



ECO.MAC10 Conflicts and Trade-Offs Between Macroeconomic Objectives

AQA 7136 · Calculators not allowed · about 90 minutes

Total Marks

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Name: _____ Date: ____ / ____ / ____

Answer all questions. Questions 1 to 11 require short answers; the final question (12) is an extended essay requiring full sentences and a supported judgement. A diagram is required in Question 6, state clearly what you draw. Time suggested: 90 minutes.

- 1** Explain the short-run Phillips curve trade-off between inflation and unemployment in the context of an economy experiencing rising aggregate demand.

(Total for Question 1 is 3 marks)

- 2** Explain the monetarist critique that the long-run Phillips curve is vertical at the natural rate of unemployment (NAIRU), in the context of expectations of inflation.

(Total for Question 2 is 3 marks)

- 3** Explain the growth-versus-inflation conflict that can arise when an economy operates above potential output due to demand-side stimulus.

(Total for Question 3 is 3 marks)

- 4** Explain the growth-versus-current-account conflict that arises from 'import-sucked-in' effects when domestic growth strengthens.

(Total for Question 4 is 3 marks)

- 5** Explain the growth-versus-environment conflict that may occur when rapid GDP growth increases pollution and resource depletion.

(Total for Question 5 is 3 marks)

- 6** Diagram: Short-run Phillips curve and supply-side shock. In the space provided draw a short-run Phillips curve (inflation rate on the vertical axis, unemployment rate on the horizontal axis). Mark a point A on the SRPC representing the initial equilibrium with moderate inflation and unemployment. Then show and label a shift of the SRPC caused by a negative supply-side shock (for example a large rise in oil prices). Clearly label axes, the initial SRPC and the shifted SRPC, and mark new point B showing the effect on inflation and unemployment. Explain in words the movement between points A and B and why the curve shifts.

(Total for Question 6 is 6 marks)

- 7** Explain why attempts to reduce unemployment below the natural rate using expansionary monetary policy can, according to monetarists, lead to accelerating inflation rather than a permanently lower unemployment rate.

(Total for Question 7 is 3 marks)

- 8** Explain how a strong recovery in domestic demand that raises GDP might reduce net exports and therefore worsen the current account, explicitly referring to income elasticity or marginal propensity to import in your explanation.

(Total for Question 8 is 4 marks)

- 9** State two policy options a government could use to mitigate the environmental costs of rapid GDP growth while still supporting some growth, and briefly explain how each helps reduce the conflict.

(Total for Question 9 is 2 marks)

- 10** Explain briefly why a short-run policy that stimulates demand to reduce cyclical unemployment might be less effective if the economy is close to its potential output, referring to the shape of the SRAS curve.

(Total for Question 10 is 2 marks)

- 11** State one potential conflict between achieving a balanced current account and pursuing an export-led growth strategy, and explain the reason in one sentence.

(Total for Question 11 is 3 marks)

- 12** Evaluate the view that it is possible for a government to achieve all of its macroeconomic objectives simultaneously, considering objectives such as low inflation, low unemployment, strong economic growth, a balanced current account and environmental sustainability. In your answer include analysis of trade-offs, the role of expectations, supply-side policies, and any relevant time horizons. Use diagrams where helpful and reach a supported judgement.

(Total for Question 12 is 15 marks)

Mark scheme · ECO.MAC10 Conflicts and Trade-Offs Between Macroeconomic Objectives

Question 1

- **M1** identifies that a short-run inverse relationship exists: higher inflation is associated with lower unemployment
- **A1** explains mechanism: rising AD increases demand for labour, reducing unemployment and allowing wages and prices to rise
- **A1** links to short run: firms expand output using existing capacity so unemployment falls but inflation rises
- **Answer: In the short run higher AD reduces unemployment by raising labour demand, which pushes up wages and prices; therefore there is an inverse trade-off where lower unemployment accompanies higher inflation.**

