

IB Economics ‘Give Me Five’ Macroeconomics SL

8.1 CIRCULAR INCOME FLOW

Leakages in a circular income flow

1. Saving
2. Taxes
3. Imports

Injections in a circular income flow

1. Investment
2. Government spending
3. Exports

Factor incomes

1. Wages
2. Rent
3. Interest
4. profit

8.2 MEASURES OF ECONOMIC ACTIVITY

Total spending in the expenditure approach

1. Consumption
2. Investment
3. Government Spending
4. Net exports

Approaches to measuring aggregate output

1. Expenditure approach
2. Income approach
3. Output approach

Why national income statistics do not accurately measure the ‘true’ value of output

1. GDP and GNI do not include non-marketed output
2. GDP and GNI do not include output sold in underground (parallel) markets
3. GDP and GNI do not take into account quality improvements in goods and services
4. GDP and GNI do not account for the value of negative externalities (pollution, toxic wastes, etc..)
5. GDP and GNI do not take into account the depletion of natural resources
6. GDP and GNI and differing domestic price levels

Government spending (Public investment)

1. Airports
2. Roads
3. Public transport
4. Schools
5. Hospitals

8.4 THE BUSINESS CYCLE

Phases of the business cycle

1. Expansion
2. Peak
3. Contraction
4. Trough

9.1 AGGREGATE DEMAND AND THE AGGREGATE DEMAND CURVE

Components of aggregate demand

1. Demand of consumers
2. Demand of businesses
3. Demand of the government
4. Demand for foreign exports minus demand for imports

Reasons for downward sloping aggregate demand curve

1. Wealth effect
2. Interest rate effect
3. International trade effect

Causes of changes in consumption spending

1. Changes in consumer confidence
2. Changes in interest rates
3. Changes in wealth
4. Changes in personal income taxes
5. Changes in the level of household indebtedness

Causes of changes in investment spending

1. Changes in business confidence
2. Changes in interest rates
3. Changes in technology
4. Level of corporate indebtedness
5. Changes in business taxes (fiscal policy)
6. Legal/institutional changes

Causes of changes in government spending

1. Changes in political priorities
2. Changes in economic priorities: deliberate efforts to increase aggregate demand

Causes of changes in export spending minus import spending

1. Changes in national income abroad
2. Changes in exchange rates
3. Changes in the level of trade protection

Determinants of aggregate demand

1. Interest rates
2. Federal Deficit
3. Money supply
4. Consumer confidence

9.2 SHORT-RUN AGGREGATE SUPPLY AND SHORT-RUN EQUILIBRIUM IN THE AD-AS MODEL

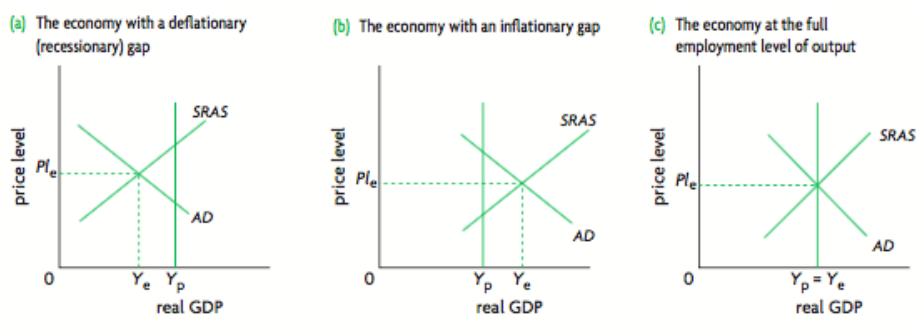
Reasons for sticky labour prices

1. Labour contracts fix wages
2. Minimum wage legislation
3. Labour unions resisting wage cuts
4. Wage cuts having a negative effect on worker morale

Changes in Short-Run Aggregate Supply

1. Changes in wages
2. Changes in non-labour resource prices
3. Changes in business taxes
4. Changes in subsidies offered to businesses
5. Supply shocks

