS-LM model. For instance, if there is a downturn in the world economy, policymakers may decide to enact expansionary fiscal and monetary measures, such as raising public expenditure and lowering interest rates. If other nations do not adopt expansionary policies, the efficacy of these measures may be constrained.

International cooperation can support global economic development by amplifying the effects of monetary and fiscal policies across nations. For instance, if several nations coordinate their monetary and fiscal policies, they can develop a more substantial stimulus package that encourages global economic development. This can support global economic stability and avoid a recession.

Additionally, global economic challenges like trade imbalances or currency fluctuations may be lessened by international collaboration. By cooperating, nations can create rules and agreements that support stable currencies and equitable trade, thereby reducing the risk of economic instability and fostering economic expansion.

Overall, the IS-LM model gives decision-makers an effective tool for analyzing the potential effects of global cooperation on the economy and figuring out the ideal degree of cooperation to prevent a recession or encourage economic growth. Policymakers can contribute to the development of a more secure and thriving global economy by using the model to guide their choices.

There are numerous instances of nations that have successfully adopted international cooperation policies based on the IS-LM model. One such instance is the G20 nations' concerted response to the worldwide financial crisis of 2008.

Aggregate demand in the global economy significantly fell during the financial crisis, which had a negative impact on output and jobs. Policymakers from G20 nations adopted coordinated fiscal and monetary policy measures based on the IS-LM model to address this downturn.

To promote economic development and avert a deeper and longer-lasting recession, G20 nations adopted expansive fiscal and monetary policies, such as raising government spending and lowering interest rates. Furthermore, G20 nations coordinated their policy responses to avert a global financial crisis and advance economic security worldwide.

These well-coordinated policy reactions assisted in boosting economic expansion and averting a deeper and more protracted recession. In 2009, the coordinated policy responses of the G20 countries served to boost the global GDP by two to three percentage points, according to an IMF report from 2014.

The coordinated efforts by European Union nations to address the European debt crisis and the coordinated efforts by Asian nations to address the Asian financial crisis in the late 1990s are two additional instances of international cooperation policies based on the IS-LM model. In both instances, nations collaborated to put into place well-coordinated policy reactions to avert a more serious and protracted downturn and to advance economic stability.

Investment in R&D:

Investment in R&D can be considered to move the IS curve to the right in the IS-LM model, increasing production and interest rates. This is because spending on R&D may result in higher levels of investment and consumption, which in turn may increase the demand for products and services.

R&D spending can also result in technical advancement, which can move the LM curve to the right, lowering interest rates and raising output. This is so because advancements in

technology may result in higher output and efficiency, which may reduce the need for money and lower interest rates.

Other nations that have adopted IS-LM model-based policies to foster innovation and technology during times of economic downturn have profited from them. Germany during the global financial crisis of 2008 is one such case.

A substantial decline in aggregate demand during the financial crisis resulted in a decline in output and employment for the German economy. To combat this downturn, policymakers put into place initiatives like the "High-Tech Strategy 2020" that encourage invention and technology.

Significant R&D investments were made as part of the "High-Tech Strategy 2020" plan, with an emphasis on vital industries like renewable energy, healthcare, and information and communication technologies. These investments supported technological advancement and innovation, which in turn served to generate new business prospects and jobs, resulting in economic growth and stability.

The "High-Tech Strategy 2020" initiative also included measures to assist start-ups and small to medium-sized businesses, such as financing for business incubators and accelerators and tax breaks for R&D and innovation. In developing industries and sectors, these rules promoted entrepreneurship and employment creation.

In general, Germany's IS-LM model-based policies to support innovation and technology during the global financial crisis of 2008 helped to encourage a culture of innovation and entrepreneurship, resulting in economic growth and stability. Even in times of economic downturn, lawmakers can contribute to the development of a more innovative and prosperous economy by supporting entrepreneurship, spending in R&D, and fostering a supportive regulatory environment.

Conclusion:

In conclusion, a global recession can be avoided by implementing macroeconomic tools and policies that support stability and development. A comprehensive plan to avoid or lessen the impacts of a global recession should include investments in infrastructure, monetary policy, international cooperation, education, research and development, and infrastructure.

Policymakers can boost aggregate demand, boost productivity, and encourage innovation and entrepreneurship by utilizing these policies and instruments. Additionally, they can collaborate to support the fair trade and stable currencies that are crucial for the expansion and stability of the world economy.

Despite not being a miracle cure, history has shown that these policies and tools can be useful in fostering economic development and averting recession. Policymakers can build a more prosperous and resilient global economy that helps people and societies all over the world by continuing to hone and adapt these policies and tools.

Image sources:

<https://www.economicdiscussion.net/is-lm-curve-model/fiscal-and-monetary-policies-and-is-lm-curve-model/10586>