4.5 Macroeconomic policy

Name: _____ Class: _____ Date: _____ **Total: 15 marks**

KEY WORDS multiplier • crowding out

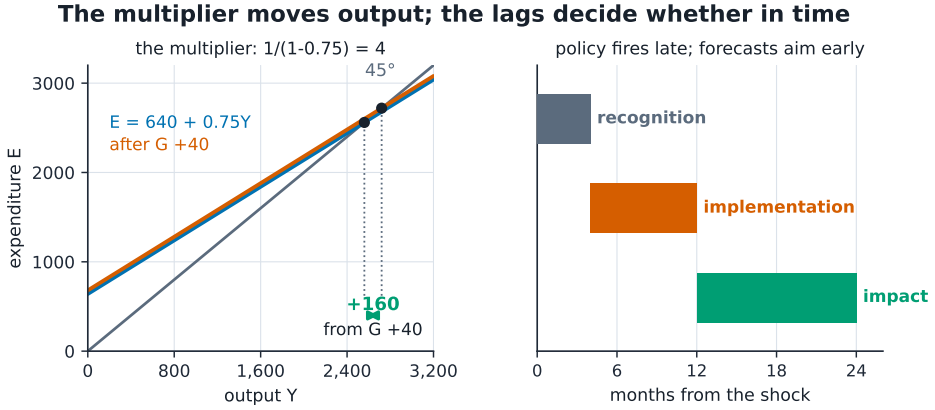
Objective

Compute spending, tax and balanced-budget multipliers; choose packages that close a stated gap; grade policy by arrival time, not announcement; apply the framework to the 2021–23 episode.

1 Key knowledge and worked examples

■ The fractions and the clocks

Spending multiplier $1/(1-MPC)$; tax multiplier $-MPC/(1-MPC)$; balanced-budget multiplier exactly 1. **Crowding out** and leakages make real multipliers smaller. Recognition, implementation and impact lags decide whether help arrives on time.



The multiplier moves output; the lags decide whether it moves in time

■ Worked example. Aurora's −60 gap

MPC 0.75: $G+15 \to +60$; $T-20 \to +60$; both $\times 4$ and $\times 3$ ✓. Equal G and T rises net exactly their own size ✓. Each closes the gap; debt, composition and speed are the judgement.

2 Practice

2.1 MPC is 0.8. Compute the spending multiplier and the tax multiplier. [2]

2.2 With those multipliers: G rises 30; T falls 50. Compute each effect on output and the combined change. [3]

2.3 G and T both rise by 30 (MPC 0.8). What happens to output, and what is this result called? [2]

2.4 The output gap is −100. Two parties propose G +25 and T −40. Show what each delivers, and name one reason each might overshoot in reality. [4]

2.5 For the 2021–23 episode (UK CPI peak 11.1% in Oct 2022; policy rates near zero to 4–5% by 2023): in three lines, apply (a) the supply shock's effect on the Phillips trade-off, (b) the lags, (c) one limit of the whole reading. [4]