## Money and the Prices in the Long Run and Open Economies

## Name

## Institutional Affiliation

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**Introduction**

Gross Domestic Product has remained the sole measure of economic growth for a long time in the American economy. It refers to the value of a country’s output and is usually a measure of the market value of a country’s final goods and services in monetary value over a period. Calculation of a country’s GDP involves the addition of consumption to the government spending, the country’s total investment and finally the capital expenditure required. GDP is a measure of a country’s economic growth, and the value varies according to factors like political stability and environmental factors among others (Johnson, 2013). The government can as well impact on economic growth through fiscal and monetary policies. Most of these strategies affect the interest rates as well as aggregate demand in the country.

**History of changes in GDP**

Though the country used other measures of economic growth in the early 19th century, it fully adopted the use of GDP as the only measure of economic value in the 20th century. Since then, the country has experienced an average GDP of 3.21% up to date. The highest GDP growth rate in the country’s history was 16.90 percent that America experienced during the first quarter of the year 1950 (Bernanke, 2010). On the other side, the nation experienced a record low GDP growth of 10% in the first quarter of the year 1958. Since then the country has experienced fluctuations of high low GDP growth. The economy grew at a rate of 2.3% in the year 2017 with a GDP value of $20.2 trillion. The first quarter of the year 2018 also reveals a stable economic growth of 2.3% through the estimate was lower. The rate is expected to grow by 2% in 2018, 2.4% in the year 2019 and 2% in 2020.

**Savings**

They refer to the percentage of income not spent by a country. It is also the percentage of Gross Domestic Product that households of a country hold. A recent survey reveals that 21% of Americans do not own a bank account while about 67% of the population has less than $1,000 in savings. Between the periods 1959 to 2018, the average of American household savings averaged 8.25% with fluctuations of high and low seasons (National Bureau of Research). The highest record in household savings was 17% in the year 1975 while the lowest record in the country’s savings was 1.9% in the year 2005 1950 (Bernanke, 2010). The savings rate dropped from 2.9% in November to 2.4% in December 2017. The prices then grew to 3.2% in January, 3.4% in February and then recorded a drop to 3.1% in March 2018. The savings growth rate in the country is expected to grow at the same rate of 2.3% over the next five years.

**Investment**

The value of personal savings equals the value of their investments. The value of America’s savings and investments has declined significantly over time. However, the global financial crisis is the main cause of the decline because it affected households negatively reducing their productive capacity. The slow growth rate in America’s investments cannot keep pace with the country’s depreciation and deterioration of infrastructure (National Bureau of Research). As a result, America relies on foreign investment to fund its expenditures. The country’s investments constituted a percentage of 9 percent of the GDP in the year 1969 while it has continued the downward trend to less than 4 percent of the country’s GDP in 2018. During the year 2009, the country’s investments hit rock-bottom at about 1 percent of the country’s GDP 1950 (Bernanke, 2010). One of the causes of low investment rate is the fact that American consumers are living beyond their means. If this does not stop, then the country’s investment is likely to fall beyond zero by the year 2022.

**Real interest rates**

The real interest rate refers to the interest that an investor, lender or saver gets receives. It is necessary to note that this rate considers inflation. It is the nominal interest rate less the rate of inflation. The regulation of America’s interest rates is purely the work of the Federal Reserve through fiscal measures to regulate inflation. Between the periods 1972 to 2018, the Federal Reserves’ interest rates have averaged 5.72 percent (National Bureau of Research). The interest rates reached a record low in 2008 at 0.25 percent while the highest ever recorded rate was 20 percent in the year 1980. During the recent meeting of the Federal Reserve Board, the interest rates were set between 1.5 and 1.75. The interest rates are expected to rise between 2.1% in the year 2018 and 2.9% in the year 2020.

**Unemployment**

It refers to a situation in which individuals have no employment. According to the Bureau of Labor Statistics, unemployment refers to people who are not currently employed and that have been actively looking for jobs in the economy. Between the period 1948 and 2018, the unemployment rate in the United States averaged 5.78 percent. During this period, the highest percentage of unemployment was recorded at 10.8% in the year 1980 while the lowest record was set in the year 1953 at 2.50%. In the first quarter of the year 2018, the unemployment rate decreased from 4.1% in May to 3.9% in April (National Bureau of Research). The unemployment rate in America is expected to decline to 3.8% this year and stagnate at 3.6% from 2019 to 2022.

**How Government Policies Influence Economic Growth**

The government controls the economy through the application of monetary and fiscal policies. Monetary policies refer to the actions of the central bank and other regulatory committees. These policies target the interest rates which in turn influence the supply of money in the economy. When the Federal Reserve increases the interest rates, the circulation of money in the economy reduces as few people are borrowing (Woodford, 2011). In turn, the level of investments decreases as high rates discourage spending. The strategy of raising the interest rates is helpful in reducing inflation in a country. On the other side, when the Federal Reserve lowers the interest rates, the circulation of money in the economy increases which in turn increases borrowing and the level of investments.

