

Inflation, unemployment and policy judgement

Edexcel IAL Economics WEC12 section 2.3.6 full package with SAM anchors

1. Topic 4 at a glance

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WEC12 macro second half: spec section 2.3.6 in full - the six macroeconomic objectives, the four conflicts between them, supply-side policies and demand-side policies with the central bank's roles.

Must-know: the Phillips curve trades inflation against unemployment in the short run, points (4, 8), (6, 5), (8, 3), (10, 2); supply-side policy shifts LRAS right; fiscal uses G and T; monetary uses interest rates, QE, lending criteria and reserve ratios; the central bank targets inflation, banks the government and the banks, and is lender of last resort.

2. Macroeconomic objectives

Macroeconomic objectives

Growth (rising real GDP); low and stable inflation (a target anchors expectations); low unemployment (resources wasted inside the PPF); current-account equilibrium; a balanced government budget; greater income equality.

Each objective has a measure from topic 3 - real GDP growth, CPI inflation, the ILO rate, the current-account balance, the budget balance, an inequality measure - and each trades off against at least one other objective.

3. Conflicts between objectives

Conflicts between objectives

Inflation versus unemployment: the short-run Phillips curve - cutting inflation from 8 to 3 moves unemployment from 4 to 8 along the labelled points. Growth versus environment: output raises emissions - the SAM India extract: Delhi schools closed for smog while growth ran hot. Inflation versus current account: reflation raises prices AND imports together. Growth versus equality: skill-biased growth widens gaps.

Judgement questions want the conflict NAMED, the mechanism EXPLAINED and the trade-off WEIGHED - the evaluation marks live there.

4. Supply-side policies

Supply-side policies

Supply-side policy raises productivity, competition and incentives - LRAS shifts right. Free market: deregulation of product and labour markets; privatisation; tax reduction; welfare payment reform; cutting firms' bureaucracy costs. Interventionist: education, training and skills; investment tax incentives or subsidies; infrastructure; start-up finance; regional policy.

On the model, LRAS from 85 to 105 along $AD \ P = 90 - Y/2$ cuts the price level from 47.5 to 37.5 while output RISES - growth and disinflation together. Strengths: market policies are cheap and fast to announce; interventionist policies fix real capacity constraints. Weaknesses: uncertain incentives, worsened equality; slow, costly, government failure.

5. Demand-side policies and the central bank

Demand-side policies and the central bank

Fiscal policy: government spending and taxation. Monetary policy: interest rates, asset purchases (QE - the SAM Q10 mechanism: bond purchases improve loan availability, lifting C and I and the price level), lending criteria, reserve requirements. Reflationary raises AD; deflationary cuts it. Against a vertical LRAS a reflation only raises the price level - the model shows 47.5 to 57.5 with no output gain.

The central bank: implements monetary policy; pursues the inflation target (credibility shifts the Phillips curve favourably); banker to the government; banker to the banks - lender of last resort. SAM context: India's base rate cut 6.5 to 6.25 to support demand. Strengths: monetary policy is quick and insulated; fiscal is direct. Weaknesses: lags, crowding out, deficits.

Check yourself

Check yourself

The six objectives with their measures; the four conflicts with the Phillips curve points.

The five free-market and five interventionist supply-side instruments with strengths and weaknesses.

Fiscal versus monetary; reflationary versus deflationary; the four monetary instruments; QE's mechanism; the base rate; the central bank's four roles.