

Cambridge IGCSE · Economics 0455 · Notes

The macroeconomic aims of government

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What you need to know

This topic has two syllabus outcomes. In plain words, you should be able to:

1. **The five macroeconomic aims:** name and explain the aims a government has for the whole economy: **economic growth**, **full employment** (low unemployment), **stable prices** (low inflation), **balance of payments stability** and **redistribution of income**. For each one, explain **why** a government chooses it, and the **criteria** (targets) it may set to judge whether it has been achieved.
2. **Conflicts between aims:** explain how working towards one aim can make another harder to reach, especially **full employment versus stable prices**, **economic growth versus balance of payments stability**, and **full employment versus balance of payments stability**.

How the government tries to reach its aims (fiscal, monetary and supply-side policy) and how growth, unemployment and inflation are measured are separate topics. Here you need only enough about them to link a policy to the aim it serves.

Understand it

What a macroeconomic aim is

Microeconomics looks at single markets, firms and households; macroeconomics looks at the **whole economy**. A **macroeconomic aim** (or objective) is an outcome a government wants for the whole economy, such as "prices rising by about 2% a year".

Keep three things apart; multiple-choice questions mix them up on purpose:

- **Aims** are the outcomes: growth, low unemployment, low inflation, a stable balance of payments, a fairer spread of income.
- **Policies (tools)** are what the government does to reach them: changing interest rates, taxes, subsidies, government spending, education and training, a minimum wage. "A sales tax of 10%" or "subsidies to farmers" is a policy, not an aim.

- **Microeconomic goals** belong to firms or single markets: profit maximisation, equilibrium prices in a market, high wages for one group. They are not macroeconomic aims.

Watch for the **opposite** of an aim dressed up as one: deflation, unemployment, income inequality and high government borrowing are problems, not aims.

Aim 1: Economic growth

Economic growth is an increase in a country's **output** of goods and services (its real GDP) over time.

Why governments want it:

- More output means **higher incomes**, so people can buy more goods and services: **living standards rise**.
- Producing more needs more workers, so **unemployment falls**.
- Higher incomes and spending bring in **more tax revenue**, which can pay for schools, hospitals and roads without raising tax rates.
- Growth can help **reduce poverty**, especially if the extra income reaches low-income households.

Criteria: a steady rate of growth each year, for example real GDP rising by **2–3% a year**, that can be kept up (**sustainable**) without causing high inflation or using up resources. Governments want growth that is steady rather than fast and then collapsing.

Aim 2: Full employment (low unemployment)

Unemployment is when people who are willing and able to work cannot find a job. **Full employment** does not mean nobody is unemployed: some people are always between jobs. It means that nearly everyone who wants a job has one.

Why governments want it:

- Unemployed workers are **wasted resources**: the economy produces less than it could, so output and growth are lower.
- Unemployed people have **lower incomes**, so living standards fall and **poverty** rises; it can also lead to stress, ill health and crime.
- The government collects **less tax** (income tax and spending taxes) and must pay **more in unemployment benefits**. Spending on benefits has an opportunity cost: that money could have gone on education or health. So **lower unemployment improves the government's budget**, and full employment is the aim most likely to move a budget towards surplus.
- People out of work for a long time **lose skills** and fall behind new technology, which makes them harder to employ.

Careful: lower unemployment raises **output** (production), not necessarily **productivity** (output per worker). If the extra workers are less skilled, productivity may even fall.

Criteria: a low unemployment rate, for example **below 4–5%** of the labour force.

Aim 3: Stable prices (low inflation)

Inflation is a sustained rise in the general price level. **Stable prices** means prices rising slowly and steadily, not that they never change.

Why governments want it:

- **Confidence and planning.** When prices are predictable, consumers buy with confidence and firms can plan ahead. Firms are more willing to **invest**, and **multinational companies** are more willing to set up in the country, which brings jobs and growth.
- **International competitiveness.** If a country's prices rise faster than other countries', its **exports become dearer** and its **imports cheaper** by comparison. Exports fall and imports rise, harming the **current account** of the balance of payments.
- **Fairness.** Inflation redistributes income in a random way: **savers and lenders lose** (their money buys less), **borrowers gain**, and people on fixed incomes see their purchasing power fall.
- **Costs of changing prices.** Firms must keep reprinting price lists and menus (**menu costs**), and consumers spend time shopping around for the lowest price (**shoe-leather costs**).
- **Avoiding deflation.** A falling price level is also harmful: people **delay buying** because goods will be cheaper later, so demand falls, firms cut output and jobs, and the economy can slide into **recession**.

