UNIT 2

MACROECONOMIC PERFORMANCE & POLICY

Edexcel IAL Economics | Complete 20-Mark Mastery Guide

What This Document Covers

PART 1 — The Master Story: How Unit 2 Fits Together

Unit 2 builds one unified argument: how the macroeconomy is measured, what drives it, and how governments try to manage it. The AD/AS model is the spine — every topic either feeds into it or uses it. Understanding the logic of this model is the key to answering every 20-marker in Unit 2.

1.1 The Unit 2 Argument in Six Steps

MEASURING THE ECONOMY

GDP, inflation, unemployment, and the balance of payments are the four headline measures. They tell us whether the economy is performing well. But each measure has limitations, and they can tell conflicting stories.

AGGREGATE DEMAND IS THE SHORT-RUN ENGINE

AD = C + I + G + (X-M). Changes in any component shift the AD curve, moving the economy to a new short-run equilibrium. The multiplier amplifies these shifts: a small change in injection causes a larger final change in national income.

AGGREGATE SUPPLY SETS THE LONG-RUN LIMIT

LRAS represents the economy's productive capacity. In the short run, AS is upward sloping (costs are sticky). In the long run, the classical view holds LRAS is vertical; the Keynesian view holds LRAS has a horizontal section when resources are unemployed.

EQUILIBRIUM NATIONAL INCOME IS WHERE AD = AS

Actual output is determined by the intersection of AD and AS. Output gaps arise when actual output is below (negative) or above (positive) potential output. These gaps drive the policy response.

GOVERNMENTS USE DEMAND-SIDE AND SUPPLY-SIDE POLICIES

Demand-side policies (fiscal and monetary) shift AD. Supply-side policies shift LRAS. The question is always: which is appropriate given the current state of the economy and the objectives being pursued?

MACROECONOMIC OBJECTIVES CAN CONFLICT

Growth, low inflation, low unemployment, current account equilibrium, and fiscal balance are the five main objectives. They cannot all be maximised simultaneously — trade-offs and the Phillips Curve are the central evaluation tool in Unit 2.

PART 2 — Topic Linkage Maps

2.1 Measures of Economic Performance — and Why They Link to Everything Else

The four measures are not just definitions — they are the diagnostic tools policymakers use to decide which policies to apply. Understanding their limitations is crucial for evaluating policy effectiveness.

Measure	Key Limitations + Links to Other Topics
Real GDP growth rate	Does not measure distribution of income; does not capture informal economy; does not reflect wellbeing or sustainability. High GDP growth may worsen the current account deficit (more imports) and cause inflation (positive output gap).
Inflation (CPI)	CPI basket may not reflect all consumers' spending patterns. Inflation erodes real wages (link to unemployment and consumer spending). Cost-push inflation may cause stagflation — simultaneous rise in inflation and unemployment — making policy difficult.
Unemployment rate (ILO)	Underestimates total unemployment (ignores underemployment, discouraged workers). Demand-deficient unemployment can be reduced by expansionary fiscal or monetary policy. Structural unemployment requires supply-side policy — important evaluation distinction.
Balance of payments (current account)	Persistent deficit may signal uncompetitiveness. Deficit can worsen if government stimulates domestic demand (more imports). Link to exchange rates: depreciation improves competitiveness but may worsen terms of trade and cause imported inflation.

2.2 Aggregate Demand — The Short-Run Driver

The AD curve shows total planned expenditure at each price level. A shift in any component shifts the entire AD curve. The size of the shift in national income depends on the multiplier.

Key linkages:

- **LINK:** Consumption (C) is the largest component (~65% of GDP in most economies). It is driven by disposable income, interest rates, consumer confidence, and wealth effects. Low interest rates boost C — link to monetary policy.
- **LINK:** Investment (I) is the most volatile component. It responds sharply to interest rates, business confidence, and credit availability. This is why monetary policy works primarily through the investment channel.
- **LINK:** Government expenditure (G) is determined by fiscal policy. Expansionary fiscal policy shifts AD right. Austerity (cutting G or raising T) shifts AD left. Link to fiscal multiplier and crowding out.

- **LINK:** Net exports (X-M) depend on the exchange rate, domestic vs foreign growth, and relative price competitiveness. A weaker exchange rate boosts exports but raises import costs — potential inflationary effect.
- **MULTIPLIER LINK:** The multiplier amplifies all AD changes: if MPC = 0.8, multiplier = 1/(1-0.8) = 5. A 1 billion pound injection of government spending creates 5 billion of additional national income — but only if there are unemployed resources.