Question 2

- **M1** states that in the long run inflation expectations adjust so there is no trade-off between inflation and unemployment
- **A1** explains that workers and firms incorporate expected inflation into wage and price setting, returning unemployment to the natural rate
- **A1** concludes that the long-run Phillips curve is vertical, so attempts to keep unemployment below NAIRU cause accelerating inflation
- **Answer: As inflation expectations adapt, wages and prices adjust so unemployment returns to the natural rate; therefore the long-run Phillips curve is vertical and there is no permanent inflation-unemployment trade-off.**

Question 3

- **M1** identifies that growth above potential uses spare capacity and increases demand relative to supply
- **A1** explains mechanism: as output approaches capacity firms face rising costs and bid up prices, causing demand-pull inflation
- **A1** links to conflict: policy aimed at higher growth therefore risks higher inflation when near full capacity
- **Answer: When growth pushes output above potential, spare capacity is used up, production costs rise and firms raise prices, so policies that raise short-run growth can generate demand-pull inflation.**

Question 4

- **M1** identifies that stronger growth raises domestic income and spending, including on imports
- **A1** explains mechanism: higher imports reduce net exports, worsening the current account while growth increases GDP
- **A1** links to conflict: a policy boosting growth can therefore worsen the trade balance via import leakage
- **Answer: Higher domestic growth increases incomes and spending on imported goods, reducing net exports and potentially deteriorating the current account, so growth can conflict with external balance.**

Question 5

- **M1** identifies that rapid growth can raise resource use and emissions
- **A1** explains mechanism: higher production and consumption increase pollution, waste and resource depletion unless production becomes cleaner
- **A1** links to conflict: short-run policies to boost growth may therefore damage environmental objectives unless accompanied by regulation or green investment
- **Answer: Rapid GDP growth often increases resource use and emissions; unless growth is green, short-run growth policies can worsen pollution and deplete resources, creating a trade-off with environmental objectives.**

Question 6

- **B1** diagram: correctly labelled axes with 'Inflation rate' vertical and 'Unemployment rate' horizontal
- **B1** diagram: initial SRPC drawn as a downward-sloping curve and labelled SRPC1, with point A on it
- **B1** diagram: shifted SRPC drawn to the right/upwards of SRPC1 (label SRPC2), representing higher inflation at each unemployment rate, with point B on SRPC2 showing higher inflation and higher unemployment
- **M1** explains mechanism for shift in words: a negative supply shock raises costs and reduces aggregate supply, increasing inflation and unemployment simultaneously (stagflation)
- **A1** explains movement from A to B: at the original unemployment rate inflation rises because higher costs raise prices, and unemployment also rises because reduced supply and higher costs lower output and labour demand
- **A1** links the diagram shift to concept: the SR trade-off worsens because the whole SRPC shifts so for any given unemployment rate inflation is higher
- **Answer: Diagram: SRPC downward sloping; SRPC shifts to SRPC2 to show higher inflation at each unemployment rate. Point A on SRPC1 to point B on SRPC2 shows higher unemployment and higher inflation caused by the negative supply shock raising costs and reducing output.**

Question 7

- **M1** identifies that expansionary policy raises AD, temporarily reducing unemployment below the natural rate
- **A1** explains that over time workers and firms expect higher inflation and negotiate higher wages/prices, eroding the real wage effect that reduced unemployment
- **A1** concludes that unemployment returns to the natural rate while inflation continues to rise, producing accelerating inflation if policy persists
- **Answer: Expansionary policy raises AD and temporarily cuts unemployment, but as inflation expectations adjust wages and prices rise, removing the temporary employment gain; unemployment returns to the natural rate while inflation accelerates if policy continues.**

Question 8

- **M1** identifies that higher domestic income increases demand for imports or that imports have a positive income elasticity
- **A1** explains mechanism using MPm or income elasticity: a higher marginal propensity to import means each extra pound of domestic income produces a relatively large increase in import spending
- **M1** relates to net exports: rising imports reduce (X-M), so net exports fall as domestic demand recovers
- **A1** links to current account: the trade balance and current account can deteriorate even while GDP rises because import leakage offsets some of the rise in output
- **Answer: If imports are income elastic or the marginal propensity to import is high, a recovery raises import spending strongly as incomes grow; this raises M and reduces (X-M), so the current account can worsen even as GDP rises.**