A stable inflation rate also makes workers less likely to demand big pay rises, which keeps firms' costs down.

Criteria: an **inflation target**, often **2%** a year, sometimes with a range such as "between 1% and 3%". Many central banks are given this target and set interest rates to meet it.

Aim 4: Balance of payments stability

The **balance of payments** records a country's money flows with the rest of the world. The part that matters most here is the **current account**: mainly the value of exports minus the value of imports of goods and services.

Why governments want stability:

- A **large, lasting current account deficit** means the country spends more abroad than it earns. It must be paid for by borrowing from abroad or using up reserves of foreign currency, which cannot go on for ever. It can also mean firms in the country are losing sales to foreign firms, so jobs are lost in export industries and in firms competing with imports, and it can push the **exchange rate down**, making imports (including raw materials) dearer.
- A **large, lasting surplus** is not ideal either: the country's people are consuming less than they produce, and other countries may complain or put up trade barriers.

Criteria: a current account that is roughly **in balance over time**, for example a deficit or surplus no bigger than about **3% of GDP**, rather than a large deficit year after year.

Aim 5: Redistribution of income

Income is spread unequally: a few people earn a lot and many earn little. **Redistribution of income** means making the spread **more equal**, mainly by taking a larger share of tax from the rich and using it to help people on low incomes (benefits, free education and health care, a minimum wage).

Why governments want it:

- To **reduce poverty**, so that everyone can afford basic necessities such as food, shelter and health care.
- **Fairness** and social stability: very large gaps between rich and poor can cause resentment and crime.
- Low-income households spend most of any extra income, so giving them more **raises total spending**, which supports firms and jobs.
- Better education and health for poorer families make them more productive workers in future.

Criteria: a fall in the **gap** between the richest and poorest groups, or a fall in the **share of people living in poverty**, for example "cut the share of people in poverty from 18% to 15% by 2030".

Judging an economy against its targets

A government checks each aim against its criterion. Here is a made-up country, Country T, with GDP of \$250bn:

Aim	Criterion (target)	This year	Target met?
Economic growth	real GDP up 2–3% a year	2.6%	Yes
Full employment	unemployment below 5%	3.8%	Yes
Stable prices	inflation 2%, within 1–3%	5.6%	No: 2.6 points above the top of the range
Balance of payments stability	current account deficit no more than 3% of GDP	deficit of 4.2% of GDP (\$10.5bn)	No: 1.2 points too big
Redistribution of income	people in poverty down from 18% to 15%	16%	Not yet: 2 of the 3 points achieved

Notice the pattern: the aims about **jobs and output** are being met, while the aims about **prices** and the **balance of payments** are not. That is no accident, as the next section shows.

Why aims can conflict

Several aims pull in the same direction when **total demand** (spending in the whole economy) rises: firms sell more, produce more and hire more workers, so **growth rises and unemployment falls**. But the same extra spending pushes up **prices** and pulls in more **imports**. So a government often cannot meet every aim at once and has to choose which matters most at the time.

Full employment versus stable prices

- To cut unemployment, a government raises total demand (for example by cutting interest rates or taxes, or spending more). Households and firms spend more.
- Firms find it hard to raise output fast enough, especially when the economy is **close to full capacity**, so the extra demand pulls prices up: **demand-pull inflation**.
- As unemployment falls, workers become scarce. Firms compete for them with **higher wages**, and trade unions can bargain harder. Wages are a big part of firms' costs, so firms raise prices: **cost-push inflation**.
- It works the other way too: to bring inflation down, the government cuts total demand, so firms sell less and **unemployment rises**.

Economic growth versus balance of payments stability

- Growth raises **incomes and employment**, so people spend more, and some of that spending goes on **imports**.
- Firms may sell more of their output in the booming **home market** and **export less**.
- To produce more, firms need more **imported raw materials and machinery** (capital goods).
- Fast growth can cause **inflation**, which makes the country's **exports less price competitive** and imports relatively cheaper.
- All of these push the current account towards a **deficit** (or shrink a surplus). And to cut a deficit, a government may reduce spending in the economy, which **slows growth**.