Short run equilibrium states of the economy



9.4 AGGREGATE SUPPLY AND EQUILIBRIUM IN THE KEYNESIAN MODEL

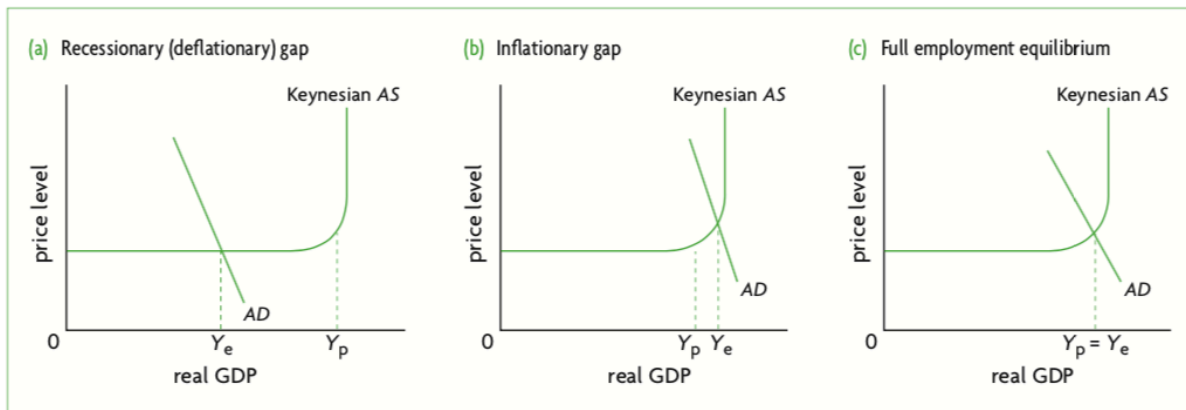
Reasons for getting stuck in the short-run

1. Wage and price downward inflexibility.

2. The inability of the economy to move into the long run.

Equilibrium states of the economy in the Keynesian model

1. Recessionary gap
2. Inflationary gap
3. Full employment equilibrium

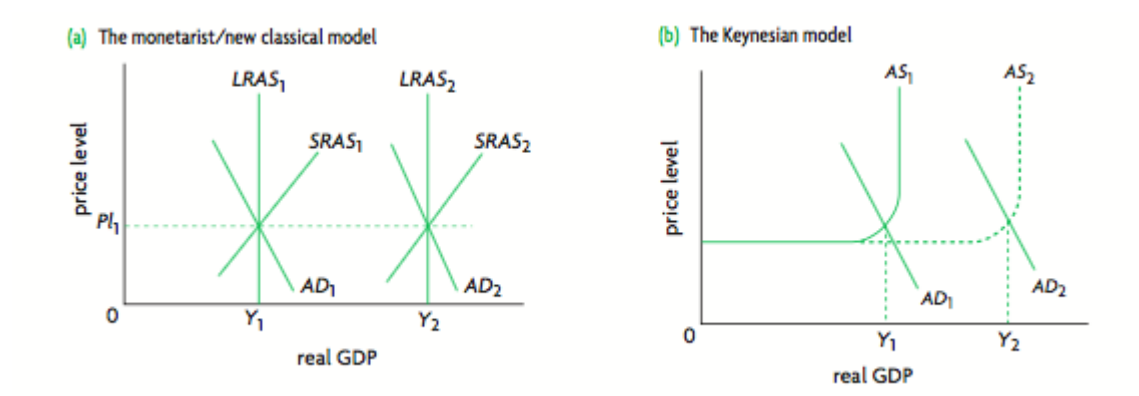


9.5 SHIFTING AGGREGATE SUPPLY CURVES OVER THE LONG TERM

Factors affecting long-run aggregate supply

1. Increases in quantities of the factors of production
2. Improvements in the quality of factors of production
3. Improvements in technology
4. Increases in efficiency
5. Institutional changes
6. Reductions in the natural rate of unemployment

Long-term economic growth: achieving potential (full employment) output in a growing economy



10.1 LOW UNEMPLOYMENT

Types of unemployment

1. Structural
2. Cyclical
3. Frictional
4. Natural

Reasons for hidden unemployment

1. Unemployment figures include unemployment workers not actively seeking work
2. No distinction between full-time and part-time employment
3. No distinction on the type of work done
4. Do not include 'underground' employment

Economic consequences of unemployment

1. Loss of real output (Real GDP)
2. Loss of income for unemployed workers
3. Loss of tax revenue for government
4. Cost to the government for unemployment benefits
5. higher income inequality

Causes of structural unemployment

1. Changes in demand for particular labour skills
2. Changes in the geographical location of jobs

Labour market rigidities

1. Minimum wage legislation
2. Labour union activities and wage bargaining with employers
3. Employment protection laws
4. Generous unemployment benefits

10.2 LOW AND STABLE RATE OF INFLATION

Problems with the consumer price index (CPI)

1. Different rates of inflation for income earners
2. Different rates of inflation depending on regional or cultural factors
3. Changes in consumption patterns due to consumer substitutions when relative price changes
4. Changes in consumption patterns due to increasing use of discount stores and sales
5. Changes in consumption patterns due to introduction of new patterns
6. Changes in product quality
7. International comparisons
8. Comparability over time

Redistribution effects

1. People who receive fixed incomes or wages.
2. People who receive incomes or wages that increased less rapidly than the rate of inflation.
3. Holders of cash
4. Lenders
5. Savors

Why deflation rarely occurs in the real world

1. Wages of workers do not ordinarily fall
2. Large oligopolistic firms may fear price wars
3. Firms want to avoid incurring menu costs resulting from price changes

