

10.3 Effectiveness of policy options to meet all macroeconomic objectives

Name: _____ Class: _____ Date: _____

Total: 24 marks

KEY WORDS laffer curve • crowding out • time lags
• tax revenue • effectiveness of policy options

Objective

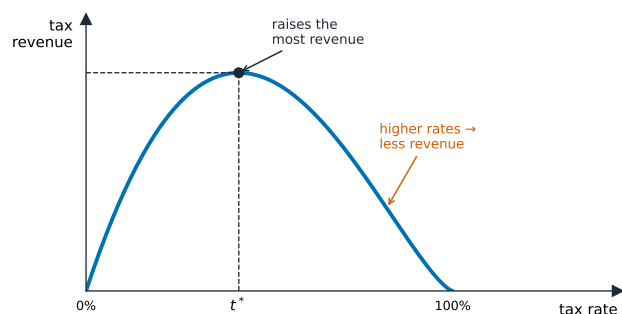
Build the skills to answer exam questions on the **effectiveness of policy options** – the strengths and weaknesses of **fiscal, monetary and supply-side** policy, including **crowding out** and the **Laffer curve**.

You must be able to:

- explain the strengths and weaknesses of each policy
- explain crowding out and the Laffer curve
- evaluate the best policy mix to meet objectives

1 Key knowledge and worked examples

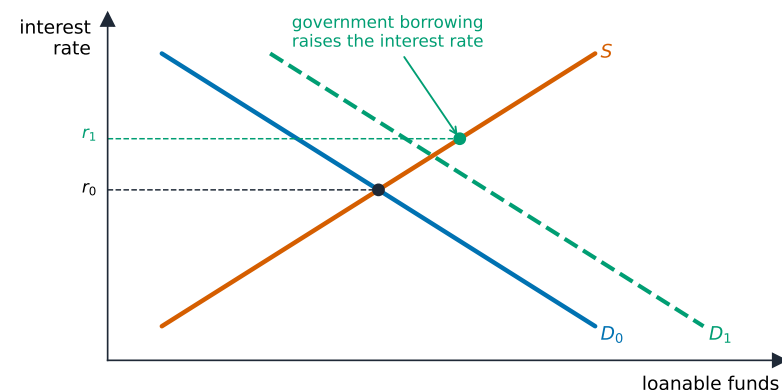
■ The Laffer curve



peak revenue at t^* • beyond t^* : rate $\uparrow$ revenue $\downarrow$

Revenue is zero at 0% and 100%; going above t lowers revenue*

- **Fiscal policy:** powerful and targeted, but has **time lags**, raises **national debt**, and risks **crowding out**.
- **Monetary policy:** flexible, but works with a lag and is weak in a deep slump.



govt borrow $\Rightarrow r \uparrow \Rightarrow$ private $\downarrow$

A key limit on fiscal policy: crowding out private investment

- **Supply-side policy:** raises growth *and* lowers inflation, but is slow and costly.
- **Laffer curve**: above the revenue-maximising rate t^* , higher tax rates cut revenue.

Answer shapes: an **Explain [up to 8]** answer may use a diagram (AO3); **Discuss [12]** adds a judgement (AO4).

2 Practice

2.1 Define the term *crowding out*. [2]

2.2 State what the **Laffer curve** shows. [2]

2.3 State one weakness of monetary policy. [1]

3 Exam-style questions

3.1 According to the Laffer curve, raising the tax rate **above** the revenue-maximising rate will: [1]

A always raise tax revenue
B lower tax revenue
C leave tax revenue unchanged
D raise the money supply

3.2 Explain how heavy government borrowing can crowd out private investment. [6]

3.3 Discuss which policy a government should rely on most to achieve long-term economic growth. [12]