

Government macroeconomic intervention

A-Level Economics

Governments try to steer the whole economy. This handout covers what they aim for and the three sets of tools they use.

Macroeconomic policy objectives

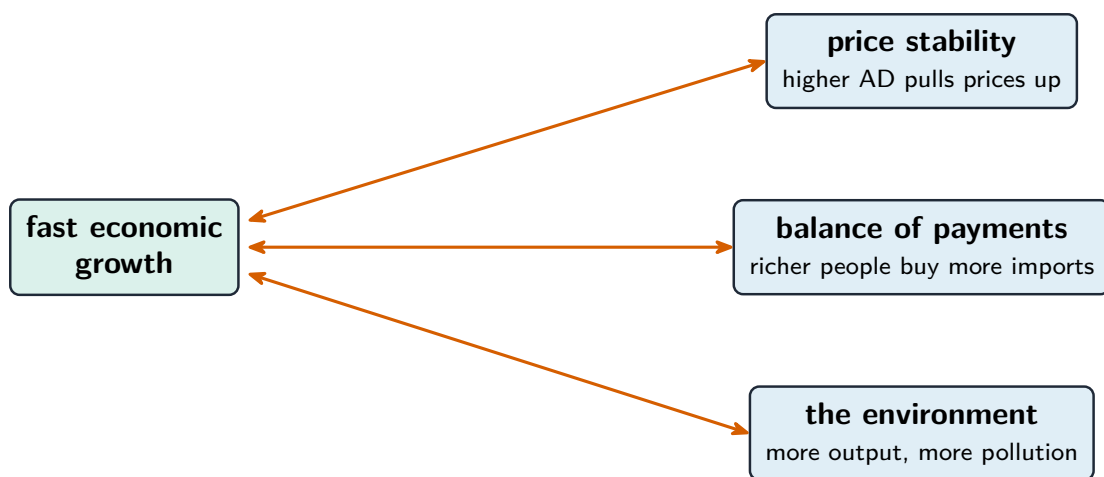
A government usually has five main aims:

- **price stability** 物价稳定 — low and steady **inflation** 通货膨胀 (often a target of about 2% a year).
- **full employment** 充分就业 — jobs for almost everyone who wants to work.
- **economic growth** 经济增长 — a rising real output over time.
- **balance of payments** 国际收支 stability — not importing far more than the country exports for years on end.
- **redistribution of income** 收入再分配 — narrowing the gap between rich and poor.

Conflicts between objectives

The aims can **conflict** 冲突 — reaching one can hurt another:

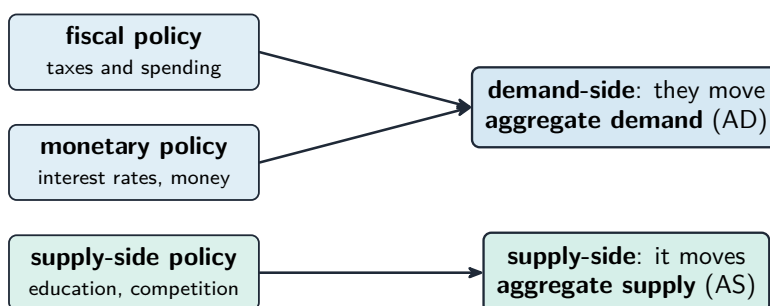
- **growth versus inflation**: fast growth raises **aggregate demand** 总需求, which can pull prices up.
- **growth versus the balance of payments**: as incomes rise, people buy more imports, worsening the trade balance.
- **unemployment versus inflation**: cutting unemployment by raising demand can cause more inflation.
- **growth versus the environment**: more output often means more pollution.



the same tension links **full employment** and **price stability**:
cutting unemployment by raising demand can cause more inflation

Chasing fast growth can pull against price stability, the balance of payments and the environment

The government has three sets of tools. Fiscal and monetary policy are **demand-side policies** 需求侧政策 (they work on AD). Supply-side policy works on **aggregate supply** 总供给.



