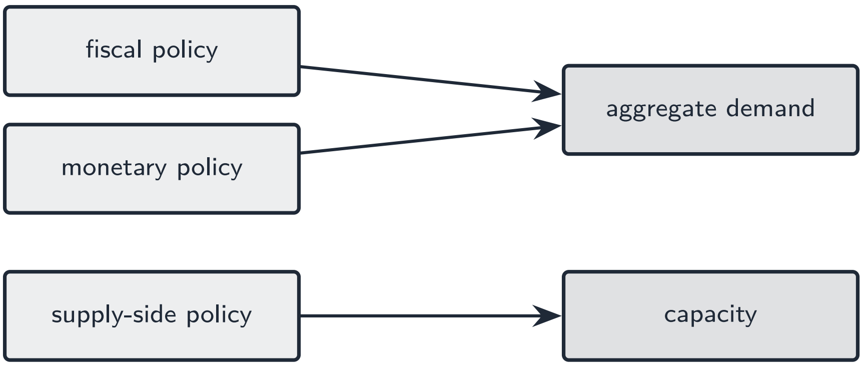
Government macroeconomic intervention (A Level)

A-Level Economics

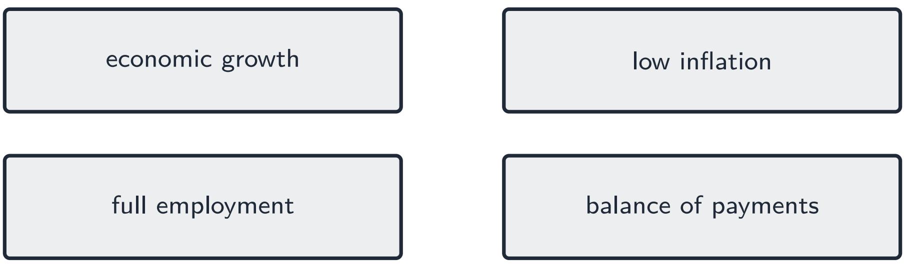
This topic pulls the macroeconomics together: the goals a government has, how they clash, and how well its tools work.

Objectives and the tools to reach them

Governments aim at several **macroeconomic objectives** 宏观经济目标 at once:



Fiscal and monetary policy act on demand; supply-side on capacity



The four macroeconomic objectives

Objective	How it is measured
economic growth 经济增长	the % change in real GDP
price stability 物价稳定 (low **inflation** 通货膨胀)	the % change in the consumer price index
full employment 充分就业	the unemployment rate
balance of payments 国际收支 stability	the current account balance

To reach these goals, the government uses three sets of tools:

- **fiscal policy** 财政政策 — changing government spending and taxes.
- **monetary policy** 货币政策 — changing the **interest rate** 利率 and the money supply.
- **supply-side policy** 供给侧政策 — raising the economy's capacity and productivity.

Fiscal and monetary policy mainly work on **aggregate demand** 总需求, so they are quick but can cause inflation. Supply-side policy works on capacity, so it is slow but lasting.

Central banks, such as the European Central Bank, are a main tool of macroeconomic policy.

Links and trade-offs between objectives

The objectives are **interrelated** — reaching one can move another. Often there is a **trade-off** 取舍, a **conflict** 冲突 where gaining on one goal costs you on another.

- **unemployment versus inflation.** Raising demand to cut unemployment tends to push prices up. The **Phillips curve** 菲利普斯曲线 shows this short-run trade-off. (In the long run it may disappear.)
- **growth versus inflation.** Fast demand-led growth can overheat the economy and cause inflation.
- **growth versus the balance of payments.** As incomes rise, people buy more imports, so the current account can worsen.

- **growth versus the environment.** More output often means more pollution and use of resources.
- **growth versus equality.** Growth does not always reach everyone, so the income gap can widen.

these goals pull against each other

lower unemployment $\rightleftharpoons$ higher inflation

faster growth $\rightleftharpoons$ higher inflation

faster growth $\rightleftharpoons$ worse current account

faster growth $\rightleftharpoons$ more pollution

The objectives pull against each other, so a government must trade one off against another — there is rarely a way to win on all of them at once

Because the goals are linked, a government must often accept "second best" on one aim to protect another. A clever policy mix tries to ease the trade-offs — for example, supply-side policy can raise growth **and** lower inflation, easing the usual clash.

The effectiveness of policy

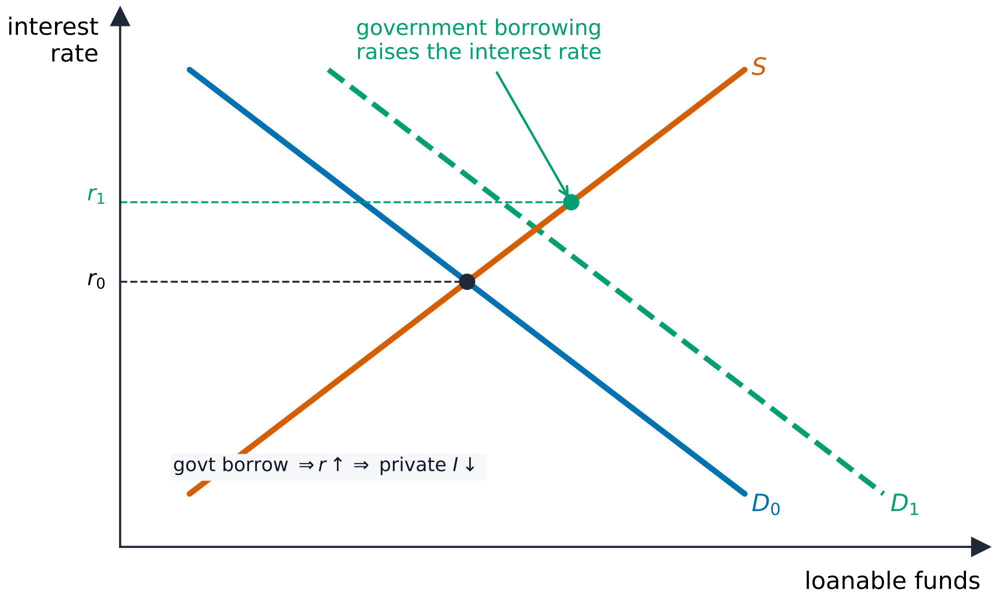
Each tool has strengths and weaknesses.

