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ABSTRACT

Economic research has traditionally focused on building theoretical models with strong internal consistency, alongside the development of empirical tools such as econometrics. However, relatively less attention has been given to the practical challenges involved in applying these tools to test theoretical relationships. Important aspects such as the use of control variables, the nature of causality, and the stability of economic relationships over time often remain overlooked. Ignoring these elements can lead to misleading conclusions, particularly in developing economies where policy decisions rely heavily on such analyses. Historically, policymakers have concentrated on macroeconomic variables such as inflation, employment, balance of payments, and overall economic growth. In recent times, greater emphasis has been placed on microeconomic behavior as well. For a more comprehensive understanding of economic performance, it is essential to incorporate firm-level variables, such as business growth and cash flow, into broader economic analysis.

Keywords: Microeconomics, Macroeconomics, Economic Growth, Cash Flow, Inflation, Unemployment.

INTRODUCTION

Microeconomics plays a crucial role in understanding how individuals and firms make decisions, as these choices have both personal and societal consequences. Incentives significantly influence behavior, but it cannot be assumed that individuals always act according to perfectly rational or balanced decision-making frameworks. Similarly, aggregate economic outcomes cannot simply be explained by combining the behavior of representative individuals.

Empirical evidence suggests that many observed economic patterns do not depend on a single model of individual behavior. Instead, similar macro-level outcomes can arise from diverse decision-making processes. Structural factors such as income constraints, institutional settings, and social influences often play a more decisive role in shaping aggregate results. This allows microeconomic propositions to be categorized into two groups: those supported by empirical evidence across various behavioral assumptions—such as downward-sloping demand and income-based consumption patterns—and those that rely heavily on specific theoretical assumptions, particularly the idea of perfectly rational individuals.

While micro-level processes are essential for understanding individual behavior and its broader implications, they do not always determine macroeconomic outcomes in a direct or predictable way. At times, collective actions—such as strikes or consumer boycotts—can significantly influence overall economic trends. Therefore, it is important to study how individuals actually behave in real-world conditions and how they respond to changes in the economic environment.

Insights from behavioral economics, psychology, and sociology have shown that traditional assumptions about human behavior often fail to capture reality. The widely used model of “economic man,” which assumes rational and self-interested decision-making, does not adequately explain observed behavior in many situations.

In recent years, economists have increasingly attempted to provide microeconomic foundations for macroeconomic analysis. However, this approach has been questioned by both economists and philosophers. While it is often assumed that macroeconomic outcomes are determined by micro-level behavior, this relationship is not always straightforward. The distinction between micro and macro perspectives arises from their different objectives and analytical approaches. As a result, macroeconomic outcomes cannot always be fully explained by microeconomic principles alone.

Countries that have implemented unstable macroeconomic policies—such as persistent inflation, large fiscal deficits, and distorted exchange rates—have generally experienced slower growth and greater economic volatility. However, these outcomes may also be influenced by weak institutional frameworks, including poor governance, lack of accountability, corruption, and political instability. These institutional factors often interact with economic policies, making it difficult to isolate the direct impact of macroeconomic decisions.

Economics as a discipline is broadly divided into two areas: microeconomics and macroeconomics. Macroeconomics focuses on the overall functioning of the economy, examining variables such as national income, employment levels, and inflation. These issues are central to public policy and are frequently discussed in political and economic debates. In contrast, microeconomics studies individual markets and the behavior of consumers and firms, analyzing how supply and demand determine prices and output levels.

Macroeconomic analysis typically considers the economy at a national level, exploring how different markets interact to produce aggregate outcomes. It also examines the role of government in managing economic growth, controlling inflation, and stabilizing the economy. Furthermore, macroeconomics often extends beyond national boundaries, as economies are interconnected through trade, investment, and financial flows.

On the other hand, microeconomic analysis focuses on specific markets, such as those for automobiles, energy, or agricultural products. These markets are often influenced by both domestic and global factors. In many cases, individual markets operate on an international scale, as seen in industries like oil and technology. Therefore, both microeconomic and macroeconomic perspectives are essential for a comprehensive understanding of economic growth and development.

Objective

1. To understand how financial variables influence overall economic performance.
2. To examine the relationship between cash flow and economic growth and the effects of cash flow on economic growth.