Fiscal and monetary policy work on aggregate demand; supply-side policy works on aggregate supply

Fiscal policy

fiscal policy 财政政策 is the use of government **spending** and **taxation** to influence the economy.



Governments use fiscal policy — government spending and taxation, set through the legislature — to steer the economy.

The **budget** 预算 compares the two:

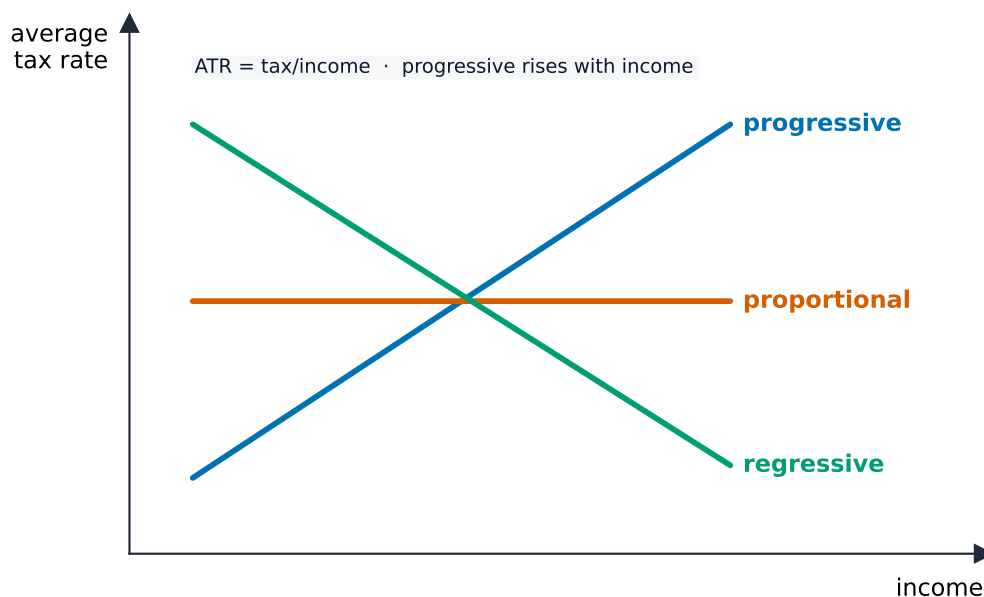
- a **budget deficit** 预算赤字 is when spending is greater than tax revenue. The government must borrow, adding to the **national debt** 国债.
- a **budget surplus** 预算盈余 is when tax revenue is greater than spending.

Types of tax

- a **direct tax** 直接税 is paid straight to the government on income or profit (income tax, corporation tax).
- an **indirect tax** 间接税 is a tax on spending (added to the price of goods).

Taxes are also grouped by how the rate changes with income:

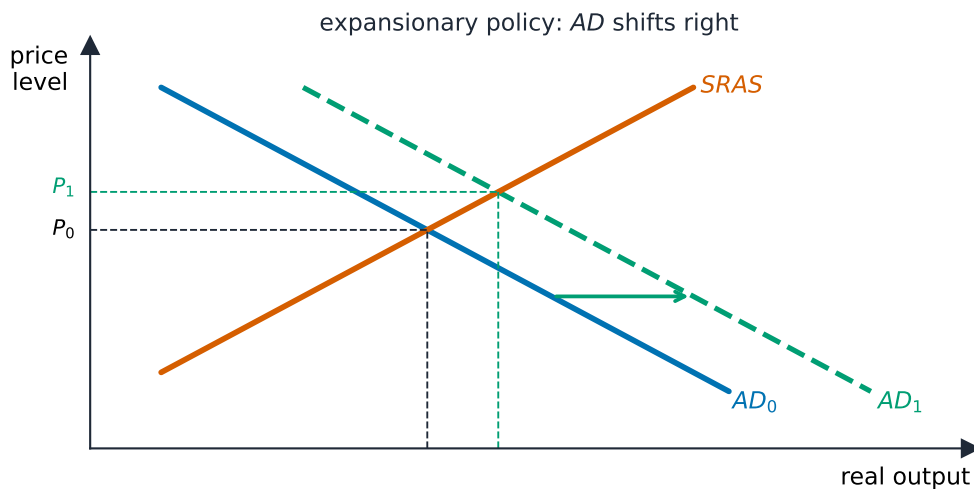
Type	How it works
progressive tax 累进税	the rate rises as income rises (the rich pay a larger share)
proportional tax 比例税	the rate stays the same at every income
regressive tax 累退税	the rate falls as income rises (the poor pay a larger share)



