# MANDELL FLEMING MODEL IN OPEN ECONOMY

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**Abstract.** *In this article, the author studies the unique aspects and possibilities of the Mandell-Fleming model in the open economy system. In addition, proposals and recommendations have been developed for the cases of its use.*

**Key words:** *economy, Mandell Fleming model, open economy.*

We have seen in the previous topics that no country in the world is cut off from foreign economic ties and relations. For this reason, a complete macroeconomic model should embody the operations carried out in both domestic and foreign markets.

A complete macroeconomic model is an open economy model.

An open economy is an economy that:

a) that the country exports and imports a certain part of the goods and services it produces;

b) means that the country borrows and gives loans in the world financial markets.

If all goods and services produced in a closed economy are sold domestically, and all expenses are divided into three parts: consumption, investment and government expenses, then a significant part of the products produced in an open economy is exported abroad. In this case, the export of goods and services produced in the country (expenditures made by foreigners to purchase goods and services produced in our country) is also included as the fourth element in the costs of manufactured products.

A small open economy and a large open economy are different. A small open economy is the economy of a small country. A small open economy model includes a capital account and a current account. Such an economy does not have a large share in the world market and cannot practically influence the world interest rate. Since the savings and investments of a small open economy make up a very small amount of the world's savings and investments, the world interest rate determined according to the conditions in the world financial markets is considered as an (exogenous) indicator determined in this economy. A large open economy is an economy in which, due to its large scale, the interest rate is formed under the serious influence of the processes taking place inside the country.

A large open economy is the economy of a large country (USA, PRC, Germany, Japan, Russia, etc.) that owns a large part of the world's savings and investments. Such countries can influence the world financial rate. The main indicators of an open economy are:

a) foreign trade quota in GDP;

b) share of export in production volume;

c) the share of imports in consumption;

d) share of foreign investments in the volume of investments.

The degree of openness of the economy usually depends on the volume of foreign trade of the country or the political line of the government. For example, the UK economy is considered relatively open because it is highly dependent on foreign trade. The US economy is relatively closed, because foreign trade does not play a decisive role in its development.

An open economy envisages the use of foreign currency in international settlements. It is reflected in the balance of payments, in particular, the balance of current operations and the balance of capital movements.

Internal equilibrium is the balance of demand and supply in conditions of full employment in the absence of inflationary processes (or its stable low level). In the short-term period, the problem of internal balance is provided, first of all, by the regulation of aggregate demand by means of budget tax and monetary policy. External balance means maintaining a balance of payments equal to zero under conditions of a fixed or floating exchange rate.

In some cases, this problem is divided into two mutually independent parts:

a) maintaining the established state of the balance of current operations;

b) maintaining a fixed amount of foreign exchange reserves.

The methods of maintaining external and internal balance are the same: budget-tax and monetary-credit policy. In some cases, the exchange rate policy is also highlighted as an independent method. Ensuring the external balance is complicated by the mobility of capital movement (intensification of the process of capital inflow between countries in response to changes in the domestic interest rate compared to the world interest rate). The problem of ensuring internal and external balance is related to the operation of commodity, money and foreign exchange markets. Ensuring internal and external balance emerges as an important problem of macroeconomic regulation, as it requires taking into account the interaction and feedback of internal and external variables.

Analysis of economic policy in an open economy is based on the Mandell-Fleming model. This model represents the equilibration of the economy in the short run and is a modified form of the IS-LM model for a small open economy.

Both models assume price invariance and explain the causes of changes in aggregate demand. The main difference between them is that the IS-LM model is a closed economy model, while the Mandell-Fleming model is an open economy model. The problem of internal and external balance is often analyzed by means of a modified form of the IS-LM model, with the addition of the third VV curve. The VV curve describes the equilibrium level of the balance of payments. The model is constructed for both fixed and free-floating exchange rate regimes and for different levels of capital mobility.

Thus, in the conditions of the noted exchange rate, the budget-tax policy, different from the monetary policy, was able to successfully influence the level of income and, in turn, the internal balance. The level of influence increases with the growth of capital mobility.

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