

## Using fiscal policy to manage the economy

Macroeconomic problem	Demand management fiscal policy (short run)	Supply-side fiscal policy (long run)	Problems
High unemployment	<ul style="list-style-type: none"> <li>Decrease rate of indirect taxes. This will cause an increase in consumption, assuming a high MPC and high expectations, due to increased disposable income.</li> <li>Decrease the rate of direct taxes. This is likely to cause the same effects as decreasing indirect taxes but is likely to have a greater impact.</li> <li>Increase discretionary government spending; both current and capital.</li> </ul>	<ul style="list-style-type: none"> <li>Increase discretionary capital government expenditure, for example of training for the unemployed. This will increase occupational mobility and so lower the natural rate of unemployment in the economy.</li> <li>Reduce welfare payments to reduce disincentives to work and so increase participation in the work force, thus increasing aggregate supply.</li> </ul>	<ul style="list-style-type: none"> <li>Inflation is caused as resources become scarcer as employment increases – that is as the LRAS curve becomes more inelastic.</li> <li>Time lags and the multiplier may worsen the effects of inflation.</li> <li>The economy may be near the rate of natural unemployment and so proportionally high inflation will be suffered for an increase in employment.</li> <li>Arguably government capital expenditure is allocated less efficiently than private capital expenditure, as governments may have goals other than efficiency.</li> <li>Conflict of decreased taxes and higher government spending.</li> </ul>
Low growth	<ul style="list-style-type: none"> <li>Generally SR fiscal policy has a very limited effect on LR growth.</li> <li>Decrease rate of indirect taxes. This will cause an increase in consumption, assuming a high MPC and high expectations, due to increased disposable income.</li> <li>Decrease the rate of direct taxes. This is likely to cause the same effects as decreasing indirect taxes but is likely to have a greater impact.</li> <li>Increase government spending on subsidising investment by firms. In the short run this will increase AD, and in the long run this will increase AS.</li> </ul>	<ul style="list-style-type: none"> <li>Increase discretionary capital government expenditure, for example of training for the unemployed. This will increase occupational mobility and so lower the natural rate of unemployment in the economy.</li> <li>Lowering the lower rates of direct tax as in the LR this should increase participation by decreasing disincentives to work. Lowering the higher rates of tax should, to a limited degree encourage entrepreneurship within the economy.</li> <li>Increase government spending on training and education to:                             <ul style="list-style-type: none"> <li>Increase participation</li> <li>Increase mobility</li> <li>Increase productivity</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Inflation as resources become scarcer and as employment increases.</li> <li>The efficiency of capital spending by the government is debateable. Many argue that government spending 'crowds out' more efficient private investment as the government has goals other than efficiency.</li> <li>Conflict of decreased taxes and higher government spending.</li> </ul>
High inflation	<ul style="list-style-type: none"> <li>Increase indirect and direct rates of taxes to decrease disposable income and so decrease consumption within the economy.</li> <li>Decrease discretionary government spending.</li> </ul>	<ul style="list-style-type: none"> <li>Implement long run economic growth policies to shift the aggregate supply curve outwards. Increase incentives for investment and government expenditure.</li> </ul>	<ul style="list-style-type: none"> <li>Lower aggregate demand in the short run causes higher unemployment in the short run.</li> <li>Higher corporation tax is likely to cause a decrease in investment so may cause a long run problem.</li> </ul>
Balance of payments deficit	<ul style="list-style-type: none"> <li>Increase indirect and direct rates of taxes to decrease disposable income. This will decrease spending on luxury goods, which are imports. Direct taxes are described as a 'blunt' instrument as they have a large effect but affect the entire economy, not just the target.</li> <li>Increase tariffs (tax on imported goods) to make imports less attractive, so UK consumers buy UK produced goods and services. This is called an expenditure switching policy.</li> </ul>	<ul style="list-style-type: none"> <li>Make exports more competitive by:                             <ul style="list-style-type: none"> <li>Subsidising private investment in research and development</li> <li>Government spending on research and development, education and infrastructure.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Tariffs not effective if demand for imports is price inelastic (which is true of the UK). Often there is no UK substitute for a good or service and sometimes there is no EU substitute.</li> <li>Tariffs make for political difficulties and are illegal within the EU and EFTA.</li> </ul>