

6.1 Government and the economy

Name: _____ Class: _____ Date: _____

Total: 22 marks

KEY WORDS inflation • fiscal policy

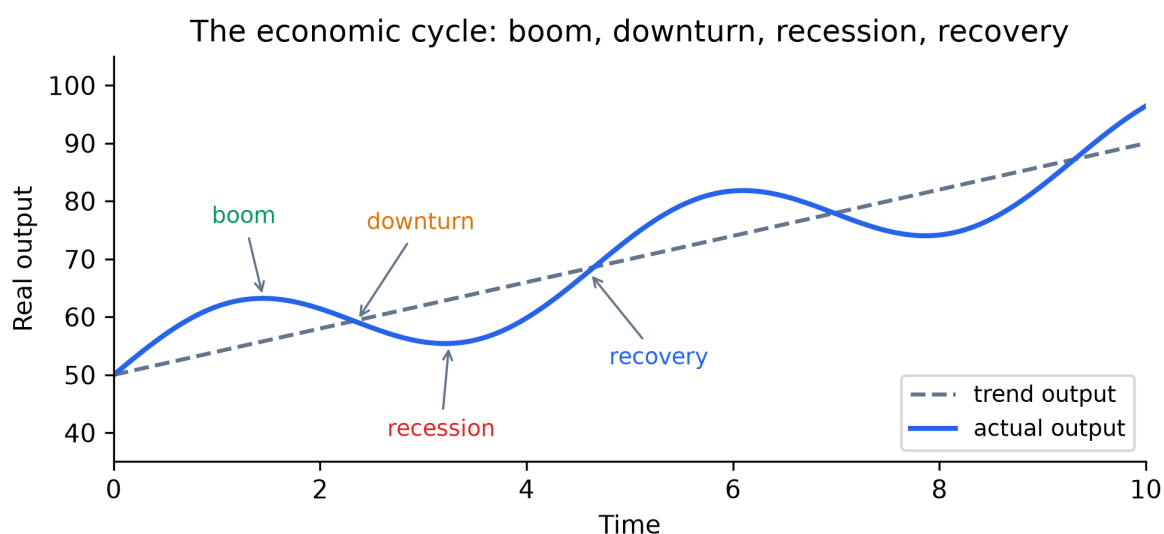
Government and the economy

Objective

Apply the six objectives with their measures, the CPI calculation, the inflation types, the policy families on the AD/AS model, and the trade-offs between objectives (spec 2.1.1–2.1.3).

1 Key knowledge and worked examples

Objectives and policies. Growth is rising real GDP; the cycle runs boom → downturn → recession → recovery. CPI from a weighted basket: 50/30/20 with relatives 110/100/120 → CPI 109 → 9% inflation. Demand-pull: AD right; cost-push: SRAS left. AD $P = 90 - Y/2$ vs SRAS $P = 20 + Y/2$ at (70, 55); a reflation to AD +15 gives (85, 62.5). Fiscal: G and T; monetary: interest rates; supply-side: seven measures. Trade-offs: unemployment ↔ inflation; growth ↔ inflation; growth ↔ environment; inflation ↔ current account.



Original cycle; the stage effects are worked in the questions.

2 Practice

2.1 Define economic growth and name one limitation of GDP as its measure. [2]

2.2 A CPI basket has weights 50, 30 and 20 with price relatives 110, 100 and 120. Calculate the CPI and the inflation rate. [3]

2.3 Distinguish demand-pull from cost-push inflation by their diagrams. [2]

2.4 Name any four of the five types of unemployment. [2]

2.5 Name the four trade-offs between macroeconomic objectives. [2]

3 Exam-style questions

3.1 (*Original.*) On AD $P = 90 - Y/2$ and SRAS $P = 20 + Y/2$, equilibrium is (70, 55). A reflationary policy shifts AD up by 15 at every output. Find the new equilibrium and state the effect on output and the price level. [4]

3.2 (*Original.*) The central bank raises interest rates. Explain the mechanism by which this is expected to reduce inflation, and name one trade-off the policy accepts. [4]

3.3 (*Original.*) A country's growth is 5% but air pollution is rising. Explain the trade-off and suggest one policy that eases it. [3]
