
ЕКОНОМІЧНИЙ АНАЛІЗ НА МАКРО- ТА МЕЗОРІВНЯХ

UDC 336

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PROBLEMS OF MACROECONOMIC STABILIZATION IN GEORGIA IN THE CONDITIONS OF AN OPEN ECONOMY

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Abstract

In the open economy control conditions, the government's main concern should be ensurance of macroeconomic stabilization. One of real tools for achieving this goal is monetary and budgetary levers' combination, in which strong fiscal stimul should be merged with monetary policy, although herewith it requires tough coordination between government-led public and the National Bank's monetary policies.

In addition, we have to note noted that monetary levers should be used to influence tax balance, while fiscal policy should be oriented only on regulation of aggregate demand. Cutting taxes and decreasing government spending is essential to stimulate production in Georgia, as well as increasing research funds and developing effective system for qualification growth.

Keywords: *open economy; macroeconomic stabilization; tax policy; monetary policy.*

JEL classification: H22, E52, E44, E60, P40, O23

Theoretical and methodological base of the work. The subject of work was prepared in Batumi Shota Rustaveli State University. Main part of this work is based on the following sources: Peter H. Lindert "International Economics"; Qatamadze D. "International Economic Relations"; Paul Krugman, Maurice Obstfeld "international Economics"; "Internation Economic Relations: Tutoria (Ed. Smitienko BM) Univ. 2nd; National Statistic's Office of Research's Methofology. Also should be noted profferesors': Ernst Engel's, Stephan Linder's, Paul Samuelson's, Vernon Raimond's, Eli Heckscher's, Bertil Ohlin's, Jagdish Bhagwati's, Milton Friedman's and Alexander Hamilton's scientific works.

Exceptionally, we should emphasize Georgian authors: G. Abuselidze [1; 2], L. Korghanashvili [8], T. Shengelia [9], I. Gogorishvili, M. Abdaladze, E. Lekashvili, N. Papachashvili, R. Phutkaradze, G. Todua, R. Lortkiphanidze, A. Abralava [10], E. Eteria [11], etc. The aim of working on the subject paper is processing methodological fundaments of macroeconomic stabilization in Georgia.

Research. At present stage country's main concern should be focused to ensure macroeconomic stabilization in conditions of given exchange system. In such conditions quite often it is difficult ro regulate macroeconomic policy (both internal and external tax balance) simultaneously.

In national currency¹ floating managing system both equilibrium can not be achieved simultaneously,

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¹ Georgian national currency is Lari

because conditions to achieve one of those equilibrium requires disruption of conditions of achieving second equilibrium and vice versa. Therefore it is necessary to collaborate and implement well thought actions' system of state intervention, to simultaneously establish both types of equilibrium. In nowadays reality one of the tools of achieving internal and external equilibrium is using monetary levers to have control over tax balance (to regulate aggregate supply), while budgetary policy should be oriented only on aggregate demand regulation.

To reach the equilibrium of aggregate demand and tax balance the government of Georgia should choose such complex of macroeconomic measures, which can have simultaneous influence on goods and services, money and capital market. On based of observed cause-effect relationships of our country's macroeconomic imbalances, it becomes clear that each event affects the national income, tax balance of payments and the interest rate. It is impossible to use monetary or fiscal policies to influence separately income or payment balance. Of course in this case aggregate supply regulation is also important, as in our country still exists real opportunity of labor productivity, production volume and simultaneous increase of working places.

Catalyzing production growth is possible by introducing optimal tax rates [1]; by reducing administrative costs from budget and with freed up financial resources increase investment-innovation costs, to subsidize research and development activities, or to develop effective system to train work worce. All directions of supply stimulation policies by their nature is controversial. Besides, it has slow affect on economy. Their benefits will be revealed only after a long period of time, through gradual responses of economic activities. In short time interval internal stabilization problem can be solved. First of all, by methods of regulating aggregate demand, as well as by help of fiscal and monetary policies [3, p. 295].

