

MARKET FAILURES

MPA 612: Economy, Society, and Public Policy

March 20, 2019

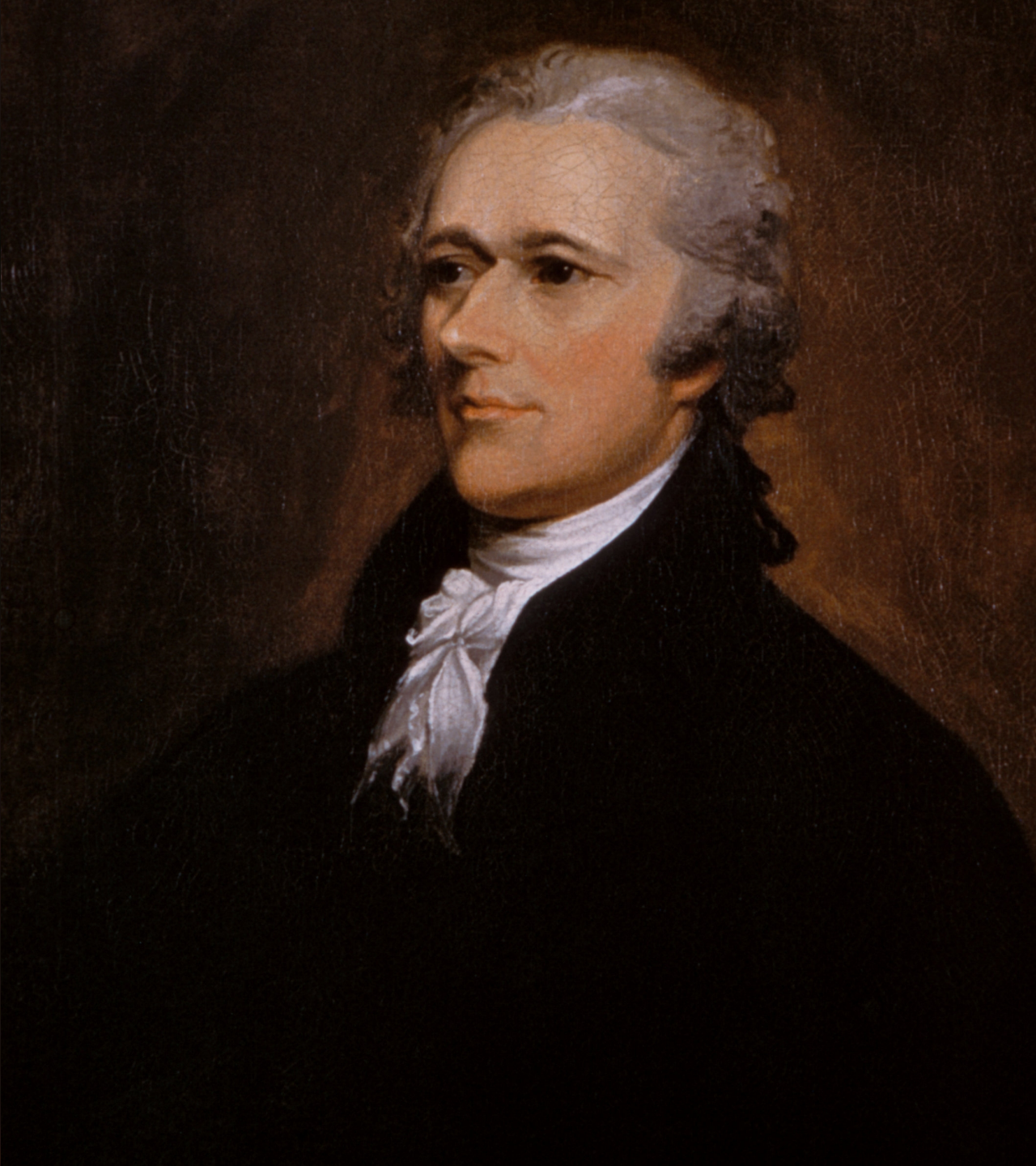
*Fill out your reading report
on Learning Suite*

