

# Macroeconomic

# policy

EconomicReviewExtras

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In this volume of ECONOMIC REVIEW, Peter Smith discusses aspects of macroeconomic policy. Here the focus is on the main targets of policy at the macroeconomic level

### Aims of macroeconomic policy

- economic growth
- control of inflation
- full employment (low unemployment)
- stability in the balance of payments
- sustainable public finances
- protecting the environment
- ensuring a fair distribution of income

### Economic growth

- A fundamental aim of any government is to improve the standard of living of its citizens.
- Growth is monitored through the annual percentage change in real gross domestic product (GDP) (see Figure 1).
- Many other targets of macroeconomic policy are important because they facilitate economic growth.

### Price stability

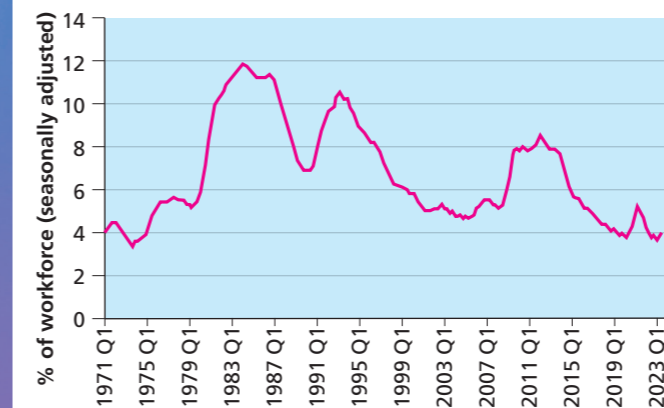
- Price stability has been seen as an important aim for macroeconomic policy in recent decades.
- Price stability helps firms to have good expectations about the course of the economy, so they are more likely to be prepared to undertake investment.
- Investment is a key component that allows economic growth to take place.
- Inflation is measured by the percentage change in the consumer price index.
- The need to control inflation became apparent during the cost-of-living crisis in 2022/23.

### Full employment

- When unemployment is relatively high, this suggests that the economy is not making the best use of its human resources — in other words, it is operating below full employment.
- Unemployment will never be zero, because there will be some people who are unable to work, or who are in the process of changing jobs.
- The ILO measure of unemployment captures the percentage of people in the workforce who are unemployed.
- High unemployment imposes costs on society and on those individuals who are unable to find a job.

### The balance of payments

- The balance of payments accounts identify transactions that take place between UK residents and the rest of the world.
- Commentators on the UK economy often express concern when there is a large deficit on the current account of the balance of payments.
- Under floating exchange rates, equilibrium in the balance of payments overall can be assured by changes in the exchange rate.
- Imbalance between the components of the balance of payments can lead to problems.



Source: Calculated from ONS data

Figure 3 ILO unemployment 1971–2022 (quarterly)

### Public finances

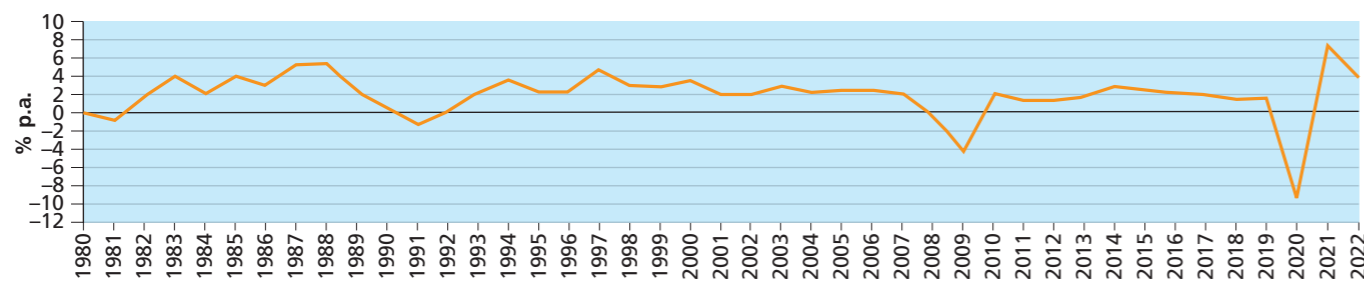
- When government expenditure exceeds its revenue, the government needs to borrow.
- The accumulation of government debt over time is known as the national debt.
- During the cost-of-living crisis that began in 2022, interest rates rose rapidly.
- This raised questions about the sustainability of public sector debt.

### The environment

- Concern for the planet in the face of climate change has brought environmental issues to prominence.
- From a macroeconomic perspective, the question is whether economic growth can be sustainable in environmental terms.
- Economic growth cannot be pursued in total disregard of its environmental consequences.
- One key issue here has been the development and promotion of renewable energy sources.

