ESSAY 3

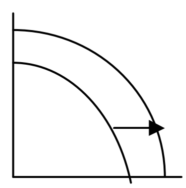
Explain what the main macroeconomic policy objectives are and why are there problems when trying to achieve them together?
What is full employment? It is desirable to achieve it?

Governments management of the economy is always a key political issue. Each government must set targets and objectives when it assumes power in order to improve welfare of the country as a whole. The four main macroeconomic policies to reach this target are the country economic sustainable growth, to reach equilibrium in international trade, to stable low inflation and to achieve a less unemployment index

Economic growth is an increase in the real level of national output, measured by the annual percentage change in real GDP (gross domestic product). It is also defined as a long-term expansion of the productive potential of the economy.

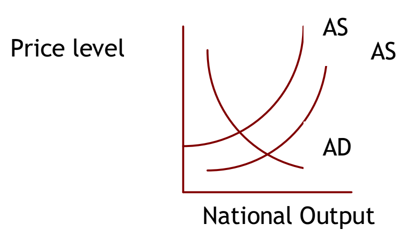
Growth stimulates higher employment as there is more investment in the country; it has a positive impact on company profits and business confidence. So a higher demand for imports are produced, increasing international trade. It has a positive effect in governments finances because of the high level of tax revenues they receive. This is why a greater spending on merits goods can be made. However, if the economy grows too quickly there is a danger of inflation as demand races ahead of the ability of the economy to supply goods and services. Producer then take advantage of this by raising prices for consumers. In addition, fast growth can create negative externalities which damages overall social welfare. There is also the fact that not all of the benefits of economic growth are evenly distributed and is rarely balanced between regions and across industries.

An increase in productive potential is shown by the outward shift in the production possibility frontier



Inflation is the annual rate of change of the general price level, or a sustained increase in the average price level. It is focused on the overall level of prices throughout the economy, rather than prices in one particular moment. The aim of the government is to stable it in a low rate because deflation, which is negative inflation would mean that the economy is not growing due to less demand and lower prices.

One of the causes of inflation is when firms respond to rising production costs by raising their prices in order to maintain their profit margins. Higher costs shifts a firm's supply curve upwards and lead to an increase in price.



Cost rise due to rising imported raw materials caused by inflation in other countries or by a fall in the value of the coin in the foreign exchange markets, rising labour costs caused by wage increases and higher indirect taxes imposed by the government.
Cost inflation is more likely when unemployment is falling to low levels. In this circumstances there will be shortages of skilled labour. This means that businesses may have to offer higher pay to attract and retain their best workers when they are looking to expand their output.

Demand-pull inflation is likely when there is full employment of resources and aggregate supply is inelastic, an increase in aggregate demand will lead to a general increase in prices, this might rise due to a depreciation of the exchange rate, which increases the price of imports. A reduction in direct or indirect taxation causes demand to rise also.

Inflation can be a problem because it creates a range of economic and social costs; it depends on the degrees of inflation, since low stable inflation has less damaging effect on the economy than hyperinflation where prices are out of control. In both cases, money loses its value and therefore people lose confidence in money. Inflation can get out of control leading to higher wage demands, then businesses increase prices to maintain profits. Inflation can favour borrowers at the expense of savers because inflation erodes the real value of existing debt. As inflation can disrupt businesses planning due to the uncertainty on what will happen in the next few months, planned investment spending is reduced. Lower investment has a detrimental effect on the economy long run growth potential. Inflation is a possible cause of higher unemployment, particularly if one country experiences a much higher rate of inflation than another, leading to a loss of international competitiveness and a subsequent worsening of their international trade performance.

By stabilizing inflation employment and economic growth continues increases, but international trade is low because inflation incentives imports due to a price increase hence better profits for the importers.

International trade is important because countries need to export goods and services to finance imports of products they cannot supply in the country. Exports represent an injection of demand into the circular flow of income. There is a potential improvement in economic welfare if countries specialize in the products in which they have comparative advantages and then trade with other nations. International competition stimulates higher allocative and productive efficiency. Furthermore imports can help to satisfy excess demand for consumers. A trade deficit during a boom helps to reduce demand- pull inflation. In order to reduce inflation because it increases as prices arise due to the trade efficiency, governments introduces import controls, this are barriers to the free movement of good and services between countries. Tariffs or tax on imports are used to restrict imports and raise revenue for the government. To import quotas reduces the quantity of a product that is imported and indirectly reduces the amount of money that the export producers receive. Exports subsidies are payments to a domestic producer who exports a good abroad. Exporting increases GDP and employment because it incentives production, but trade increases inflation as prices arise.

Officially, the unemployed are people who are registered as able, available and willing to work at the going wage ate in a suitable job but who cannot find work despite an active research for work.

Unemployment is multi-casual. Frictional unemployment is transitional unemployment due to people moving between jobs. Structural unemployment occurs when people are made unemployed because of capital–labour substitution or when there is a long run decline in demand. Certain industries see seasonal changes in demand and employment, cyclical unemployment is involuntary unemployment due to lack of aggregate demand for goods and services. Classical unemployment is though to be the result of real wages being above their market clearing level leading to an excess supply labour. Voluntary unemployment also exists, when a worker chooses not to accept a job at the going wage rate.

Unemployment is a waste of scarce resources leading to a loss of potential output. When it is high, it affects government finances as there is an increased spending on unemployment benefits and other welfare payments. In order to reduce it governments encourage an improvement in the employability of the labour supply so that the unemployed have the right skill to take up the available job opportunities. They also achieve improvement in the incentives for people to search and then accept paid work and a sustained period of economic growth so that the new jobs are being created. A growing economy creates jobs for people entering the labour market for the first time and it provides employment opportunities for people currently employed and looking for work.

When there is a high rate of employment, wages are higher, hence prices rise, hence inflation increases, hence growth is negatively altered. When incomes and spending are growing there is an increase in the demand for imports. Unless this is matched by a rise in export sales, the trade balance in goods and services will worsen.

Full employment is achieved when the labour market has reached a state of equilibrium, when those who are willing and able to work at going wage rates are able to find work. Another interpretation is when the total of people out of work matches the number of unfilled job vacancies. The problem with this is that estimates of the scale of job vacancies vary considerable. The true number of jobs available is probably three times the official published figure. Moreover, unemployment cannot fall to zero since there will always be frictional unemployment caused by people moving into the labour market and other switching between jobs. The prospect of reaching full-employment is diminished by the continuing problem of skill shortages. Using all the labour resources means using even the low skilled people. Another obstacle to reaching full-employment is the risk that wage and price inflation will pick up as more people find work and total spending in the economy causes businesses to raise prices. When unemployment is falling there is pressure on firms to bid up wages both to attract and retain staff. Labour shortages that cause acceleration in wage inflation might persuade banks to increase interest rates. This would slow down the economy and the rate of new job creation might suffer as a result.

Although falling unemployment will create inflationary pressure in the economy, it has been proved that unemployment and inflation have continued to fall together. It can be explained as that labour market becomes flexible. It is better able to match the unemployed with the new jobs, and the economy has been able to attract sufficient new workers into the labour force to meet a rising demand for labour. Inflation can be kept low through the impact of new technology and more intense competition in many markets.

In conclusion the four main macroeconomic objectives are difficult to achieve together because the improvement of one involves scarifying other one. Reaching full-employment is not desirable as it causes damages in the total economy, however a 2% of unemployment is considered full-employment in first world countries, and that is the target.