2.3 Aggregate Supply — Short Run vs Long Run

The SRAS curve slopes upward because wages and costs are sticky in the short run. The LRAS curve represents the economy's full productive potential — its position determines the natural rate of unemployment and the non-inflationary rate of growth.

Short-Run AS (SRAS) shifts when:	Long-Run AS (LRAS) shifts when:
Raw material and energy costs change (e.g. oil price rise shifts SRAS left)	Technology improves (e.g. AI, automation raises productivity — shifts LRAS right)
Exchange rate changes affect import prices (depreciation raises input costs)	Education and skills of the workforce improve (supply-side policy effect)
Indirect taxes rise (increases costs across the economy)	Competition policy promotes efficiency and innovation
Subsidies fall (reduces producer support, raises costs)	Deregulation reduces barriers and bureaucratic costs for firms
Link: cost-push inflation occurs when SRAS shifts left without a change in demand	Link: supply-side policies aim to shift LRAS right — the only way to raise output without inflation

Keynesian vs Classical LRAS — The Central Theoretical Debate in Unit 2

CLASSICAL VIEW: LRAS is vertical at the natural rate of output (YFE). The economy self-corrects to full employment in the long run through wage and price flexibility. Government demand-side intervention is unnecessary and causes inflation without permanently raising output.

KEYNESIAN VIEW: LRAS has three sections: (1) horizontal at low output (unemployed resources; AD increases raise output without inflation), (2) upward sloping (approaching capacity; both output and price level rise), (3) vertical at full employment. Government intervention is needed in recessions because wage/price rigidity prevents self-correction.

WHY THIS MATTERS FOR 20-MARKERS: Which model you use determines your view of fiscal/monetary policy effectiveness. The Keynesian model supports active demand management; the classical model supports supply-side reform as the primary tool. Top-band answers present both and evaluate which is more relevant to the context.

2.4 National Income, the Multiplier, and Circular Flow

The circular flow of income links all spending decisions in the economy. Injections (I, G, X) increase national income; withdrawals (S, T, M) reduce it. The equilibrium level of national income is reached when planned injections equal planned withdrawals.

The multiplier is central to evaluating demand-side policy:

- Higher MPC means higher multiplier: consumers spend more of each additional pound of income, creating more rounds of spending.
- Higher MPM, MPS, or MPT reduces the multiplier: income leaks out of the circular flow faster.

- Multiplier formula: k = 1 / (1 - MPC) or k = 1 / (MPS + MPT + MPM)
- Key evaluation: the multiplier is larger when there are unemployed resources. At full employment, additional spending just causes inflation (the classical view).
- Balanced budget multiplier: equal rises in G and T still increase national income (multiplier = 1) because taxation reduces spending less than government spending increases it.

2.5 Economic Growth — Actual vs Potential

This is the output gap concept, which connects measurement, AD/AS, and policy directly.

Negative Output Gap (Actual < Potential)	Positive Output Gap (Actual > Potential)
Economy operating below full capacity — unemployed resources	Economy operating above sustainable capacity — overheating
Characteristics: high unemployment, low inflation, current account may improve (less imports)	Characteristics: low unemployment, rising inflation, current account may worsen (demand for imports rises)
Policy response: expansionary fiscal or monetary policy to shift AD right, or supply-side to raise LRAS	Policy response: contractionary fiscal or monetary policy to reduce inflationary pressure
Keynesian: multiplier is large — government spending effective	Classical: output cannot sustainably exceed LRAS — must cool demand, not stimulate supply

2.6 Macroeconomic Objectives and Policy Conflicts

This is the most important section for 20-mark evaluation. Governments pursue six objectives simultaneously, but they trade off against each other. The Phillips Curve is the key analytical tool.

