The key indicators of the macroeconomic environment

Whilst the majority of producers and consumers make choices that shape up the economy, it is the government's actions that influence policies and it is the policies that endeavour to guide decisions and achieve rational outcomes. The government's manipulation of policies leads to the topic of macroeconomics where it is concerned with the economy as a whole. Anderton (2006) explains that one of the reasons why macroeconomics is useful is because it provides data about the performance of an economy. With this data, it allows economists to compare the current performance of the economy with the past and that it also allows the comparison with other economies. The main objectives of macroeconomic policy include a high but sustainable rate of economic growth, low unemployment, price stability and balance of payments equilibrium.

The direction of this essay will be firstly clarifying each indicator of macroeconomic performance and its importance to the economy along with the various policy tools available to governments, examine the relationship between the objectives, finally analyse the impact of globalisation in different types of economies along with the positive and negative outcomes formed as a result from the implementation of new policies due to the phenomenon. The sustainable increase in economic growth is important, as it will give a rise in the material standard of living, thus increasing the real GDP per capita will mean that on average, the population can enjoy more goods and services. In particular, developing countries experiencing economic growth will result in more individuals will be able to afford necessities therefore enabling a country to reduce or possibly eliminate absolute poverty. The benefit from the government's perspective from this macroeconomic objective is that they will receive more income from an increase in tax revenues without the need to manipulate tax rates, as national income increases.

Also interesting to read aboutfiscal policy questions and answersLawrence (2009) argues that although economic growth does bring benefits to an economy, it can have costs such as it “ may be at the expense of negative externalities, such as environmental damage” and that it “ may result in the depletion of non-renewable resources” from the rapid development of the BRIC economies, which may in fact be harmful to future generations as it could be more expensive to correct the negative externalities and to find other alternative renewable resources through research and development. In the situation of a country experiencing a slow rate of growth there are various policies available to increase the level of demand, thus aiding economic growth. These policies are called reflationary policies and can include altering the fiscal and/or monetary policy such as a cut in interest rates, cut in taxes or increase the level of government expenditure. However, if demand soars, businesses may not be able to increase production to meet the increase in demand and consequently prices may rise instead of output. This would create inflationary pressures and deflationary policies would have to be implemented, which is quite simply the opposite of the reflationary policies and would be rendered fruitless.

The unemployment rate is very closely related to the rate of economic growth. If an economy is experiencing growth, then more jobs will be generated to meet demand. However, if there is a stunt in growth, then it will have the opposite effect, as firms need to reduce output levels and therefore lay people off. The government need to take careful consideration the level of economic growth if they are to achieve the low rate of unemployment objective. Both economic growth and unemployment tends to behave cyclically, where in periods of economic recessions, there will be high unemployment rates and in periods of economic booms, the rates will be lower.

Grant (2009) explains that that the government can take measures to lower unemployment levels by making work more attractive and making the unemployed more attractive to employers. This can include the January 2012 proposal raising in the threshold of income tax (BBC News, 2012) and keeping a sufficient gap between the level of earnings one can receive by working and the amount received in benefits. The Bank of England has set an inflation target of 2% with a 1% leeway to deliver price stability and low inflation, to help achieve economic stability and provide the right conditions for sustainable growth and unemployment (Bank of England, 2012). Inflation can be caused domestically for example, through the change in pricing strategies of retailers based on the market mechanism.

A rise in VAT rates would also be an example of domestic inflation and a prime example is the recent increase of VAT rates to 20% in the UK, which resulted in an increase in inflation rates from 4% for the next three quarters reaching its highest rate at 5. 2% (ONS, 2011). Inflation can also be caused from external sources including changes in the prices of goods and services in the international economy, for example a rise in price of crude oil prices or other imported commodities. Also the fluctuations in the exchange rate can impact the inflation rate as a depreciation of the pound against other currencies may cause higher import prices and therefore increase general prices.

Generally, there are two main types of inflation, demand-pull and cost-push. To counter the increase in demand-pull inflation, deflationary policies can be put forward and can include increasing taxes, interest rates and reducing government expenditure. Cost-push inflation can be avoided by ensuring there are low unemployment levels and sustainable economic growth. The balance of payments position can be said to be in equilibrium when the flows of money in and out of a country is balanced.

In the case of significant outflows of money, they have to be financed and may lead to borrowing from foreign governments or banks. However, this source of financing is very difficult to sustain at high levels over the long term and therefore government will want to avoid significant balance of payments deficit over the long term due to the large interest rates they yield. There are trade offs between each objective and Arnold (2010, 333) provides a classic example of one called the Phillips Curve where it shows the " relationship between price inflation and unemployment" where " higher the wage inflation means lower unemployment and lower wage inflation means higher unemployment". This theory concludes to policy makers that lowering both wage inflation and unemployment was virtually impossible; therefore they had to choose one or the other.

Another conflict between policy objectives includes sustainable economic growth and balance of payments equilibrium. As an economy grows led by consumer spending, it tends to cause a deficit in the current account because the rise in spending is more favoured towards imported goods rather than domestically produced goods. On the other hand, if economic growth was export lead, then economic growth can be achieved without causing a current account deficit but this is very difficult to achieve. With a budget deficit, policy makers may feel that they need to reduce it, thus tightening fiscal policy by increasing taxes cutting government spending leading to a decrease in aggregate demand and ultimately lower economic growth.

Yet policies in aid to reduce a budget deficit can be counterproductive where policies implemented could reduce tax revenues and spending cuts leading to lower growth and unemployment will result in lower income from tax and more expenses on benefits. All policies are interlinked and it is practically impossible for the government to achieve all the macroeconomic objectives entirely. Globalization can be a talking point amongst many governments, as they perceive it to be a major impact on their economies and is defined " as the increasing interaction among, and integration of, the activities, especially economic activities, of human societies around the world" (Mussa, 2003). The debate in this nature would be whether globalization is in essence an economic, political or a cultural phenomenon. Mellahi et al (2005) explains that we define globalization as a diverse process of the three, which is deepening the integration of the world economy, strengthening the political interdependence between countries and causing values to converge across nations.

Undoubtedly, the rise of globalization has conveyed that economic shocks from one point in the world can quickly spread and become a global problem for example, the recent financial crisis. Domestic policy makers face problems with the interconnectedness of the global economies due to the fact that the source of inflation or unemployment may be a global problem and are uncontrollable. An increase in foreign direct investments i. e. FDI’s, has also accompanied the rise of globalization.

The advantages that it brings to an economy can include increased employment levels, stimulating the domestic economy, freer flow of capital and prevailing obstructions to trade whereas the disadvantages includes the hindering national sovereignty, political instability and MNEs suffering from diseconomies of scale.