

OCR Economics A-level

Macroeconomics

Topic 3: Implementing Policy

3.4 Policy Conflicts

Notes

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Potential conflicts and trade-offs between the macroeconomic objectives:

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:

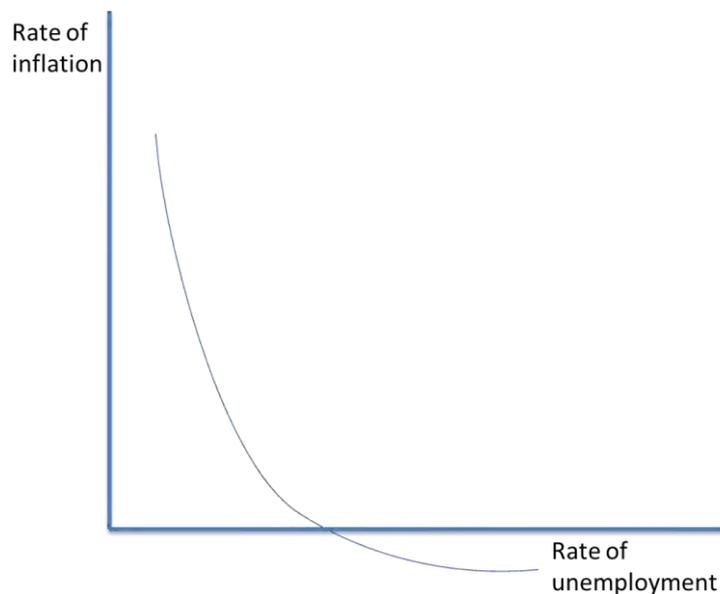
High rates of economic growth are likely to result in high levels of negative externalities, such as pollution and the usage of non-renewable resources. This is because of more manufacturing, which is associated with higher levels of carbon dioxide emissions.

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.

Potential policy conflicts and trade-offs:

This occurs when one macroeconomic policy has a larger impact than another, which conflicts with the other policy or reduces its effectiveness.

Environment vs competitiveness:

If 'green taxes' are implemented, such as carbon taxes, or if there are minimum prices on pollution permits, the competitiveness of domestic firms could be compromised. This is because they are limited in their production.

Progressive taxes vs inflation:

Taxes to reduce inequality could lead to higher rates of inflation. For example, a higher VAT rate increases the price of goods for firms and consumers.

Fiscal vs monetary policy:

Expansionary fiscal policies involve more government borrowing, which could cause interest rates and the inflation rate to rise.

Interest rate vs inequality:

The low interest rate could affect the distribution of income. Savers only receive a small return on their savings.

