

Potentially useful/helpful information for your second coursework

[1] Firstly three things to look at as recommended by John Hudson.

(1) An EXCELLENT 20-minute video clip explaining monetary policy:
<http://www.bankofengland.co.uk/education/filmsgames/index.htm>
Watch the “What if?” video, but the others are very good too.

(2) Measuring GDP
<http://www.statistics.gov.uk/cci/nugget.asp?ID=56>
The above link takes you to a guide to calculating GDP and measuring the UK’s economic activity.

(3) The Big Mac Index
<http://www.economist.com/markets/bigmac/index.cfm>
The above links you into an international news magazine, *The Economist*. It regularly collects data on the price of a good sold in many countries: the McDonald’s Big Mac hamburger. There are three hyperlinks in the Big Mac index, one an explanation, one a video clip, and also the latest index.

[2] Secondly, a reminder about your coursework, taken from the main course website (<http://staff.bath.ac.uk/hssjrh/macyr1no.htm>):

ESSAY Number TWO: Deadline MIDDAY, Friday, 25th April.

The student is to log into the IFS Website and run their Virtual Economy model of the economy. I will give you the following specific changes to make. These will be different for different students

- 1. Change Direct Taxation by x_1 (e.g. 23 to 26)*
- 2. Change Indirect Taxation by x_2 (VAT) OR INTEREST RATES*
- 3. Change Government expenditure by x_3 (e.g. both government capital spending and government current spending)*

To calculate x_1 - x_3 take your date of birth: e.g. 29.06.83 (29 June, 1983)

For x_1 subtract second number from first (2-9 = -7). If in excess of 5 in absolute value then divide by 2 and if necessary round up) -7 is in excess so divide by 2 = -3.5 and round up to -4. [Note a negative increase is in fact a decrease]. This is then x_1 . Repeat for x_2 with third and fourth digits, =0-6=-6, divide by 2=-3 no need to round up hence x_2 =-3. For x_3 use final two digits: 8-3=5, No need to divide by 2 hence x_3 =5. If any number is zero you may raise it to 1%. The above does leave latitude for you to make certain decisions (e.g. what exactly is direct taxation). This is part of the project and you are to defend those decisions and the marks will in part depend upon the assumptions you make. If you are to change interest rates then you should divide your number by 4.

You are to report the impact of the above on (i) inflation, (ii) unemployment and (iii) the balance of payments. This will be the case for each of the above on their own and for all three combined. You are then to comment, i.e. explain, these changes.

Word Limit 1250 Words

NOTE: Given your word limit, it may not be possible to do all of this, students must use their initiative. Note too getting the formula right is not too important as long as each student can show how they got their numbers from their date of birth that is fine. Also note the above differs from what I said in the lecture as it allows declines in taxes, etc, which was not the case in the lecture version. The above is correct.

[3] Here is how to begin:

Log on to the IFS Model Link in the website:

<http://www.bized.co.uk/virtual/economy/ve/>

Click on "Fourth Floor (The Model).
Click on "Selected Variables Form".

[4] Here are two questions emailed to John Hudson of me followed the replies. They might answer some of your questions too:

QUESTION:

"I know you didn't want stupid questions about the coursework, but can I ask one?

I was just wondering, do you change all the variables for the sections (e.g. increasing National Health Service, Education, Law and order and Defence spending when increasing government spending) or just change one?"

ANSWER:

"Not stupid at all. But you won't like the answer. Basically on all such issues where there is a choice to be made, make it AND justify it. When you all get jobs you will have to be making such decisions all the time and this is part of the indirect impact of education in getting you used to the process. Marks will partially be awarded on how good your assumptions and justifications are."

QUESTION:

I have been looking at the essay and I have a few questions which I hope you can help me with. Firstly, I am unsure what I need to change on the model. For example, in the case of government spending: do I change only government spending on health or do I change all three variables(on health, education and defence)? Does the same apply to taxes? Secondly, when analysing the graphs, is it necessary to explain the trend of inflation/unemployment/balance of payments before any changes to the model or do we just analyse why these will change as we change the taxes and government spending?

