5 Government macroeconomic policy – Part 1

Name: _____ Class: _____ Date: _____

Vocabulary

Write each word three times.

English	**Write it 3 times** (English)		
price stability			
inflation			
full employment			
economic growth			
balance of payments			
conflict			
Fiscal policy			
expansionary			
contractionary			
budget deficit			
budget surplus			
direct tax			
indirect tax			
progressive			

English	Write it 3 times (English)
regressive	

Recall

In topic 4 you met GDP, aggregate demand and supply, unemployment and inflation. Bring this with you:

- Output, jobs and prices can all go wrong in an economy.
- Aggregate demand (AD) is total spending: $C + I + G + (X - M)$.

At AS we study how the **government** tries to steer the whole economy.

New ideas

1 Macroeconomic policy objectives

A government usually has five main aims:

- **price stability** – low, steady **inflation** ;
- **full employment** – jobs for almost everyone who wants one;
- **economic growth** – rising real output;
- **balance of payments** stability;
- a fairer spread of income.

These can **conflict** – for example, raising demand to cut unemployment can pull prices up (more inflation).

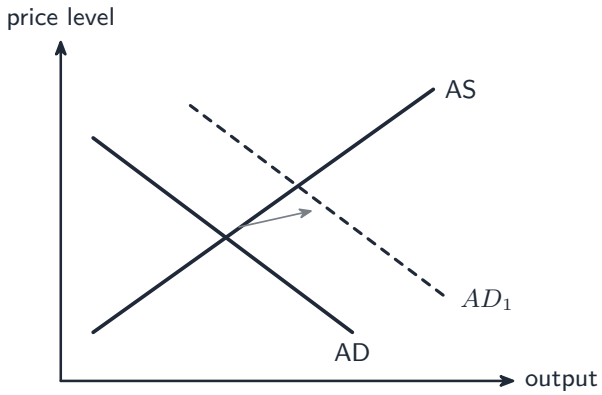
Micro-check. Name **two** macroeconomic policy objectives. [1]

2 Fiscal policy

Fiscal policy is the use of government **spending** and **taxation** to influence the economy.

- **expansionary** fiscal policy raises spending or cuts taxes → AD rises (to fight a recession);
- **contractionary** fiscal policy cuts spending or raises taxes → AD falls (to fight inflation).

A **budget deficit** is when spending is greater than tax revenue (the government must borrow). A **budget surplus** is the opposite.



Micro-check. Which kind of fiscal policy would fight a **recession** – expansionary or contractionary? [1]

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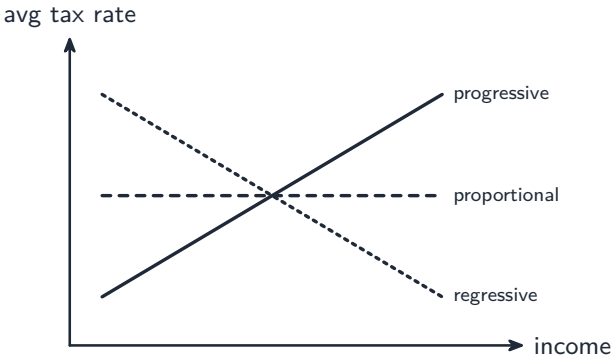
3 Direct and indirect taxes

- a **direct tax** is paid straight to the government on income or profit (income tax);
- an **indirect tax** is a tax on spending (added to a good's price).

Taxes can also be **progressive** (the rate **rises** with income – the rich pay a larger share), proportional, or **regressive** (the rate **falls** as income rises).



Micro-check. Income tax on a person's earnings is a **direct** or an **indirect** tax? [1]

Watch out: expansionary fiscal policy (more spending / lower taxes) *raises* AD to fight a recession; contractionary (less spending / higher taxes) *lowers* AD to fight inflation. Direct tax = on income/profit; indirect tax = on spending. Objectives can *conflict*.

Practice

5.1 State **two** of the government's macroeconomic objectives. [2]

5.2 Define **fiscal policy**. [2]

5.3 A government wants to **raise** aggregate demand. State **one** fiscal action it could take. [1]

5.4 State the difference between a **budget deficit** and a **budget surplus**. [2]

5.5 State whether each is a **direct** or an **indirect** tax: (a) income tax; (b) a tax added to the price of petrol. [2]

5.6 Challenge. A government cuts taxes to reduce unemployment. Explain why this might also push up inflation. [2]