11.1 ECONOMIC GROWTH

Explaining economic growth

1. Increases in actual output
2. Increases in production possibilities

11.2 EQUITY IN DISTRIBUTION OF INCOME

Types of poverty

1. Relative
2. Absolute

Causes of poverty

1. Low incomes
2. Unemployment
3. Low levels of human capital
4. Low levels of capital or land ownership
5. Discrimination
6. Geography
7. Age
8. Limited social services
9. Poverty itself may further develop poverty

Consequences

1. Low living standards
2. Lack of access to health care and education
3. Higher infant, child and maternal mortality
4. Higher levels of preventable diseases
5. Social problems
6. Inability to realise one's full potential (me)

Methods to promote income equity

1. Transfer payments
2. Subsidized provision or direct provision of merit goods
3. Government intervention in markets
4. Taxation

Types of direct taxes

1. Personal income tax
2. Corporate income tax
3. Wealth tax
4. Payroll taxes

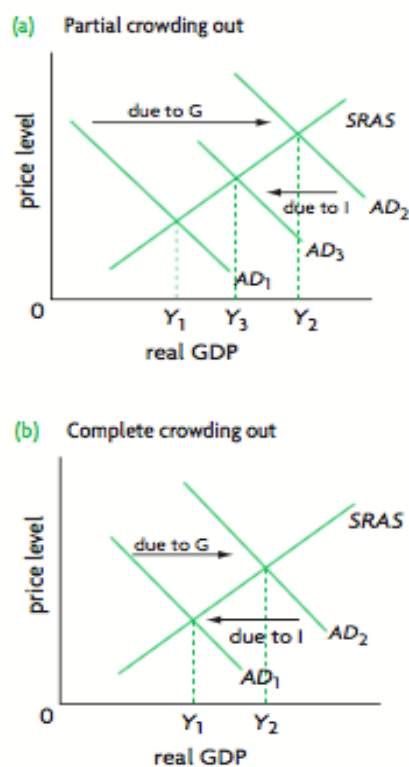
Types of indirect taxes

1. General expenditure taxes (sales tax)
2. Excise taxes
3. Custom duties (tariffs)

12.2 FISCAL POLICY

Fiscal policy

1. Taxation
2. Sales of goods and services (public sector)
3. Sales of government owned firms



Types of contractionary fiscal policy

1. Decreasing government expenditure
2. Increasing personal income taxes
3. Increasing business taxes
4. Combination of decreasing spending and increasing taxes

Types of government expenditure

1. Current expenditures
2. Capital expenditures
3. Transfer payments

Effects of fiscal policy

1. Change in level of governments spending
2. Level of consumption spending
3. Level of investment spending

Strengths of fiscal policy

1. Pulling an economy out of a deep recession
2. Dealing with rapid and escalating recession
3. Ability to target sectors of an economy
4. Direct impact of government spending on aggregate demand
5. Ability to affect potential output

Weaknesses of a fiscal policy

1. Problems with time lags
2. Political constraints
3. Inability to deal with supply-side causes of instability
4. In a recession, tax cuts may not be very effective in increasing aggregate demand.
5. Inability to 'fine tune' an economy
6. Crowding out (Government deficit)

12.3 MONETARY POLICY

Responsibilities of central banks

1. Banker to the government
2. Banker to commercial banks
3. Regulator of commercial banks
4. Conduct monetary policy

Role of monetary policy

1. Changes in interest rate and aggregate demand
2. Expansionary monetary policy

3. Contractionary monetary policy
4. Monetary policy and inflation targeting

Advantages of inflation targeting

1. A lower rate of inflation
2. A more stable rate of inflation
3. Improved ability to anticipate the future rate of inflation
4. Greater coordination between monetary and fiscal policy
5. Greater central bank transparency and accountability

Disadvantages of inflation targeting

1. Reduced ability of the central bank to respond to supply-side shocks
2. Reduced ability of the central bank to pursue other macroeconomics objectives
3. Reduced ability of the central bank to deal with unexpected events
4. Finding an appropriate inflation target
5. Difficulties of implementation

Strengths of monetary policy

1. Relatively quick implementation
2. Central bank independence
3. No political constraints
4. No crowding out
5. Ability to adjust interest rate incrementally

Weaknesses of monetary policy

1. Time lags
2. Possible ineffectiveness in recession
3. Conflict between government objectives
4. Inability to deal with stagflation

12.4 SUPPLY-SIDE POLICIES

Forms of investment in human capital

1. Training and education
2. Improved healthcare services and access to these

Forms of industrial policies

1. Support for small and medium sized enterprises
2. Support for 'infant industries'

Ways of encouraging competition

1. Privatisation
2. Deregulation
3. Private financing of public sector projects

4. Contracting out the private sector
5. Restricting monopoly power
6. Trade liberalisation

Labour market reforms

1. Abolishing minimum wage legislation
2. Weakening the power of labour unions
3. Reducing unemployment benefits
4. Reducing job security

Incentive related policies

1. Lowering personal income taxes
2. Lowering taxes on capital gains and interest income
3. Lowering businesses taxes