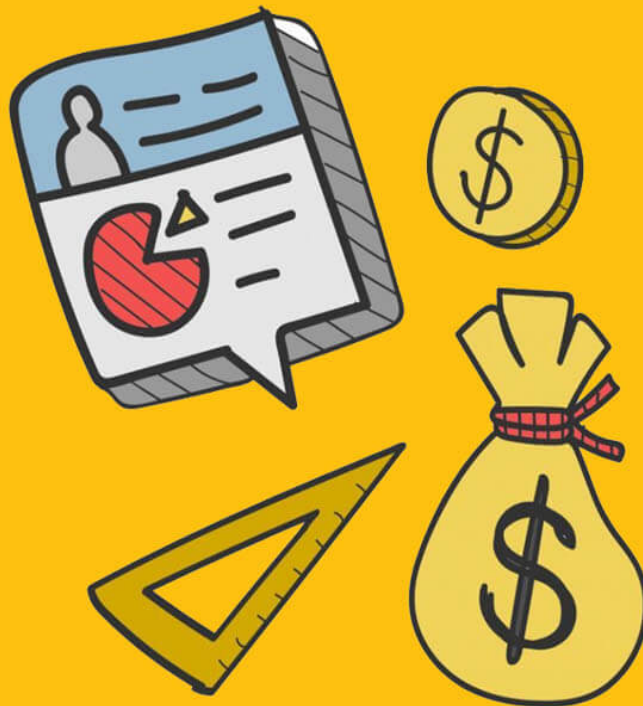




Exam Papers Practice

The Objectives of Government Economic Policy



**AQA A Level Economics
Revision Notes**

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The government has four main macroeconomic objectives. These aim to provide **macro stability**.

Economic growth:

In the UK, the long run trend of economic growth is about 2.5%. Governments aim to have sustainable economic growth for the long run.

In emerging markets and developing economies, governments might aim to increase economic development before economic growth, which will improve living standards, increase life expectancy and improve literacy rates.

Minimising unemployment:

Governments aim to have as near to full employment as possible. They account for frictional unemployment by aiming for an unemployment rate of around 3%. The labour force should also be employed in productive work.

Price stability:

In the UK, the government inflation target is 2%, measured with CPI. This aims to provide price stability for firms and consumers, and will help them make decisions for the long run. If the inflation rate falls 1% outside this target, the Governor of the Bank of England has to write a letter to the Chancellor of the Exchequer to explain why this happened and what the Bank intends to do about it.

This is a good summary by the Bank of England about the government's inflation target:

<http://www.bankofengland.co.uk/monetarypolicy/Pages/framework/framework.asp>
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Stable balance of payments on current account:

Governments aim for the current account to be satisfactory, so there is not a large deficit. This is usually near to equilibrium.

A balance of payments equilibrium on the current account means the country can sustainably finance the current account, which is important for long term growth.

Additionally, the government might have the following macroeconomic objectives.

Balanced government budget:

This ensures the government keeps control of state borrowing, so the national debt does not escalate. This allows governments to borrow cheaply in the future should they need to, and makes repayment easier.

Greater income equality:

Income and wealth should be distributed equitably, so the gap between the rich and poor is not extreme. It is generally associated with a fairer society.

The importance of each objective changes over time.

Potential conflicts and trade-offs between the macroeconomic objectives (generally in the short run):

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Economic growth vs inflation:

A growing economy is likely to experience inflationary pressures on the average price level. This is especially true when there is a positive output gap and AD increases faster than AS.

Economic growth vs the current account:

During periods of economic growth, consumers have high levels of spending. In the UK, consumers have a high marginal propensity to import, so there is likely to be more spending on imports. This leads to a worsening of the current account deficit. However, export-led growth, such as that of China and Germany, means a country can run a current account surplus and have high levels of economic growth.

Economic growth vs the government budget deficit:

Reducing a budget deficit requires less expenditure and more tax revenue. This would lead to a fall in AD, however, and as a result there will be less economic growth.

