

Section 4 Government and the macroeconomic

- Chapter 24 The role of government

- Factors that influence the role of government
- The government's influence on the local economy
- Functions** of government at local and national levels
 - as a **producer**
 - natural monopoly
 - essential products
 - as an **employer**
 - employs workers and managers to operate its state-owned enterprises
 - private sectors - 打工 - public sector
 - Private sector firms provide a range of products and services for the public sector
- The **role** of the government at an international level
 - trade blocs**
 - free** international trade

- Chapter 25 The macroeconomic aims of government

- Governments' macroeconomic **aims**
 - Economic growth
 - actual** economic growth
 - potential** economic growth
 - Diagram

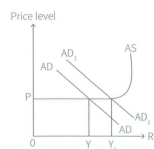


Fig. 25.2: Actual economic growth

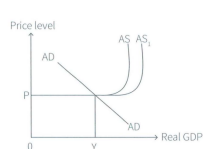


Fig. 25.3: Potential economic growth

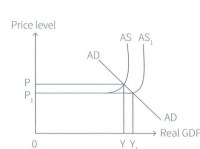


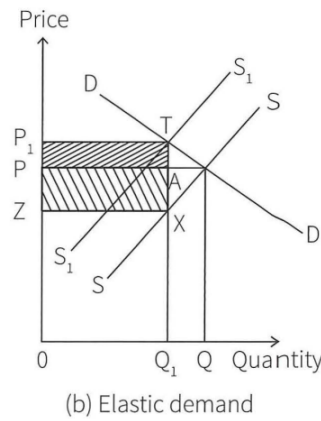
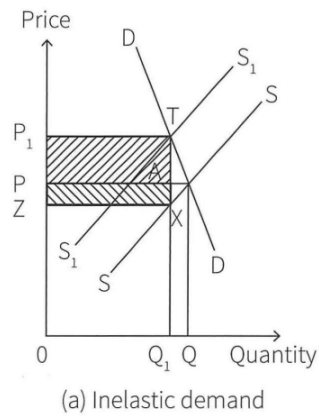
Fig. 25.4: Potential economic growth causing a rise in national output

- Aggregate demand (AD)
- Aggregate supply (AS)
- $GDP = C + I + G + (X - M)$
- The reason **why** government **aim for** economic growth
 - raise people's **living standards**
 - helps to achieve **other** economic **aims**
- Criteria** that governments set for economic growth
 - level of output**

- current maximum possible output and growth in productive capacity
- Low unemployment
 - unemployment rate

$$\frac{\text{Unemployment}}{\text{Labour force}} \times 100$$
 - The reasons why governments aim for low unemployment
 - Unemployment is a waste of resources
- Price stability
 - The reasons why governments aim for price stability
 - it ensures greater economic certainty and prevents the country's products from losing international competitiveness.
 - Governments --- inflation
 - not aiming for a 0% change in price.
 - a slight rise in prices can provide some benefits
 - measures of inflation tend to overstate rises in prices.
 - Governments try to avoid a fall in the price level if it is caused by a fall in aggregate demand. This is because it could result in a decline in output and a rise in unemployment.
- Balance of payments stability
 - most governments want the value of their exports to equal the value of their imports
 - what the country earns from exports equals what it spends on imports.
- Redistribution of income
 - A significant gap between the rich and the poor can cause social unrest ---- high cost
- Possible conflicts between macroeconomic aims
 - The risk that full employment may conflict with stable prices (inflation)
- Chapter 26 Fiscal policy
 - The budget
 - budget deficit
 - budget surplus
 - The reasons for government spending
 - To influence economic activity
 - To reduce market failure
 - To promote equity
 - To pay interest on national debt
 - The reasons for levying taxation
 - To redistribute income

- To **discourage** the consumption of **demerit** goods
- To **raise** the **costs** of firms (external cost)
- To **discourage** the consumption of **imports** and hence **protect domestic** industries
- To **influence** economic activity
- The main categories of taxes
 - PART 1
 - **Direct taxes**
 - Income tax
 - Corporation tax
 - Capital gains tax
 - Inheritance tax
 - **Indirect taxes**
 - Sales tax
 - Excise duties
 - Licence
 - PART 2
 - **Progressive tax**
 - **Proportional tax**
 - **Regressive tax**
- The principles of taxation
 - Equity
 - Certainty
 - Convenience
 - Economy
 - Flexibility
 - Efficiency
- Impact of tax
 - Taxation
 - Tax **base**
 - the source of tax revenue, that is what is taxed
 - Tax **burden**
 - relates to the amount of tax paid by people and firms
 - **Impact** of taxation
 - Whether the producer or the consumer **bears more** tax depends on the **elasticity**



