

Government and the economy

Pearson Edexcel · International GCSE · Economics

Pearson Edexcel International GCSE in Economics (4EC1), specification Issue 3, February 2026. This topic covers spec sections 2.1.1–2.1.3 in full: the six macroeconomic objectives (rows a–f of 2.1.1), government policies (2.1.2a–d) and the trade-offs between objectives (2.1.3a). Worked numbers are original and re-derived below.

Must-know for this topic:

Family	Content
CPI	weights 50/30/20 with relatives 110/100/120 → CPI 109 → 9% inflation
objectives	growth, low stable inflation, low unemployment, current-account balance, environment, redistribution
AD/AS	AD $P = 90 - Y/2$ vs SRAS $P = 20 + Y/2$ at (70, 55); reflation → (85, 62.5)
trade-offs	unemployment ↔ inflation; growth ↔ inflation; growth ↔ environment; inflation ↔ current account

The macroeconomic objectives

Economic growth (2.1.1a) is the increase in real GDP; it is measured by GDP increases, but GDP has LIMITATIONS (non-market activity, distribution, environmental damage, price differences). The **economic cycle** diagram shows BOOM (above trend), DOWNTURN, RECESSION (below trend, falling output) and RECOVERY. Each stage moves growth, inflation and unemployment together: a boom raises growth and inflation and cuts unemployment; a recession does the reverse. Growth's impacts: employment, living standards, poverty, productive potential, inflation (if demand outruns capacity) and the environment. **Inflation**

(2.1.1b) is a sustained rise in the price level (deflation: a sustained fall), measured by the **consumer price index** (CPI) – a weighted basket: weights 50/30/20 over goods with price relatives 110/100/120 give $CPI = 55 + 30 + 24 = 109$, so inflation is 9%. DEMAND-PULL inflation comes from AD shifting right (output AND prices rise); COST-PUSH from SRAS shifting left (prices rise, output falls). Interest rates and inflation move opposite: higher rates cut demand and inflation. Inflation hits prices, wages (real pay), exports (dearer), unemployment (if policy deflates), MENU COSTS, SHOE-LEATHER COSTS, uncertainty, confidence and investment. LOW UNEMPLOYMENT (2.1.1c) is measured by the **ILO unemployment measure**; its types are CYCLICAL, STRUCTURAL, SEASONAL, VOLUNTARY and FRICTIONAL; its impacts run through output, wasted resources, poverty, benefit spending, lost tax revenue, confidence and society. A CURRENT-ACCOUNT SURPLUS OR BALANCE (2.1.1d) means exports near imports in goods

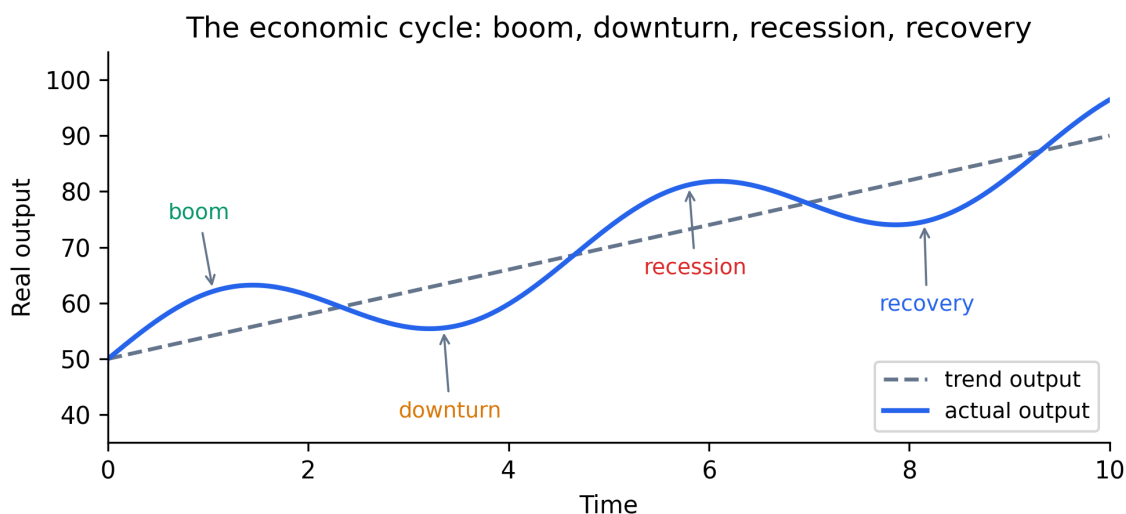
(visibles) and services (invisibles); deficits follow poor quality or dear domestic goods and an overvalued exchange rate; a deficit leaks demand abroad and can be inflationary. ENVIRONMENTAL PROTECTION (2.1.1e) targets visual, noise, air and water pollution – through taxation, subsidy, regulation, fines, pollution permits and public parks. REDISTRIBUTION (2.1.1f) attacks income inequality and absolute/relative poverty through progressive taxation, benefit payments, and education and healthcare investment.