Relationship between Cash Flow, Micro-Macro Economics, and Economic Growth

In this context, examining the relationship between cash flow and economic growth becomes highly significant. Cash flow, particularly at the firm level, reflects the financial health and operational efficiency of businesses. When organizations maintain stable and positive cash flows, they are better positioned to invest, expand operations, generate employment, and contribute to overall economic development. Thus, cash flow serves as an important link between applied economics and macroeconomic outcomes such as growth.

Understanding this relationship also requires a clear distinction between microeconomics and macroeconomics. Microeconomics deals with individual economic units such as households, firms, and specific industries. It focuses on decision-making at a smaller scale, including how resources are allocated and how prices are determined in individual markets. In contrast, macroeconomics examines the economy as a whole, including large-scale variables such as national income, employment, inflation, and economic growth. In simple terms, microeconomics analyzes individual components, whereas macroeconomics studies the overall system.

Traditionally, classical economic theory assumed that markets naturally move toward equilibrium, where demand equals supply. According to this view, any imbalance—such as excess demand—would lead to price increases, encouraging producers to increase supply until equilibrium is restored. For many years, economists believed that the economy as a whole functioned in a similar manner to individual markets.

However, this assumption was challenged during the Great Depression of the 1930s. During this period, economies experienced prolonged unemployment, reduced output, and widespread economic instability. Despite apparent demand, production did not increase as expected, and the economy failed to return to equilibrium. Classical economic theory could not adequately explain this persistent disequilibrium.

A major shift occurred in 1936 when economist John Maynard Keynes introduced *The General Theory of Employment, Interest and Money*. Keynes argued that the overall economy could remain in a state of imbalance for extended periods and that micro-level market adjustments alone were insufficient to restore stability. He emphasized the role of aggregate demand and suggested that government intervention was necessary to stimulate economic activity. This marked the beginning of macroeconomics as a distinct field of study.

The difference between microeconomics and macroeconomics lies primarily in their scope and focus. Microeconomics studies the behavior of individuals and firms, particularly how they make decisions regarding the allocation of limited resources. It examines factors such as supply, demand, pricing, and production at a detailed level. For example, microeconomic analysis might explore how a firm can increase efficiency, reduce costs, and remain competitive in its market.

On the other hand, macroeconomics focuses on aggregate economic indicators and overall economic performance. It examines issues such as Gross Domestic Product (GDP), unemployment rates, inflation, and economic growth. For instance, macroeconomic analysis may investigate how changes in exports, government spending, or employment levels influence national income and economic stability.

Although microeconomics and macroeconomics appear distinct, they are closely interconnected. Changes at the macro level often influence micro-level decisions. For example, rising inflation increases the cost of raw materials, which directly affects firms' production costs and pricing strategies. Similarly, decisions made by individual consumers and firms collectively shape broader economic outcomes.

In essence, microeconomics adopts a bottom-up approach, focusing on individual behavior and market interactions, while macroeconomics follows a top-down approach, analyzing the economy as a whole. Both perspectives are essential for a comprehensive understanding of economic systems. Together, they provide valuable insights into how businesses operate, how resources are allocated, and how economic growth can be sustained over time.

Similarities Between Microeconomics and Macroeconomics

Although economics is commonly divided into two branches—microeconomics and macroeconomics—this separation is largely conceptual rather than absolute. In practice, both areas are closely interconnected and often overlap in their application and analysis.

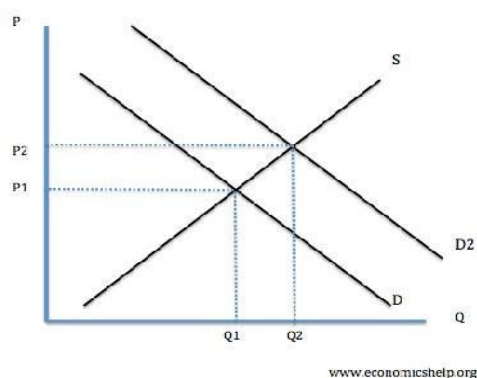
One important similarity is that macroeconomic analysis frequently relies on microeconomic principles. For instance, when examining phenomena such as deflation, economists often apply micro-level concepts like price elasticity of demand to understand how changes in prices influence consumer behavior. This demonstrates that macro-level issues are often analyzed using tools developed in microeconomics.

There is also a strong two-way relationship between the two fields. Changes at the micro level can significantly influence macroeconomic outcomes, and macroeconomic conditions, in turn, affect individual markets and decision-making. For example, an increase in oil prices at the market level can lead to higher production costs across industries, resulting in cost-push inflation at the macro level. Similarly, technological advancements that reduce production costs at the firm level can contribute to overall economic growth.