Full employment versus balance of payments stability

- More people in work means **higher incomes**, so spending rises, including spending on **imports**.
- If low unemployment pushes **wages** up, firms' costs rise, their prices rise, and **exports become less competitive**.
- Both worsen the current account.

Other conflicts you can use:

- **Growth versus stable prices**: fast growth in total demand can cause demand-pull inflation.
- **Growth versus redistribution**: in a boom, profits and high earners' incomes may rise faster than wages, and cheaper borrowing helps borrowers while savers get lower returns, so inequality can widen.

Aims that usually do not conflict:

- **Growth and full employment** normally go together: more output needs more workers.
- **Redistribution and full employment**: giving low-income households more to spend raises demand and so supports jobs. This pair is **not** one of the usual conflicts.
- **Stable prices and balance of payments stability**: low inflation keeps exports competitive, which helps the current account.

Conflicts can be eased

Conflicts are not certain. Inflation is less likely when the economy has **spare capacity** (many unemployed workers and idle machines), because output can rise without prices rising, and when long-term unemployed workers are willing to take jobs without a pay rise. Policies that raise the economy's **productive capacity**, such as education, training and better infrastructure, can raise output and jobs while also **lowering firms' costs**, so growth and employment rise with less inflation and more competitive exports.

Key facts and formulas

This topic has no formulas. "Learn it" means you must remember it.

Fact	Status
The five aims: economic growth, full employment/low unemployment, stable prices/low inflation, balance of payments stability, redistribution of income	Learn it
Aims are outcomes; interest rates, taxes, subsidies and government spending are policies (tools), not aims	Learn it
Typical criteria: growth of 2–3% a year; unemployment below about 5%; inflation target of about 2%; current account deficit or surplus within about 3% of GDP; a smaller gap between rich and poor or less poverty	Learn it
Full employment → more tax revenue and less benefit spending → better government budget	Learn it
Stable prices → confidence and investment, competitive exports, no random redistribution, no menu or shoe-leather costs, no deflation spiral	Learn it
Higher total demand → growth ↑, unemployment ↓, but inflation ↑ and imports ↑	Learn it
Main conflicts: full employment v stable prices; growth v balance of payments stability; full employment v balance of payments stability	Learn it
Usually not a conflict: redistribution and full employment; growth and full employment	Learn it

How to do it

We have tagged 27 questions on this topic (2021–2025): 16 multiple choice on Paper 1 and 11 structured questions on Paper 2. One multiple-choice question was set twice, so 26 are different. Each structured question has one part about this topic, so there are 27 question parts in all. They came up this often.

Question type	Question parts
Multiple choice (concept)	16

Question type	Question parts
Analyse (4 or 6 marks)	7
Discuss (6 or 8 marks)	4

1. Multiple choice (concept) (16 question parts)

1. **Decide what the question asks for:** an aim, a reason for an aim, a conflict, or which aim a policy serves.
2. **Sort each option:** is it an outcome for the whole economy (an aim), a policy or tool, a goal of a firm or single market, or the opposite of an aim?
3. **For a conflict or a side effect, trace the chain:** what happens to total demand, then to prices, wages, imports, tax revenue and benefits.

Variations you will meet:

- **Recognise which targets are macroeconomic aims** (7 parts). The answer is one of the five aims, sometimes two together: growth together with keeping inflation low, low unemployment, steady low inflation alongside a stable balance of payments, or a stated inflation target (a target is a criterion for an aim, so it counts). Traps: subsidies to farmers, a sales tax, raising interest rates, a minimum number of years of schooling, raising productivity in the public sector (all policies); profit maximisation, equilibrium prices, high wages, low wages (micro goals); deflation, income inequality, unemployment, high government borrowing, high external costs (problems, not aims). In a "which is **not** an aim" question, pick the problem.
- **Conflicts between aims** (5 parts). Why does full employment conflict with stable prices? It leads to **higher wages** (and higher demand). Why might measures to cut unemployment raise inflation? They **increase demand**. Retraining the unemployed has an adverse effect on another aim when higher earnings lead to **demand-pull inflation**; options about higher productivity, lower benefit spending or a more stable balance of payments are benefits, not adverse effects. Which pair is **not** likely to conflict? **Redistribution of income and full employment**.
- **Match a policy or outcome to the aim it serves** (3 parts). A central bank cutting interest rates in a recession is aiming at **economic growth**; a central bank setting its interest rate to limit price rises is aiming at **low inflation**. Achieving **full employment** is most likely to increase a budget surplus (more tax, fewer benefits).
- **Why a government chooses an aim** (1 part). The most likely reason for aiming at price stability is to **improve international competitiveness**. Raising wage demands, cutting consumer spending or cutting benefit spending are not reasons for price stability.