The Six Macroeconomic Objectives

1. ECONOMIC GROWTH: Rising real GDP per capita — raises living standards, reduces unemployment, increases tax revenue
2. LOW AND STABLE INFLATION: Typically a target of ~2% CPI in most economies — preserves purchasing power and business confidence
3. LOW UNEMPLOYMENT: Particularly demand-deficient and structural unemployment — reduces human cost, raises productive capacity
4. CURRENT ACCOUNT EQUILIBRIUM: Neither persistent deficit (implies borrowing) nor large surplus (implies underconsumption)
5. BALANCED BUDGET: Government spending broadly equal to tax revenue over the cycle — reduces public debt burden on future generations
6. INCOME EQUALITY: Reducing the gap between rich and poor — justified on welfare and social cohesion grounds

The Five Key Objective Conflicts — Your Evaluation Toolkit

Policy / Objective 1	Conflicts With...
Expansionary fiscal/monetary policy to stimulate growth and reduce unemployment	Creates inflationary pressure as AD rises and positive output gap opens (short-run Phillips Curve)

Achieving economic growth through rising domestic demand	Worsens the current account deficit as rising incomes pull in more imports
Deflationary policy (raise taxes, cut spending) to reduce inflation	May raise unemployment (move along the Phillips Curve) and reduce growth
Pursuing income equality through redistribution (progressive taxes)	May reduce incentives to work, invest, and take entrepreneurial risks — potentially slowing growth (supply-side argument)
Balancing the government budget (austerity)	Reduces aggregate demand, slows growth, may raise unemployment and worsen the current account (lower growth = less exports)

The Phillips Curve shows the short-run trade-off between inflation and unemployment. As unemployment falls (economy heats up), inflation rises. Governments must choose a point on the curve. In the long run, the classical view holds that the curve is vertical at the natural rate of unemployment (NAIRU) — there is no permanent trade-off.

PART 3 — Generic Chains of Analysis for 20-Markers

These are the five most versatile chains for Unit 2. Each covers a major category of essay question. Learn the logical steps — the context adapts to whatever question is set.

Chain A — Expansionary Fiscal Policy, AD, Multiplier, and Policy Effectiveness

CHAIN: Expansionary Fiscal Policy

1. Government increases spending (G) or cuts taxes, raising households' disposable income → 2. Aggregate demand (AD) shifts right at every price level → 3. Real national output rises from Y1 toward Y2 in the short run → 4. Multiplier amplifies the initial injection: total rise in income = initial injection x multiplier → 5. Unemployment falls as firms hire more labour to meet higher demand → 6. If economy approaches full employment: inflationary pressure builds (positive output gap) → 7. Budget deficit widens: government borrowing increases

Evaluation Points for Chain A

Effectiveness depends critically on the size of the multiplier: if the economy is open with high MPM, much of the injection leaks abroad as imports — multiplier is small

Time lags: fiscal policy takes time to implement (political process, legal changes) — by the time it takes effect, the economic situation may have changed

Crowding out (classical argument): government borrowing raises interest rates, which reduces private investment — fiscal stimulus is partially offset

At full employment (LRAS vertical), expansionary policy only causes inflation — no lasting output gain

If consumers expect higher future taxes (to repay borrowing), they may increase savings now, offsetting the fiscal stimulus (Ricardian equivalence argument)

Fiscal policy is more effective in a closed economy at below-full-employment output — context matters enormously

Chain B — Monetary Policy, Interest Rates, Investment and AD

CHAIN: Monetary Policy (Rate Cut)

1. Central bank reduces the base interest rate → 2. Commercial banks pass on lower rates to borrowers → 3. Cost of borrowing falls: businesses find more investments profitable (MEC rises above interest rate) → 4. Investment (I) rises — component of AD increases → 5. Consumers with mortgages have higher disposable income — consumption rises → 6. AD shifts right — real output rises toward potential → 7. If there are unemployed resources: output rises with limited inflation → 8. If economy is near full employment: mainly inflationary

Evaluation Points for Chain B

Liquidity trap (Keynesian): if interest rates are already near zero (zero lower bound), further cuts have no effect — animal spirits or confidence determine investment more than the interest rate

Banks may not pass on full rate cut if they need to maintain profit margins — transmission mechanism is imperfect

Business investment driven by confidence and expected demand, not just cost of capital — low rates alone may be insufficient if confidence is low

Monetary policy has asymmetric effects: easier to cool inflation by raising rates than to stimulate a depressed economy

Quantitative easing (QE) as an alternative when rates are near zero: increases money supply directly, but risk of asset price inflation and worsening inequality

Independent central bank (e.g. Bank of England) can act faster than fiscal policy — advantage in responding to sudden shocks

Chain C — Supply-Side Policy, LRAS, and Long-Run Growth

CHAIN: Supply-Side Policy

1. Government invests in education and training (interventionist supply-side policy) → 2. Human capital of the workforce improves — higher productivity per worker → 3. Unit labour costs fall relative to competitors — international competitiveness improves → 4. LRAS shifts right: the productive capacity of the economy increases → 5. At the same price level, more output can be produced without inflationary pressure → 6. Actual growth can now be higher without overheating — sustainable non-inflationary growth achieved → 7. Unemployment falls as firms can produce more; real wages may rise