Under a progressive tax the average rate rises with income; under a proportional tax it stays flat; under a regressive tax it falls.

Using fiscal policy

- **expansionary** 扩张性 fiscal policy raises government spending or cuts taxes. This raises AD, to fight a recession and unemployment.
- **contractionary** 紧缩性 fiscal policy cuts spending or raises taxes. This lowers AD, to fight inflation.



expansionary: $AD \rightarrow \cdot Y \uparrow, P \uparrow$

Expansionary fiscal or monetary policy shifts AD right, raising output and the price level; contractionary policy does the reverse.

Effectiveness. Fiscal policy can act fast on AD, but it has problems: time lags (a budget is set once a year), large deficits and debt, and **crowding out** 挤出效应 — when heavy government borrowing pushes up interest rates and reduces private investment.

Monetary policy

monetary policy 货币政策 is run by the **central bank** 中央银行. Its main tool is the **interest rate** 利率, but it can also change the **money supply** 货币供给 or influence the **exchange rate** 汇率.



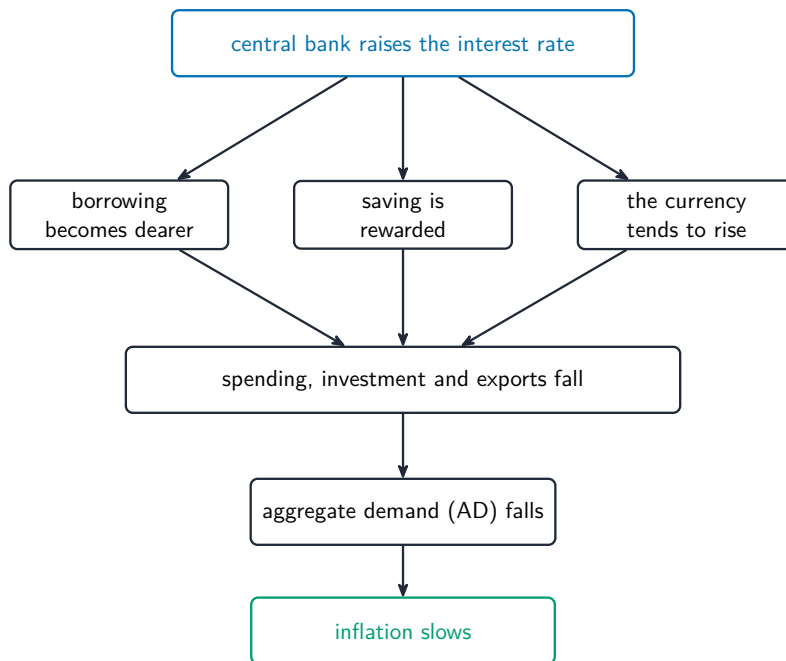
A central bank, like the Bank of England, sets the interest rate — the main tool of monetary policy.

The transmission mechanism

The **transmission mechanism** 传导机制 is how a change in the interest rate reaches the wider economy. If the central bank **raises** the interest rate:

- borrowing becomes dearer, so households and firms spend and invest less.
- saving is rewarded, so people spend less.
- the currency tends to rise, so exports fall.

All of these lower AD, which slows inflation. A **cut** in the interest rate does the opposite, raising AD.

