Government & the Macroeconomy

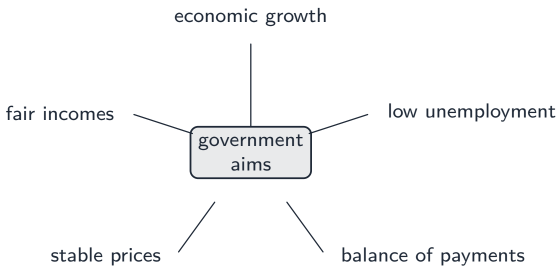
IGCSE Economics ▪ Topic 4

IGCSE Economics

What we will cover

1 Aims and tools

Government aims



Five **macroeconomic** 宏观经济 aims:

- **economic growth** 经济增长
- **full employment** 充分就业
- **price stability** 价格稳定
- balanced trade & fair incomes

Aims can conflict.

Policy tools

- **fiscal policy** 财政政策 – spending & tax
- **monetary policy** 货币政策 – interest rates
- **supply-side policy** 供给侧政策 – improving the economy's capacity

Central banks set the monetary tools

Policy tools – overview

Three sets of tools for the same aims:

- **fiscal policy** 财政政策 – government spending and tax
- **monetary policy** 货币政策 – interest rates (and the money supply)
- **supply-side policy** 供给侧政策 – raising what the economy can produce

Supply-side tools, by name

Privatisation	**Privatisation** 私有化: selling a state industry to private owners, in the hope that competition raises efficiency.
Deregulation	**Deregulation** 放松管制: removing rules that keep new firms out, so incumbents face competition.
Incentives	Lower marginal tax rates and targeted subsidies change the **incentives** 激励 to work, save and invest.
Training	Education and training raise **productivity** 生产率 – the slowest tool, and the only one that lifts capacity permanently.

> Supply-side policy shifts what the economy *can* produce. Demand-side policy only moves how much of it is bought.

Policy tools – overview, in detail

Fiscal	Monetary	Supply-side
government spending & taxes	interest rate & money supply	raise capacity & productivity

Exam: fiscal = G & T; monetary = interest rate / money; supply-side = capacity & productivity

> The government's three sets of policy tools for managing the macroeconomy

The budget, and the three outcomes

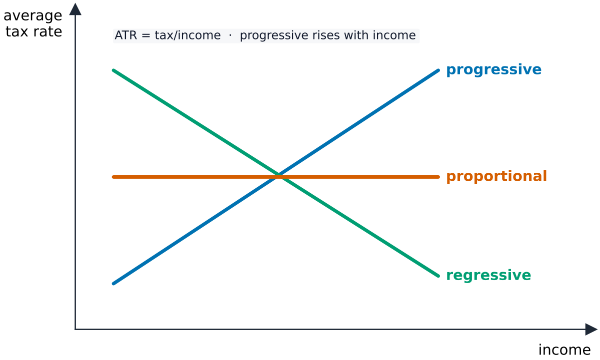
the budget 预算	government spending set against tax raised
a budget deficit 预算赤字	spending exceeds tax, so the government must borrow
a budget surplus 预算盈余	tax exceeds spending
a balanced budget	the two are equal
expansionary fiscal policy	raise spending or cut tax – used to fight unemployment, and it widens the deficit
contractionary	cut spending or raise tax – used to fight inflation

> A deficit is not automatically bad: borrowing to invest in what raises future output is different from borrowing to fund today's spending.

Taxes

- **direct tax** 直接税 (on income) vs **indirect tax** 间接税 (on spending)
- **progressive** 累进税 – higher % on the rich
- **regressive** 累退税 – hits the poor harder

Taxes, in detail



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

How taxes are classified

by *what* is taxed	the first of the two groupings
a direct tax 直接税	paid straight to the government from **income** 收入 or **profit** 利润 – income tax, corporation tax
an indirect tax 间接税	paid on spending, collected by the seller – VAT, duties
by *who pays what share*	the second grouping
progressive 累进税	a higher percentage as income rises
regressive 累退税	a lower percentage as income rises – most indirect taxes are regressive

> The two groupings are independent. An indirect tax is usually regressive, but that is a consequence, not a definition.

2 Problems

Inflation

Inflation 通货膨胀 is a general rise in prices, from:

- **demand-pull** 需求拉动 – too much spending
- **cost-push** 成本推动 – rising costs

Demand-pull	Cost-push
total demand grows faster than supply → "too much money chasing too few goods"	firms' costs rise (wages, materials) → they raise prices to cover them

Exam: demand-pull = AD excess; cost-push = rising costs (wages, oil, imported inputs)

Measuring inflation, and what it does

the CPI 消费者价格指数	pick a basket of goods a typical family buys, weight each by how much is spent on it, and track the total cost
what the number is	the percentage change in that cost over a year
purchasing power 购买力	money loses it – each unit buys less
savings	become worth less, unless interest exceeds inflation
exports	the country's goods become dearer than other countries', which hurts exports
and deindustrialisation 去工业化	as a country develops, jobs shift primary → secondary → tertiary

> The basket and the weights are what make the CPI meaningful – and both must be revised as spending habits change.