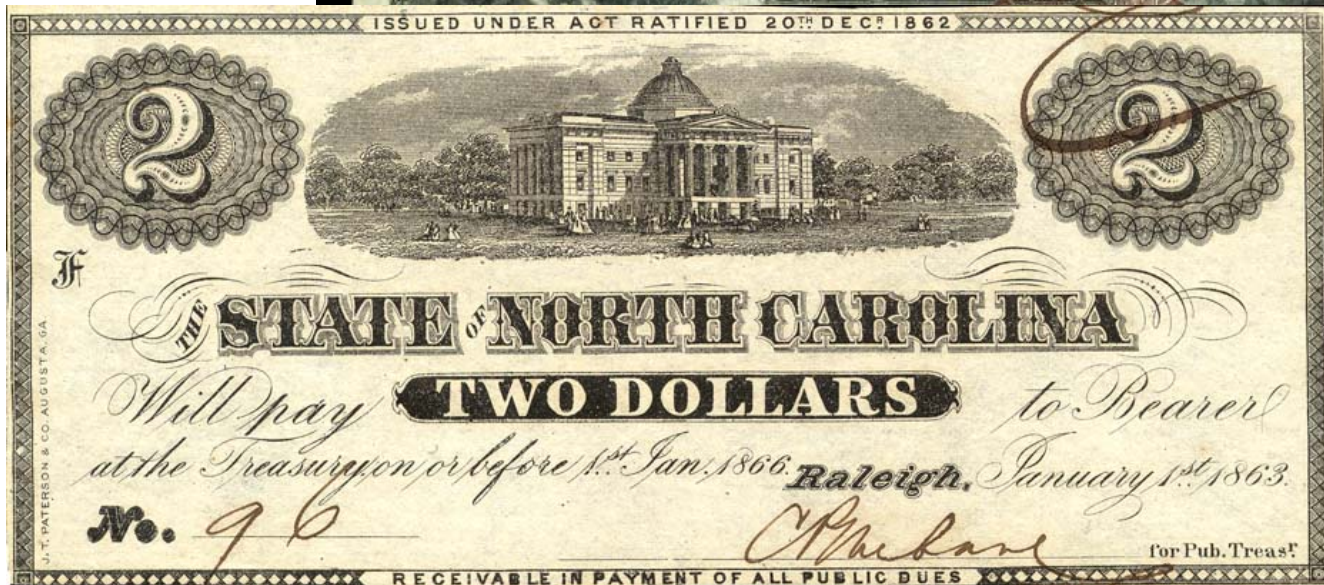
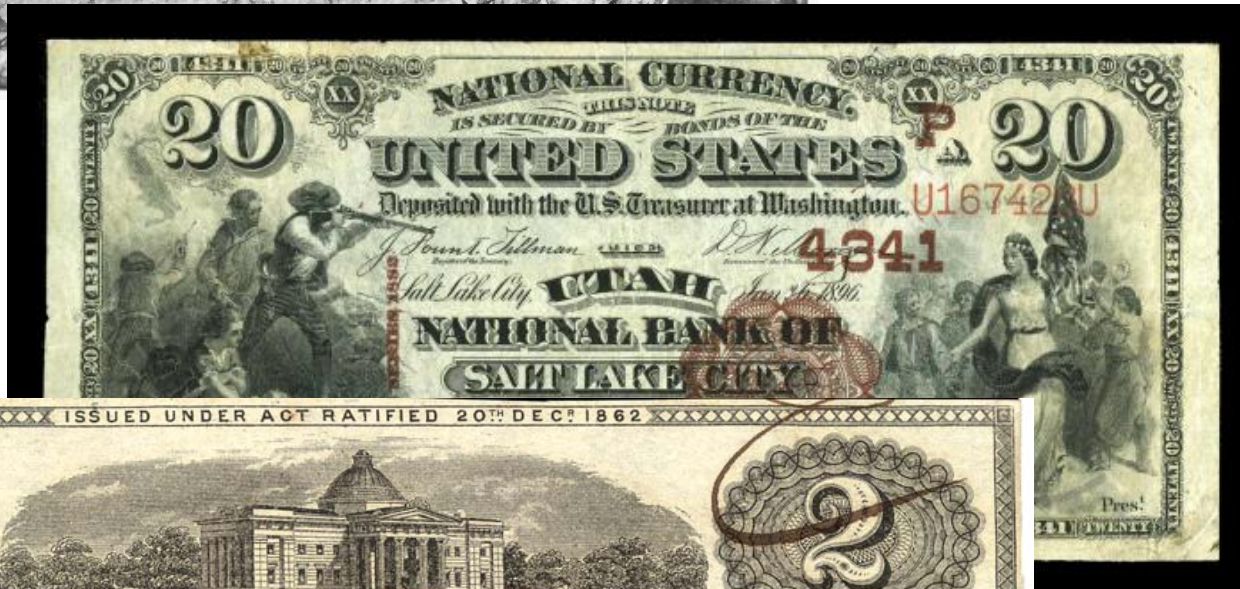
PLAN FOR TODAY

Monetary and fiscal policy

Multiplicative Products, Inc.

