

4.	a)	Explain how the concept of elasticities can determine the effectiveness of policies implemented by a government to achieve its macroeconomic goals.	[10]
	b)	Discuss whether policies implemented by a government, in a bid to achieve its macroeconomic goals, would always lead to a conflict with its microeconomic goals.	[15]

Part A

Introduction

- Define elastic concepts used in essay (e.g. XED and PED).
- List macroeconomic goals.

Body

1. Marshall-Lerner condition and how depreciation can correct current account deficit

- [Mechanism of policy & linking to macroeconomic goal]:
 - Explain how a depreciation can be used to increase export revenue and decrease import expenditure to reduce a current account deficit to bring about healthy BOP.
- [How elasticity concept affects the effectiveness]:
 - However, this will only be effective if $PED_x + PED_m > 1$ (Marshall-Lerner Condition). If condition is not met, a depreciation will reduce export revenue and increase import expenditure instead. This will increase the size of a current account deficit.

2. Interest elasticity and monetary policy to increase actual economic growth

- [Mechanism of policy & linking to macroeconomic goal]:
 - Explain how expansionary monetary policy (increasing money supply to reduce interest rates) can be used to increase C+I and AD, ceteris paribus. This can then lead to an increase in actual economic growth, assuming that economy has spare capacity.
- [How elasticity concept affects the effectiveness]:
 - Even if the central bank has successfully reduced the r in the economy, the interest elasticity of demand for I may also limit the effectiveness of such an exp. mp.
 - In Fig 6.2d, when faced with a relatively interest inelastic MEI_1 (Marginal Efficiency of Investment), a reduction in r from r_1 to r_2 would only increase I from I_0 to I_1 , leading to a limited rise in AD and, hence, RNY.
 - **Demand for investment is interest inelastic if business outlook is poor.**
 - Firms would not increase borrowing by much even when interest rate falls because they want to avoid taking risks. Hence, the effectiveness of exp. mp is reduced.
 - However, the same reduction in r will increase I from I_0 to I_2 when the demand for I is much more interest elastic (MEI_2). This will mean a more significant rise in AD and hence RNY.

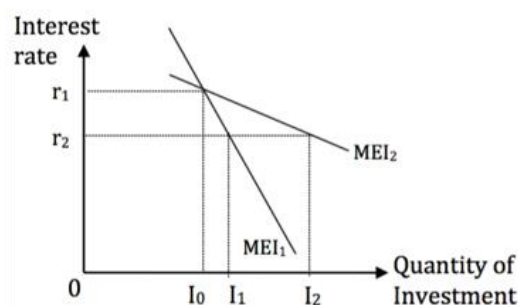


Fig 6.2d: Interest elasticity of demand for investment

3. PED of imports and how tariffs can correct current a/c deficit

- [Mechanism of policy & linking to macroeconomic goal]:
 - Explain how tariffs can be used to reduce import expenditure and current account deficit.
- [How elasticity concept affects the effectiveness]:
 - If demands for imports are price inelastic, an increase in price of imports brought about by tariffs would lead to a less than proportionate fall in Q_d of imports. Therefore, import

expenditure might increase. This would then limit the ability of tariffs to reduce current account deficit.

4. XED of domestic goods with respect to price of imported goods and how tariffs can increase consumption and actual economic growth

- [Mechanism of policy & linking to macroeconomic goal]:
 - As an expenditure-switching tool, tariffs can be used to reduce import expenditure by increasing price of imports. This can help by switching from spending of domestic residents on imports to domestic consumption. This can then help to increase AD, ceteris paribus, and actual economic growth if there is sufficient spare capacity in the economy.
- [How elasticity concept affects the effectiveness]:
 - The XED of domestic products with respect to price of foreign imports may be very low if they are poor substitutes.
 - Therefore, the extent to which a rise in price of imports can lead to a rise of domestic consumption, and therefore actual economic growth, is limited.

