25 marker model answer | Economics A Level AQA style

I have written a practice question below with a sample answer. This answer would likely score full marks or close to this.

Here is the question:

"Evaluate the extent to which there is conflict between macroeconomic objectives"

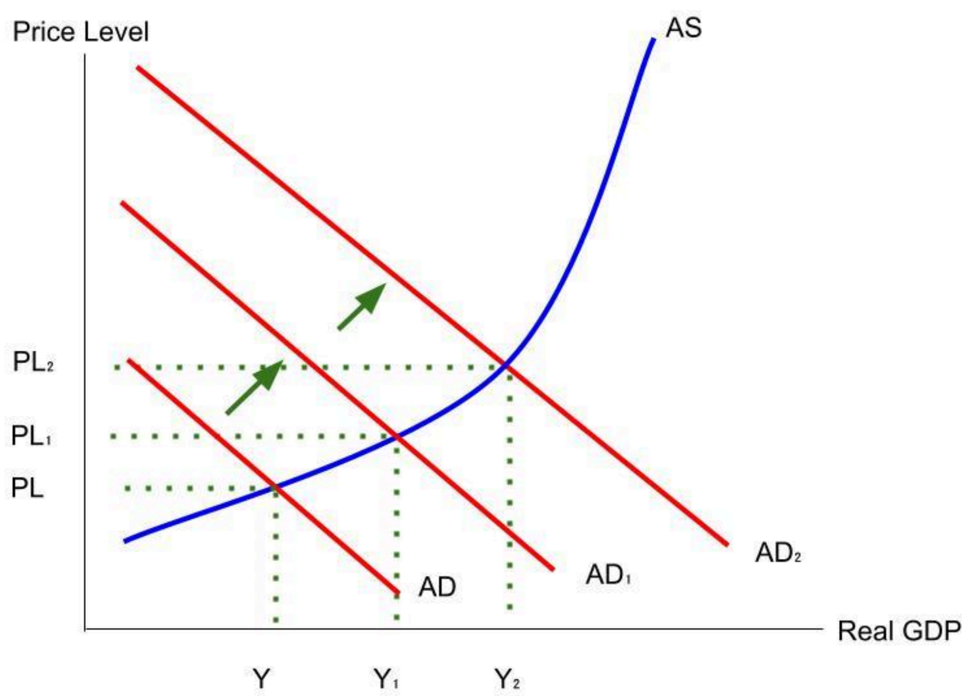
[25 marks].

Here is a model answer:

The four main macroeconomic objectives include sustained economic growth, low and stable inflation, low unemployment and a satisfactory balance of payments. Other possible macroeconomic objectives for the government could include protecting the environment (hence the Government's Net Zero emissions by 2050 target), or reducing inequality.

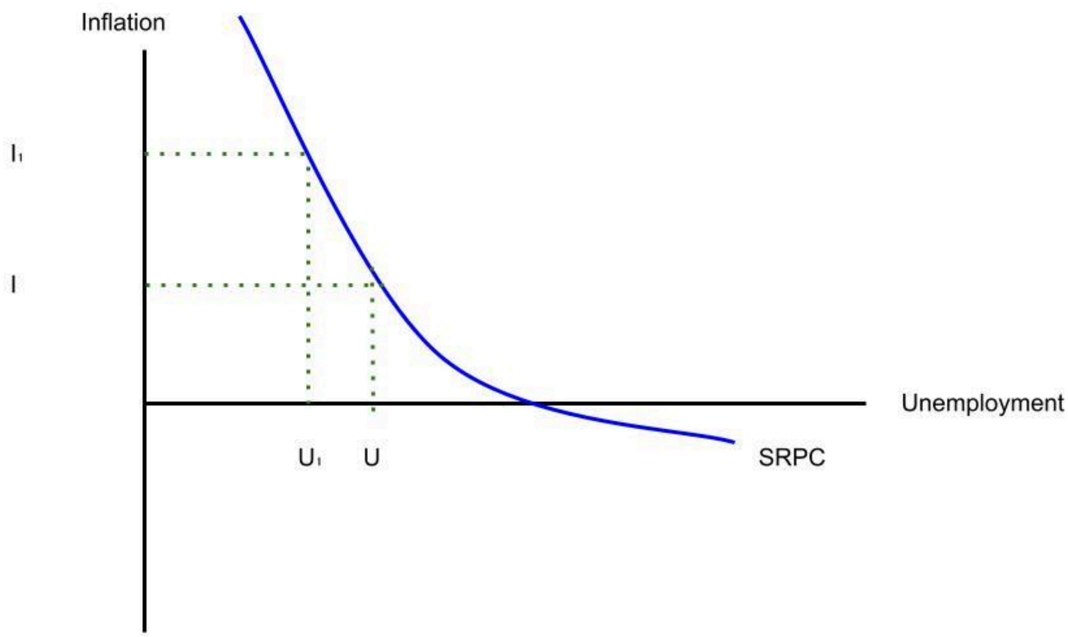
There is a tradeoff between **economic growth and stable inflation**. Expansionary monetary policy, such as persistently low interest rates for a decade in the UK and quantitative easing peaking at £895 billion, has reduced the cost of borrowing and the reward for saving. This encourages consumption and investment. This boosts aggregate demand, as consumption and investment are components of AD: AD = C + I + G + X - M. Also there is a **multiplier effect**. This means a change in a component of AD leads to an even greater change in AD and real GDP.