- The impact of direct tax
- The impact of indirect taxes

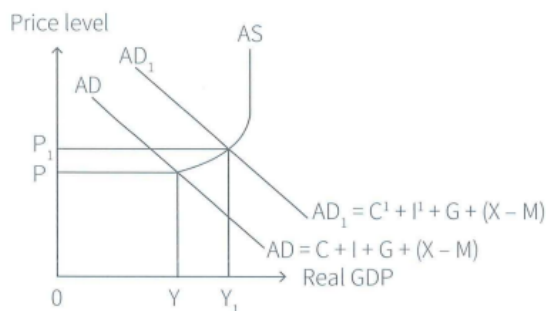
- Changes in taxes
 - flat taxes

- Fiscal policy and budget

- Fiscal policy has **direct effect** on the budget balance

- The effects of fiscal policy on government macroeconomic aims

- **expansionary** fiscal policy



- **contractionary** fiscal policy

- Chapter 27 Monetary policy

- The money **supplies**

- The money supply consists of **all the money** in an economy at any one time
 - How to change

- Increase

- **print** more
 - **buy back** government bonds
 - encourage commercial banks to **lend** more

- Decrease

- **sell** government **bonds** to the commercial banks
 - **raise reserve requirements** for commercial banks to discourage lending

- **Monetary policy**

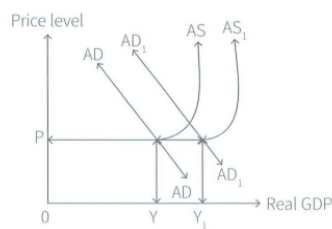
- Changes in the money supply
 - if the money supply is increased, there is likely to be an **increase in consumer spending and investment**.
 - Such a rise in aggregate demand is likely to increase output.
- Changes in the rate of interest
 - a rise in the rate of interest is likely to reduce aggregate demand (by lowering consumer expenditure and investment)
 - **pay more interest for loans which borrowed past**
 - **more expensive for borrow**
 - **increase the incentive to save**
 - a down in the rate of interest is likely to increase aggregate demand (**stimulate capital investment**)
- Changes in the **exchange rate**
 - A government may instruct its **central bank** to **change directly** the country's foreign exchange rate or to try to influence it to move in a particular direction
 - want the price of the exchange rate **fall** by **encouraging a rise in exports**
 - want the price of the exchange rate **raise** by encouraging a
- The **effects** of monetary policy on government macroeconomic **aims**
 - Monetary policy is used to **increase aggregate demand**
 - increase the economic growth rate and reduce unemployment --- may use **expansionary monetary policy** [reducing the rate of interest or increasing the money supply]
 - Monetary policy is often used to **control changes in the price level** in the economy
 - If it is thought that the price level is rising too quickly, the **central bank** may **increase** the **rate of interest** or **reduce** the growth in the **money supply**
 - The intention behind this **contractionary monetary policy** would be to **reduce aggregate demand** and the **upward pressure on prices**
- Chapter 28 Supply-side policies
 - Supply-side policy
 - measures designed to **increase aggregate supply**
 - **Improving education and training**
 - increase the skills of workers
 - reduce costs and raise the quality
 - likely to be more occupationally mobile
 - **Lowering direct taxes and increasing incentives**
 - Adv
 - increase the incentive to work and invest

- increase the reward from working
- the unemployed search for work more actively
- increase the labor force
- increase the incentive to invest.
- Disadv
 - working fewer hours
 - make unemployment worse--- a fall in aggregate demand and so output and employment

- Deregulation
- Privatization
- Labor market reforms
- Subsidies

• **Effects** of supply-side policy on government macroeconomic **aims**

- In the **long** run, **all the government's** macroeconomic aims have the potential to **benefit** from supply-side policy
 - **output and employment to increase without inflation**



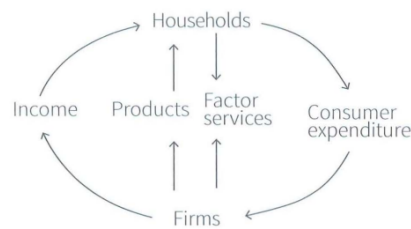
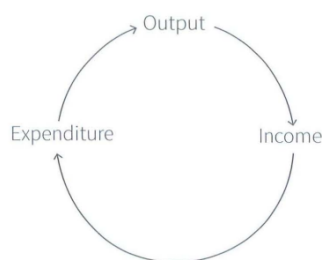
- Increasing the **effectiveness** of macroeconomic policies

• Chapter 29 Economic growth

• **Definition** and **measurement** of economic growth

- Gross domestic product (**GDP**)

- Flow



• The **methods** of calculating GDP

- The **output** method
- The **income** method
- The **expenditure** method

• **Nominal** and **real** GDP

- Real GDP per head
 - dividing real GDP by population
 - Changes in population size can make a significant contribution to changes in real GDP
- The difficulty of measuring real GDP
 - the existence of unrecorded economic activity, both legal and illegal, and non-marketed goods and services

- Recession

- Economic growth

- The policies to promote economic growth

- Chapter 30 Employment and unemployment

- Employment, unemployment and full employment
- Change in the patterns of employment
- Change in the levels of employment
- The measures of employment
- The causes and types of unemployment
- The consequences of employment
- The policies to reduce unemployment

- Chapter 31 Inflation and deflation

- The definition of inflation and deflation
- Measurement of inflation and deflation
- The causes of inflation
- The consequences of inflation
- Policies available to control inflation
- The causes of deflation
- The consequences of deflation
- Policies available to control deflation
- Policy conflicts