Fiscal policies refer to the activities of the government to adjust the tax rates and level of spending to regulate economic growth. Budgetary policies target the aggregate demand of a country and eventually affect economic development. These strategies impact on economic growth by growing total demand through increases in spending and lowering taxes (Agnello & Sousa, 2013). On the other side, it could reduce aggregate demand by increasing taxation and decreasing government spending.

**Impact of Monetary Policies in the Long-Run Behavior**

The government uses expansionary policies in three ways: reducing the interest rates, lowering discount reserve requirement and Open Market Operations. The impact of monetary policies on the economy in the long-run gives either the price or the income effect. Expansionary monetary policy by the authorities reduces a country’s interest rates and in turn, there is increased supply of money in the economy. People will have a higher incentive to invest while they will save less. Financial assets including bonds will decrease in value and investors will buy more in anticipation for future benefits (Bernanke, 2010). Increased rate of investment will, in turn, lower the price of unemployment in the country. The higher economic growth associated with high levels of investment will as well drop the rate of inflation in a nation. On the other side, the contractionary policy aims at reducing the circulation of money in the economy. These strategies are more or less the opposite of expansionary policies. The Open Market Committee may raise the federal discount rates as well as sell securities through Open Market Operations. These policies increase the interest rates which in turn reduce the desirability of customers to borrow money (Woodford, 2011). In turn, the bond prices go up, and investments will decrease. The unemployment rate will rise while the rate of inflation increases in the country.

**Impact of Trade Deficits or Surpluses on the GDP**

Trade deficits and surpluses are measures of a country’s international trade that indicate the excess value of either imports or exports. A deficit, in this case, is a situation where the imports exceed the exports while a surplus represents a case in which the export value exceeds the import value in a country. In the case of a trade deficit, then consumers will spend more on foreign products compared to the amount that the state sells its domestically produced goods to foreign countries (Johnson, 2013). Trade deficits usually have adverse effects to the country’s GDP, especially over a long duration. For one, it may hinder the growth of domestic companies as there is less consumption of local products. Employment levels may also fall in the local arena while the foreign markets may provide more job opportunities. Trade deficit impacts negatively on the current accounts balance while it also reduces the balance of payment. The value of the country’s domestic currency also decreases compared to that of the foreign money. As a result, the nation relies significantly on foreign debt which is payable at an interest. If the debt escalates to higher levels, it may result in a currency crisis that will hinder economic growth.

A trade surplus on the other side represents a favorable balance of trade. Because the country sells more goods than it buys from outside, the current account has more money. As a result, it is possible to purchase assets from other countries and as a result, financing the debt and also offers a degree of political influence. When the state has more money, then the investments increase which increases employment in the country. In the long-run, the surplus in the trade leads to increased GDP which is an indicator of economic growth.

**Importance of Market for Loanable Funds and Foreign Currency Exchange**

The demand for loanable funds and foreign currency exchange is of concern to foreign investors. The prices of loanable funds are one of the determinants of the real interest rates. Banks make their profits through investing in clients’ deposits. In this case, when a client seeks a loan from the bank, the bank imposes an interest rate on the repayment value. This interest rate, therefore, influences the rate at which the borrowed money grows and thereby influencing the country’s inflation (Johnson, 2013). Countries investing in foreign land, therefore, need to determine the interest rates of the destination country’s loanable funds. An attractive country of destination is one which offers low-interest rates on funds to attract borrowing. Lower rates of interest on funds are not only beneficial to the borrower but also to the lender since the country will borrow large amounts of money for development projects which borrowers will pay back with interest. In the long-run, this will generate economic growth. Foreign exchange markets involve the countries’ purchasing power as well as their credit capacity both locally and internationally (Johnson, 2013). These markets provide the means by which a country exchanges its currency for another. As a result, it is possible to reduce the currency risk by clearing the existing debts. Countries can improve their competitive position by maintaining the superiority of their currency like in the case of the American dollar. Borrowers will have to part with more money in the loan repayment. A country’s strategic plan regarding international trade involves increased economic growth and increased productivity.

**Recommendations on Strategic Management**

A strategic plan regarding international trade is achievable if the government sets up strategies to control trade like tariffs, quotas, taxes, volume limitations and foreign capital. A thorough examination of the country’s economy is required as well as the availability of capital whether through loanable funds or a country’s savings. If a nation purposes of increasing its productivity, then it must develop strategies that strengthen its local currency such that it attracts investors. A balance of trade is a requirement in the development of procedure because it represents the readiness of the market. Any strategic plan is achievable based on the policies involved as well as the duration of which the country hopes to achieve them.

**Conclusion**

The value of a country’s GDP depends on factors such as savings, consumption, investment and government spending. The government has a level of control over the economic growth of a country through fiscal and monetary policies. These strategies aim at regulating the interest rates which further impact on private spending as well as investments. The lower the prices, the higher the incentive to invest and the vice versa is right. Other factors that are of importance to economic growth include the availability of loanable funds that are helpful in creating investments. The value of the currency in the economy is also useful in determining the attractiveness of the economy to investors. The county’s economic growth depends to a great extent on the level of investments.

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