

Macro-Economic Issues

Economics is concerned with the process of satisfying the needs and wants of the population, by using the limited resources of the economy (land, labour, capital and enterprise, otherwise known as the 'factors of production') in the most efficient way. There are generally considered to be four main objectives of an economy:

- 1) **A low level of unemployment**
- 2) **A low level of inflation**
- 3) **A high level of economic growth**
- 4) **A good foreign trading position**

Unemployment is defined as the number of people in the workforce in a country who are looking for a job, but cannot find one.

The two major measures of unemployment are the '**claimant count**' (where people must declare that they are out of work, capable of working, available to work and actively seeking work) and the '**International Labour Organization (ILO)**' count (where people must be out of work, have been looking for work in the past 4 weeks and must be available to start work in the next 2 weeks).

The main types of unemployment are:

- 1) **Structural:** where people are unemployed due to changes in the structure of the economy.
- 2) **Frictional:** where people are unemployed because they have left one job and are waiting to start another job.
- 3) **Seasonal:** where people are unemployed due to the seasonal nature of their jobs.
- 4) **Cyclical:** where the level of consumer demand is low.

Unemployment can be very damaging to an economy because it can lead to falling output, high government spending, and falling aggregate demand.

There are several methods that a government can use to reduce the amount of unemployment in an economy:

- 1) **Policies to increase demand:** such as reducing taxation or reducing interest rates.
- 2) **Retraining incentives offered to the unemployed.**
- 3) **Helping new businesses to set-up,** and offering incentives to existing businesses to relocate to areas of high unemployment.

Inflation is defined as a general and sustained rise in the average prices of goods and services within an economy over a period of time. It is calculated by reference to the **Retail Price Index (R.P.I)**, which is a weighted index, designed to indicate any changes in the average price level in the UK.

The main types of inflation are:

- 1) **Cost-push:** where an increase in the costs of the business, such as raw materials or wages, forces the producers to increase their prices.

2) **Demand-pull:** where the level of customer demand outstrips the number of products that the business can produce.

3) **Increases in the money supply:** this can cause inflation where rises in the money supply have increased at a faster rate than the output of products.

Inflation can be very damaging to an economy because it leads to the reduced purchasing power of the pound, uncertainty about the future, a fall in investment and savings, and increasing costs for businesses.

There are several methods that a government can use to reduce the rate of inflation in an economy:

- 1) Increasing interest rates to discourage high levels of customer spending.
- 2) Reducing the amount of credit (borrowing) that is available to customers.
- 3) Incomes policies, where pay increases are limited, so to deter high levels of costs and expenditure.

Economic growth. This term refers to a real growth (i.e. accounting for the effects of inflation) in the income per capita (or income per head) of the population over a given period of time.

It is normally measured by reference to **Gross Domestic Product (G.D.P)** and **Gross National Product (G.N.P)**.

Gross Domestic Product is the total value of a country's output over a period of time (usually 12 months).

Gross National Product is calculated by adding G.D.P. to the net income from abroad (i.e. the income earned on overseas investments by UK citizens and businesses, minus the income earned by foreigners investing in the UK).

Economic growth is likely to lead to an increase in the amount of investment in the economy, as well as an increase in the number of new businesses starting up, leading to increases in output, expenditure and income.

An economy moves through a number of 'highs' and 'lows' over time, which indicates the level of growth in the economy. This is known as the '**Trade Cycle**'. It refers to the fluctuation of employment, income, expenditure and output in an economy over time – thus showing us the level of economic growth. We can identify several feature from the diagram:

'Peak' or 'Boom'. The economy is at its peak. Consumption and investment will be at high levels, and pay rises are likely to be large. Businesses are likely to be making high levels of profit and there will be strong inflationary pressure.

'Recession'. This refers to a situation where the G.D.P. of an economy has fallen for two successive quarters (6 months). It is characterised by falling customer demand, low investment, and rising unemployment. Other features of a recession include falling house prices, and falling business and consumer confidence.

'Slump' or 'Trough'. This is the bottom of the trade cycle, and this stage is characterised by a high level of unemployment, very low levels of consumption and investment and a poor international trade situation.