Unemployment

Unemployment 失业: people who want a job cannot find one. Types:

- **frictional** 摩擦性, **structural** 结构性
- **cyclical** 周期性, **seasonal** 季节性

Unemployment wastes labour resources

Sectors and the changing pattern of employment

- the **primary sector 第一产业** extracts raw materials (farming, fishing, mining);
- the **secondary sector 第二产业** makes things (manufacturing, construction);
- the **tertiary sector 第三产业** provides services (banking, tourism, retail, transport).

Unemployment – types

- **frictional unemployment** 摩擦性失业 – short-term unemployment between jobs (a worker who just left one job and is looking for the next).
- **structural unemployment** 结构性失业 – a whole industry shrinks, so workers' skills are no longer wanted.
- **cyclical unemployment** 周期性失业 – a recession cuts total demand, so firms need fewer workers.

Unemployment – types, in detail

Frictional	Structural	Cyclical	Seasonal
short gaps between jobs	skills no longer match jobs	low demand in a recession	only certain times of year

Exam: name the type + cause — cyclical needs demand stimulus; structural needs retraining

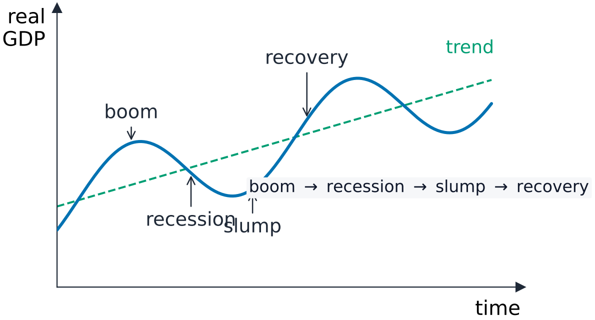
> The four types of unemployment: frictional (between jobs), structural (skills no longer match), cyclical (low demand in a recession) and seasonal

The two ways unemployment is measured

the claimant count 失业救济申领人数	counts people claiming **unemployment benefit** 失业救济金
what it misses	those who want work but do not claim, or are not eligible – so it understates
the labour force survey 劳动力调查	a survey counting people not working, looking for work, and ready to start
why it is preferred	internationally comparable, and it captures non-claimants
counted in neither	people not looking for work – retired, or full-time students
so	a fall in the rate is good news only if those people found jobs, not if they stopped looking

That last point is the standard evaluation mark: a falling rate can mean discouraged workers leaving the labour force.

The business cycle



The **business cycle** 经济周期 swings between boom & recession.

In a recession the government can boost spending or cut interest rates.

Around the business cycle

Boom	Output above trend, unemployment low, inflation rising.
Slump	A deep **slump** 萧条: output falling, unemployment high, and investment postponed.
Recovery	**Recovery** 复苏: output rising again, confidence returning, and unemployment falling last.
How it is measured	By **gross domestic product** 国内生产总值, and by the **consumer prices index** 消费者价格指数 for the inflation that accompanies each phase.

> Government policy is counter-cyclical: expand in the slump, tighten in the boom. **Redistribution of income** 收入再分配 runs through both.

Causes and effects

Growth comes from more or better factors of production: investment in new machines, a bigger or more skilled workforce, and new technology.

Good effects: higher incomes, more jobs, better **living standards 生活水平**, and more tax for the government to spend.

Types of unemployment

$\boxed{\text{unemployment}}$

people who want a job
but cannot find one
$\rightarrow$ less output, less income

> Unemployment means people who want a job cannot find one

Economic growth

Investment in new buildings and capital, seen in Shanghai's Pudong skyline, drives economic growth

Exam tips

- Learn the government's five aims (growth, low unemployment, low inflation, balance of payments, fair incomes) – they can **conflict**, e.g. fast growth can pull up inflation.
- **Fiscal policy** = government spending and taxes; **monetary policy** = the central bank changing interest rates; **supply-side policy** = raising what the economy *can* produce.
- Key rates: unemployment rate = unemployed $\div$ labour force $\times$ 100; inflation rate = change in CPI $\div$ old CPI $\times$ 100; growth = change in real GDP $\div$ old real GDP $\times$ 100.
- **Deflation** (falling prices) can be harmful, because people delay buying, so demand and jobs fall.

3 Recap

Worked example – economic growth

Real GDP was £500bn last year and £515bn this year. Find the growth rate.

- Growth $= \dfrac{\text{change in real GDP}}{\text{original real GDP}} \times 100$
- $= \dfrac{515 - 500}{500} \times 100$
- $= \dfrac{15}{500} \times 100 = 3\%$
- Real GDP already has inflation removed, so this is a genuine rise in output.

Always use real, not nominal, GDP – nominal rises with prices alone. Two quarters of negative growth is the usual definition of a recession.

Topic 4 – key takeaways

1 Aims

growth, jobs, stable prices, fair incomes

2 Tools

fiscal, monetary & supply-side policy

3 Taxes

direct vs indirect; progressive vs regressive

4 Problems

inflation & unemployment

Check yourself

1. What does fiscal policy change?
2. Which policy uses interest rates?
3. Which tax takes a bigger % from the rich?
4. Name one cause of inflation.

Answers **1.** government spending & taxation **2.** monetary policy **3.** a progressive tax **4.** demand-pull or cost-push