

Best Uses:

- Key use of AS/AD is to show how government intervention can be used to grow an economy
- The text below gives you a good summary of its importance in terms of dealing with inflation, unemployment and growth.
- It is of course also key for a government implementing development policies**

ED 20 Demand Side policies

Demand side policies¹
 $AD = C + I + G + X - M$

- (A)**
 Demand side policies to shift AD outwards: **AD1 to AD2**
1. INCREASE **G** - Fiscal
 2. DECREASE **T** -Fiscal
 3. INCREASE **M_s** – Monetary
 4. Decrease **Rate of interest** – Monetary
 5. Foreign income increases or exchange rate decreases
 6. Expectations: inflation, income + profits. All of these factors improve consumer and business confidence and confidence is a key factor in spending

- (B)**
 What is the economic problem ?
- The key problems are inflation / unemployment (= policy conflict. See web 409)
 - While some agreement exists on both sides, for example the government must use fiscal policy to manage the economy, the difference is how the government uses policies i.e. to stimulate Aggregate Demand or Aggregate Supply.
 - Monetarists favour the use of market led strategies
 - Keynesians favour government led strategies. If the economy is at e3 Keynesian policy runs into trouble
 - The best solution is probably a combination of policies that both sides put forward

- (C) What can we conclude about Monetarists and Keynesian policy?**
1. At some juncture the AS is vertical. See **diagram**. Therefore if the AD curve shifts in this vertical region the outcome will be higher inflation with no increase in employment / wealth / economic growth / output
 2. A mixture of policies must be used to stimulate the economy or to manage the economy
 - Fiscal – taxes, spending, transfer payments
 - Monetary – interest rates/money supply
 - Legislative- minimum wage, anti-trust
 - Direct intervention e.g. setting wage rise restrictions or use of national pay agreements.
 - Foreign trade policy – higher or lower value for the currency
 3. Where LRAS is vertical the only alternative is to shift the LRAS outwards i.e. increase the ability of the nation to produce more = shift the PPF
 - Requires more quantity and quality of capital and labour
 - More efficient resource allocation