2. Analyse (4 or 6 marks) (7 question parts)

Points-marked: **a mark for each link** in a chain of reasoning, so write **three developed chains** for 6 marks (two for 4 marks), each ending at the aim or conflict in the question. A list of points without the links earns little.

Variations you will meet:

- **How two aims conflict** (3 parts). Start by naming the conflict (1), then build the chain from "Why aims can conflict" in Understand it. For **growth versus the balance of payments**: growth raises employment and incomes (1) → people buy more, including imports (1) → firms switch sales to the home market and export less (1) → the current account moves into deficit (1); firms also import more raw materials and capital goods (1); growth can cause inflation (1) which makes exports less price competitive (1). When the question starts from a **policy** (for example "how a cut in interest rates might create conflicts"), use **at least two** conflicts, because one conflict alone was capped at 4 of 6 marks: cheaper borrowing → more spending → demand-pull inflation (employment v stable prices); more spending on imports → current account deficit (growth v balance of payments); more investment and jobs → higher wages → more imports (employment v balance of payments).
- **Why a government aims for stable prices or lower unemployment** (2 parts). Use the "Why governments want it" chains in Understand it. You may write from the other direction ("inflation harms because...", "unemployment harms because..."); mark schemes accept it. A good first point is that the problem may **currently be high**, then the chains: wasted resources → lower output; lower incomes → poverty; less tax and more benefits → opportunity cost for the budget; skills lost.
- **How a policy or project helps the government achieve its aims** (2 parts, for example building roads, or developing a new industry). Go **aim by aim**, one chain each:
 - **Employment**: the project creates jobs (building it, running it, suppliers) → incomes rise → spending rises → more jobs in other firms.
 - **Growth**: better infrastructure or a new industry lowers firms' costs (cheaper, faster transport) → more investment, including by multinational companies → more output.
 - **Balance of payments**: lower costs make exports more competitive, or the new industry sells to foreign visitors and customers → more export revenue → smaller current account deficit.
 - **Stable prices**: lower costs of production reduce cost-push inflation.
 - **Redistribution**: easier access to jobs for people in poorer areas → less poverty.

Use figures from the question's source (jobs created, share of GDP) where they are given.

3. Discuss (6 or 8 marks) (4 question parts)

The 8-mark Section B parts are **levels-marked**: Level 3 (6–8) needs **both sides developed** and a judgement. The 6-mark Section A parts give **up to 4 marks a side**, and simply reversing a point from the other side earns nothing.

Plan:

1. **Name the aims** you will use, in one line (examiners rewarded answers that used the aims as their structure).
2. **Why it might help**: two or three developed chains, each ending at a named aim.
3. **Why it might not**: two or three **new** chains, not the first side reversed. The usual ones: extra demand causes **inflation**; more **imports** worsen the current account; **opportunity cost** of the government's spending; **time lags**; the benefits may not reach the poor.

4. **Judgement:** what the answer depends on (spare capacity in the economy, how long it takes, whether other countries react, what else the money could be spent on).

