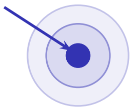
Government Macroeconomic Intervention

A-Level Economics ▪ Topic 5

A-Level Economics



What we will cover

the state steers the economy

1 Objectives

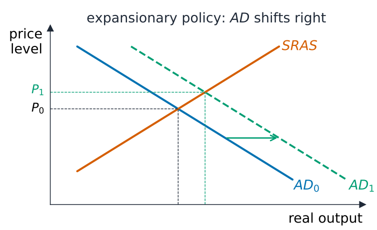
Macroeconomic objectives

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.

2 Fiscal policy

Fiscal policy and the budget

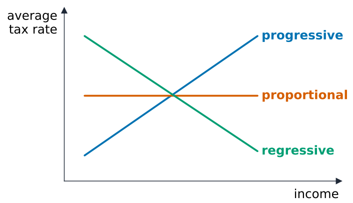


Fiscal policy 财政政策 uses government spending & taxation.

- **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

3 Monetary policy

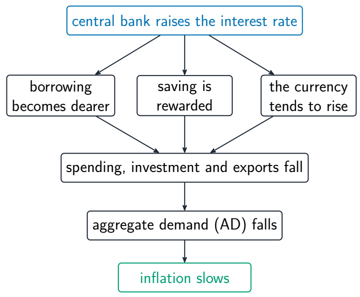
Monetary policy

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.

Government Macroeconomic Intervention
└ Monetary policy

The transmission mechanism



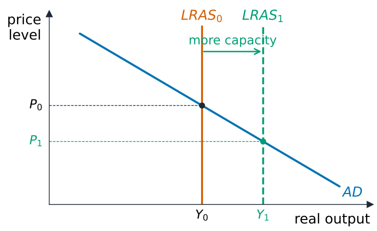
A higher interest rate works through three channels:

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

All lower AD, slowing inflation.

4 Supply-side policy

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

5 Recap

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 ⇒ AD rises, and the multiplier amplifies it.
- But it is slow to legislate and worsens the budget deficit.
- Monetary: cut rates ⇒ cheaper borrowing, less saving, weaker currency ⇒ AD rises.
- But confidence is low and rates may be near zero ⇒ 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

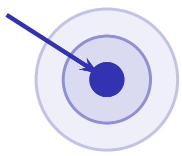
2. **Fiscal**
spending & tax move AD; risk of crowding out

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