Government policies

Fiscal policy (2.1.2a) uses government revenue (DIRECT taxes on income, INDIRECT on spending) and expenditure; a FISCAL DEFICIT (spending above revenue) reflate but risks debt and crowding out; a SURPLUS deflates. **Monetary policy** (2.1.2b) is focused on INTEREST-RATE changes set by the central bank: higher rates raise borrowing costs, cutting consumption and investment (the transmission mechanism) and cooling inflation; the central bank may also use ASSET PURCHASES (quantitative easing) to add money when rates are near zero.

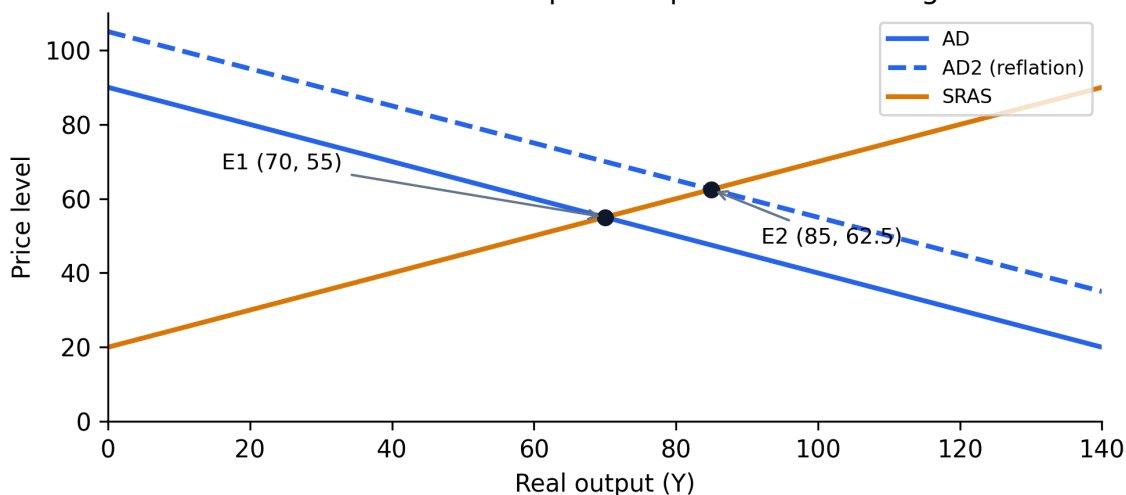
Supply-side policy (2.1.2c) raises productivity and total output: privatisation, deregulation, education and training, regional policies, infrastructure spending, lower business taxes (to stimulate investment) and lower income taxes (to encourage work). GOVERNMENT CONTROLS (2.1.2d): regulation, legislation, fines and pollution permits – each with advantages (direct effect, flexibility) and disadvantages (enforcement cost, unintended consequences).

