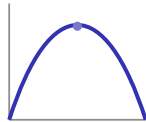


Government Macroeconomic Intervention

A-Level Economics ■ Topic 10

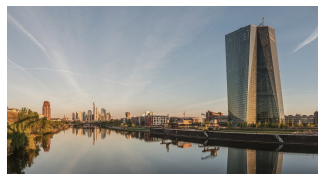
A-Level Economics



Government Macroeconomic Intervention

What we will cover

- 1 Objectives & tools
- 2 Trade-offs between objectives
- 3 Fiscal policy & crowding out
- 4 The Laffer curve
- 5 Monetary & supply-side
- 6 Putting it together



a central bank steers policy

1 Objectives and tools

Objectives and tools



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

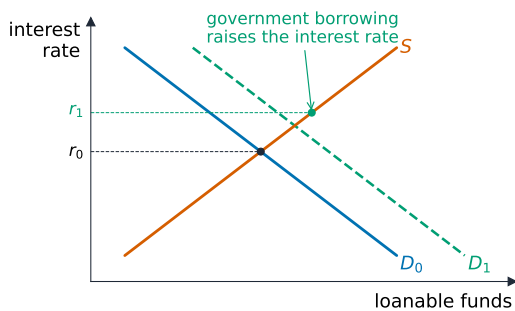
- lower unemployment $\Rightarrow$ higher inflation
- faster growth $\Rightarrow$ higher inflation
- faster growth $\Rightarrow$ worse current account
- faster growth $\Rightarrow$ more pollution

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

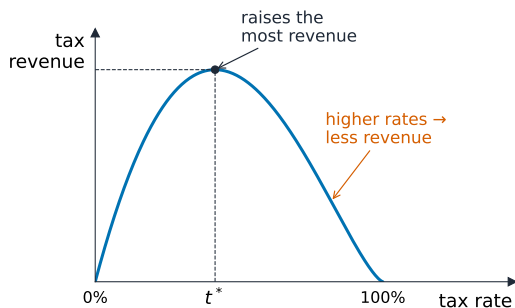
Fiscal policy and crowding out



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

flexible (change anytime),
but a long lag – low rates
may not revive borrowing

supply-side

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

Macro objectives **con-**
flict: growth and employ-
ment pull against inflation
and the current account.
Supply-side policy is the
only route that can im-
prove both at once.

Topic 10 – key takeaways

1 Trade-offs

objectives conflict – gain one, lose another

2 Crowding out

government borrowing raises interest rates

3 Laffer curve

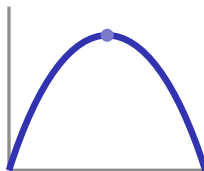
above t^* a higher rate cuts revenue

4 Policy mix

demand-side short term, supply-side long term

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