'Recovery' or 'Expansion'. Income, output and employment start to rise again, consumption and investment gradually increase and the economy starts to expand again.

In order to improve the G.D.P. or the G.N.P. per capita (i.e. in order to achieve a faster rate of economic growth), then the government must ensure that the workforce is adequately educated and trained to perform their jobs effectively, significant amounts of investment in new machinery and production techniques are undertaken, and natural resources must be used to their optimum efficiency.

Balance of payments. This is a record of a country's financial transactions with the rest of the world over a given period of time (normally 12 months).

The current account of the balance of payments measures both 'visible' trade (that is, the imports and exports of tangible goods such as furniture and cars) and 'invisible' trade (that is, the imports and exports of intangible services, such as banking, shipping, and insurance). The capital account of the balance of payments measures any flows of capital between the UK and other countries (purchase of shares and other forms of investment).

Protectionism is the term that refers to a government's policies of protecting its domestic businesses from more competitive foreign imported goods. The government can use a variety of these protectionist policies (also known as barriers to trade):

1) **Quotas:** These place a physical restriction on the number of units of a product allowed to enter the country.

2) **Tariffs:** A tariff is a tax, which is placed on an imported good, which makes the imported good more expensive, making the domestically produced good more appealing and competitive.

3) **Embargo:** This is a ban on all trade with a certain country.

4) **Technical barriers:** This involves imposing strict technical standards for the supply of a product in a country, making it difficult for foreign producers to sell their products in the UK.

The exchange rate is the external price of a country's currency, expressed in terms of another currency. For example, £1 = 3.1 Deutschmarks.

A free-floating exchange rate system involves the value of the currency being allowed to float (fluctuate) according to the supply and demand for the currency.

A demand for sterling is created when the UK exports goods and services (foreigners must pay for these goods and services using sterling, which they purchase in exchange for their own currencies).

A supply of sterling is generated when the UK imports goods and services (i.e. the UK must pay for these imports using the foreign currency of the country concerned). These foreign currencies are purchased in exchange for sterling on the world currency market.

An increase in the value of the pound is known as an **appreciation**, and a fall in the value of the pound is known as **depreciation**. A strong pound makes goods and services produced in the UK more expensive for foreigners to purchase, but makes foreign goods and services cheaper to import.

A **fixed exchange rate system** involves the value of the currency being fixed against other currencies and not being allowed to fluctuate in response to the demand and supply for it. This involves government intervention on a regular basis, buying the currency when its value is threatening to fall, and selling the currency when its value is threatening to rise.

Under this system, the government can devalue the currency if it feels that its value is too high against foreign currencies, making their goods and services uncompetitive. This devaluation of the currency boosts the international competitiveness of the country's exports, by making them cheaper for other countries to purchase.

Alternatively, the government can revalue the currency if it feels that its value is too low against foreign currencies, making the level of demand too high for their goods and services and leading to inflation.

Competition

The competitive structure of an industry will directly affect the level of output, the amount of employment, and the price level of the goods and services produced. According to economic theory, there are several different types of competitive structure that can exist in an industry:

- 1) Monopoly:** This is where a single producer dominates the industry, having the freedom to charge whatever price he feels he wants to and having the ability to restrict the levels of output and quality.
- 2) Duopoly:** This refers to a situation where 2 businesses dominate the industry (**for example**, 'Unilever' and 'Procter & Gamble' dominate the detergent market). They will often not compete on the price of their products, but instead will compete on other aspects such as advertising, and after-sales service.
- 3) Oligopoly:** This is where a small number of businesses (3 – 8) dominate the industry (e.g. supermarkets, banks, oil companies). Again, they are very large businesses and they have the ability to earn very high levels of profit.
- 4) Monopolistic Competition:** This refers to a situation where many businesses exist in an industry, and each has a wide product range and a degree of product differentiation. Profits are not as high as in an oligopolistic industry.
- 5) Perfect Competition:** This is a theoretical extreme, which does not exist in reality, there are a large number of very small businesses, each of which produces an identical product. The price for each product is the same and all businesses only make what are termed 'normal profit' in the long-run (i.e. they make enough revenue to simply cover their costs).