

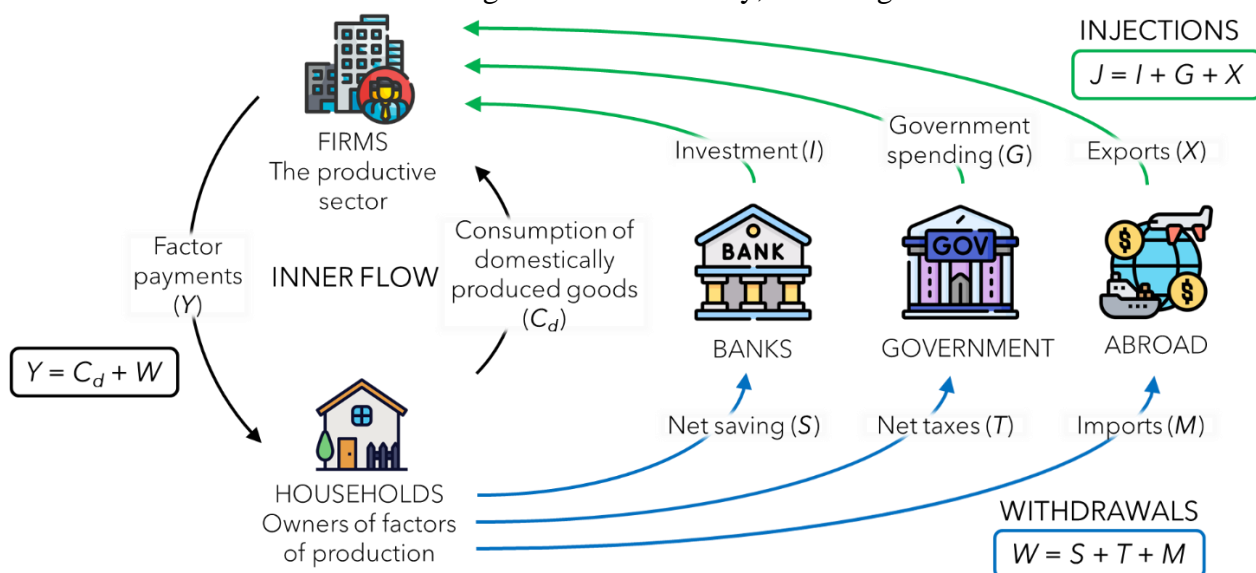
Economics Workshop

Topic 10: Macroeconomic Environment

1. State the four major macroeconomic objectives.
 - High but sustainable rate of economic growth
 - Low level of unemployment
 - Low and stable rate of inflation
 - Favourable (and sustainable) balance of payment position

2. Give examples of macroeconomic policy instrument
 - Fiscal policy (government spending and taxation)
 - **Growth:** increasing government spending, reducing taxes and tax incentives
 - **Unemployment:** relocation incentives, employment subsidies, geographical subsidies
 - **Inflation:** decreasing government spending and increasing taxes (less demand-pull inflation)
 - Monetary policy (money supply and interest rate)
 - **Growth & unemployment:** reducing interest rates
 - **Inflation:** increasing interest rates (discourage spending)
 - Others (competition policy, import controls, exchange rate controls)
 - **Unemployment:** reducing exchange rates to make exports more competitive
 - **Inflation:** deregulation (decrease government power over an industry) will increase long-term competitiveness and costs of business.

3. Draw the circular flow of income diagram of the economy, including all sectors



4. Define the following:
- (a) **Aggregate demand (E)** is the total planned spending on goods and services made within the country. $E = C_d + I + G + X = C_d + J$
 - (b) **Transfer payments** is transferring money without goods or services exchange. Transfer payments are usually excluded in the GDP calculation.
 - (c) **Net savings (S)** is one of the three withdrawals in the circular flow of income. $S = \text{savings} - \text{borrowing} - \text{drawing on past savings}$.
 - (d) **Consumption of domestically produced goods and services (C_d)** is the amount of income households return to firms when they consume domestically produced goods and services.

5. Explain the effect of an increase in injections on the four macroeconomic objectives

Increase in injections will result in firms producing more, encouraging **higher economic growth**. In order to produce more, firms will have to employ more factors of production including workers. This results in a **lower level of unemployment**.

However, a lower level of unemployment implies that households have more spending power (income Y) and thus increasing the aggregate demand. A persistent increase in the level of aggregate demand will cause a **demand-pull inflation**, driving up inflation.

Also, if national income Y increases, **imports will also increase** as households are able to buy more goods from abroad.

6. You are given the following information for an economy:

Consumer expenditure	\$160 m
Investment expenditure	\$40 m
Government expenditure	\$80 m
Exports	\$40 m
Imports	\$60 m
Net income from overseas	\$20 m

What is the total value of this economy's GDP?

Using the expenditure method: $GDP = C + G + I + X - M = 160 + 80 + 40 + 40 - 60 = \260 m

7. Assume that the multiplier has a value of 3. Now assume that the government decides to increase aggregate demand in an attempt to reduce unemployment. It raises government expenditure by \$100 million with no increase in taxes. Firms, anticipating a rise in their sales, increase investment by \$200 million, of which \$50 million consists of purchases of foreign machinery. How much will GDP rise?

$$\Delta E = 100 + 200 - 50 = \$250 \text{ million}$$

$$k = \Delta GDP / \Delta E$$

$$3 = \Delta GDP / 250\text{m}$$

$$\Delta GDP = \$750 \text{ million}$$

8. What are the two main causes of inflation?
- Demand-pull inflation is caused by a persistent increase in the level of aggregate demand, eg lower interest rates
 - Cost-push inflation is caused by a persistent increase in costs independent of the level of aggregate demand, eg increases in wages or raw materials costs.

9. A country has a total population of 100 million, an employed workforce of 80 million, and an unemployed workforce of 5 million. What is the unemployment rate?

$$\text{Unemployment rate} = \text{number of unemployed} / \text{number of labour force} = 5 / (80 + 5) = 5.88\%$$

10. The military stops buying homing pigeons and instead starts sending telegraphs. The resulting unemployment in the pigeon breeding industry is
- **Structural unemployment** where the methods of communication changes
 - **Technological unemployment** where the introduction of labour-saving technology is introduced. In this case, telegraphs are more efficient in terms of reliability and cost savings.