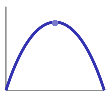
Government Macroeconomic Intervention

A-Level Economics ▪ Topic 10

A-Level Economics



What we will cover

1 Objectives & tools

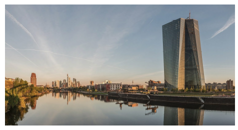
2 Trade-offs between objectives

3 Fiscal policy & crowding out

4 The Laffer curve

5 Monetary & supply-side

6 Putting it together



a central bank steers policy

1 Objectives and tools

Objectives and tools

objectives

growth | price stability | full employment | balance of payments

tools

fiscal 财政政策 | **monetary** 货币政策 | **supply-side** 供给侧政策

Fiscal & monetary work on **AD** 总需求 (quick); supply-side on capacity (slow but lasting).

2 Trade-offs

Trade-offs between objectives

Objectives conflict, so a gain on one costs another:

- unemployment ↕ inflation (**Phillips curve** 菲利普斯曲线)
- growth ↕ inflation
- growth ↕ balance of payments
- growth ↕ the environment

these goals pull against each other

lower unemployment ⇌ higher inflation

faster growth ⇌ higher inflation

The objectives are interrelated

trade-off 取舍	a **conflict** 冲突 in which gaining on one objective costs you on another
growth against inflation	demand-led growth pushes prices up as spare capacity runs out
growth against the current account	rising incomes suck in imports
growth against equality	growth does not always reach everyone, so the income gap can widen
unemployment against inflation	the short-run Phillips curve relationship
the consequence	a government must often accept "second best" on one aim to protect another

> A clever policy mix eases a trade-off rather than pretending it is not there. Naming which aim was sacrificed is the evaluation mark.

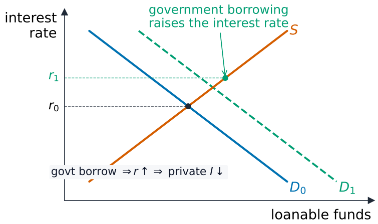
3 Effectiveness

Fiscal policy and crowding out

Fiscal policy acts directly on demand, but:

- **time lags** 时滞; adds to the **national debt** 国债
- **crowding out** 挤出效应 – borrowing raises interest rates, cutting private investment

Fiscal policy and crowding out, in detail



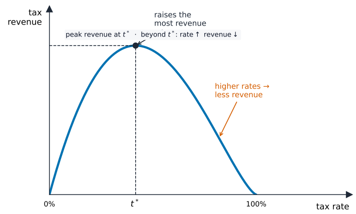
> Heavy government borrowing shifts the demand for loanable funds right, raising the interest rate ($r_0 \to r_1$) and crowding out private investment.

The Laffer curve

The **Laffer curve** 拉弗曲线: as the tax rate rises, **tax revenue** 税收收入 first rises, then falls.

> Very high rates discourage work & invite avoidance – above t^*, raising the rate *lowers* revenue.

The Laffer curve, in detail



> The **Laffer curve** 拉弗曲线: as the tax rate rises, **tax revenue** 税收收入 first rises, then falls.

Monetary and supply-side policy

monetary
flexible (change anytime), but a long lag – low rates may not revive borrowing

supply-side
raises growth and cuts inflation – but slow & costly

Putting it together

No single policy hits every target – goals conflict and effects come with delays.

> Governments combine **demand-side** 需求侧政策 policy for the short term with supply-side for the long term, and accept trade-offs.

Which tool acts on what

Demand-side policies	**Demand-side policies** 需求管理政策 – fiscal and monetary – shift **aggregate demand** 总需求. They work in months, and they cannot raise capacity.
Supply-side policy	Acts on capacity: skills, infrastructure, competition, incentives. It works in years, and it is the only non-inflationary route to growth.
The headline target	**Economic growth** 经济增长 is measured as the percentage change in real GDP – so it is an *actual* growth figure, whatever caused it.
The combination	Governments usually pair demand-side policy for the short term with supply-side for the long, and accept that some goals must be traded off.

> Match the tool to the diagnosis: an output gap needs demand, a capacity ceiling needs supply. Using the wrong one buys inflation.

Objectives and the tools to reach them

economic growth | low inflation

full employment | balance of payments

> The four macroeconomic objectives

Objectives and the tools to reach them, continued

fiscal policy → aggregate demand
monetary policy → aggregate demand
supply-side policy → capacity

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

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.

4 Recap

Worked example – a policy trade-off

A government uses expansionary policy to cut unemployment. What is the trade-off?

- Higher AD ⇒ firms hire more ⇒ unemployment falls.
- But nearer full capacity, scarce labour bids wages up and firms pass costs on ⇒ inflation rises.
- That is the short-run **Phillips curve** 菲利普斯曲线 trade-off.
- Higher incomes also pull in imports ⇒ the current account worsens too.

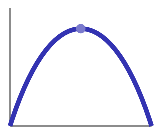
Macro objectives conflict: growth and employment pull against inflation and the current account. Supply-side policy is the only route that can improve both at once.

Topic 10 – key takeaways

1. **Trade-offs**
   objectives conflict – gain one, lose another
2. **Crowding out**
   government borrowing raises interest rates
3. **Laffer curve**
   above t^* a higher rate cuts revenue
4. **Policy mix**
   demand-side short term, supply-side long term

Check yourself

1. Which curve shows the unemployment–inflation trade-off?
2. Crowding out raises what, cutting investment?
3. Above t^*, a higher tax rate does what to revenue?
4. Which policy raises growth and cuts inflation?



Answers **1.** the Phillips curve **2.** the interest rate **3.** lowers it **4.** supply-side policy