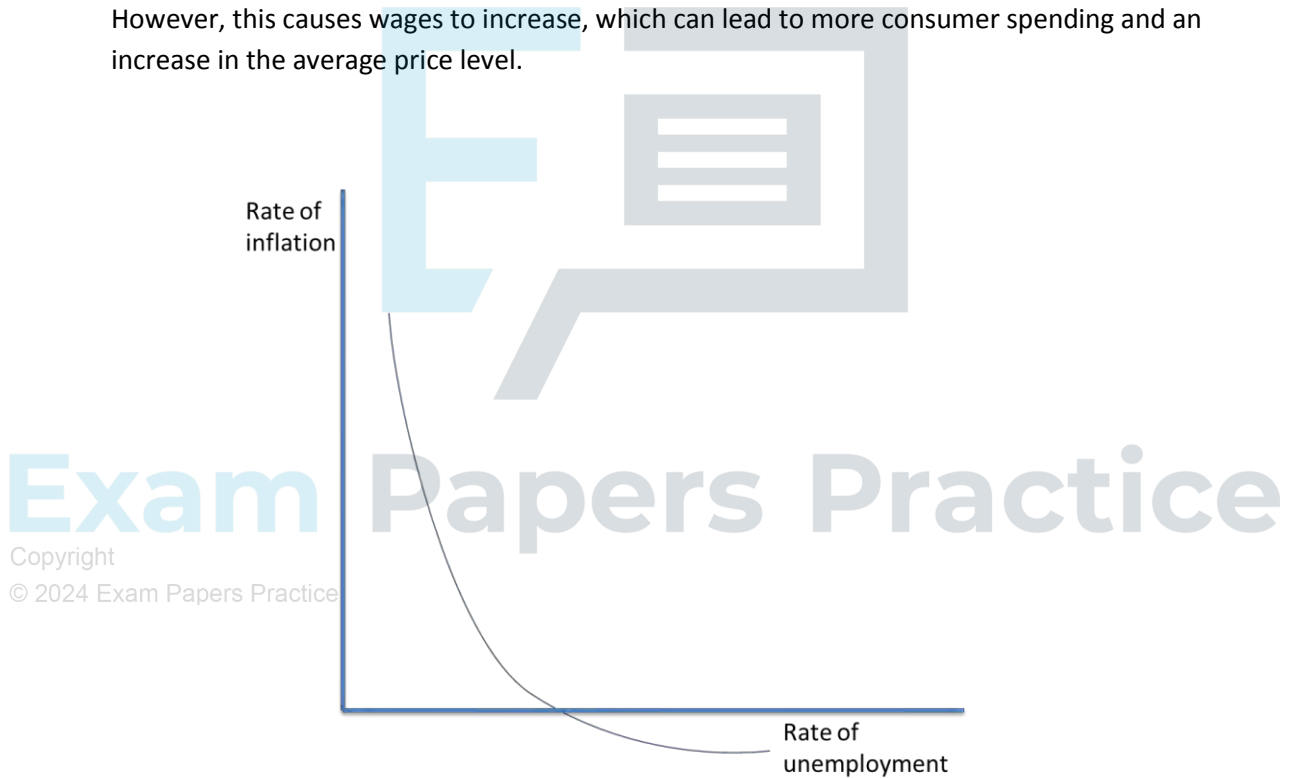
Economic growth vs the environment:

High rates of economic growth are likely to result in high levels of negative externalities, such as pollution and the usage of non-renewable resources. This is because of more manufacturing, which is associated with higher levels of carbon dioxide emissions.

Unemployment vs inflation:

In the short run, there is a trade-off between the level of unemployment and the inflation rate. This is illustrated with a **Phillips curve**.

As economic growth increases, unemployment falls due to more jobs being created. However, this causes wages to increase, which can lead to more consumer spending and an increase in the average price level.



The extent of this trade off can be limited if supply side policies are used to reduce structural unemployment, which will not increase average wages.