Conflicting Goals In Economic Growth Essay, Research Paper

Conflicting Goals in Economic Growth

Goals of monetary policy are to “promote maximum employment, inflation

(stabilizing prices), and economic growth.” If economists believe it’s possible

to achieve all the goals at once, the goals are inconsistent. There are

limitations to monetary policy.

The term “maximum employment” means that we should try to hold the

unemployment rate as low as possible without pushing it below what economists

call the natural rate or the full- employment rate. Pushing unemployment below

that level would cause inflation to rise and thereby ruin the other objective–

stable prices, economic growth, which is our objectives in the long run.

Overall financial stability will lead to a better balance between

consumption and saving that will make resources available for investment

purposes, reduce changes in the economy created by the inflation in the past,

and by the reactions of savers, as well as fostering high and sustainable

economic growth; and contribute towards an investor friendly environment that

will attract foreign investors to the country.

Evidence has suggested that economies perform better, in terms of growth,

employment and living standards, in low inflation environments than they do when

inflation is persistently high. This evidence is a comparison across countries

over long periods. The association between economic performance, measured by

growth of output or growth of productivity, and inflation. This indicates a

negative relation; that is, the higher the inflation, the lower the rate of real

growth.

Evidence suggesting that low inflation promotes growth has motivated

recent decisions by a number of central banks and governments, most notably New

Zealand. Canada, the United Kingdom and Sweden also have moved in recent years

to establish monetary policy with official low inflation targets. Decisions to

adopt a policy objective of low inflation suggest that other policy-makers are

reading the evidence pertaining to inflation and growth as we are.

Consistent attempts to expand the economy beyond its potential for

production will result in higher and higher inflation, while ultimately failing

to produce lower average unemployment. Therefore, most economists would argue

that there are no long-term gains from consistently pursuing expansionary

policies.

Monetary policy can determine the economy’s average rate of inflation in

the long run. And that’s important for the economy, because high inflation can

hinder economic growth. For example, when inflation is high, it also tends to

vary a lot, and that makes people uncertain about what inflation will be in the

future. That uncertainty can hinder economic growth in a couple of ways–it adds

an inflation risk premium to long-term interest rates and it complicates the

planning and contracting by business and labor that are so essential to capital

formation. High inflation also hinders economic growth in other ways. For

example, because the tax system isn’t in agreement with inflation, high

inflation arbitrarily helps and hurts different sectors of the economy. In

addition, it makes people spend their time hedging against inflation instead of

pursuing more productive activities.

Because the government can determine the economy’s average rate of

inflation, some commentators–and some members of Congress as well–have

emphasized the need to define the goals of monetary policy in terms of price

stability, which is achievable.

One kind of conflict involves deciding which goal should take precedence

at any point in time. For example, the government needs to be careful to avoid

letting short-run temporary successes in preventing employment losses during

recessions lead to longer-run failures in maintaining low inflation. Another

kind of conflict involves the potential for pressure from the political arena.

For example, in the day-to-day course of governing the country and making

economic policy, politicians may be tempted to put the emphasis on short-run

results rather than on the longer-run health of the economy. The government is

somewhat insulated from such pressure, however, by its independence, which

allows it to achieve a more appropriate balance between short-run and long-run

objectives.

When unemployment is high the policy that should take place is inflation

should increase slightly to drive up prices in order to cause increases in

output. When unemployment is below average and nearing full employment the

policy that should take place is to slightly lower the productivity of the

workers and therefore cause a decrease in the output. This would slow the

economy down and into the ideal condition of maximum employment. When the

production is at its maximum and unemployment at a minimum the government must

raise the inflation rate in order to make sure that the situation stays where it

is. It must be sure not to raise inflation too sharply or else everyone will be

afraid to spend their money.

The belief that a 4% unemployment rate and stable prices are inconsistent

is shaped by the widely accepted “natural rate hypothesis.” It argues that

monetary policy has no effect on the economy’s unemployment rate, which is often

called the natural rate of unemployment. The reason is that, in the long run,

unemployment depends on so-called “real” factors–such as technology and

people’s preferences for saving, risk, and work effort; these factors are beyond

the reach of monetary policy. Most current estimates place the natural rate of

unemployment in the range of 5?6?.

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