Level		Descriptors
L3	7-10	<ul style="list-style-type: none"> Provides at least three possible ways in which elasticity concepts can affect effectiveness of macroeconomic policies – not all three points have to be free of errors to attain L3, however, that would be expected of a 10m answer. Clear analysis of how the workings of policies in bringing about macroeconomic goals. Clear explanation of how elasticity concepts can affect the effectiveness of these policies. Effective use of economic framework (e.g. AD/AS framework). Makes relevant and essential assumptions (e.g. holding other factors of AD constant, level of spare capacity etc.)
L2	5-6	<ul style="list-style-type: none"> Provides at least two possible ways in which elasticity concepts can affect effectiveness of macroeconomic policies Superficial/incomplete explanation of the workings of policies in bringing about macroeconomic goals. Superficial/incomplete explanation of how elasticity concepts can affect the effectiveness of these policies. Limited or erroneous use of economic framework (e.g. AD/AS framework). Limited use of assumptions (e.g. holding other factors of AD constant, level of spare capacity etc.)
L1	1-4	<ul style="list-style-type: none"> Conceptual errors Insufficient elaboration and link to economic frameworks

b)	Discuss whether policies implemented by a government, in a bid to achieve its macroeconomic goals, would always lead to a conflict with its microeconomic goals.	[15]
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Note: Students have to first explain how policies can achieve specific macroeconomic goals, before explaining how, in the process, there is a trade-off with microeconomic goals.

Introduction

- List microeconomic goals (macroeconomic goals already established in Part A)
- Stand

Thesis: Policies to achieve macroeconomic goals may conflict with microeconomic goals

1. Expansionary fiscal policy (reduction of tax) to increase actual economic growth and reduce cyclical unemployment may cause inequity to worsen

- [Mechanism of policy & linking to macroeconomic goal]:
 - Explain how expansionary policy (reduction of tax) can help to bring about actual economic growth and reduce cyclical unemployment (link to C+I+G, AD and multiplier)
- [Explain trade-off with microeconomic goal]
 - A reduction in direct taxes may exacerbate income inequality because these direct taxes tend to be progressive (i.e. there is a larger tax burden on the rich). Often, the poorest households and unemployed are not taxed. When taxes are cut, it increases disposable income of the rich without raising that of the poorest income groups. This exacerbates the income gap and hence this can cause inequity to worsen

2. **Demand management policies to increase AD may lead to increase in I and over-pdn of goods that can lead to negative externalities (fall in AE)**
 - [Mechanism of policy & linking to macroeconomic goal]:
 - Explain how expansionary monetary policy (reduction of interest rates) can help to bring about actual economic growth and reduce cyclical unemployment (link to C+I+G, AD and multiplier)
 - [Explain trade-off with microeconomic goal]
 - A fall in interest rates which can promote greater investments can lead to an over-production of goods that give rise to negative externalities (e.g. garment production in China leading to water pollution due to emission of dyes) – *students need to make links to MSC/MSB framework, identify third parties and how that are adversely affected by the over-production*
3. **Protectionist measures to reduce current a/c deficit may lead to productive inefficiencies, allocative inefficiency and/or inequity**
 - [Mechanism of policy & linking to macroeconomic goal]:
 - Explain how quotas or other forms of protectionism can help to reduce import expenditure and therefore reduce current account deficit
 - [Explain trade-off with microeconomic goal]:
 - Explain how protectionism reduces level of competition as market share of foreign firms is reduced
 - This fall in level of competition and increasing market dominance can lead to:
 - X-inefficiency and productive inefficiency
 - Increase in allocative inefficiency - *Students should use market structure theory to explain how protectionism acts like barriers to entry and hence increases market share and power of domestic firms. These increase the DD for domestic firms and make their goods less price elastic. Therefore, they are able to set a higher price and the profit-maximising price would be much greater than marginal cost. This worsens allocative inefficiency. The use of diagram to show deadweight loss in this instance will be helpful.*
 - Worsening of inequity between firms and consumer – *Students should explain why existing firms can make more profits due to the increase in market share (as explained above). The increase in supernormal profits at the expense of consumers worsen inequity between producer and consumer*