In some cases, certain markets are so influential that they bridge the gap between micro and macroeconomics. For instance, a rise in automobile prices may initially appear as a microeconomic issue within a specific industry. However, because the automobile sector plays a major role in the economy, such changes can influence broader economic indicators and even impact government policies such as interest rates and inflation control measures.

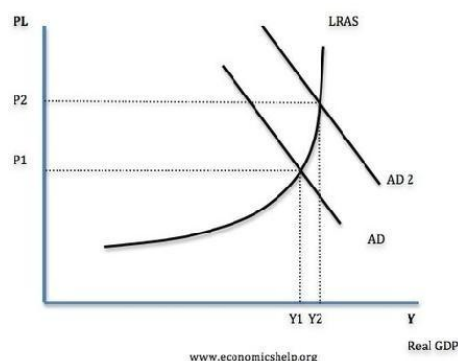
The relationship between macroeconomics and microeconomics can also be understood by moving from broader economic trends to individual markets. While macroeconomics examines large-scale variables like economic growth and inflation, microeconomics focuses on specific market dynamics, such as how an increase in demand for a product—like toy cars—affects its price and supply. These individual market behaviors collectively contribute to overall economic patterns.

In summary, microeconomics and macroeconomics are deeply interconnected. While they differ in scope and focus, both rely on similar principles and continuously influence each other. A complete understanding of economic systems requires integrating insights from both perspectives.



The macro diagram is looking at Real GDP (which is the total amount of output produced in the economy) instead of quantity. Instead of the price of a good, we are looking at the overall price level (PL) for the economy.

Macro diagrams are based on the same principles as micro diagrams, we just look at Real GDP rather than Quantity and Inflation rather than Price Level (PL).



There are three work streams within this Sub programmes

Macroeconomic Policy, Microeconomic Policy, and Economic Modelling

Macroeconomic Policy

Governments rely on a range of policy instruments—such as taxation, public spending, subsidies, access to credit, and interest rate adjustments—to achieve their development objectives. Macroeconomic policy focuses on coordinating these tools in a manner that supports sustainable development and improves overall economic performance. It plays a crucial role in influencing key variables such as employment levels, investment activity, and economic growth.

A well-designed macroeconomic framework helps create conditions that encourage stable and inclusive growth, particularly growth that generates employment opportunities. It also assists policymakers in understanding the trade-offs involved in decision-making, enabling them to prioritize among competing economic objectives.

The primary aim of this policy approach is to identify suitable macroeconomic strategies, evaluate them in light of development and employment goals, and provide informed recommendations for policy formulation. In doing so, it considers national priorities, lessons from global experiences, and the challenges posed by international economic conditions, including financial crises and market volatility.

Microeconomic Policy

Microeconomic policy is concerned with improving the functioning of individual sectors, firms, and households within the economy. Its main objective is to enhance efficiency, productivity, and investment in the real sector, thereby increasing income levels and improving living standards.

This policy area focuses on identifying and evaluating different options that can support economic development and employment generation. It involves assessing how policies impact businesses and households and making recommendations to improve their effectiveness. Additionally, microeconomic policy emphasizes

the importance of building strong institutional frameworks and maintaining reliable economic data systems related to firms and industries, including those receiving government support or incentives.

By promoting efficiency and equity, microeconomic policies contribute to the creation of employment opportunities and ensure a more balanced distribution of economic benefits across society.

Economic Modelling

The economy is a highly complex and dynamic system, making it essential to use structured and quantitative tools for effective policy analysis. Economic models provide a simplified representation of the relationships between key economic variables, allowing policymakers to better understand how different factors interact.

Such models are particularly important when evaluating macroeconomic policies, as changes in one variable often influence many others. Economic modelling helps in assessing the overall impact of policy decisions on indicators such as economic growth, employment, inflation, sectoral performance, and income distribution.

The main purpose of economic modelling is to project possible future economic scenarios under different policy combinations, measure the likely effects of policy changes or external shocks, and analyze the role of uncertainty in economic outcomes. For example, models can be used to study how fluctuations in global oil prices or international trade conditions may affect domestic economic performance.

Macroeconomic Stability, Inclusive Growth, and Employment

Macroeconomic Stability and Growth

Recent global financial crises have demonstrated how instability in the macroeconomy can negatively affect living standards. Sharp fluctuations in economic activity, rising inflation, excessive public debt, and volatile exchange rates can lead to job losses, increased poverty, and setbacks in development progress.