On the AD/AS model, a reflationary fiscal or monetary policy shifts AD from $P = 90 - Y/2$ up by 15: equilibrium moves from (70, 55) to (85, 62.5) – more output, higher prices; supply-side policy shifts SRAS right instead, raising output with LOWER prices.

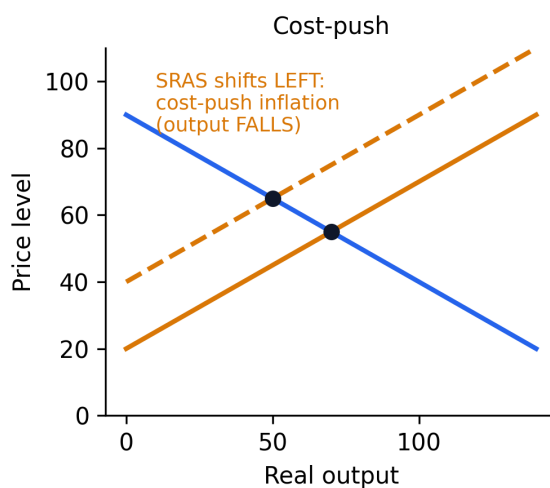
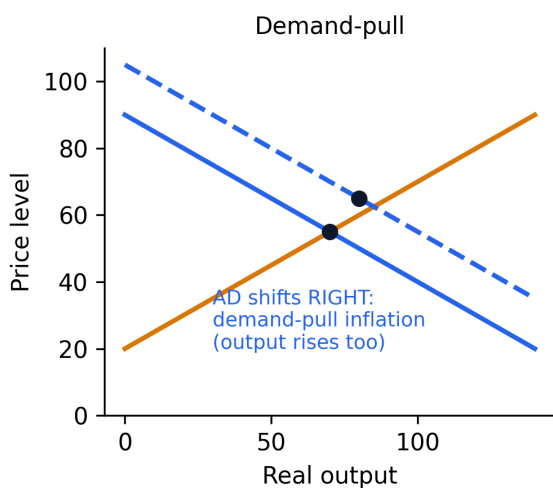


Original cycle with boom, downturn, recession and recovery annotated.

A reflation shifts AD: output and price level rise together



Original model: the reflation moves equilibrium from (70, 55) to (85, 62.5).



Original panels: AD right raises output with prices; SRAS left (cost-push at (50, 65)) raises prices and cuts output.

Relationships between objectives and policies

The trade-offs (2.1.3a): UNEMPLOYMENT and INFLATION – deflating demand cuts inflation but costs jobs; GROWTH and INFLATION – fast growth overheats into demand-pull inflation; GROWTH and ENVIRONMENTAL PROTECTION – output raises pollution; INFLATION and the CURRENT ACCOUNT – dearer exports worsen the trade balance. Every policy answer should name the trade-off it accepts.

Checklist

- Growth: definition, GDP measurement and its limitations; the cycle's four stages and each stage's effects; growth's six impacts (2.1.1a).
- Inflation and deflation definitions; CPI from the weighted basket ($109 \rightarrow 9\%$); demand-pull vs cost-push; the interest-rate link; the nine impact groups incl. menu and shoe-leather costs (2.1.1b).
- Unemployment: ILO measure, five types, seven impact groups (2.1.1c).
- Current account: visibles and invisibles; deficit/surplus causes; the exchange-rate link; deficit impacts (2.1.1d).
- Environment: four pollution types; six intervention measures (2.1.1e).
- Redistribution: inequality and poverty definitions; three reasons and three instruments (2.1.1f).
- Fiscal (direct/indirect, deficit/surplus), monetary (interest-rate mechanism, QE), supply-side (seven measures), controls (four, with pros and cons) (2.1.2a–d).
- The four trade-offs between objectives (2.1.3a).

Boundary notes: Paper 2 (macroeconomics, 80 marks, four 20-mark questions) rewards data-response calculation (the CPI arithmetic) and trade-off evaluation. All worked numbers are original.