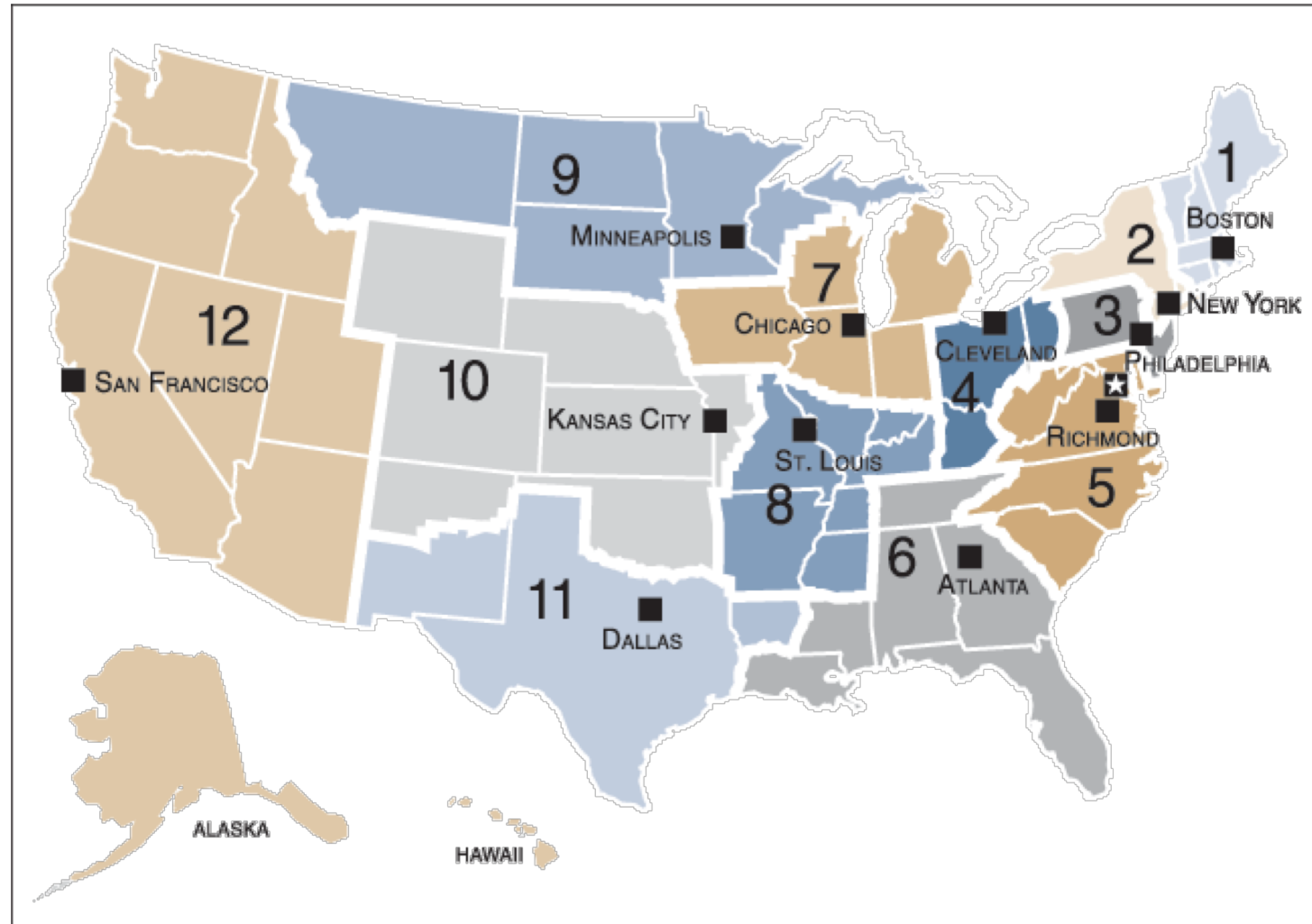
MONETARY AND FISCAL POLICY





Period	% Change in Money Supply	% Change in Price Level
1832–37	+ 61	+28
1837–43	– 58	–35
1843–48	+102	+ 9
1848–49	– 11	0
1849–54	+109	+32
1854–55	– 12	+ 2
1855–57	+ 18	+ 1
1857–58	– 23	–16
1858–61	+ 35	– 4

THE FEDERAL RESERVE SYSTEM



PURPOSES OF THE FED

**Regulate banks and keep
financial plumbing running**

**Use monetary policy to control
inflation and unemployment**

This dual mandate is unique to the Fed



Mike Bird ✓

@Birdyword

Follow



Jamaica's central bank is just blowing every other monetary authority out of the water in the communications department. Nothing but respect.



Bank of Jamaica



1:15 AM - 11 Jan 2019

MONEY SUPPLY

How much money exists

Type of money	M0	MB	M1	M2	M3	M4
Notes and coins in circulation (outside Federal Reserve Banks and the vaults of depository institutions) (currency)	✓	✓	✓	✓	✓	✓
Notes and coins in bank vaults (vault cash)		✓				
Federal Reserve Bank credit (required reserves and excess reserves not physically present in banks)		✓				
Traveler's checks of non-bank issuers			✓	✓	✓	✓
Demand deposits			✓	✓	✓	✓
Other checkable deposits (OCDs), which consist primarily of negotiable order of withdrawal (NOW) accounts at depository institutions and credit union share draft accounts.			✓	✓	✓	✓
Savings deposits				✓	✓	✓
Time deposits less than \$100,000 and money-market deposit accounts for individuals				✓	✓	
Large time deposits, institutional money market funds, short-term repurchase and other larger liquid assets					✓	
Commercial paper						✓

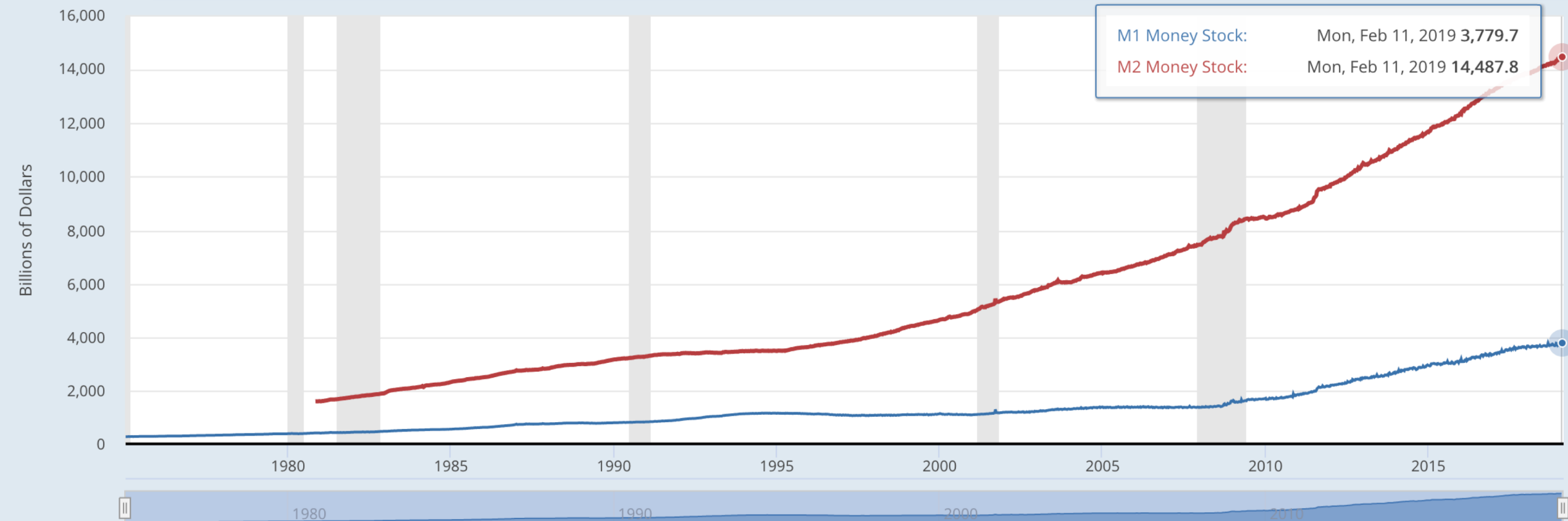
MONEY SUPPLY

M0: Physical currency

MB: M0 + Fed notes and deposits

M1: M0 + checks

M2: M1 + savings accounts



Shaded areas indicate U.S. recessions

Source: Board of Governors of the Federal Reserve System (US)