Maintaining macroeconomic stability is therefore essential for achieving long-term and inclusive growth. The central objective of macroeconomic policy is to promote economic and social well-being in a manner that is both sustainable and equitable. Since unemployment and underemployment are major contributors to poverty, an important policy goal is to keep the economy operating close to full employment.

In developing countries, this means ensuring that job creation—particularly in the formal sector—keeps pace with population growth and migration from rural to urban areas. Sustained economic growth not only generates employment opportunities but also increases government revenues, enabling greater investment in critical social sectors such as healthcare, sanitation, and access to clean water.

Economic growth has played a significant role in reducing global poverty over recent decades. As a result, achieving stable and consistent growth remains a primary objective of macroeconomic stabilization policies. This goal is supported by maintaining stability in key intermediate variables, particularly price levels and external balances, as these directly influence investment decisions and economic confidence.

To achieve these outcomes, countries need sufficient flexibility to use macroeconomic tools effectively. This includes adopting counter-cyclical fiscal and monetary policies, managing exchange rates appropriately, encouraging productive investment, and ensuring strong regulation of the financial sector. In addition, coordination of economic policies at the international level is important, especially in areas that have global implications.

Policy Coherence for Economic Growth

Sustained economic growth is not achieved solely through macroeconomic stability; it also depends on a well-coordinated set of complementary policies. Countries that have experienced consistent growth have implemented a balanced combination of trade, financial, and investment policies, alongside progressive labour market and social strategies. Although the specific mix of policies varies across nations, certain common characteristics can be identified.

A key feature of successful growth strategies is the central role of the private sector. Businesses are the primary drivers of investment, innovation, and trade. However, for firms to perform effectively, they require supportive conditions such as strong infrastructure, quality education systems, access to research and development, and reliable financial services. In many developing regions, particularly rural areas and among micro, small, and medium enterprises (MSMEs), significant gaps still exist in these areas. Addressing these shortcomings demands sustained public investment and international cooperation, including access to development finance and infrastructure support.

Another critical factor in economic transformation is scale. Structural change, which is essential for long-term growth, often requires substantial investment. Many developing countries face challenges due to the absence of sufficiently large domestic enterprises capable of financing and managing major projects. Therefore, policy efforts should focus on nurturing medium and large-scale firms to strengthen the connection between profits and reinvestment within the domestic economy.

Successful development also depends on the alignment of various policy areas, including macroeconomic, employment, industrial, trade, environmental, and social policies. These policies must work together in a mutually reinforcing manner to achieve sustained growth. Moreover, national policy coherence should be supported by an enabling international environment that allows countries the flexibility to implement their development strategies effectively.

A capable and efficient state is essential for ensuring policy coherence. Governments play a central role in designing, implementing, and coordinating policies that drive economic and social transformation. Strong institutional capacity, transparency, and accountability are necessary for effective governance. Where institutional weaknesses exist, they must be addressed to enhance the state's ability to promote collaboration, learning, and innovation. Additionally, well-developed institutional networks are required to support the activities of non-government actors and facilitate long-term growth.

Inclusive growth is another vital component of sustainable development. Development goals are not limited to reducing poverty but also aim to promote dignity, equality, and social justice. For growth to be meaningful, its benefits must be widely shared across different sections of society. This involves creating opportunities for individuals to acquire productive assets such as education and skills, enabling them to participate in economic activities, and ensuring that support systems are in place for those who are unable to benefit directly.

Recent global movements and social developments have highlighted the importance of equity, both as a goal in itself and as a factor that enhances the legitimacy of economic policies. Economic growth does not automatically result in fair distribution of benefits. In some countries, rapid growth has not significantly reduced poverty, while others with slower growth have made considerable progress in improving social conditions. Examples from certain Asian economies and Nordic countries demonstrate that a more equal distribution of income and wealth can coexist with strong and sustained economic performance.

The relationship between inequality and growth is complex and influenced by various factors such as income distribution, employment generation, and gender equality. Empowering women and promoting gender equity are particularly important, as they contribute not only to social development but also to economic efficiency. Policies aimed at market expansion and integration often have different impacts on men and women, making it essential to design strategies that promote inclusiveness and equal opportunities.

