Course: Understanding economic policy making
Assignment 1:Economic policy simulator
Name: Klaas Joris Schut

Gaps in the business cycle of country 1

- A gap between government spending and income (the country is running a deficit of around 3-4 %/year with the exception of year 3)
- There seems to be a gap between real and potential GDP (of around 2-3 %/year with the exception of year 1)
- There is a gap between the expected and real inflation (inflation is 2% higher than expected)
- There is a gap between the expected stabilization of debt (as % of GDP) (of the IMF) and real public debt growth

Fiscal policies used by the authorities and its desirableness

The authorities seem to be following a slightly expansive fiscal policy. This is the result of the high spending (especially in year 4 and 5) compared to a slight increase in taxes (less than 2% in 4 years). This results in a gap between government spending and income.

This approach is not appropriate to close the gaps. Although this policy can help GDP growth it seems to have little effect. However, it does have an effect on the other gaps as it boosts inflation and increases government debt.

Monetary policies used by the authorities and its desirableness

The authorities seem to be following a contracting monetary policy (interest rates seem to increase steadily in year 1 to 4).

This is not effective as it decreases GDP by lowering the level of investment which in turn slows GDP growth. Nevertheless, it does seem to keep the inflation in check (the increase of the level of inflation in year 4 seems to be caused by the huge increase of government in year 3).

Problems country 1

- High public debt
- Decreasing level of investment
- High inflation rate (especially year 4)
- Stagnation of GDP growth (if nothing happens they will likely fall in a recession next year)

Effects of deregulation

- Investment increases
- FDI increases

Year	**1**	**2**	**3**	**4**	**5**	**6**
Tax rate	34.40	38.20	38.40	36.00	40	50
Interest rate	17.5	17.44	19.05	23.24	13.24	3.24
Growth social spending	11.29	-3.71	21.85	0	-10	-10
Structural reform	2	2	2	2	1	1
Consumption (GDP=100 Year 4)	60.55	58.04	56.93	61.5	62.35	63.87

Investment (GDP=100 Year 4)	19.47	18.32	18.04	18.50	21.54	22.96
Government spending (GDP=100 Year 4)	19.1	19.3	20.1	20	18.56	16.88
GDP growth (%=real)	4.3	1.3	1.9	0.4	2.44	3.71
Budget deficit (as %GDP)	3.4	3.3	9.8	4.9	-0.68	-13.54
Taxes as % of GDP	na	na	na	22.14	24.94	31.93
FDI as % total investment	28.2	22.7	19.6	11.4	12.0	11.5
Public debt (as % of GDP)	49.4	52.6	55.9	57.4	62.3	61.62
Inflation rate	7.00	6.8	8.50	14.72	7.11	7.14
Unemployment rate (%)	13.30	11.30	11.70	12.30	11.83	11.72

Fiscal policy: I choose for an contracting fiscal policy as this reduced public debt (which was rising to a undesired level). Although this had the potential to cause deflation. This however is offset by the expansive monetary policy. Tax increase was used as a means to control GDP growth, which now remains at a desirable level given the infrastructure of the country.

Monetary policy: I choose for an expansionary monetary policy as this stimulate investment and consumption. Both are needed for GDP growth. Although this results in an increase in inflation this is offset by the contacting fiscal policy causing crowding in to occur. Given the fact we want more investment this is good.

Structural reform: I choose for deregulation as it is currently very hard to run a company in this country ie to start a company you need to go through 17 procedures (OECD average is 6) and firing employees is hard (it take 127 days longer than the OECD average and 10 more procedures are needed). As GDP growth needs to come primary from increased investment deregulation was the option for this parameter.