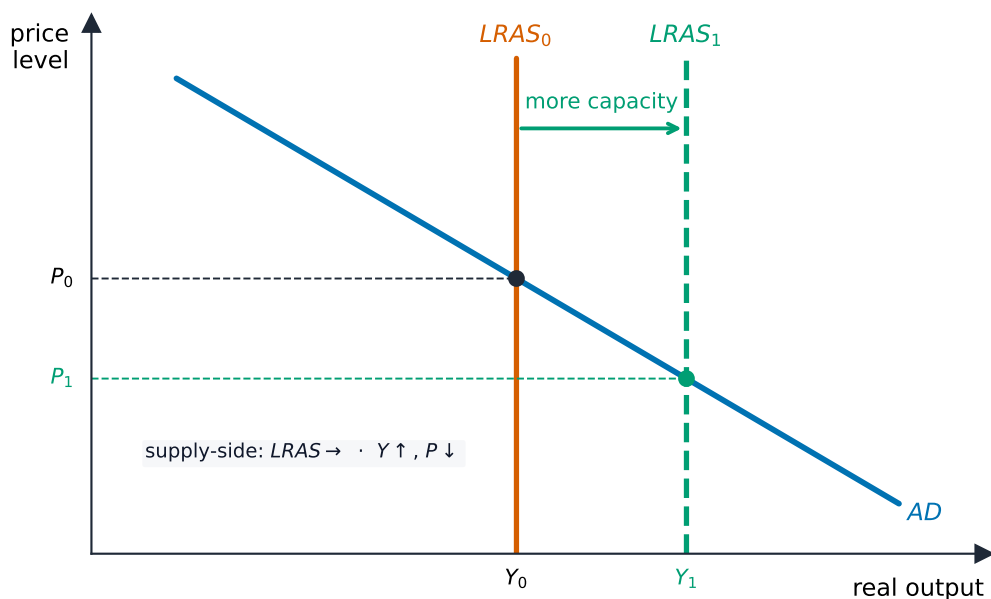


A higher interest rate works through three channels to cut spending, investment and exports, lowering AD and slowing inflation.

Effectiveness. Monetary policy is flexible (the rate can change at any time), but it works with a time lag of a year or more. In a deep slump, even very low rates may not make worried firms and households borrow.

Supply-side policy

supply-side policy 供给侧政策 tries to raise the economy's **productive capacity** 生产能力 — to shift long-run aggregate supply to the right. It aims to make markets work better and raise **productivity** 生产率.



Supply-side policy raises capacity, shifting LRAS right: real output rises and the price level falls — growth with lower inflation.

There are two kinds.

Market-based policies let markets work more freely:

- cutting income tax and benefits to strengthen the **incentive** 激励 to work.
- **privatisation** 私有化 — selling state firms to private owners, who run them for profit.
- **deregulation** 放松管制 — removing rules that block competition.

Interventionist policies use the government directly:

- spending on education and **training** 培训 to raise workers' skills.
- spending on **infrastructure** 基础设施 — roads, ports and broadband.
- support for research and new technology.

Effectiveness. Supply-side policy is powerful because it can raise growth **and** lower inflation at the same time, with no trade-off. But it is slow (education takes years to pay off), costly, and some measures, like cutting benefits, can widen inequality.

Worked example. An economy is in a deep recession with a large output gap, and interest rates are already near zero. Which policy should the government use, and why is the other one weak here? **Monetary policy is weak:** with the base rate already near zero there is almost no room to cut further, and even cheap credit will not make firms invest when they expect no demand. **Fiscal policy is stronger:** government spending raises aggregate demand **directly**, without waiting for anyone to choose to

borrow, and the **multiplier** means each pound spent raises national income by more than a pound as it is re-spent. Weigh the costs against it - a bigger **budget deficit** and rising debt, plus **time lags** on large projects. Match the policy to the **constraint named in the question**: here it is the zero lower bound, and that is precisely what makes fiscal policy the answer.

Exam tips

- Match a **policy to an objective**: fiscal and monetary policy act on demand; supply-side policy raises long-run capacity.
- Explain how a change in **interest rates** works through AD, and fiscal policy through G and T .
- Evaluate policy with **time lags, side effects and conflicts** between objectives.
- **Supply-side** measures (education, tax incentives) are long-run and slow to work.