fred.stlouisfed.org

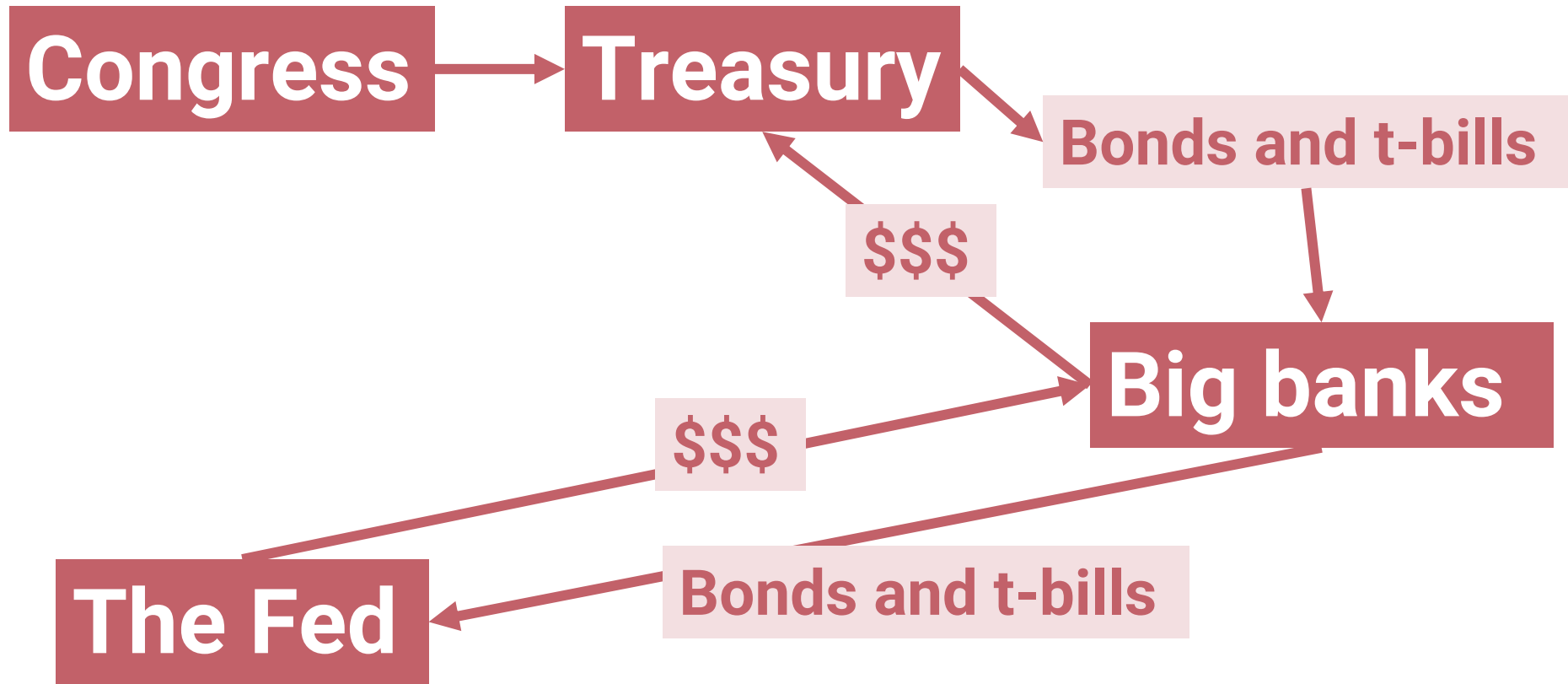
HOW TO MANIPULATE MONEY SUPPLY

Reserve requirements

Discount rate

Open market operations

FUNDING THE FEDERAL GOVERNMENT





Donald J. Trump ✓

@realDonaldTrump

Blocked



The only problem our economy has is the Fed. They don't have a feel for the Market, they don't understand necessary Trade Wars or Strong Dollars or even Democrat Shutdowns over Borders. The Fed is like a powerful golfer who can't score because he has no touch - he can't putt!

8:55 AM - 24 Dec 2018

29,787 Retweets 123,617 Likes



53K 30K 124K



Donald J. Trump ✓

@realDonaldTrump

Blocked



It is incredible that with a very strong dollar and virtually no inflation, the outside world blowing up around us, Paris is burning and China way down, the Fed is even considering yet another interest rate hike. Take the Victory!

6:27 AM - 17 Dec 2018

24,496 Retweets 105,338 Likes



26K 24K 105K



Fed Explains Pause as Officials Debate Future Rate Increases



Jerome H. Powell, the Federal Reserve chairman, has said the Fed has adopted “a patient, wait-and-see approach regarding future policy changes.”

