Chapter 26 Government and Policy

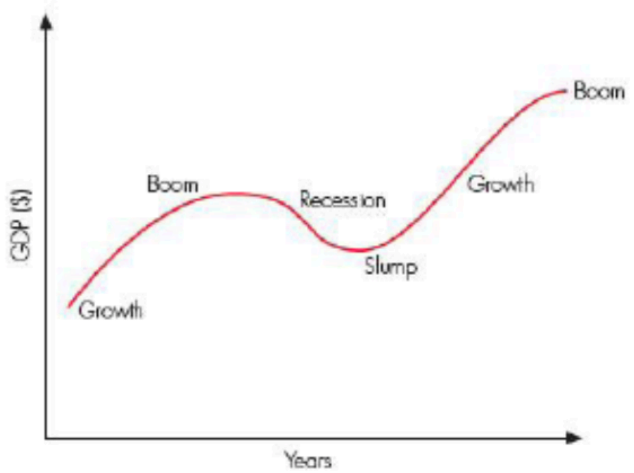
Key terms

1. Inflation: the increase in the average price level of goods and services over time.
2. Unemployment: exist when people who are willing and able to work cannot find a job.
3. Economic growth: when a country's Gross Domestic Product increases- more goods and services are produced than in the previous year.
4. Balance of payments: records the difference between a country;s exports and imports.
5. Real income: the value of income, and it falls when prices rise faster than money income.
6. Gross Domestic Product(GDP): the total value of output of goods and services in a country in one year.
7. Recession: a period of a fall in Gross Domestic Product.
8. Exports: goods and services sold from one country to other countries.
9. Imports: goods and services bought in by one country from other countries.
10. Exchange rate: the price of one currency in terms of another, for example 1$=38฿
11. Exchange rate depreciation: the fall in the value of a currency compared with other currencies.
12. Fiscal policy: any changes by the government in tax rates or public sector spending.
13. Direct taxes: paid directly from incomes - for example, income tax or profit tax.
14. Indirect taxes: added to the prices of goods and taxpayers pay the tax as they purchase the goods - for example, VAT.
15. Disposable income: the level of income a taxpayer has after paying income tax.
16. Import tariff: a tax on imported product,
17. Import quota: a physical limit to the quantity of a product that can be imported.

1. Government economic objective

- Low inflation
- Low unemployment
- High economic growth
- Balance of payment stability

2. The business cycle



Stages in business cycle	Characteristics
1.Growth	• GDP is rising. • Unemployment is falling. • Businesses get high profit.
2.Boom	• Too much spending. • Price is rising. • Low unemployment and shortage of labour. • Businesses face high cost.
3.Recession	• Too little spending. • GDP is falling. • High unemployment. • Business experience falls in demand and profit.
4.Slump	• A long recession. • Very high unemployment. • Price may fall. • Many businesses fail in this period

3. Government policy

3.1 Fiscal policy by changing tax and government spending

Fiscal policies to deal with economic recession

Fiscal policy	Explanation
1) Increasing government spending	⇒ An increase in government spending raises aggregate demand(AD=C+I+G+NX). ⇒ It increases production and employment. ⇒ It increases national output and employment.
2) Cutting income tax	⇒ A cut in income tax increases disposable income. ⇒ People have higher ability to spend and aggregate demand increases. ⇒ Firms increase production and employment. ⇒ It increases national output and employment.

3.2 Monetary policy : by changing interest rate

Monetary policies to deal with economic recession

Monetary policy	Explanation
1.Reducing interest rate	⇒ **People** increase spending rather than saving due to lower return on saving. Consumption rises. **(C⇧)** ⇒ **Businesses** borrow more money to invest due to lower cost of borrowing. Investment rises.**(I⇧)** ⇒ **Hot money** outflows to deposit money abroad, resulting in currency depreciation and trade balance improved.**(NX⇧)** ⇒ Aggregate demand increases (AD = **C**+**I**+G+**NX**). ⇒ It results in higher production and employment.

3.3 Supply side policy: try to improve efficient of supply goods and services eg. Education and training, Privatisation, Increasing competition in the market