Evaluation Points for Chain C

Long time lags: education investment takes 15-20 years to fully feed through into the labour market — not useful for short-run stabilisation

Benefits are uncertain: not all education investment translates into productivity gains (skills mismatch, brain drain if skilled workers emigrate)

Free-market supply-side policies (deregulation, tax cuts) may increase inequality — equity trade-off

Privatisation only improves efficiency if competitive markets exist — in natural monopoly sectors, it may not improve performance

Supply-side policies cannot solve demand-deficient unemployment — structural reform is irrelevant if firms have no reason to hire

However, supply-side policies are the ONLY sustainable way to raise potential output and living standards in the long run — demand-side policies cause inflation if the economy is already at capacity

Chain D — Cost-Push Inflation, Stagflation, and Policy Dilemma

CHAIN: Cost-Push Inflation

1. External shock raises input costs (e.g. oil price rise, exchange rate depreciation raises import prices) → 2. Short-run aggregate supply (SRAS) shifts left — costs increase at every output level → 3. For a given AD curve, both the price level rises AND real output falls → 4. Stagflation: simultaneous rise in unemployment (lower output) and inflation — the worst of both worlds → 5. Government faces a dilemma: expanding AD reduces unemployment but worsens inflation; contracting AD reduces inflation but deepens recession → 6. Neither fiscal nor monetary policy can simultaneously achieve both objectives → 7. Supply-side policy (boosting productivity) is the theoretically correct long-run response, but has long time lags

Evaluation Points for Chain D

The severity of the policy dilemma depends on whether the cost-push shock is temporary or permanent — temporary shocks may be accommodated

If inflation expectations become 'unanchored', workers demand higher wages to compensate, causing a wage-price spiral — makes the dilemma worse

An independent central bank with a credible inflation target helps anchor expectations — reduces the second-round effects of cost-push shocks

The correct policy response depends on the source: monetary policy addresses demand-pull; supply-side addresses structural causes; cost-push requires a mix

In practice, most modern economies use monetary policy as the primary stabilisation tool, accepting some output loss to keep inflation on target

Chain E — Policy Conflict: Growth vs Inflation (Phillips Curve)

CHAIN: Growth vs Inflation Trade-Off

1. Government pursues expansionary policy to reduce unemployment (e.g. cut interest rates, raise G) → 2. AD shifts right — real output rises toward and beyond full employment level → 3. Labour market tightens: unemployment falls below the NAIRU → 4. Workers bargain for higher nominal wages — firms face rising labour costs → 5. Firms pass costs on: price level rises — inflation increases → 6. Economy has moved along the short-run Phillips Curve: lower unemployment, higher inflation → 7. If government attempts to hold unemployment at this low level, inflation continues to accelerate → 8. Long-run: workers adjust inflation expectations upward — SRPC shifts up; unemployment returns to NAIRU at higher inflation (expectations-augmented Phillips Curve)

Evaluation Points for Chain E

The short-run trade-off exists but is unstable: if inflation expectations are adaptive, repeated attempts to hold unemployment below NAIRU cause accelerating inflation

The NAIRU is not fixed: supply-side policies can reduce structural unemployment and shift the NAIRU left — lowering the 'natural' rate of unemployment without inflation

In the long run (classical view), the Phillips Curve is vertical — there is no permanent trade-off between inflation and unemployment

In a recession with large negative output gap, the trade-off may be less acute — both output and inflation can improve simultaneously

Modern central banks use forward guidance and inflation targeting to manage expectations directly, reducing the instability of the short-run trade-off

PART 4 — The Universal 20-Mark Essay Structure for Macroeconomics

The structure is the same as Unit 1, but the content is macroeconomic. The key difference is that Unit 2 essays almost always require you to discuss policy effectiveness AND policy conflicts. Plan for both in your structure.