Variations you will meet:

- **Will a policy or event help the government achieve its aims?** (3 parts: improving education, more exports of "green" products, a subsidy on exports).
 - **Improving education** helps: a more skilled, productive workforce attracts investment → growth; skills make it easier to find work → less unemployment; higher productivity lowers average costs → more stable prices and more competitive exports → balance of payments; everyone gets the chance of a better-paid job → more equal income. It might not: the extra government spending raises total demand → inflation; skilled workers may **emigrate** → lost growth; there may not be enough graduate jobs → graduate unemployment; if only the rich can get the better education, inequality rises; better-educated workers may demand higher wages → higher costs → less competitive exports; the benefits take years to arrive.
 - **More exports** (or an **export subsidy**) help: higher export revenue → current account improves; more output → growth; more workers needed → less unemployment. They might not: higher total demand → demand-pull inflation; firms outside the growing industry may lose sales and cut jobs; other countries may **retaliate**, so exports do not rise; demand for the product may be price-inelastic, so a subsidy barely raises sales; the subsidy has an opportunity cost.
- **Can a government reduce unemployment without increasing inflation?** (1 part). Yes: if there is **spare capacity**, output can rise without prices rising; long-term unemployed workers may take jobs without a pay rise; education and training raise productivity and lower costs, so supply rises with demand; subsidies can lower firms' costs as they hire. No: raising demand near full capacity causes **demand-pull inflation**; scarce workers push **wages** up → **cost-push inflation**; tax cuts may not raise spending if confidence is low. Judgement: it depends on how close the economy is to full capacity and whether the policy raises supply as well as demand.

Worked examples

Example 1

Analyse how the macroeconomic aims of full employment and stable prices may conflict. [6]

To reduce unemployment, a government may increase total demand, for example by cutting taxes (1). Households have more to spend, so spending on goods and services rises (1). If firms cannot increase output quickly enough, especially when the economy is near full capacity, the extra demand pulls up prices, causing demand-pull inflation (1).

As unemployment falls, there are fewer workers available, so firms compete for them by offering higher wages (1). Wages are a large part of firms' costs, so their costs of production rise (1) and firms pass these on as higher prices, causing cost-push inflation (1).

The conflict also runs the other way: to bring inflation down, the government may reduce total demand, so firms sell less and cut jobs, and unemployment rises (1). (Any 6.)

Example 2

The government of Country R is building a new airport. It expects the airport to create 12 000 jobs and to double the number of foreign tourists visiting each year. Analyse how the new airport could help the government achieve its macroeconomic aims. [6]

Building and running the airport needs workers, such as construction workers, pilots and shop staff (1), creating about 12 000 jobs and reducing unemployment (1). These workers earn incomes and spend them in local shops, raising total demand and creating more jobs in other firms (1).

With twice as many tourists, spending by foreign visitors counts as exports of services (1), so export revenue rises and the current account of the balance of payments improves (1).

Faster, cheaper air transport lowers the costs of firms that send goods and staff abroad (1), which may attract investment by multinational companies (1), raising output and so economic growth (1). (Any 6.)

Example 3

Discuss whether or not a government can achieve all of its macroeconomic aims at the same time. [8]

A government's macroeconomic aims are economic growth, full employment, stable prices, balance of payments stability and a more equal distribution of income.

Why it might. Several aims support each other. When output grows, firms need more workers, so growth and full employment are achieved together; more people in work also means less poverty, which helps redistribute income. With low unemployment the government collects more tax and pays out less in benefits, so it can afford more spending on education for poorer families (developed point for).

Low and stable inflation keeps the country's exports price competitive, so it helps the current account at the same time as it gives firms the confidence to invest and grow. And if the government raises the economy's productive capacity through training and better infrastructure, firms' costs fall, so output and jobs can rise without prices rising (developed point for).

Why it might not. Growth and full employment usually come from higher total demand. Near full capacity, extra spending pulls prices up, and scarce workers win higher wages that push firms' costs and prices up, so stable prices are harder to keep (developed point against).

Higher incomes also mean more spending on imports, and inflation makes exports less competitive, so a fast-growing economy with low unemployment often has a growing current account deficit. To cut the deficit or the inflation, the government would have to reduce demand, which slows growth and raises unemployment (developed point against).

Judgement. It depends on the state of the economy. With lots of spare capacity, a government can raise growth and employment for a time without much inflation or a large deficit, especially if its policies also raise productivity. Near full capacity, the aims conflict, so the government has to decide which aim matters most at the time. Both sides are developed and the judgement says what the answer depends on, so this meets the Level 3 descriptor (6–8 marks).