Erin Schaff for The New York Times

FISCAL POLICY

**Government uses policy levers
to influence the economy**

Taxing and spending



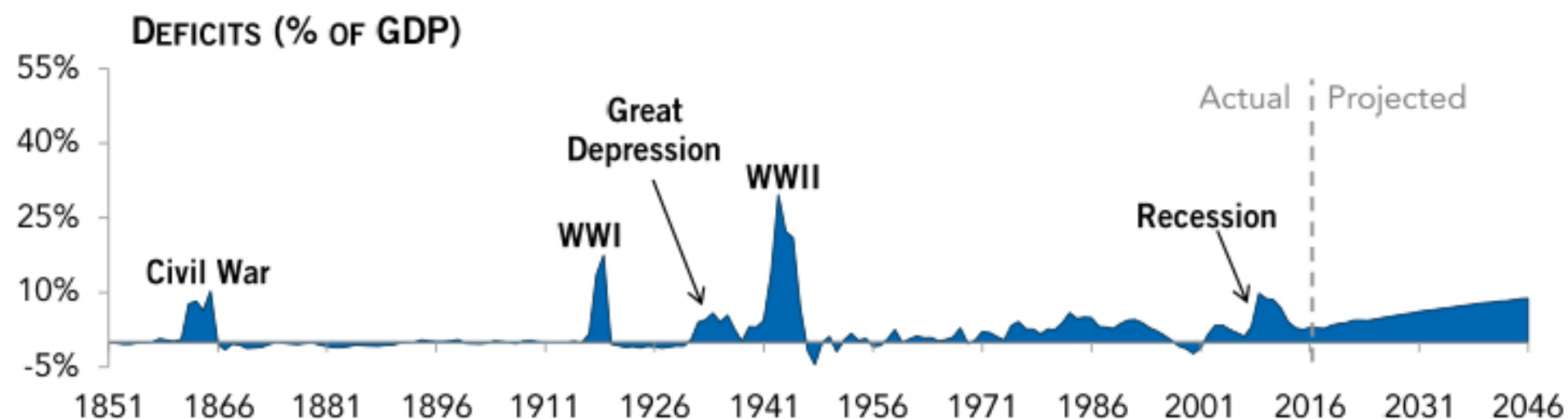
DEBT AND DEFICITS

Deficit

Revenue – expenditures in 1 year

Debt

All the past deficits added up



SOURCE: Congressional Budget Office, *The 2016 Long-Term Budget Outlook*, July 2016; Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2017*, February 2016; and the *Historical Statistics of the United States, Millennial Edition Online*, Cambridge 2006. Compiled by PGPF.

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THINK OF AMERICA'S DEBT AS YOUR FAMILY BUDGET

Annual Family Income: \$21,737*
Annual Family Expenses: \$38,188
Annual 'Credit Card' Debt: **\$16,451**
Budget Cuts/Savings: \$385

TOTAL 'CREDIT CARD' DEBT: \$142,000*

*Estimated 2014 U.S. Budget Cuts: In Hundreds of Millions of Dollars

FISCAL YEAR 2012



Receipts:
\$2,468,599,000,000

Outlays:
\$3,795,547,000,000

Deficit:
\$1,326,948,000,000

Projected national
debt (end of FY):
\$16.350.885.000.000

HOUSEHOLD BUDGET



Family income:
\$24,686

Money spent:
\$37,955

New debt:
\$13,269

Total family debt:
\$163,509

It works the same way for the government. **You can't borrow your way out of debt**, whether you're a typical American family or the entire U.S. government. At some point, you've got to say, "Enough is enough!" and make the hard cuts necessary to win over the long haul.



FEDERAL GOV. \neq HOUSEHOLD

**Government can create money
with Fed/Treasury magic**

Only real limit to government expenditure is inflation, not taxes;
theoretically there could be no need to tax

There's no due date

**Treasury bonds are exceptionally
stable = super low interest rates**

MAIN DEBT/DEFICIT QUESTION

Can the economy absorb new government spending without driving inflation?

Balancing the federal budget is a helpful trick for curbing inflation, but not all that necessary

Monetary policy

Money supply

Interest rates

Bonds

The Fed

Fiscal policy

Taxation

Public spending

Congress and the
Executive Branch

MULTIPLICATIVE PRODUCTS, INC.

02:50

202×87

243×22

992×37

562×60

141×90

536×21

724×20

510×24

553×92

268×38

262×19

776×35

384×93

783×56

257×21

17,574	5,346	36,704
33,720	12,690	11,256
14,480	12,240	50,876
10,184	4,978	27,160
35,712	43,848	5,397