For example higher investment increases business revenues and profits for firms that receive the investment funds, increasing incomes of workers. These workers then spend more in local areas, thus increasing consumption and AD. Altogether AD shifts right from AD to AD2. This boosts economic growth, leading to higher real GDP from Y to Y2. However it also boosts inflation, with the price level rising from PL to PL2. As AD exceeds AS at the original price level PL, the price level rises to ration AD. This is **demand-pull inflation**.



This depends on the position of the economy on the Keynesian AS or LRAS curve. On the **flatter part of the Keynesian AS**, real GDP is lower. Here, a given increase in real GDP only leads to a small increase in price level and inflation. As there is high spare capacity, an increase in aggregate demand does not raise wages, costs and hence prices very much - workers have low bargaining power as unemployment is high, so cannot ask for much higher wages. This was the case in the 1930s Great Depression. So the tradeoff between economic growth and inflation is weaker when there is high spare capacity.

There is a tradeoff between **unemployment and inflation**. Falling unemployment means workers can bargain for greater wage rises. This is because workers have more bargaining power - firms will find it harder to replace workers when unemployment is low. Greater wage rises increase firm costs. In the UK economy in early 2023, unemployment was low at 3.7% while inflation was high at 10.5%. Firms may **pass on cost rises to consumers** in the form of higher prices, generating cost-push inflation. The Phillips curve diagram below shows this: as unemployment falls from U to U1, inflation rises from I to I1 along the short-run Phillips curve. In addition, low unemployment, for given wages, means higher total incomes across the whole economy. This increases real disposable incomes, increasing consumer spending. This boosts aggregate demand, so AD shifts right, which leads to a higher price level.



But this depends on the **slope of the Phillips curve**. Globalisation means a greater percentage of goods come from abroad. So import prices are more important to the consumer basket and are largely determined by global supply and demand, less by domestic unemployment. So a change in unemployment does not affect the prices of a significant proportion of the basket of goods. This means there is less of a tradeoff between unemployment and inflation.

There may not be a tradeoff between economic growth and a satisfactory balance of payments if growth is driven by **increased productivity**. The balance of payments measures the cross-border transactions between UK based agents and agents abroad. Consider Rishi Sunak's policy to have everyone learn maths until age 18. This will shift the long-run aggregate supply of the UK economy to the right, achieving growth without being inflationary by increasing UK productivity. Specifically there will be a **lower price level**, making exports more price competitive relative to imports. This increases export demand and reduces import demand, as domestic products are now less expensive compared to import prices. So net exports may increase, reducing the size of the current account deficit.

This depends on the **cause of economic growth**. The analysis above assumed the growth is driven by supply-side policies. However growth may be driven by rising aggregate demand, for example because of higher consumption. This shifts AD right, raising the price level and real GDP. A higher price level makes exports **less price competitive**, reducing export demand. Higher real incomes may increase import demand. So net exports fall and the current account deficit worsens. So whether there is a tradeoff between growth and the current account position depends on the drivers of growth.

Overall there are conflicts between macroeconomic objectives to some extent, but most conflicts can either be managed or are subject to changes in macroeconomic conditions. For example conflicts between growth and inflation or current account can be managed through **supply-side policies**. But the extent of macroeconomic tradeoffs depends on the foresight of the government. Supply-side policies come with long time lags, such as **the HS2 rail project**. So a myopic (**short-termist**) government may not implement the necessary supply-side policies to avoid tradeoffs. Only a forward-looking government can attempt to prevent major future macroeconomic tradeoffs.

That is the end of the model answer

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Key evaluation points

Micro diagrams

Macro diagrams

Micro real world examples

Macro real world examples

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