Financial markets react quickly to policy, which affects how well a policy works.

Fiscal policy

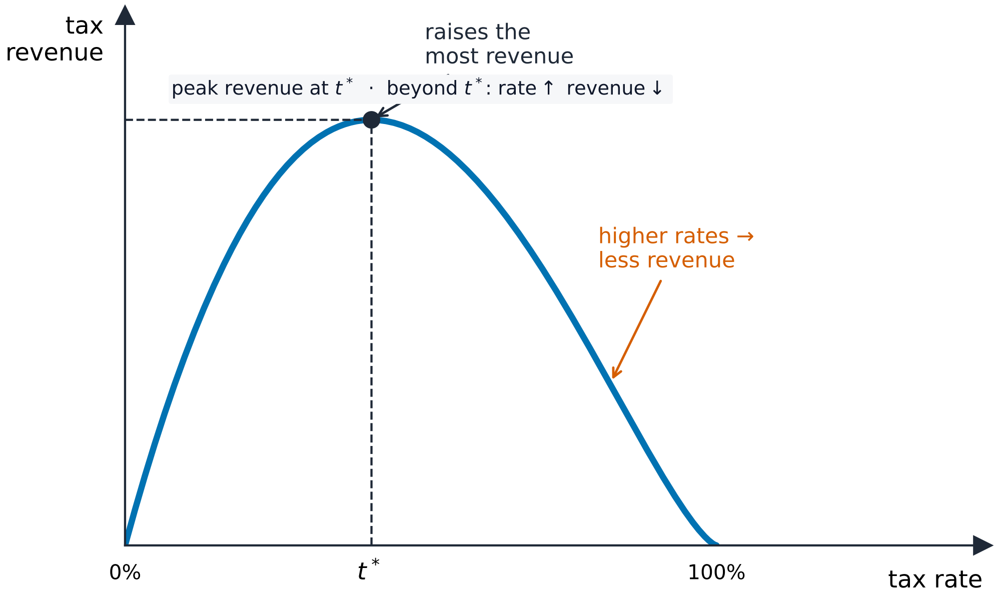
It can act directly and powerfully on demand, and it can target particular groups or regions. But:

- it suffers **time lags** 时滞 — a budget is set once a year, and the effects take time.
- large deficits add to the **national debt** 国债.
- it can cause **crowding out** 挤出效应 — heavy government borrowing raises interest rates and reduces private investment.



Heavy government borrowing shifts the demand for loanable funds right, raising the interest rate ($r_0 \to r_1$) and crowding out private investment.

The **Laffer curve** 拉弗曲线 is a useful warning. It shows that as the tax rate rises, **tax revenue** 税收收入 first rises but then **falls**: very high rates discourage work and encourage tax avoidance, so revenue drops. There is a tax rate that raises the most revenue, and going above it is self-defeating.



Tax revenue is zero at both a 0% and a 100% tax rate; it peaks at the rate t^*, and pushing rates above t^* actually lowers revenue.

Monetary policy

It is flexible — the interest rate can be changed at any time. But it also works with a long time lag, and in a deep slump even very low rates may fail to make worried firms and households borrow.

Supply-side policy

It is the only tool that can raise growth and lower inflation together, with no trade-off. But it is slow (education and training take years), it is costly, and some measures (like cutting benefits) can widen inequality.

Putting it together

No single policy can hit every target. The objectives conflict, the effects come with delays, and the future is uncertain. So governments usually combine **demand-side policies 需求侧政策** (fiscal and monetary) for the short term with supply-side policy for the long term, and accept that some goals must be traded against others.

Worked example. A government cuts interest rates to reduce unemployment. Which other objective is put at risk, and why? Lower rates make borrowing cheaper and saving less attractive, so consumption and investment rise: **aggregate demand** rises, output rises, and unemployment falls. But that same rise in demand pulls **prices** up, especially as the economy nears full capacity - so the objective at risk is **low**

inflation. This is the classic **Phillips curve** trade-off: lower unemployment bought at the price of higher inflation. It also tends to worsen the **current account**, because richer consumers buy more imports. Name the **objective** at risk and the **mechanism** joining the two - and remember that a **supply-side** policy is the one tool that can improve both objectives at once, which is usually the evaluation the question is fishing for.

Exam tips

- Show the **trade-offs between objectives** (for example growth versus inflation, unemployment versus inflation).
- Evaluate **policy effectiveness** using time lags, expectations and the state of the economy.
- Match the tool (fiscal, monetary, supply-side, exchange rate) to the target, and judge the conflicts.