

Macroeconomic activity, objectives and policy

IB DP Economics SL Unit 3 sections 3.1-3.7 full package

1. Unit 3 at a glance

Unit 3 at a glance

IB Economics SL Unit 3.1-3.7: measuring economic activity, AD/AS and the business cycle, the macroeconomic objectives with inequality and poverty, monetary, fiscal and supply-side policies - on the shared diagram AD $P = 90 - Y/2$ vs SRAS $P = 20 + Y/2$ at (70, 55). The multiplier, natural rate and deflator algebra are HL.

Must-know: GDP three ways, real vs nominal, per head; $AD = C + I + G + (X - M)$; a rightward AD shift to (85, 62.5) buys output with inflation; $CPI\ 109 = 9$ percent; LRAS 85 to 105 cuts prices 47.5 to 37.5 with rising output; the objectives conflict in pairs.

2. Measuring economic activity

Measuring economic activity

GDP is final output within a country - by output, income or expenditure, which agree in principle. Nominal turns real by removing price changes (the deflator idea); per head divides by population. Welfare limits: non-market activity, distribution, the environment - hence the OECD Better Life Index, the Happiness Index and the Happy Planet Index.

The business cycle - recovery, boom, recession, trough - shows short-run variation around the trend; each stage moves growth, inflation and unemployment together.

3. AD and AS

AD and AS

$AD = C + I + G + (X - M)$ with each component's shifter; price-level changes move along, component changes shift. SRAS rises with prices; the long run divides schools - Keynesian flat-then-vertical, monetarist vertical at full employment, where demand management moves only prices.

On the diagram a stimulus moves (70, 55) to (85, 62.5) - output with inflation; against a vertical LRAS only the price level rises. The Keynesian reads spare capacity, the monetarist reads inflation: choose the diagram with the camp in mind.

4. Objectives, inequality and poverty

Objectives, inequality and poverty

Low unemployment (ILO measure; cyclical, structural, seasonal, frictional - with costs to the person, society and the economy); low stable inflation (CPI basket 109 = 9 percent; demand-pull vs cost-push); economic growth with its consequences for living standards, environment and equity.

Inequality and poverty (3.4): the Lorenz curve and Gini - quintiles 5/10/15/20/50 read as 0.40; absolute vs relative poverty; redistribution buys equity at possible incentive cost. The objectives conflict in pairs - unemployment vs inflation, growth vs environment, growth vs equity.

5. The three policy families

The three policy families

Monetary: the interest-rate mechanism - dearer borrowing cuts C and I, cools inflation; QE at the zero bound; the India 6.5-to-6.25 cut shows a 25-point easing. Fiscal: spending and taxation shift AD; structural vs cyclical deficits; automatic stabilisers; lags and debt as constraints.

Supply-side shifts LRAS right: education, infrastructure, deregulation, privatisation, lower work/investment taxes, labour reform - LRAS 85 to 105 cuts prices 47.5 to 37.5 with output rising: growth with disinflation, the contrast the IB wants drawn.

Check yourself

Check yourself

GDP three ways; real vs nominal; welfare limits and the three alternative indicators; the cycle's stages.

AD components and shifters; the two long-run AS views read on the diagram.

The objectives with the CPI basket and the conflicts between them; Lorenz/Gini 0.40.

Monetary transmission with QE; fiscal shifts, deficits and stabilisers; the six supply-side instruments with the LRAS contrast.