2.6.4 Conflicts and trade-offs between objectives and policies

a) *Potential conflicts and trade-offs between the macroeconomic objectives*
b) *Short-run Phillips curve*
c) *Potential policy conflicts and trade-offs*

- A trade off occur when one objective is achieved at the expense of another
- Potential conflicts between objectives:
    - Inflation and unemployment: when the government tries to control inflation it is likely to try to dampen demand. Less spending will lead to less upward pressure on prices. To reduce inflation the government may increase taxes or the MPC may raise the interest rate but these will lead to less spending which means firms may lay off workers because they can't sell all their output. This lead to a cycle as unemployment leads to reduced demand and a continuing downward pressure on prices. There is trade-off between the inflation rate and unemployment. In the other direction if government reduces unemployment (e.g. subsidies, increased spending) there will be more spending so prices rises as more money is chasing the same amount of goods and services (cost-push inflation) and consumer confidence may increase causing demand-pull inflation
    - Economic growth and sustainability: when there is economic growth, standards of living tend to improve but there is a conflict between enjoying a resource today and somebody else enjoying it in the future e.g. environment impact. Governments must choose between the welfare of today's society or that of tomorrow to achieve sustainable growth
    - Inflation and equilibrium on the current account of the balance of payments: controlling inflation should make a country more competitive internationally so lead to an improve in the balance of payments. Exports become cheaper and imports more expensive so inflation should be good. However, the actions required to control inflation can damage the balance of payments, for example, raising interest rates may raise the exchange rate by encouraging foreign investment which makes exports more expensive and imports cheaper. By contrast, contractionary fiscal policy tends to improve the balance of payments as people have less money to purchase foreign good
    - Aggregate demand and other objectives: a right shift in AD will increase output but also prices leading to a lack of international competitiveness, reduction in exports. However, a shift in AS enables a government to achieve all four objectives at the same time suggesting supply-side policies are more effective
    - Economic growth and inflation: A rapidly growing economy can cause larger increases in prices due to an increase in demand leading to higher inflation. Likewise, attempts to reduce inflation can restrict growth
    - Economic growth and a reduction in wealth inequality: economic growth can increase inequality, as not everyone benefits equally from a

growing economy for example demand for low skilled workers may decrease in the face of automation. Governments can decrease income inequality by increasing welfare payments, progressive taxation and increasing the minimum wage. However, taxes can damage further growth by acting as a disincentive

- Short-run Phillips curve: it shows a trade-off between inflation and unemployment and was calculated by plotting historical inflation and unemployment data
- Conflicts between macroeconomic policies:
    - Fiscal policy and monetary policy: Changes in the fiscal policy have a direct impact on the MPC's decisions. If they think fiscal policy is too loose they may raise the interest rates and if they believe it is too tight they might cut interest rates. If there is a large fiscal deficit, there must be borrowing. Increased demands in the money markets for firms means others borrowers, might have to pay more to borrow money
    - Monetary policy and supply-side policy: changes in interest rates and other monetary policy decisions have a direct impact on the costs of firms, therefor shifting AS. Higher interest rates= fall in AS, lower interest rates= increase in AS
    - Supply-side and fiscal policy: changes in supply-side policies have a direct impact on government spending. For example, improving education and health services encourages people to more productive but requires government spending. Supply-side policies increase the budget deficit in the short term but could decrease it in the long-term. However, some supply-side policies, such as reducing bureaucracy, are unlikely to make a significant impact on government spending and taxation. Some supply-side policies, such as privatisation and cutting benefits, will tend to reduce the budget deficit, however, privatisation is a one-off fiscal improvement, and cutting benefits can lead to increased long-term costs to the government due to social issues