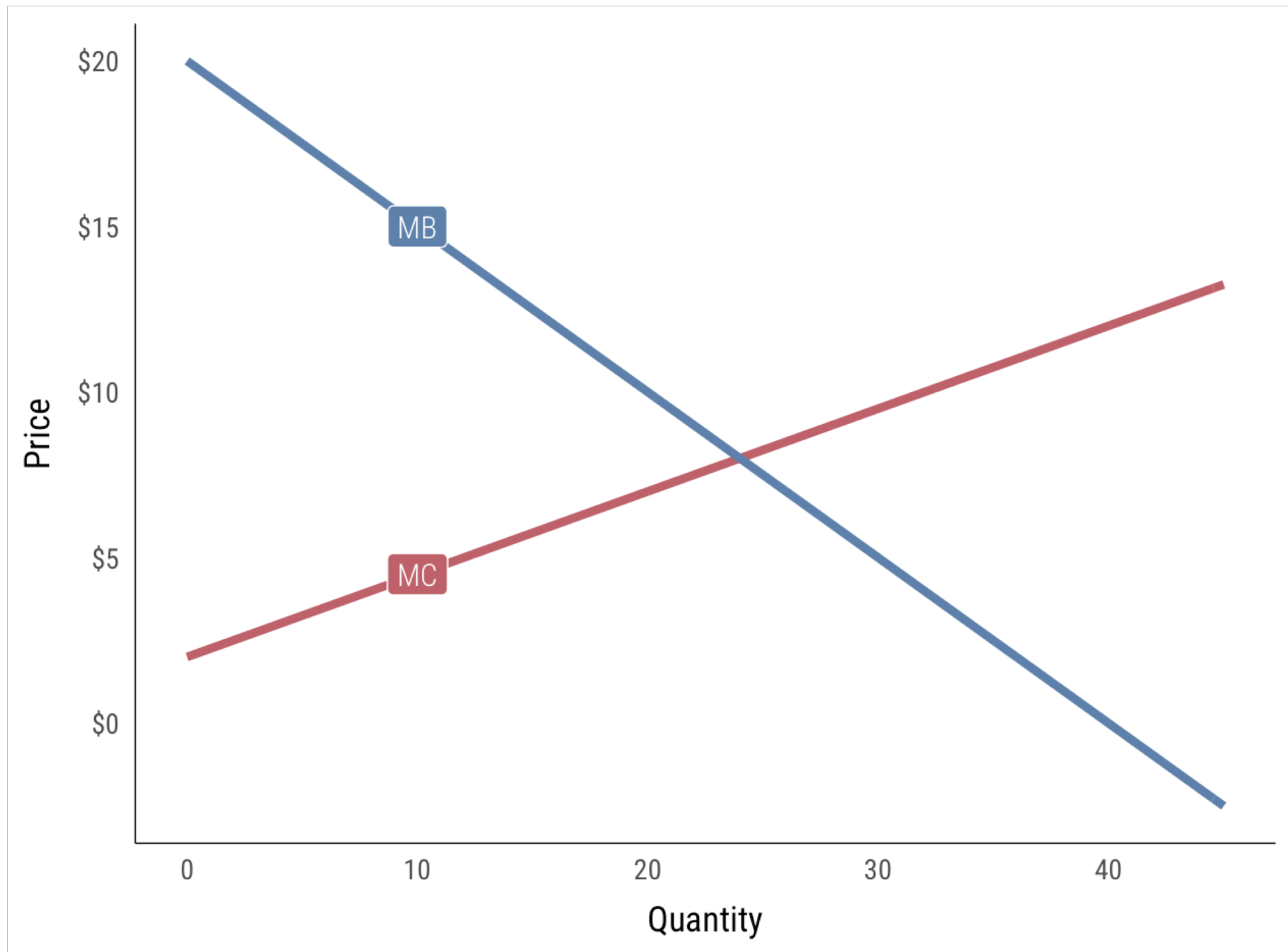
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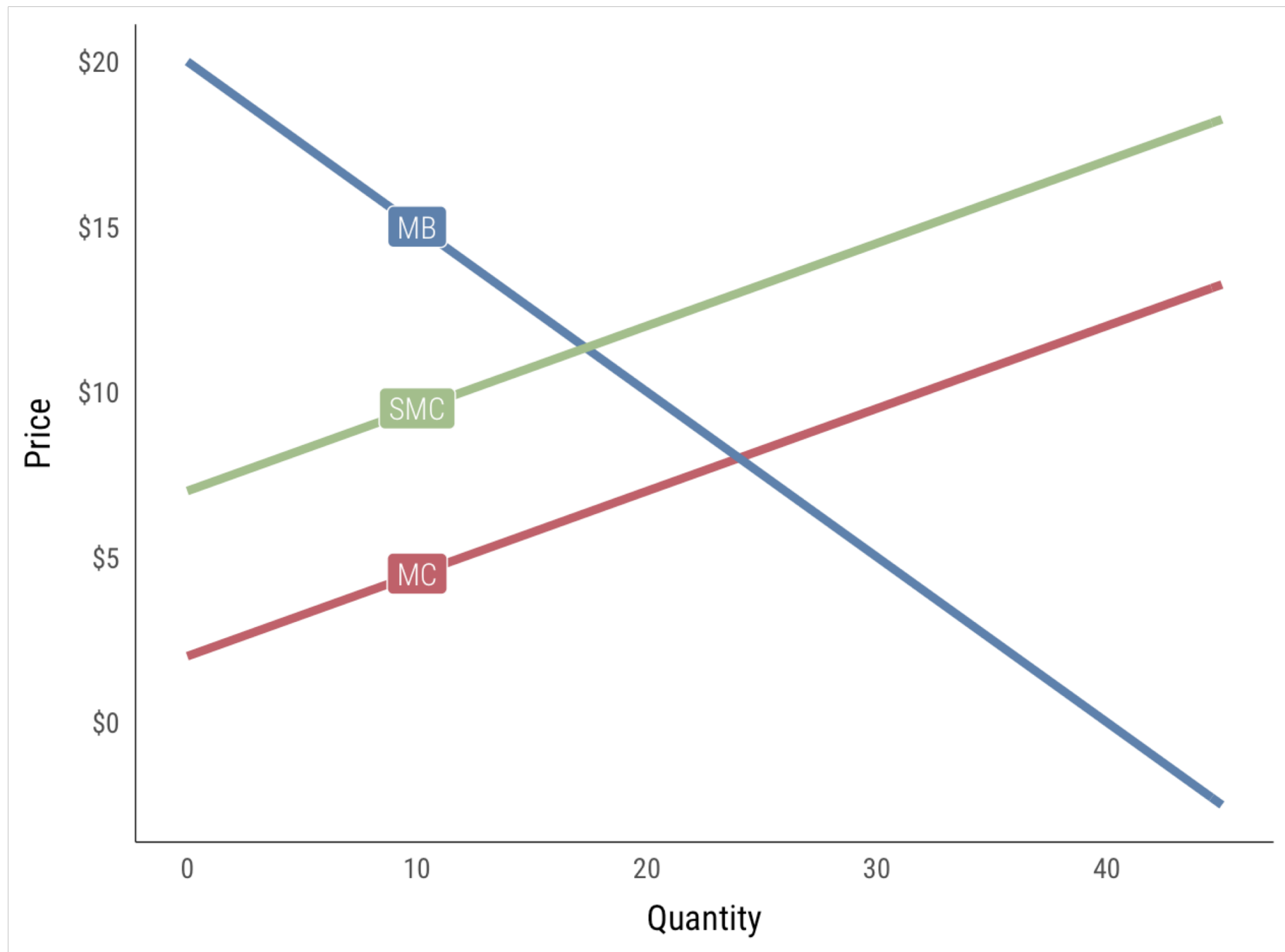
EXTERNAL EFFECTS

(aka externalities)

**A cost or benefit to
someone who did not
choose that cost or benefit**

Social marginal cost/benefit





02:50

648×38

135×58

396×22

661×11

296×27

551×39

108×37

573×45

709×23

699×14

848×24

378×19

853×56

332×12

237×29

24,624	7,830	8,712
7,271	7,992	21,489
3,996	25,785	16,307
9,786	20,352	7,182
47,768	3,984	6,873

02:50

02:50

660×13

923×37

681×60

309×55

374×22

788×13

354×11

556×21

166×74

363×18

281×37

745×95

372×52

598×13

544×95

8,580	34,151	40,860
16,995	8,228	10,244
3,894	11,676	12,284
6,534	10,397	70,775
19,344	7,774	51,680

