Summary

3.6 Demand management—fiscal policy

Subject	Year	Start date	Duration
Economics	IB2	Week 4, October	1 week 2 hours

Course Part

Macroeconomics

Description

3.6 Demand management – fiscal policy, you should be able to:

- Be familiar with the following economics terminology: fiscal policy, intervention, government expenditure, taxation, burden, infrastructure, austerity, direct taxes, indirect taxes, state-owned enterprise, privatisation, current expenditure, capital expenditure, transfer payment, expansionary fiscal policy, distribution of income, contractionary fiscal policy, multiplier, marginal propensity to consume, marginal propensity to save, marginal propensity to tax, marginal propensity to import, crowding out, automatic stabilisers.
- Explain that the government earns revenue primarily from taxes (direct and indirect), as well as from the sale of goods and services and the sale of state-owned (government-owned) enterprises.
- Explain that government spending can be classified into current expenditure, capital expenditure and transfer payments, providing examples of each.
- Distinguish between a budget deficit, a budget surplus and a balanced budget.
- Explain the goals of fiscal policy, including: low and stable inflation, low unemployment, a stable economic environment for long-term growth, reducing business cycle fluctuations, equitable distribution of income and external balance.
- Explain how changes in the level of government expenditure and/or taxes can influence the level of aggregate demand in an economy.
- Explain the mechanism through which expansionary fiscal policy can help an economy close a deflationary (recessionary) gap.
- Explain the mechanism through which contractionary fiscal policy can help an economy close an inflationary gap.
- Evaluate the effectiveness of fiscal policy, by appraising its strengths (targeting of specific economic sectors, stimulating the economy even in deep recession) and its constraints (political pressure, time lags and sustainable debt).
- Calculate the Keynesian multiplier (HL only).
- Explain crowding out (HL only).
- Explain how factors including the progressive tax system and unemployment benefits, which are influenced by the level of economic activity and national income, automatically help stabilise short-term fluctuations (HL only).

Inquiry & Purpose

Inquiry / Higher Order Questions

Type	Inquiry Questions
Skills-based	There are often conflicts between important macroeconomic objectives. What kind of knowledge criteria should policy makers use to make decisions in favour of pursuing one objective over another?

Curriculum

Objectives

Synthesis and evaluation (AO3)

Use economic concepts and examples to construct and present an argument

Syllabus Content

3.6 Demand management—fiscal policy

Fiscal policy

Sources of revenue—direct and indirect taxation, sale of goods and services from state-owned enterprises, sale of government assets

Expenditures—current expenditures, capital expenditures, transfer payments

Goals of fiscal policy

Low and stable inflation

Low unemployment

Promote a stable economic environment for long-term growth

Reduce business cycle fluctuations

Equitable distribution of income

External balance

Expansionary and contractionary fiscal policies in order to close deflationary/recessionary and inflationary gaps

Diagram: AD/AS curves showing expansionary and contractionary fiscal policy for both Keynesian and monetarist/new classical schools of thought

Keynesian multiplier (HL only)

$$\frac{1}{1 - MPC}$$

$$\frac{1}{\mathrm{MPS} + \mathrm{MPT} + \mathrm{MPM}}$$

MPC— marginal propensity to consume

MPS—marginal propensity to save

MPT—marginal propensity to tax

MPM—marginal propensity to import

Calculation (HL only): Keynesian multiplier

Calculation (HL only): the effect on GDP of a change in an injection in investment, government spending or exports, using the Keynesian multiplier

Effectiveness of fiscal policy

Constraints on fiscal policy, including:

political pressure

time lags

sustainable debt

crowding out (HL only)

Diagram (HL only): showing the crowding-out effect

Strengths of fiscal policy, including:

targeting of specific economic sectors

government spending effective in deep recession

Automatic stabilizers: progressive taxes, unemployment benefits (HL only)

Strengths and limitations in promoting growth, low unemployment, and low and stable rate of inflation

Concepts

Government intervention attempts to achieve macroeconomic objectives through a choice of policies.

ATL Skills

Approaches to Learning

Thinking

- In this unit, we will

require students to take an unfamiliar viewpoint into account when formulating arguments

Developing IB Learners

Learner Profile

Knowledgeable

Reflective