Limitations of Economic Policies

Policy Constraints – Limitations	**Monetary**	**Fiscal**	**Microeconomic**
Time Lags			
Recognition lag: the time it takes for policy makers to realise there is a problem that needs to be solved and make the necessary policy change	• Relatively short as it deals with short-term conditions • i.e. rising in inflation or falling growth usually apparent after a few months of statistics	• Relatively short as it deals with short-term conditions	• Takes longer to recognise as they address long-term economic trends
Implementation lag: delay before the relevant policy change is made	• Shortest lag as RBA board meets monthly to discuss monetary policy stance • Allows them to quickly change interest rates • RBA is an independent authority with one main objective (managing inflation) – consensus about correct policy response quickly reached	• Longer lag than monetary • Main changes to fiscal made yearly in the annual budget • Governments must balance different objectives – subject to political considerations • Decisions can take a long time due to political battles	• Longest lag • Decisions to undertake new reforms have wide-ranging and long-lasting effects • Results in debates that can take years • Highly political • Legislation can be difficult to pass
Action lag: how long it takes for the desired actions of the policy to take effect	• Medium length lag • Generally 6-18 months for the full effect of changes in interest rate to be felt by whole economy • May cause RBA to over-compensate for changes in inflation • Need for pre-emptive monetary policy to prevent serious inflation problems	• Shortest time lag • Only a few months to take effect • Set at the beginning of the financial year (mid-year) • Faster when boost economic activity than dampening it	• Longest action lag • 10 to 15 years to have visible benefits • Have negative short-term effects • Politically difficult and unpopular as politicians and economy have more of a short-term focus
Political Constraints			
Legislative constraints: refers to decisions that are made due to political considerations and influences as opposed to actually achieving economic objectives – personal agendas	• Administered by independent RBA → free of political concerns	• Can be influenced by the need to win votes • E.g. necessary tax increases avoided, which will help win votes but in the end negatively impact the economy	• Similar to fiscal • Governments may wish to achieve short-term economic growth and disregard long-term → win the approval of the public → ultimately compromise long-term sustainable growth
Conflicting goals	• Policy-makers frequently have to balance conflicting goals → difficult economic management → limitations → mistakes • **Some conflicts:** inflation/strong growth, economic objectives/welfare considerations, short-term/long-term goals		
Global Influences (international): economic management influenced by international economic conditions beyond the government's control			
International Economic Problems	• Global conditions make It difficult for domestic policies to effectively address economic problems • E.g. during a global recession expansionary macro policies may not protect Australia		

	from recession • Affect cyclical component of the budget • E.g. fall in revenues caused by a downswing may limit the government's fiscal policy options • Addressing the wrong economic issue e.g. influenced by global recession may cause Australia to adopt policies that it does not need, causing further problems
Exchange rate and credit rating constraints	• Australia's persistently high CAD + reliance on capital inflow appreciation in $A → force policy-makers to use domestic policies to address external objectives • Persistent deficits and CADs → fall in credit rating → reduction in capital inflow → government constrained to avoid large budget deficits to address the CAD with its policies
International convergence	• Free market principles constrain government decisions • Pressure to adopt policies focused on neoliberal (concept of freedom) ideology • Government may refrain from regulating the financial market because financial deregulation is considered necessary to benefit from globalisation or it might lower corporate tax refers to attract TNCs so that is moves easily across borders • Global policies → ripple effect → financial crisis