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EXAMPLES

Pollution

Vaccinations

Cell phones and driving

Car alarms

Internet bandwidth

Research

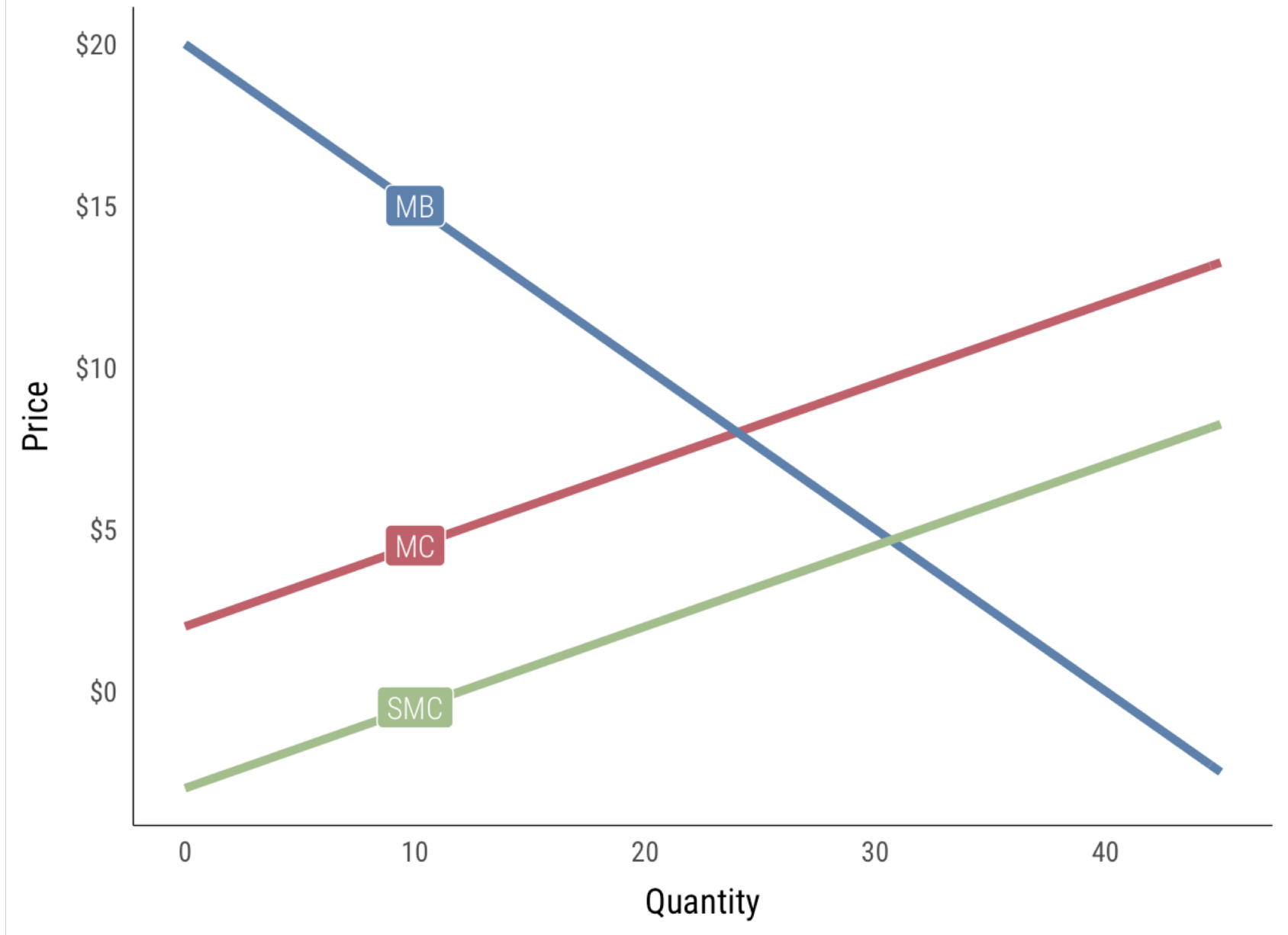
Education

Positive production effects

SMC *below* MC

Basic research

