

**Theory of knowledge: potential connections**

What criteria can be used to order macroeconomic objectives in terms of priority? Are such criteria external to economics (that is, normative)?

Is economic growth always beneficial? What could be meant by the word “beneficial”?

Is there always a cost to economic growth?

The notion of fairness can be approached from a number of perspectives—equality of opportunity, maximizing the income of the least well-off group, and absolute equality of income. Which of these notions seems to be most attractive? Why? Examine what each of these perspectives suggests is a fair distribution of income.

Equality of opportunity implies correcting for social advantage (for example, government might devote more resources to the education of a child brought up in less prosperous circumstances than one brought up in a comfortable home whose parents are university lecturers). How far should the state go in making such corrections? Should all parents be forced to read to their children so that no child should be at a disadvantage? Should the state attempt to correct for the uneven distribution of natural abilities such as IQ (intelligence quotient) by devoting proportionally more resources to children of less than average IQ.

**2.4 Fiscal policy**

Sub-topic	SL/HL core	HL
<b>The government budget</b>		
Sources of government revenue	<ul style="list-style-type: none"> <li>Explain that the government earns revenue primarily from taxes (direct and indirect), as well as from the sale of goods and services and the sale of state-owned (government-owned) enterprises.</li> </ul>	
Types of government expenditures	<ul style="list-style-type: none"> <li>Explain that government spending can be classified into current expenditures, capital expenditures and transfer payments, providing examples of each.</li> </ul>	
The budget outcome	<ul style="list-style-type: none"> <li>Distinguish between a budget deficit, a budget surplus and a balanced budget.</li> <li>Explain the relationship between budget deficits/surpluses and the public (government) debt.</li> </ul>	

Sub-topic	SL/HL core	HL
<b>The role of fiscal policy</b>		
Fiscal policy and short-term demand management	<ul style="list-style-type: none"> <li>• Explain how changes in the level of government expenditure and/or taxes can influence the level of aggregate demand in an economy.</li> <li>• Describe the mechanism through which expansionary fiscal policy can help an economy close a deflationary (recessionary) gap.</li> <li>• Construct a diagram to show the potential effects of expansionary fiscal policy, outlining the importance of the shape of the aggregate supply curve.</li> <li>• Describe the mechanism through which contractionary fiscal policy can help an economy close an inflationary gap.</li> <li>• Construct a diagram to show the potential effects of contractionary fiscal policy, outlining the importance of the shape of the aggregate supply curve.</li> </ul>	
The impact of automatic stabilizers	<ul style="list-style-type: none"> <li>• Explain how factors including the progressive tax system and unemployment benefits, which are influenced by the level of economic activity and national income, automatically help stabilize short-term fluctuations.</li> </ul>	

Sub-topic	SL/HL core	HL
Fiscal policy and its impact on potential output	<ul style="list-style-type: none"> <li>Explain that fiscal policy can be used to promote long-term economic growth (increases in potential output) indirectly by creating an economic environment that is favourable to private investment, and directly through government spending on physical capital goods and human capital formation, as well as provision of incentives for firms to invest.</li> </ul>	
Evaluation of fiscal policy	<ul style="list-style-type: none"> <li>Evaluate the effectiveness of fiscal policy through consideration of factors including the ability to target sectors of the economy, the direct impact on aggregate demand, the effectiveness of promoting economic activity in a recession, time lags, political constraints, crowding out, and the inability to deal with supply-side causes of instability.</li> </ul>	

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In one sense the imposition of taxes by government on individuals amounts to a restriction of individual freedom. How can we know when such government interference in individual freedom is justified?

## 2.5 Monetary policy

Sub-topic	SL/HL core	HL
<b>Interest rates</b>		
Interest rate determination and the role of a central bank	<ul style="list-style-type: none"> <li>Describe the role of central banks as regulators of commercial banks and bankers to governments.</li> <li>Explain that central banks are usually made responsible for interest rates and exchange rates in order to achieve macroeconomic objectives.</li> </ul>	

