

Exercise walk-through

Links between macroeconomic problems and their interrelatedness ■ 10.2

eXercise

You must be able to

- explain the main policy trade-offs
- analyse why gaining on one objective can cost another
- evaluate how a policy mix can ease a trade-off

Method — Trade-offs between objectives

- **Unemployment** $\leftrightarrow$ **inflation**: raising demand to cut unemployment pushes prices up (the **Phillips curve** 菲利普斯曲线).
- **Growth** $\leftrightarrow$ **inflation**: fast demand-led growth can overheat the economy.
- **Growth** $\leftrightarrow$ **balance of payments**: higher incomes pull in more imports.
- **Growth** $\leftrightarrow$ **the environment / equality**: more output can mean more pollution and a wider gap.

Answer shapes: AO1 + AO2 + AO3 (analysis) + AO4 (a supported judgement *in context*).

Method — Trade-offs between objectives

these goals pull against each other

lower unemployment $\Rightarrow$ higher inflation

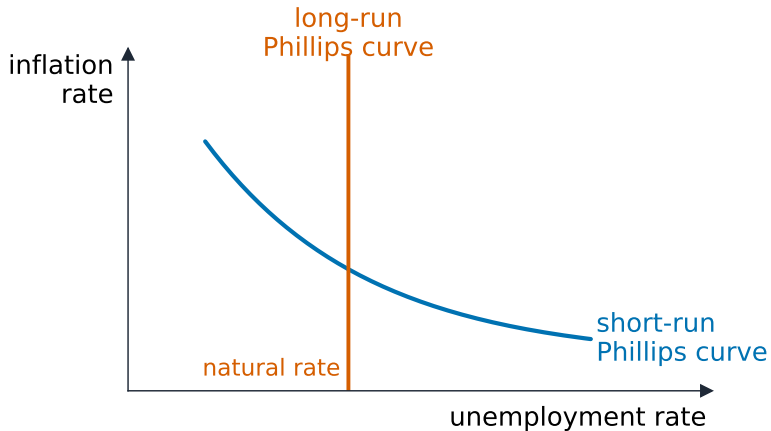
faster growth $\Rightarrow$ higher inflation

faster growth $\Rightarrow$ worse current account

faster growth $\Rightarrow$ more pollution

The objectives pull against each other, so a government must trade one off against another

Method — Trade-offs between objectives



The short-run Phillips curve shows lower unemployment bought with higher inflation

Practice 2.1 ■ 2 marks

Define the term *trade-off* between objectives.

Solution 2.1

Method: Trade-offs between objectives

Worked steps

a situation where improving one objective comes at the cost of doing worse on another (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ■ 1 mark

State one trade-off involving economic growth.

Solution 2.2

Method: Trade-offs between objectives

Worked steps

any one of: growth vs inflation; growth vs the current account; growth vs the environment; growth vs equality (1).

Practice 2.3 ■ 1 mark

State which curve shows the short-run unemployment–inflation trade-off.

Solution 2.3

Method: Trade-offs between objectives

Worked steps

the Phillips curve (1).

Exam-style 3.1 ■ 1 mark

Faster demand-led growth is most likely to **worsen** the:

- A** unemployment rate
- B** current account balance
- C** level of investment
- D** size of the labour force

Solution 3.1

Method: Trade-offs between objectives

- A unemployment rate
- B current account balance** 
- C level of investment
- D size of the labour force

Worked steps

- B. Higher incomes from growth pull in more imports, worsening the current account.**

Exam-style 3.2 ■ 6 marks

Explain why faster economic growth can worsen a country's current account.

Solution 3.2

Worked steps

[6] AO1 1 + AO3 up to 5 — as growth raises incomes, consumers spend more, including on imports → the import bill rises faster than exports → net exports fall → the current account moves towards (or deeper into) deficit.

Exam-style 3.3 ■ 12 marks

Discuss whether a government can ease the trade-offs between its macroeconomic objectives.

Solution 3.3

Method: Trade-offs between objectives

Worked steps

[12] AO1/AO2/AO3 up to 8 + AO4 up to 4. **Eased by:** supply-side policy can raise growth *and* lower inflation, easing the unemployment–inflation and growth–inflation clashes; targeted measures can protect the environment or the poor. **But:** trade-offs rarely vanish — demand policy still faces them, and supply-side policy is slow. Judgement: a smart policy mix can soften the trade-offs, especially via supply-side measures, but cannot remove them entirely — the result depends on the policies chosen and the time horizon.