The recovery speed and scope of unemployment problem depends on aggregate demand's and supply's response optimality to changes. Existing demand on goods and services depends on consumers' nominal income. Aggregate demand is proportionally related to actual income and disproportionally to prices. Aggregate demand is also depended on interest rates. In our country Banks' interest rate is high, that is why for population spending such resources is less favourable. Due to this population's aggregate demand directly depends on fiscal policy.

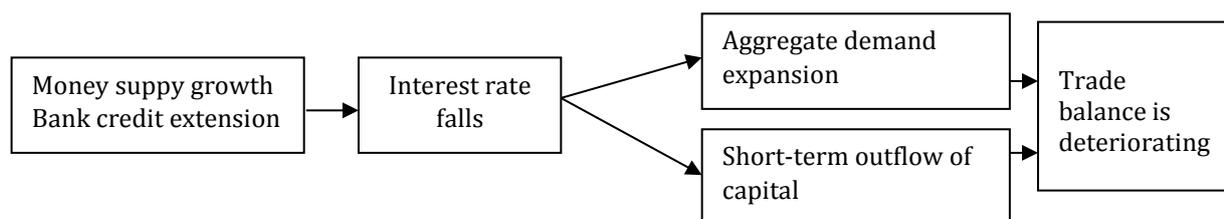
National currency supply in Georgia is determined by National Bank's monetary policy, by fiscal institutions and banking system operations, which regulate the number of credits and cash circulation. Monetary policy of National Bank in conditions of exchange market controls money supply. When exchange market experiences foreign currency deficit, then monetary policy does not control properly money supply.

The demand on national currence is proportionally correlated with the level of economic activities. As more production is done during the year, the more cash operating firms and population need for recovering future costs. The demand on money is disporotionally related to interest rate. High interest rates push people to keep bonds instead of keeping money, e.i. To reduce the demand on money.

The deficit of tax balance causes outflow of foreign currency from the country, which trade and current account balance factors are affecting. Our country's trade deficit is inversely related to domestic production. This deficit is varying depending on foreign demand changes as well, e.g. such as switching to domestically produced products instead of imported ones. A high interest rate attracts capital from abroad and establish tax balance black ink, but it is reached in a short period (one year, or even less) and it deteriorates attracted capital structure (total share of criminal origin, smuggled, venture capital in total investment is increasing). This mechanism operates backhaul in long-term period. Due to outflow of interest income abroad, tax balance over extended period worsened. Therefore, this mechanism should be used only in case, if it becomes necessary to avoid sudden crises during a short period of time. In long term perspectives higher rates have negative impact on tax balance.

Fiscal policy affects tax balance by influencing nationa income as well as interest rates. Expansionist fiscal policy degradates tax balance. Additional governmental costs increase state budget deficit. The government is forced to reduce money supply and thus to stimulate interest rate growth. The percentage rate growth will attract capital from abroad and money inflow will increase tax balance. But in long-term perspectives capital that was attracted by higher rates should be covered with interest adjunct, that in turn leads to deepening of our tax balance. Stimulating fiscal policy worsens the tax balance.

Expansionist fiscal policy impact on tax balance at fixed exchange rate system conditions (Figure 1)



The impact of monetary policy on tax balance is more highlighted. Money supply expansion worsens our country's tax balance. If National Bank allows commercial banks to expand their credit lines on pay down of reserves, then commercial banks' response to this will be expanded loan operations. With the target to increase loans competitive struggle between them will cause decrease in interest rate, followed by bilateral deterioration of tax balance. Additional costs in Georgia caused import and accordingly trade deficit growth. Money supply growth will worsen the tax balance.

Thus, the impact of monetary and fiscal policies on tax balance of our country is the same. Usage of each of them while economic activity expansion lead to tax balance deterioration. But main difference between these two policies is their impact on the interest rate, that is increasing while fiscal boosting and decrease as a result of credit expansion. But in longterm period this international flow of loans is covered from the backward flow of revenues. Therefore, both policy will influence tax balance by change of income and this influence will be the same (it will deteriorate). It is impossible simultaneously increase internal demand and improve tax balance only by using regulatory instruments of aggregate demands. The cause is desire to reach internal and external equilibrium and aggregate demand regulation only by monetary and fiscal policies.