Sub-topic	SL/HL core	HL
	<ul style="list-style-type: none"> <li>Explain, using a demand and supply of money diagram, how equilibrium interest rates are determined, outlining the role of the central bank in influencing the supply of money.</li> </ul>	
<b>The role of monetary policy</b>		
Monetary policy and short-term demand management	<ul style="list-style-type: none"> <li>Explain how changes in interest rates can influence the level of aggregate demand in an economy.</li> <li>Describe the mechanism through which easy (expansionary) monetary policy can help an economy close a deflationary (recessionary) gap.</li> <li>Construct a diagram to show the potential effects of easy (expansionary) monetary policy, outlining the importance of the shape of the aggregate supply curve.</li> <li>Describe the mechanism through which tight (contractionary) monetary policy can help an economy close an inflationary gap.</li> <li>Construct a diagram to show the potential effects of tight (contractionary) monetary policy, outlining the importance of the shape of the aggregate supply curve.</li> </ul>	
Monetary policy and inflation targeting	<ul style="list-style-type: none"> <li>Explain that central banks of certain countries, rather than focusing on the maintenance of both full employment and a low rate of inflation, are guided in their monetary policy by the objective to achieve an explicit or implicit inflation rate target.</li> </ul>	

Sub-topic	SL/HL core	HL
Evaluation of monetary policy	<ul style="list-style-type: none"> <li>Evaluate the effectiveness of monetary policy through consideration of factors including the independence of the central bank, the ability to adjust interest rates incrementally, the ability to implement changes in interest rates relatively quickly, time lags, limited effectiveness in increasing aggregate demand if the economy is in deep recession and conflict among government economic objectives.</li> </ul>	

## 2.6 Supply-side policies

Sub-topic	SL/HL core	HL
<b>The role of supply-side policies</b>		
Supply-side policies and the economy	<ul style="list-style-type: none"> <li>Explain that supply-side policies aim at positively affecting the production side of an economy by improving the institutional framework and the capacity to produce (that is, by changing the quantity and/or quality of factors of production).</li> <li>State that supply-side policies may be market-based or interventionist, and that in either case they aim to shift the LRAS curve to the right, achieving growth in potential output.</li> </ul>	
<b>Interventionist supply-side policies</b>		
Investment in human capital	<ul style="list-style-type: none"> <li>Explain how investment in education and training will raise the levels of human capital and have a short-term impact on aggregate demand, but more importantly will increase LRAS.</li> </ul>	

Sub-topic	SL/HL core	HL
Investment in new technology	<ul style="list-style-type: none"> <li>Explain how policies that encourage research and development will have a short-term impact on aggregate demand, but more importantly will result in new technologies and will increase LRAS.</li> </ul>	
Investment in infrastructure	<ul style="list-style-type: none"> <li>Explain how increased and improved infrastructure will have a short-term impact on aggregate demand, but more importantly will increase LRAS.</li> </ul>	
Industrial policies	<ul style="list-style-type: none"> <li>Explain that targeting specific industries through policies including tax cuts, tax allowances and subsidized lending promotes growth in key areas of the economy and will have a short-term impact on aggregate demand but, more importantly, will increase LRAS.</li> </ul>	
<b>Market-based supply-side policies</b>		
Policies to encourage competition	<ul style="list-style-type: none"> <li>Explain how factors including deregulation, privatization, trade liberalization and anti-monopoly regulation are used to encourage competition.</li> </ul>	
Labour market reforms	<ul style="list-style-type: none"> <li>Explain how factors including reducing the power of labour unions, reducing unemployment benefits and abolishing minimum wages are used to make the labour market more flexible (more responsive to supply and demand).</li> </ul>	
Incentive-related policies	<ul style="list-style-type: none"> <li>Explain how factors including personal income tax cuts are used to increase the incentive to work, and how cuts in business tax and capital gains tax are used to increase the incentive to invest.</li> </ul>	

Sub-topic	SL/HL core	HL
<b>Evaluation of supply-side policies</b>		
The strengths and weaknesses of supply-side policies	<ul style="list-style-type: none"> <li>Evaluate the effectiveness of supply-side policies through consideration of factors including time lags, the ability to create employment, the ability to reduce inflationary pressure, the impact on economic growth, the impact on the government budget, the effect on equity, and the effect on the environment.</li> </ul>	

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How can we know whether government should support pure research, which might contribute to the sum total of human knowledge but which might never have an impact on technology? What other knowledge issues are relevant to investment in pure research?

Investment in education and training is a common supply-side policy. What other reasons could there be for supporting the education of the population? What knowledge issues arise in answering the question as to whether government should shoulder this responsibility or whether it should be left to the market?

## Section 3: International economics

### 3.1 International trade

Sub-topic	SL/HL core	HL
<b>Free trade</b>		
The benefits of trade	<ul style="list-style-type: none"> <li>Explain that gains from trade include lower prices for consumers, greater choice for consumers, the ability of producers to benefit from economies of scale, the ability to acquire needed resources, a more efficient allocation of resources, increased competition, and a source of foreign exchange.</li> </ul>	