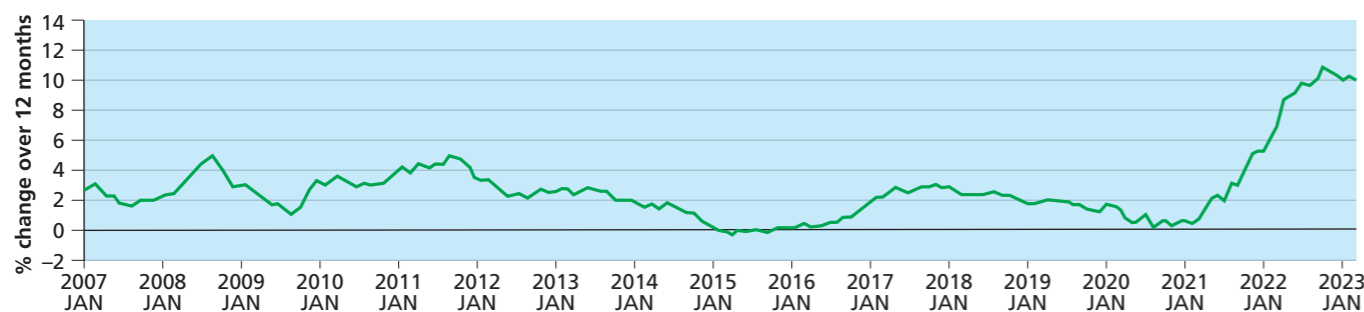
### The distribution of income

- Decisions taken at the macroeconomic level can influence the way in which income is distributed between groups in society.
- Most people would agree that it is important to reach a 'fair' distribution of income.
- UK income tax is a progressive tax that helps to reduce inequality because higher income earners pay a higher rate of tax.
- Transfers in the form of social security benefits also help to protect poorer members of society.



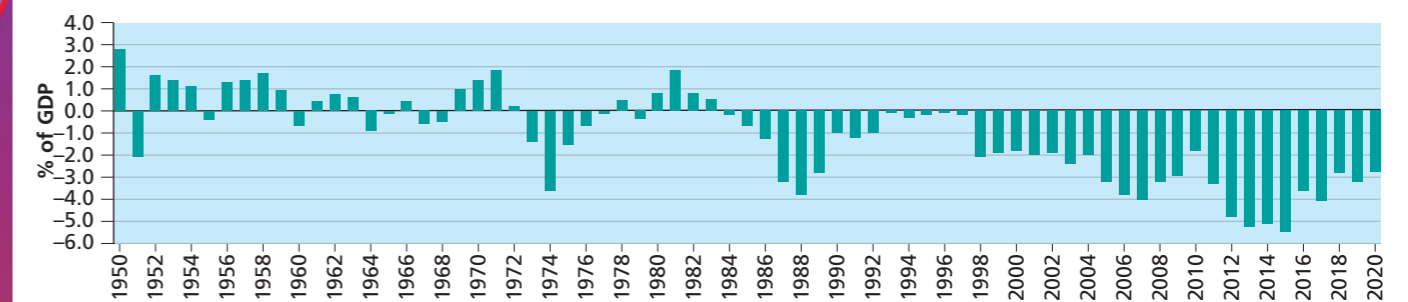
Source: Calculated from ONS data

Figure 1 Growth of real GDP in the UK, 1980–2022 (% change from previous year)



Source: Calculated from ONS data

Figure 2 Inflation in the UK since 2007



Source: Based on data from ONS series AA6H

Figure 4 The current account of the UK balance of payments, 1950–2021

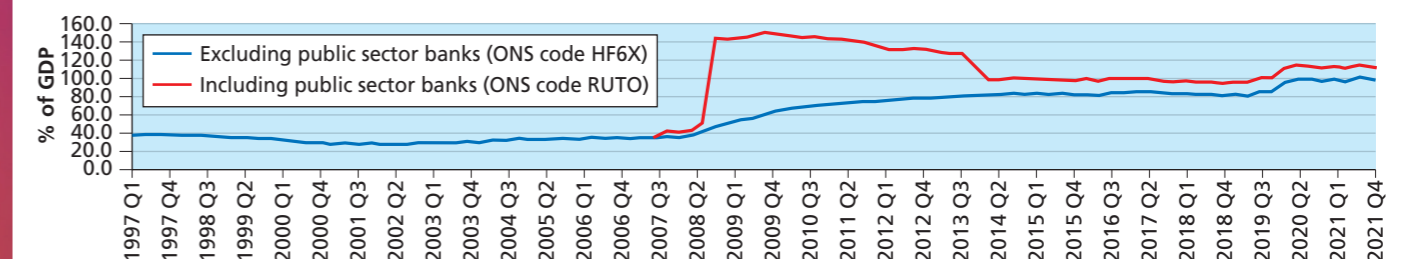


Figure 5 Public sector net debt in the UK, 1997–2021