ANSWER:

The end of the question says that you have "latitude... to make certain decisions (e.g. what exactly is direct taxation. This is part of your project and you are to defend those decisions and the marks will in part depend upon the assumptions you make".

I.e. you make the decision and justify it.

Yes, you are right, you do need to "analyse why these will change as we change the taxes and government spending". The end of the question says that you are to "report the impact of the [changes] on (i)inflation (ii)unemployment and (iii) the balance of payments". In addition, you are to "comment, i.e. explain, these changes".

Regarding trends beforehand, this is your choice. It might be nice to do this, but you have a word limit so there is a trade-off. This is a decision you have to make and concerns the overall essay style/approach.

[5] Some interesting and useful ponderings from John Hudson might be worth a read:

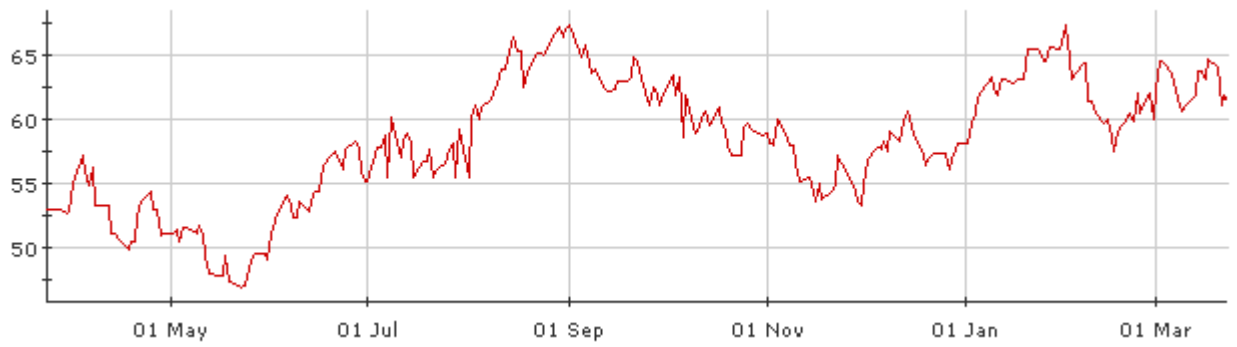
How does the model work? Basically it uses a set of equations such as we have built up in the lectures to 'model the economy'. But how can these be used to forecast the future? The basic answer is that apart from these equations the key factor is the assumptions made about the EXOGENOUS variables. Variables determined outside the model. An example would be world demand, exports depend upon this, but it will not be explained by the model. We need to make assumptions about this and other exogenous variables. Another exogenous variable is government spending and here YOU are making the assumptions on this as you run the model. What difference will it make to the model results if we have the following two scenarios:

Scenario A: World Demand to grow by 3.5% per annum 2006-2010., the price of oil to be stable at \$60 per barrel. ANSWER: Economy will grow quite rapidly and few inflationary pressures from cost of oil although maybe from falling unemployment, unemployment should be low too.

Scenario B: World Demand to grow by 1.5% per annum 2006-2010., the price of oil to rise steadily over the forecast period to \$110 per barrel. ANSWER: Economy will not grow so rapidly, inflationary pressures will build up from cost of oil. One complicating factor which would not be relevant for say France. The UK government gets a lot of tax revenue from oil. An increase in the price of oil will increase the revenue going to the government and may facilitate tax cuts or increases in government spending which will help stimulate the economy.

Note different type of oil has different prices, because it is of different quality etc. Brent crude is a commonly used price.

Brent Crude Oil



Note this diagram and others are available from http://newsvote.bbc.co.uk/1/shared/fds/hi/business/market_data/overview/default.stm.