Antithesis: Policies to achieve macro goals may not conflict with microeconomic goals

1. Supply-side policies to increase labour productivity may improve income equality
 - [Mechanism of policy & linking to macroeconomic goal]:
 - Explain how interventionist supply-side policies, like subsidies provided for training and retraining, can help to increase labour productivity and therefore potential economic growth
 - [Explain complementary microeconomic goal]:
 - Raising productivity levels of low-skilled workers help these workers' earn higher wages too and bridge their income gap with higher-skilled workers
 - High productivity levels means higher output per hour which justifies the firm paying these workers more
 - This can lead to an improvement in income equality and hence promote equity
2. Market-oriented Supply-side Policies can reduce allocative inefficiency, productive inefficiency and increase equity between producers and consumers
 - [Mechanism of policy & linking to macroeconomic goal]:
 - Explain how Market-oriented supply-side policies, like de-regulation, can reduce cost of production and hence increase SRAS. Increase in SRAS can lead to increase in real NY, alleviation of cyclical unemployment and cost-push inflation.
 - [Explain complementary microeconomic goal]:
 - Explain how Market-oriented supply-side policies, like de-regulation, which increase level of market competition can reduce market dominance and allocative inefficiency
 - Students can also explain how increase in level of market competition can reduce X-inefficiency, and supernormal profits of dominance firms, hence improving equity
3. Expansionary Fiscal Policy may also lead to increase in AE
 - [Mechanism of policy & linking to macroeconomic goal]:
 - Increase in government expenditure through expansionary fiscal policy can lead to an increase in AD, ceteris paribus, and multiplied increase in real NY. This can lead to actual economic growth and alleviation of cyclical unemployment

- [Explain complementary microeconomic goal]:
 - Increase in government expenditure on provision and subsidies of merit goods, such as education and healthcare, can increase consumption of these goods
 - Explain how this can reduce positive externalities and allocative inefficiency

Synthesis

Macroeconomic policies can have positive and negative side effects on microeconomic goals. However, government can also implement additional policies to enhance these positive side effects and reduce the negative side effects (give examples).

Level		Descriptors
L3	9-11	<ul style="list-style-type: none"> • Complete and well-developed explanation of how policies work to achieve macroeconomic goals before linking them to conflicts with microeconomic goals • Well-developed and unambiguous explanation of how microeconomic problems arise due to macroeconomic policies • Well-developed explanation of how macroeconomic policies may not lead to conflict of goals • Sufficient balance of arguments – explained whether conflict with microeconomic goals would and would not arise
L2	6-8	<ul style="list-style-type: none"> • Incomplete explanation of how policies work to achieve macroeconomic goals • Poor links between macroeconomic policies and microeconomic problems • Incomplete explanation of how microeconomic goals may/may not be compromised by macroeconomic policies • Attempt to provide balance of arguments • Answers that only seek to explain how microeconomic goals are compromised without attempted to explaining macroeconomic goals achieved from the policies will be capped at 6m as 'conflict of goals' is a key requirement of question <ul style="list-style-type: none"> ○ <i>e.g. only explaining how macroeconomic policies, like contractionary fiscal policy, may lead to worsening of inequity, without first explaining which macroeconomic goals are achieve</i>
L1	1-5	<ul style="list-style-type: none"> • Serious conceptual errors • Answer is largely out of point (e.g. answer is about limitations of macroeconomic policies without links to microeconomic goals) • For a descriptive answer that is poor in or lack economic analysis
E1	1-2	<ul style="list-style-type: none"> • Relevant stand taken but with inappropriate or inadequate justification. •
E2	3-4	<ul style="list-style-type: none"> • Relevant stand taken with appropriate and adequate justification.