4.1 The Six-Part Template Applied to Macro

INTRO (3-4 lines)	Define 1-2 key macroeconomic terms precisely. State the current context (e.g. whether the economy has a positive or negative output gap, what the inflation rate is). State your line of argument clearly.
POINT 1 — Mechanism of the policy (8-10 lines)	Use the AD/AS model explicitly. Describe the shift (which curve, which direction, why). State the new equilibrium. Apply the multiplier if relevant. Identify the effect on GDP, unemployment, inflation, and the current account.
POINT 2 — Second effect or alternative mechanism (6-8 lines)	This might be the long-run effect (supply-side perspective), the effect on a different macroeconomic objective, or the effect on a different group (workers, firms, government finances).
COUNTER-ARGUMENT — Policy limitations (6-8 lines)	Challenge the effectiveness of the policy. Use one of the evaluation chains above: time lags, crowding out, liquidity trap, stagflation dilemma, or expectations-augmented Phillips Curve.
FURTHER EVALUATION — Conditions (4-6 lines)	State what the outcome depends on. Classic Unit 2 conditionals: size of multiplier (MPC, MPM), whether the economy is at full employment, whether the central bank is independent, whether inflation expectations are anchored, the size of the output gap.
CONCLUSION (3-4 lines)	Make a direct, supported judgement. Which policy works best and under what conditions? Acknowledge the trade-off. Do not repeat your introduction — make a new, evidence-based point in your conclusion.

4.2 Evaluation Phrases for Unit 2 — Macroeconomics Specific

Evaluative Opener	Why It Earns AO4 Marks
"The effectiveness of fiscal policy critically depends on the size of the multiplier, which in turn depends on the marginal propensity to import..."	Shows that outcomes are context-dependent — not a blanket, content-free analysis
"However, at or near full employment, this analysis changes fundamentally because..."	Output-gap awareness — demonstrates the Keynesian vs classical distinction
"This argument assumes that the central bank's interest rate transmission mechanism works effectively, but..."	Critiques the real-world effectiveness of the policy instrument
"In the short run, this policy reduces unemployment, but in the long run the expectations-augmented Phillips Curve suggests..."	Time horizon analysis using the Phillips Curve — the highest-level macro evaluation

"The costs of this policy may be acceptable if the output gap is large, but less justified if the economy is already near full employment..."	Proportionality test — shows nuanced policy judgement
"Supply-side policies address the root cause rather than the symptom, but take considerably longer to have effect..."	Distinguishes between treating symptoms (demand management) vs causes (structural reform)

PART 5 — Question Banks with Argument Skeletons

Q1: 'Evaluate the effectiveness of monetary policy in achieving macroeconomic objectives'

ARGUMENTS FOR Monetary Policy

Chain B above. Central bank independence ensures decisions are made on economic not political grounds — enhances credibility and anchors inflation expectations.

Flexible instrument: interest rates can be adjusted frequently and quickly (e.g. Bank of England MPC meets monthly) — faster than fiscal policy.

Works well in demand-pull inflation: raising rates reduces consumption and investment, cooling AD and reducing the positive output gap.

QE as additional instrument when conventional monetary policy is constrained by the zero lower bound.

ARGUMENTS AGAINST / EVALUATION

Liquidity trap: near zero rates, further cuts are ineffective — investment driven by confidence, not just cost of capital.

Monetary policy has blunt transmission: affects all sectors equally, cannot target specific regions or industries facing structural unemployment.

Only effective against demand-pull inflation — cost-push inflation cannot be solved by interest rate changes without creating a recession.

QE increases asset prices, primarily benefiting wealth-holders — worsens income inequality.

CONCLUSION DIRECTION: Monetary policy is highly effective as the primary tool for demand management and inflation targeting in a stable economy. Its limitations become severe in deep recessions (zero lower bound, weak confidence), cost-push shocks, and structural unemployment — in these cases, fiscal and supply-side policies must complement it.

Q2: 'Evaluate the view that supply-side policies are the best way to improve macroeconomic performance'

ARGUMENTS FOR Supply-Side Policies

Only supply-side policies permanently expand the productive capacity of the economy — they shift LRAS right, allowing more output to be produced without inflationary pressure (Chain C above).

Address structural unemployment directly — retraining programmes, education investment, and deregulation tackle the root cause of long-term joblessness that demand-side policies cannot solve.

Improve international competitiveness — higher productivity and lower unit labour costs strengthen the current account, addressing the growth vs current account conflict.

No inflation-unemployment trade-off: shifting LRAS right moves the economy to a higher output level at the same price level — avoids the Phillips Curve dilemma.

ARGUMENTS AGAINST / EVALUATION

Long time lags: education takes 15-20 years to feed through; infrastructure projects take 5-10 years — not effective for short-run stabilisation.

Cannot solve demand-deficient unemployment — in a recession, boosting productivity is irrelevant if firms have no reason to hire (Keynesian argument).