So, government in terms of exchange rate "management" faces the dilemma of reaching macro-economic equilibrium, because the demand is low and tax balance deficit.

Purchasing power aggregate demand regulation problem (Figure 2)



Exactly this danger arised in Great Britain in 1925 while attempt to recreate gold standard. The same problem appared in America in 1961-1965. In both cases was significantly high unemployment rate, that arised necessity to expand aggregate demand (with monetary and fiscal policy leverages). But this meant foreign trade and balance of payment deterioration. The dilema remained unsolved: the Great Britain gave up maintaining gold standard and suffered from depression, while United states survived unemployeement in 1960th because of inflation².

Therefore, if we want to solve the fundamental problems of aggregate demand regulation, it is necessary to refuse one of two targets of economic policies, or to apply addition regulatory tools. In particular, the government is entitled to: refuse GEL's floating exchange rate and allow currency market to reach the equilibrium; Decline aggregate demand control; use the additional tool for economic policy [4, p. 328].

Usually denial of policy targets is unpopular step. Therefore, the most justified way for economic equilibrium regulation is the search for new instrument, tool. The most logical tool would be aggregate supply regulation. Meanwhile should be applied macroeconomic policy, which will encrease employment and income rates due to productivity and local production volume growth. Such approach will also improve competitiveness on world market and will create positive balance of payment. But economic policy makers do not have a guarantee of encreased aggregate demand, as it increases the influence of the factors that poorly react on those state events, such as technology development, qualification trainings, etc. However, there is an opportunity to gain time and solve internal and external equilibrium problems, if we do this by other measures for aggregate demand regulation.

In exchange rate floating control system conditions fundamental study of aggregate demand regulation showed that monetary and fiscal policies – these two main tools for demand regulation, have different various affects on our country's internal and external equilibrium. Exactly this difference hohlighlights existance of these two tools for economic policy regulations.

² LLindert P. H. *International Economics*. "Siakhle" Tbilisi 2009 p. 296;

Georgia. If each policy receives signals from economic system, but has delayed response to them, it can lead to volatile fluctuations, that is worse than absence of economy regulations. E.g. problems related to benefit fluctuations [6, p. 124].

Monetary and budgetary policy combination, as a tool for reaching macroeconomic stabilization (Figure 4)

The condition of tax balance	The condition of national economy	
	The high level of unemployment	The high tempo of inflation
The positive balance (TB > 0)	Credit and Budget expansion	Budget expansion, Budget expansion
Deficit (TB < 0)	Credit expansion, Budgetary restriction	Credit and Budgetary Restriction

Table 3. Combination of monetary and budget policies as a means of macroeconomic stabilization of Georgia

It is exceptionally difficult to reach both equilibrium while unregulated money supply. So far it was assumed in macroeconomic stabilization analysis, that regulatory authorities were controlling their policy tools i.e. money supply and state budget. This assumption is valid only for short period and for large sized countries, regulatory bodies of which can influence not only domestic, but also world economy as well. But in terms of our country during exchange rate stabilization system exists internal monetary policy's certain independency borders. It is very difficult to find out why it is complicated to use national monetary policy in case, when because of exchange rate regulation, Georgia is closely related to the world financial system.

Conclusion. The following measures should be implemented to solve problems in macroeconomic stabilization field:

1. It is necessary from state agencies who regulate economy to develop a coordinated national stabilization measures system and realization, to reach simultaneously internal and external equilibrium of our country's economy.
2. For internal and external equilibrium of economy one of real ways is using money-and-credit levers to affect tax balance, while fiscal policy should be aimed only to regulate aggregate demand.
3. The government should select macroeconomic measure complex, that simultaneously affects money, capital, foreign exchange, credit, goods and service market.
4. The government should encourage domestic production with decreasing taxes, government spending, funding of researches as well as developing effective system for professional development.

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