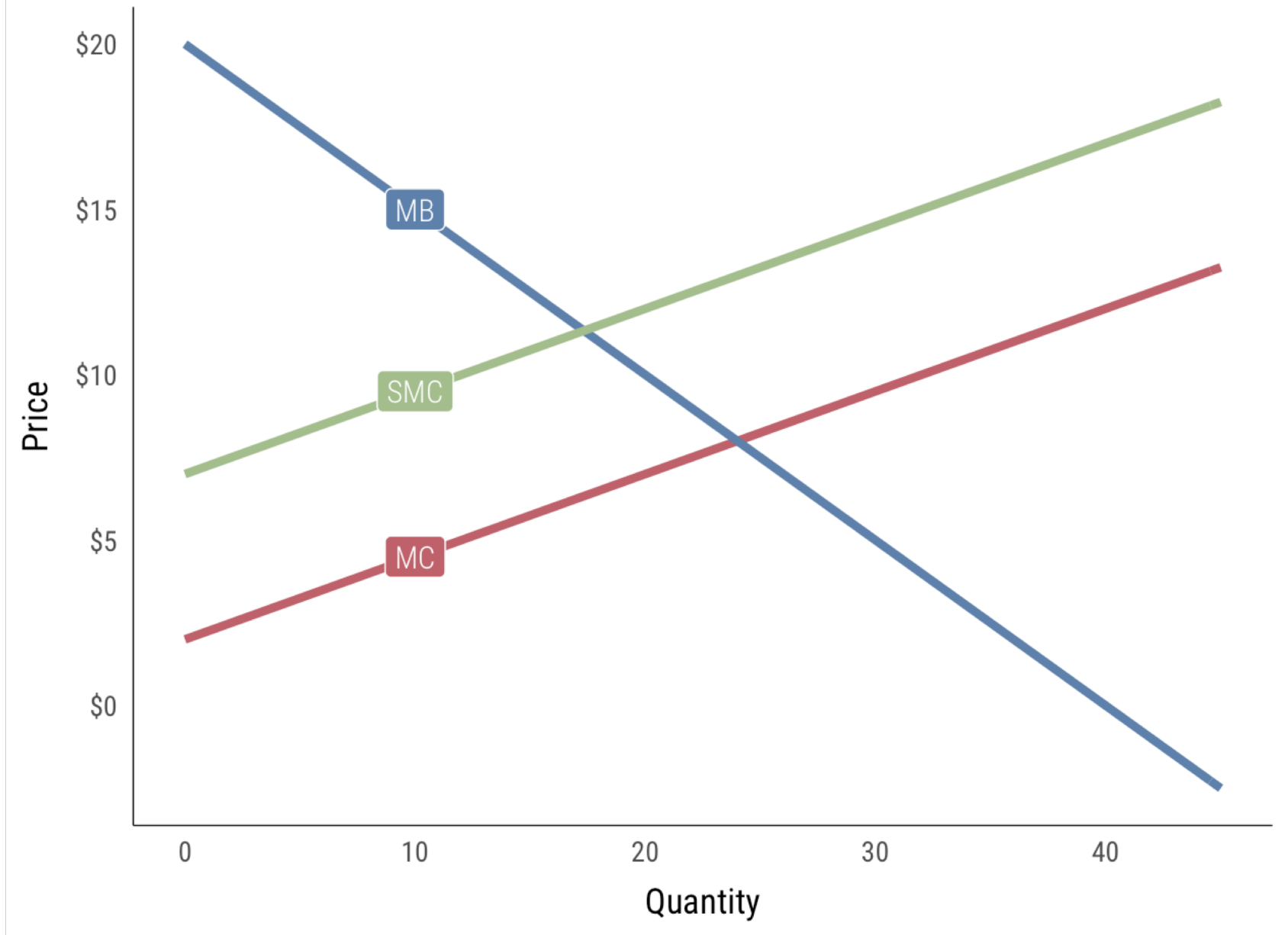
NSF, NIH, NEA



Negative production effects

SMC *above* MC

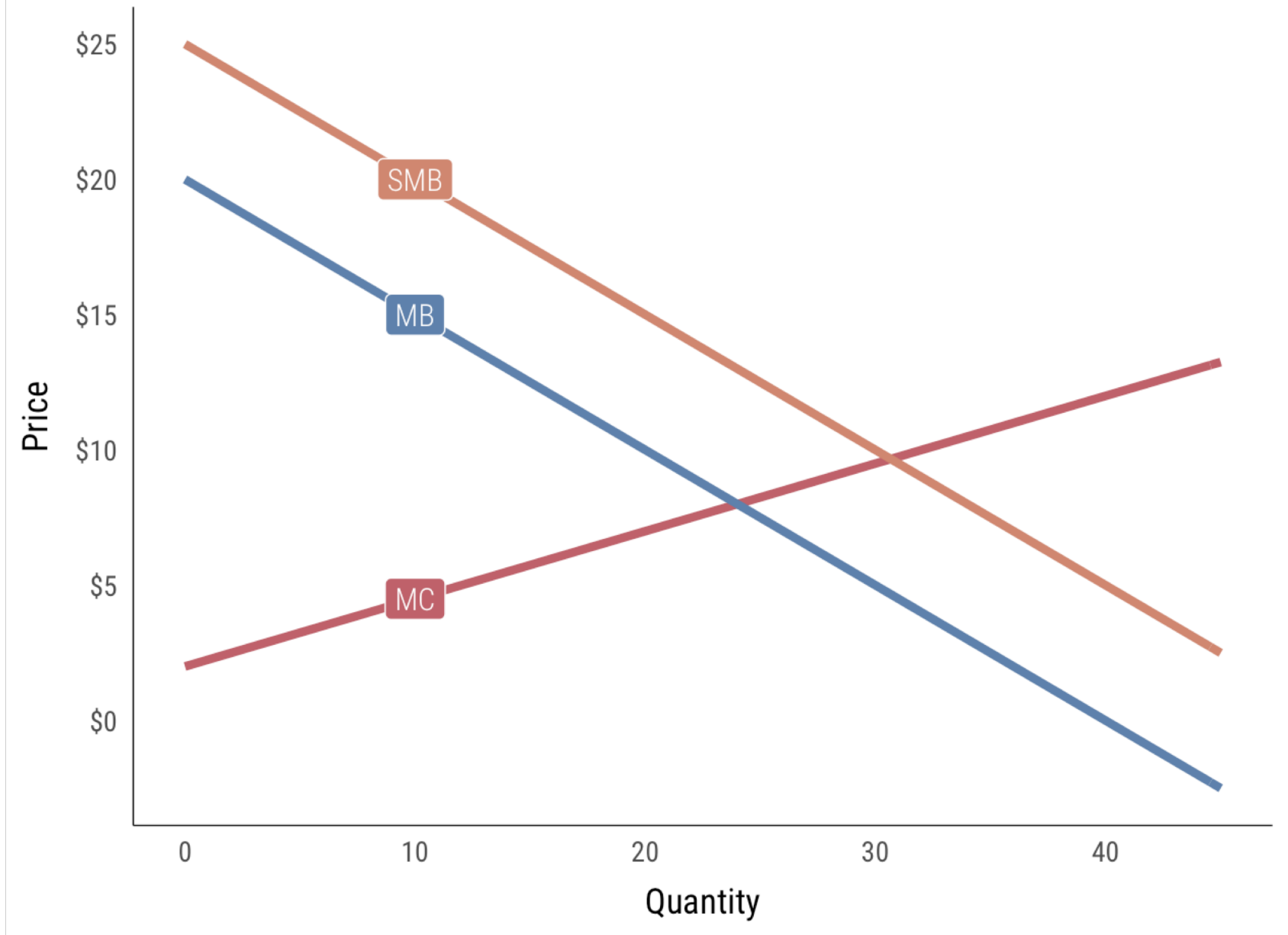
Pollution



Positive consumption effects

SMB above MB

Car alarms



Negative consumption effects

SMB *below* MB

International
airline travel