Question 9

- **B1** valid policy option one named, e.g. carbon pricing or an emissions tax
- **B1** brief explanation of how it helps, e.g. raises cost of polluting activities so firms and consumers switch to cleaner production/consumption, reducing emissions while allowing growth in low-carbon sectors
- **Answer: Example: implement carbon pricing (emissions tax) which makes polluting activity more expensive and encourages cleaner production; subsidise green investment which shifts growth toward low-carbon industries and reduces environmental damage.**

Question 10

- **M1** identifies that SRAS becomes steeper as output approaches potential, so supply is less responsive
- **A1** explains that increased AD in this region mainly raises prices rather than output, so unemployment falls little while inflation rises
- **Answer: Near potential output SRAS is steep, so demand stimulus mostly increases the price level with little extra output; unemployment therefore falls only a little while inflation rises.**

Question 11

- **M1** states a conflict, e.g. export-led growth can lead to overreliance on external demand and vulnerability to foreign shocks
- **A1** explains consequence: a boom in exports may improve the trade balance but can cause exchange rate appreciation, making other tradable sectors less competitive, or create terms of trade volatility
- **A1** links to balanced current account: rapid export growth can mask deficits in other components (income account, services) or produce cyclical swings that make a balance harder to sustain
- **Answer: Export-led growth can cause exchange rate appreciation and dependence on external demand, which may create volatility and undermine a stable, balanced current account.**

Question 12

- **Level 1** (1-5): Basic statements about possible conflicts or complements between macro objectives are offered with limited development. Answers may show little use of theory, no diagrams, and conclusions are undeveloped or missing.
- **Level 2** (6-10): Clear explanation of at least two trade-offs or interactions, for example between growth and inflation, growth and the current account, or growth and the environment. May include reference to the short-run Phillips curve, expectations and the difference between short-run and long-run policy effects. Some evaluation is present and partial judgement offered.
- **Level 3** (11-15): Comprehensive analysis of multiple trade-offs, including the monetarist critique of a permanent inflation-unemployment trade-off, role of expectations, and how supply-side policies can shift possibilities. Draws on diagrams where appropriate, considers time horizons and distributional issues, weights arguments, and reaches a well-supported and balanced judgement on whether all objectives can be achieved together.
- **Indicative content:**
 - Recognise the existence of genuine trade-offs: e.g. short-run Phillips curve trade-off between inflation and unemployment; demand-led growth can worsen the current account via import leakage; growth can increase pollution unless green measures accompany it.
 - Monetarist critique: in the long run the Phillips curve is vertical, so attempting to keep unemployment permanently below NAIRU leads to accelerating inflation; expectations matter for the persistence of trade-offs.
 - Time horizons: some objectives may be jointly achievable in the short run if spare capacity exists, but conflicts re-emerge as the economy approaches potential; supply-side policies can change the trade-off by shifting LRAS and the LRPC.
 - Role of supply-side policies: investment in infrastructure, education and technology can expand productive capacity, reduce structural unemployment and allow higher growth without inflation, though with long implementation lags and potential financing costs.
 - Policy mix and sequencing: monetary and fiscal policy can stabilise demand in the short run while supply-side reforms aim to improve long-run outcomes; active macroprudential or industrial policies can mitigate exchange rate or current account effects.
 - Constraints and practical limits: political economy, financing requirements, international shocks, and distributional consequences can prevent simultaneous attainment; environmental objectives may require growth to be restructured rather than maximised.
 - Evaluation: consider magnitude and speed of policies, trade-off intensity, whether a government accepts some relaxation of one objective to meet others, and conclude with a balanced judgement on feasibility, likely partial attainment, or need for prioritisation.