To achieve inclusive development, policymakers must give special attention to key sectors such as agriculture and social services. In many developing countries, a large proportion of the workforce is engaged in agriculture, often under conditions of uncertainty and low income. Improving rural employment opportunities, particularly outside agriculture, can significantly enhance household income and economic security.

The state must collaborate with private sector organizations, producer groups, and other stakeholders to provide essential support to rural communities. This includes investments in agricultural research, infrastructure development, education, extension services, and improved access to credit, insurance, and land resources.

Public investment in social sectors such as education, healthcare, and skill development is equally important. These investments not only address poverty directly but also stimulate economic activity by increasing overall demand. Social protection measures, including cash transfers, play a crucial role in supporting vulnerable populations such as children, the elderly, persons with disabilities, and low-income households.

In conclusion, sustainable and inclusive economic growth requires a coherent policy framework supported by effective governance, strong institutions, and a commitment to equity. By aligning economic and social policies, countries can create a development path that is both resilient and inclusive, ensuring long-term prosperity for all sections of society.

Employment and Decent Work

The creation of decent employment opportunities is a fundamental pillar of inclusive economic growth. Access to stable, productive, and dignified work provides individuals with income security and contributes significantly to social and economic progress. Employment not only supports individuals but also strengthens families and communities, thereby promoting overall development.

To achieve these objectives, sustainable development strategies must prioritize employment generation. This involves improving the productivity of workers, especially those in lower-income groups, and ensuring that they benefit from increased earnings. Strengthening labour market institutions plays a key role in enabling workers to retain the gains from their productivity. Emphasizing decent work is essential both in the short term—where it helps address unemployment crises—and in the long term, where it contributes to sustainable, equitable, and inclusive growth.

An effective employment-centered development strategy includes a combination of macroeconomic, industrial, and environmental policies that encourage investment, structural transformation, and job creation. In addition, strong social and labour market policies are necessary to ensure fair wages and safe working conditions. For growth to be inclusive and beneficial to the poor, policies related to trade, macroeconomic stability, and labour markets must be well-coordinated, as they directly influence employment opportunities and income levels.

Expansion in international trade can create employment opportunities, particularly when domestic firms and farmers are able to participate in global value chains and increase production. However, trade liberalization can also bring challenges. Rapid opening of markets, especially when combined with restrictive macroeconomic policies, may lead to wage suppression and a rise in informal employment. These outcomes are often influenced not only by global factors such as labour mobility and capital flows but also by domestic policy decisions.

In some cases, governments have prioritized low inflation and flexible labour markets over employment generation and job quality. While such policies may stabilize the economy, they can negatively impact job security and working conditions. Therefore, achieving balanced growth requires careful policy design that considers both economic efficiency and social welfare.

Structural transformation also provides opportunities to promote environmental sustainability. The transition toward a green economy has the potential to generate new employment opportunities while addressing environmental concerns. Appropriate macroeconomic policies, combined with active labour market interventions, can help manage short-term employment fluctuations and support workers in adapting to long-term structural changes.

Investment in infrastructure and human capital is crucial to ensure that wage growth is aligned with improvements in productivity. Policies such as skill development programs, minimum wage regulations, and employment protection laws contribute to a more equitable distribution of income and opportunities. In addition, social protection systems play an important role by providing security and ensuring access to essential services for all individuals.

Decent work extends beyond economic benefits; it also contributes to broader social development. Employment under conditions of freedom, equality, security, and dignity enhances individuals' sense of identity and strengthens social relationships. Research indicates that higher income levels are associated with increased awareness of governance issues, reduced tolerance for corruption, and greater participation in democratic processes. Employed individuals are also more likely to invest in education and healthcare for themselves and their families.

Furthermore, individuals with stable employment tend to exhibit higher levels of social trust and civic engagement compared to those who are unemployed. This highlights the broader societal impact of decent work, making it a key driver not only of economic growth but also of social cohesion and overall well-being.

The Macroeconomics of Fiscal Policy

In recent years, fiscal policy has become a central topic in global economic discussions, making its study particularly relevant. Government actions related to spending, taxation, and budget deficits have gained prominence as key tools for managing economic performance. For instance, during the 1990s, Japan experienced prolonged deflation and extremely low interest rates, which led policymakers to rely heavily on fiscal measures to revive economic activity. Similarly, fiscal interventions played a significant role in supporting the recovery of the United States economy following the recession of the early 2000s.

