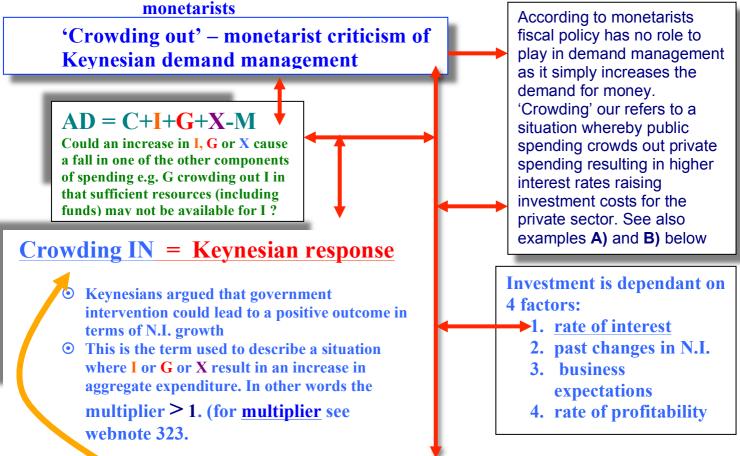
Syllabus
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SYLLABUS REFERENCE 2.4: Crowding Out -bized (HL)

- > key issue here is the role of government in stimulating economy
- > consequences of government demand management: Keynes vs



Crowding Out (monetarist)

- Excessive growth in public spending 'crowds out' private sector spending
- This is the opposite effect where the multiplier effect results in the injection (I, G or X) have an effect of < 1
- Note that the Keynesian model does not allow for a 'crowding out' effect for 2 reasons:
 - 1. I, X and G are exogenous (value not determined by variables inside of the model) and cannot affect each other and take place independent of Y
 - 2. MPC is < 1 therefore the Keynesian multiplier is always greater than 1.

A) Crowding out: HOW? If G increases on infrastructure e.g. an airport. This may in turn cause a shortage of skilled engineers and architects diverting them from investment projects that could be carried out by the Firm or at least causing delays in such investment B) Crowding out: HOW? If on the other hand G causes inflation this may increase the need for tight monetary policy in the form of higher rates of interest thus reducing the environment for Investment by the firm Note: total crowding out exists if spending in I falls by 100 % of the injection, G. Partial is < 100 %

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