Edexcel (A) Economics A-level

Theme 2: The UK Economy, Performance and Policies

2.2 Aggregate Demand

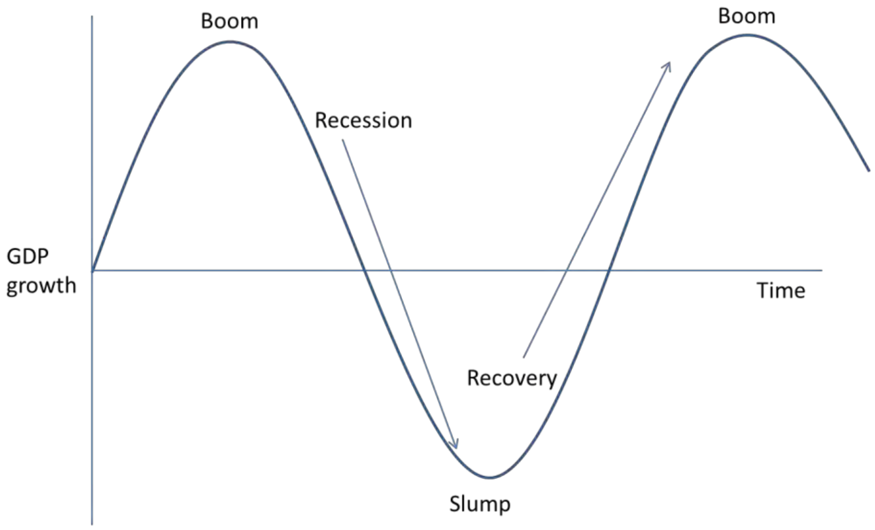
2.2.4 Government expenditure

Notes

Influences on government expenditure:

The trade cycle

- This is another term for the **business cycle,** which refers to the stage of economic growth that the economy is in.
- The economy goes through periods of booms and busts.



- Real output increases when there are periods of economic growth. This is the recovery stage.
- The boom is when economic growth is fast, and it could be inflationary or unsustainable.
- During recessions, there real output in the economy falls, and there is negative economic growth.
- During recessions, governments might increase spending to try and stimulate the economy. This could involve spending on welfare payments to help people who have lost their jobs, or cutting taxes.
- This will increase the government deficit, and they may have to finance this.
- During periods of economic growth, governments may receive more tax revenue since consumers will be spending more and earning more. They may decide to spend less, since the economy does not need stimulating, and fewer people will be claiming benefits.

Fiscal policy

- Governments use fiscal policy to influence the economy. It involves changing government spending and taxation.

- Governments might spend on public goods and merit goods, as well as welfare payments.
- Fiscal policy is a **demand-side policy**, so it works by influencing the level or composition of AD.
- **Discretionary** fiscal policy is a policy which is implemented through one-off policy changes.
- **Automatic stabilisers** are policies which offset fluctuations in the economy. These include transfer payments and taxes. They are triggered without government intervention.
- The government might use **expansionary fiscal policy** during periods of economic decline. This involves increasing spending on transfer payments or on boosting AD, or by reducing taxes.
- During periods of economic growth, governments might use **contractionary fiscal policy** by decreasing expenditure on purchases and transfer payments. Additionally, tax rates might increase. This reduces the size of the government budget deficit.