Free-market supply-side policies (deregulation, tax cuts for high earners) may increase inequality — creates social costs that offset efficiency gains.

Some supply-side policies (e.g. labour market deregulation) may reduce worker protection — political resistance and social welfare costs.

CONCLUSION DIRECTION: Supply-side policies are essential for long-run growth and are the only tool for reducing the NAIRU permanently. However, in the short run, particularly during recessions, they must be combined with demand-side policies. The 'best' approach depends entirely on the current state of the economy: supply-side is primary at full employment; demand-side is primary in a recession.

Q3: 'To what extent do macroeconomic policy objectives inevitably conflict?'

YES — Conflicts Are Inherent

The short-run Phillips Curve shows a structural trade-off between unemployment and inflation — lower unemployment requires accepting higher inflation (expansionary policy moves along the curve).

Expansionary demand-side policy to raise growth worsens the current account deficit (higher income pulls in more imports).

Fiscal austerity (to balance the budget) reduces AD, raises unemployment, and slows growth — conflict between fiscal responsibility and growth objectives.

Greater income equality (redistribution) may reduce incentives to work and invest — potential growth trade-off.

NO — Conflicts Can Be Managed

Supply-side policies can shift LRAS right, raising potential output and reducing structural unemployment WITHOUT inflationary pressure — no Phillips Curve trade-off in the long run.

A credible inflation target and independent central bank anchors expectations — reduces the risk that lower unemployment causes accelerating inflation.

In a large negative output gap, expanding AD can simultaneously reduce unemployment, maintain low inflation, and potentially improve the current account (lower domestic prices improve competitiveness).

Automatic stabilisers (progressive taxes, unemployment benefits) reduce cyclical fluctuations without requiring active policy choices, limiting the conflict in practice.

CONCLUSION DIRECTION: Conflicts are genuine and unavoidable in the short run — no policy can simultaneously maximise all objectives. However, they can be minimised through the right combination of instruments: independent monetary policy for short-run stabilisation, supply-side reform for long-run capacity, and fiscal policy for structural equity goals. The severity of the conflict depends on the state of the economic cycle.

PART 6 — Key Definitions and Quick Reference

Term	Precise Definition for 20-Mark Introductions
Aggregate demand (AD)	The total planned expenditure on goods and services in an economy at each price level over a given period; AD = C + I + G + (X-M)
Aggregate supply (AS)	The total output of goods and services that producers in an economy are willing and able to supply at each price level over a given period
National income equilibrium	The level of real national output at which aggregate demand equals aggregate supply — the economy has no tendency to expand or contract
The multiplier	The ratio of the final change in national income to the initial injection that caused it; k = 1/(1-MPC) = 1/(MPS + MPT + MPM)
Output gap	The difference between an economy's actual output (real GDP) and its potential output (the level achievable at full employment); can be positive or negative
Fiscal policy	The use of government expenditure and taxation by the government to influence the level of aggregate demand and the distribution of income
Monetary policy	The use of interest rates, money supply, and credit conditions by the central bank to control inflation and stabilise the economy
Supply-side policy	Government policies designed to increase the productive capacity (LRAS) of the economy by improving the efficiency and quantity of factor inputs
Phillips Curve (short-run)	A curve showing the inverse relationship between the rate of unemployment and the rate of inflation in the short run; illustrates the policy trade-off between these two objectives
Demand-pull inflation	Inflation caused by an increase in aggregate demand beyond the full employment level of output — prices rise because demand exceeds supply capacity
Cost-push inflation	Inflation caused by a rise in production costs (e.g. wages, raw materials) which shifts the SRAS curve to the left, raising the price level
Stagflation	The simultaneous occurrence of high inflation and high unemployment — caused by a leftward shift in SRAS; creates a policy dilemma as the two objectives conflict directly

The LRAS Debate in One Paragraph (Use This in Conclusions)

Whether demand-side policy is effective ultimately depends on the shape of the LRAS curve. In the Keynesian view, with a horizontal section, expansionary fiscal or monetary policy can raise output without causing inflation when there are unemployed resources — making demand management a powerful stabilisation tool. In the classical view, with a vertical LRAS, any demand expansion at full employment only raises the price level, not output — implying supply-side reform is the only sustainable route to growth. In practice, both insights are relevant: demand management is most effective in recessions; supply-side reform is most effective in the long run. The appropriate policy mix depends on the size and direction of the output gap.

Good luck in your exam.