Common mistakes

- **Naming a policy as an aim.** "Raising interest rates" or "subsidies" are ways to reach aims, not aims. Examiners also saw answers giving "increased total demand" or "high population growth" as aims.
- **Being too vague.** "Unemployment" or "inflation" on its own is a problem, not an aim: write "**low** unemployment" or "**stable prices / low** inflation".
- **Giving more than asked.** When a question asks for two aims that may conflict, give **one pair**; examiners saw candidates listing four aims or two pairs, wasting time.
- **Writing about the topic in general instead of the aims.** In "will green exports help the government achieve its aims?", answers about the pros and cons of going green scored poorly. Name each aim and link the change to it.
- **Stopping before the aim.** "A subsidy lets firms export more and earn more profit" never reaches an aim. Carry the chain on: more exports → higher export revenue → smaller current account deficit.
- **Confusing productivity with production.** Lower unemployment raises **output**; it does not automatically raise output per worker.
- **One conflict when the question needs more.** "Analyse how a cut in interest rates might create conflicts" (plural) was capped at 4 of 6 marks for one conflict.
- **Going off track with interest rates.** Some candidates argued that the government loses interest income when rates are cut. Stick to what the change does to spending, prices and imports.
- **Writing one side only in a Discuss question.** Level 3 needs both sides developed and a judgement.

How to get the marks

- **Identify** (2 marks): two aims, stated precisely ("low inflation", "balance of payments stability").
- **Analyse** (4 or 6 marks): each link in a chain earns a mark. Name the aim or conflict first, then write two (4 marks) or three (6 marks) chains that end at an aim. A list of unlinked points is capped.
- **Discuss** (6 or 8 marks): name the aims, give developed points on both sides, then a judgement that says **what it depends on**. In Section A (6 marks) up to 4 marks a side, so do both sides; in Section B (8 marks) Level 3 needs both sides developed.
- **Use the source.** In Section A and in the question's stem, use the figures given (jobs created, share of GDP, the inflation rate) to support a chain.
- **Use the five aims as a checklist** for any "achieve its macroeconomic aims" question: growth, employment, inflation, balance of payments, income distribution.

- **Multiple choice:** 1 mark each, no penalty for guessing. Sort options into aim, policy, micro goal or problem before choosing.

Quick check

1. Which is a macroeconomic aim of a government?
 - **A** a subsidy on public transport
 - **B** maximising the profits of state-owned firms
 - **C** a fall in the share of people living in poverty
 - **D** higher interest rates
2. Why might a fast rise in economic growth cause a deficit on the current account of the balance of payments?
 - **A** higher incomes increase spending on imports
 - **B** higher output reduces the tax revenue of the government
 - **C** higher employment reduces spending on benefits
 - **D** higher output lowers the prices of exports
3. A government's target is inflation of 2%, plus or minus 1 percentage point. Inflation in three years was 1.6%, 3.4% and 2.9%. In which years was the target met?
 - **A** year 1 only
 - **B** years 1 and 3
 - **C** years 2 and 3
 - **D** all three years
4. Which pair of aims is least likely to conflict?
 - **A** full employment and stable prices
 - **B** economic growth and balance of payments stability
 - **C** full employment and balance of payments stability
 - **D** economic growth and full employment
5. Explain two reasons why a government may aim for low unemployment. **[4]**

Answers

1. **C.** Reducing poverty is part of the aim of redistributing income. A and D are policies; B is a firm's goal. (1)
2. **A.** More income means more spending, and some of it goes on imports, so imports rise faster than exports. (1)
3. **B.** The target range is 1% to 3%: 1.6% and 2.9% are inside it, but 3.4% is 0.4 points above the top. (1)
4. **D.** More output needs more workers, so growth and full employment usually rise together. A, B and C are the three main conflicts. (1)
5. Unemployed workers are wasted resources (1), so the economy produces less than it could and growth is lower (1). Unemployment means the government collects less tax and pays more in benefits (1), money that could have been spent on education or health (1). (Also: lower incomes cause poverty and lower living standards; long-term unemployed workers lose skills.)

Past questions to try

- 0455/21/O/N/22 Q3: part (c), conflicts created by a cut in interest rates.
- 0455/22/M/J/22 Q2: part (c), why a government may make lower unemployment its main aim.
- 0455/22/F/M/23 Q3: part (d), whether an export subsidy helps a government achieve its aims.
- 0455/12/F/M/22 Q16: which pair of aims is not likely to conflict.