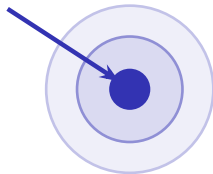


Government Macroeconomic Intervention

A-Level Economics ■ Topic 5

A-Level Economics



What we will cover

- 1 Policy objectives
- 2 Fiscal policy & the budget
- 3 Types of tax
- 4 Monetary policy
- 5 The transmission mechanism
- 6 Supply-side policy



the state steers the economy

Macroeconomic objectives

**price
stability**

物价稳定

**full
employment**

充分就业

**economic
growth**

经济增长

**balance of
payments**

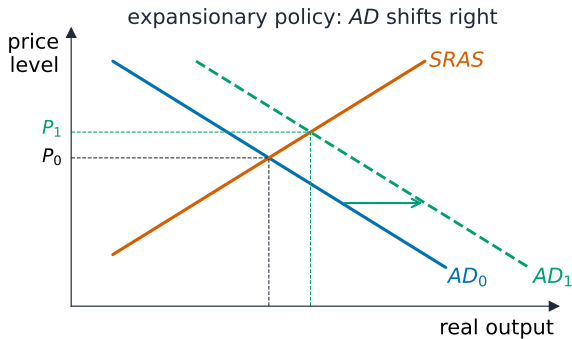
国际收支

**redistri-
bution**

收入再分配

Aims can **conflict**: fast growth can pull up inflation and worsen the balance of payments; cutting unemployment can raise inflation.

Fiscal policy and the budget

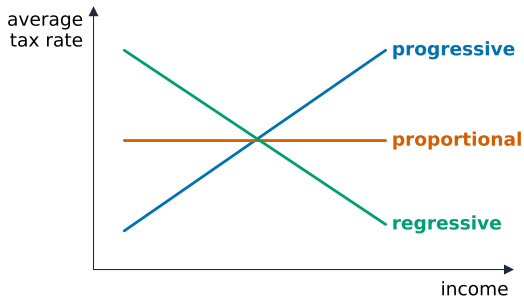


Fiscal policy 财政政策 uses government spending & taxation.

- **budget deficit** 预算赤字 – spend > tax (borrow)
- **expansionary** 扩张性 – raises AD (fights recession)
- **contractionary** 紧缩性 – lowers AD (fights inflation)

Risk: **crowding out** 挤出效应 of private investment.

Types of tax



By what is taxed: **direct** 直接税 (income, profit) vs **indirect** 间接税 (spending). By how the rate moves with income:

- **progressive** 累进税 – rate **rises**
- **proportional** 比例税 – rate flat
- **regressive** 累退税 – rate **falls**

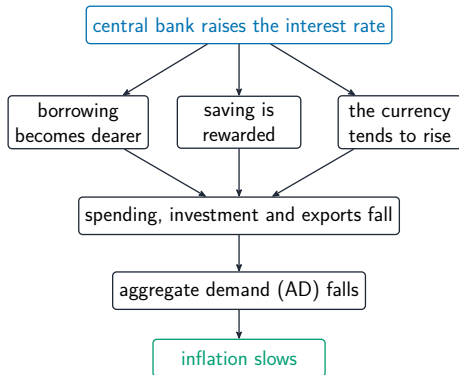
Monetary policy



Monetary policy 货币政策 is run by the **central bank** 中央银行; its main tool is the **interest rate** 利率.

Flexible (the rate can change any-time), but works with a **lag** of a year or more – and in a slump, low rates may not revive borrowing.

The transmission mechanism

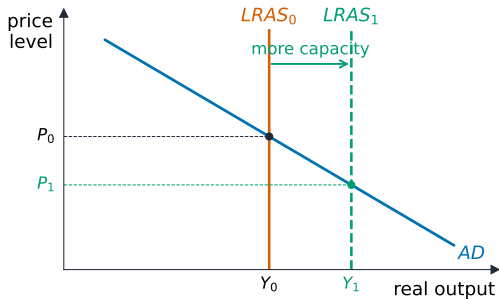


A **higher** interest rate works through three channels:

- borrowing dearer → less spending & investment
- saving rewarded → less spending
- currency rises → exports fall

All lower AD, slowing inflation.

Supply-side policy



Supply-side policy 供给侧政策
raises **productive capacity** 生产能力, shifting LRAS right.

Powerful – it can raise growth
and cut inflation with no trade-off – but slow and costly.

Two supply-side approaches

market-based 市场化

cut tax & benefits,
privatisation 私有化,
deregulation 放松管制

interventionist 干预型

training 培训,
infrastructure 基础设施,
research support

Worked example – fiscal or monetary?

An economy is in recession with a large output gap. Compare using fiscal and monetary policy.

- **Fiscal:** cut tax or raise spending $\Rightarrow$ AD rises, and the **multiplier** amplifies it.
- But it is slow to legislate and worsens the **budget deficit**.
- **Monetary:** cut rates $\Rightarrow$ cheaper borrowing, less saving, weaker currency $\Rightarrow$ AD rises.
- But confidence is low and rates may be near zero $\Rightarrow$ **a liquidity trap**.

Judge any policy on **time lag**, **size of effect** and **side effects**. Monetary is quicker to change; fiscal is more certain to work when confidence is broken.

Topic 5 – key takeaways

1 Objectives

stability, jobs, growth, trade,
fairness – they conflict

2 Fiscal

spending & tax move AD; risk of
crowding out

3 Monetary

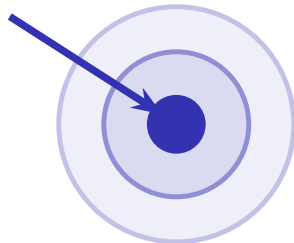
the interest rate works via
transmission

4 Supply-side

lifts LRAS – growth with low
inflation

Check yourself

- 1 A budget deficit means spending is how vs tax?
- 2 A progressive tax rate does what as income rises?
- 3 Who sets monetary policy?
- 4 Which policy shifts LRAS to the right?



Answers 1. greater than tax 2. rises 3. the central bank 4. supply-side policy