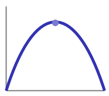
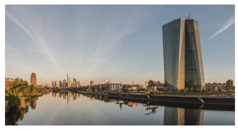
Government Macroeconomic Intervention

A-Level Economics ▪ Topic 10

A-Level Economics



What we will cover



a central bank steers policy

1 Objectives and tools

Objectives and tools

objectives

growth | price stability | full employment | balance of payments

tools

fiscal 财政政策 | **monetary** 货币政策 | **supply-side** 供给侧政策

Fiscal & monetary work on **AD** 总需求 (quick); supply-side on capacity (slow but lasting).

2 Trade-offs

Trade-offs between objectives

these goals pull against each other

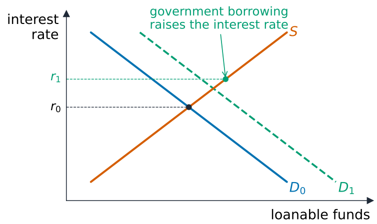
lower unemployment	⇌	higher inflation
faster growth	⇌	higher inflation
faster growth	⇌	worse current account
faster growth	⇌	more pollution

Objectives conflict, so a gain on one costs another:

- unemployment $\updownarrow$ inflation (**Phillips curve** 菲利普斯曲线)
- growth $\updownarrow$ inflation
- growth $\updownarrow$ balance of payments
- growth $\updownarrow$ the environment

3 Effectiveness

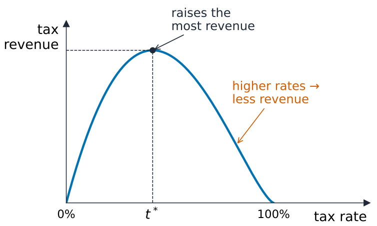
Fiscal policy and crowding out



Fiscal policy acts directly on demand, but:

- **time lags** 时滞; adds to the **national debt** 国债
- **crowding out** 挤出效应 – borrowing raises interest rates, cutting private investment

The Laffer curve



The **Laffer curve** 拉弗曲线: as the tax rate rises, **tax revenue** 税收收入 first rises, then falls.

> Very high rates discourage work & invite avoidance – above t^*, raising the rate *lowers* revenue.

Monetary and supply-side policy

monetary	supply-side
flexible (change anytime), but a long lag – low rates may not revive borrowing	raises growth and cuts inflation – but slow & costly

Putting it together

No single policy hits every target – goals conflict and effects come with delays.

> Governments combine **demand-side** 需求侧政策 policy for the short term with supply-side for the long term, and accept trade-offs.

4 Recap

Worked example – a policy trade-off

A government uses expansionary policy to cut unemployment. What is the trade-off?

- Higher AD ⇒ firms hire more ⇒ unemployment falls.
- But nearer full capacity, scarce labour bids wages up and firms pass costs on ⇒ inflation rises.
- That is the short-run **Phillips curve** 菲利普斯曲线 trade-off.
- Higher incomes also pull in imports ⇒ the current account worsens too.

> Macro objectives conflict: growth and employment pull against inflation and the current account. Supply-side policy is the only route that can improve both at once.

Government Macroeconomic Intervention
└Recap

Topic 10 – key takeaways

1. **Trade-offs** – objectives conflict – gain one, lose another
2. **Crowding out** – government borrowing raises interest rates
3. **Laffer curve** – above t^* a higher rate cuts revenue
4. **Policy mix** – demand-side short term, supply-side long term

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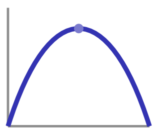
└Recap

Check yourself

1. Which curve shows the unemployment–inflation trade-off?
2. Crowding out raises what, cutting investment?
3. Above t^*, a higher tax rate does what to revenue?
4. Which policy raises growth and cuts inflation?



Answers **1.** the Phillips curve **2.** the interest rate **3.** lowers it **4.** supply-side policy