Within the European Monetary Union, countries have also re-evaluated strict fiscal rules, such as those imposed by the Stability and Growth Pact, in order to stimulate growth after extended periods of economic slowdown. At the same time, debates surrounding fiscal policy have drawn attention to the long-term consequences of persistent budget deficits, including their effects on national savings, investment levels, interest rates, and external balances. Since governments provide essential public services, they must raise revenue through taxation and other sources, making fiscal policy a critical component of economic management.

Impact of Fiscal Policy on the Macroeconomy

Fiscal policy plays a vital role in shaping aggregate demand, income distribution, and the productive capacity of an economy. In the short term, adjustments in government spending and taxation can influence both the level and composition of demand for goods and services. These changes, in turn, affect how resources are allocated across different sectors.

Over a longer period, fiscal policy contributes to economic growth by influencing factors such as human capital development, capital investment, and technological advancement. Taxation policies, in particular, affect incentives related to work, saving, and investment, thereby impacting both the scale and structure of economic activity.

There are two major perspectives in macroeconomic theory regarding the effectiveness of fiscal policy. The first, often associated with classical thinking, assumes that economies naturally return to full employment after disturbances. According to this view, fiscal interventions have limited effectiveness and may even destabilize the economy due to delays in policy implementation and response.

The alternative perspective suggests that economies may not adjust quickly due to market imperfections. For example, if consumers reduce current spending to save for the future, producers may interpret this as a decline in demand and respond by cutting production, employment, and investment. In such situations, fiscal policy can play an important role in stabilizing economic activity and supporting recovery.

The Economic Way of Thinking

Economics is fundamentally concerned with how individuals and societies make choices in situations of scarcity. While other social sciences also examine decision-making, economics is distinguished by its unique analytical approach.

Three key principles define the economic perspective on decision-making:

A strong emphasis on opportunity cost

The assumption that individuals aim to maximize their objectives

A focus on decision-making at the margin

Economists highlight that individuals evaluate alternatives by considering the benefits they must give up when making a choice. They also assume that individuals act in their own self-interest, seeking to maximize satisfaction or utility. Additionally, decisions are often made incrementally, with individuals comparing the costs and benefits of small changes in their actions.

These principles form the foundation of economic reasoning and provide a structured way to analyze choices and their consequences.

Importance of Opportunity Cost

Opportunity cost is a central concept in economics, referring to the value of the next best alternative that must be sacrificed when making a decision. Understanding this concept is essential for analyzing behavior, as it explains how individuals and firms respond to changing circumstances.

For example, environmental conditions or changes in income can alter the relative attractiveness of different choices. A rainy day may increase the appeal of indoor activities such as reading, while higher wages may increase the cost of leisure time, encouraging individuals to work more. Similarly, firms adjust their decisions based on changes in costs and expected returns.

By focusing on opportunity costs, economic analysis encourages a careful evaluation of alternatives. This approach helps individuals and policymakers make more informed decisions by considering not only the direct benefits of a choice but also the potential gains from foregone options.

Conclusion

Economics is broadly categorized into two major branches: microeconomics and macroeconomics. Understanding the distinction between these two areas is essential for analyzing how economic systems function.

Microeconomics focuses on the decisions made by individual economic units, such as consumers and firms, and examines how these decisions influence specific markets. It deals with questions related to pricing, resource allocation, and consumer behavior within particular sectors. For instance, issues like the high cost of concert tickets, the pricing of goods and services, or the distribution of household responsibilities are typically analyzed within a microeconomic framework, as they relate to individual choices and market-level outcomes.

In contrast, macroeconomics studies the economy as a whole by analyzing aggregate variables such as national income, inflation, and unemployment. It addresses broader questions concerning overall economic performance, including whether economic activity is expanding or contracting, how price levels are changing, and what trends are observed in employment. Concepts like Gross Domestic Product (GDP), inflation rates, and total employment represent cumulative outcomes of numerous individual economic activities and are therefore central to macroeconomic analysis.

Although both branches examine market behavior, their objectives differ. Microeconomics aims to understand the functioning of individual markets, while macroeconomics seeks to explain large-scale economic trends and fluctuations. Despite these differences, the two fields are closely interconnected, as individual decisions collectively shape aggregate outcomes, and macroeconomic conditions, in turn, influence micro-level behavior.

In conclusion, both microeconomics and macroeconomics are fundamental to the economic way of thinking. Together, they provide a comprehensive framework for understanding how resources are allocated, how markets operate, and how economies grow and evolve over time.

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