Economic principles & Microeconomics indices

Name:

Affiliation:

In this paper I will evaluate an article relating to the rise in the unemployment rates in the US. In tackling the paper, I will look into major economic principles highlighted and some of the macroeconomics indices, their relevance and how they affect each other. Despite the fact that the study of economics may have different approaches, the field is brought together by several central ideas commonly referred to as the ten principles of economics. These principles give a general overview of what economics is all about (Darby, M. R. 1976). A general overview on the paper shows the tradeoff between the unemployment rate and inflation in the US compared to Europe. Unemployment rates in the US had rose from 4.9% to 5.0% after a long term period of stagnation. The writer, in his article, takes this rise as good news in that the rise in unemployment rate indicates that the long term unemployed people who find it hard to get an opportunity to get a job are being motivated to join the work force. In the end of this paper I will have looked at the economic principles, as defined by Gregory Mankiw, that are related to the general rise of unemployment in the US and some of the economic indices mentioned. It will aid in having a better understanding of the economic terms, their significance and the effects on unemployment.

 One of the economic principles is that the government can sometimes improve market outcome. The main reason for government involvement in the economy is to ensure there is equity and efficiency in the resource allocation. Sometimes, a market, say labor or good markets may be faced by a crisis or failure and the government has to intervene so as change the situation (Marshall, A.1920). Mostly, the government is there to ensure there in stability, equity and efficiency in the market. There are calls by Krugman and the like for the Federal Reserve not to increase the interest rates in response to the increase in the rise in the employment level. The Federal Reserve opted to raise the interest rates due to the pre - assumed increase in the wage level. The increased interest rates will enable the government to cater for the increased wage. However, in response to this increase, the firms will reduce the workers and in turn reduce the overall employment levels (Marshall, A. 1920)

Secondly, the society faces a short run tradeoff between inflation and unemployment. Most the time, economists have the conviction that the short run effect of increasing the money supply by the government is to lower the rates of unemployment and lower prices that have been generally high in the country. However, this is opposite to the real issue at hand. Increased money supply leads to increased spending and thus increased demand for goods and services in the market. The increased demand for goods and services may at some time lead to increased prices of goods since the firms cannot meet the excess demand. However, the increased demand may motivate the firms to increase production and in turn hiring more employees thereby reducing the unemployment rate in the country. Increase in money supply, though have a positive effect on unemployment rates leads to inflation. Moreover, reducing inflation likely leads to a temporary increase in unemployment. The existence of this relationship between increased money supply and unemployment rates has however been questioned by some economists. Does this relationship ever exist? This trade- off between inflation and unemployment has been a key element in evaluation of the fluctuation in the economic activities of a country. It aid in understanding the short run effects of changes in monetary policy, government spending and taxes. In March the employment rate had strongly increased indicating the economic resilience of the country. However, the increase in employment rate may lead to an increase in the influx of American labors thus increasing the wage proportion. This in turn, makes the Federal Reserve cautious in case there is any further increase in the interest rate. The trade-off between unemployment and inflation is evident in that, due to the increased level of employment, interest rates may rise thus leading to inflation. Unemployment levels the country rising from 4.9% to 5% shows that there is an increase in the level of the jobless people entering the labor market, indicating confidence in the labor market (Mankiw, N. G. 1998)

The people response to incentive is another economic principle that is clearly manifested in the article. Most of the consumers of the labor and goods market are rational beings and aims at maximum utility from an activity. If there is any change in the utility obtained from a commodity a consumer will be quick to change behavior of consumption. Their decision will be based purely on the benefits i.e. incentive accrued from the activity. The confidence by the workers in the labor market is an incentive to them. They will flood in the market thus supply exceeds the demand. This in turn leads to the increased level of unemployment. (Mankiw, N. G. 1998)

Finally, the standard of living depends on a country’s production. There exists a huge difference in the standard of living from one country to another. These differences lie squarely on the productivity ability of a country. If a country’s capacity to produce goods and services in relation to time worked is low, then the standard of living will be as well low. In order to change the living standard of the people, the productivity system has as well to be changed, though this may take up all of time to achieve. The government, therefore, must clearly understand the policies to implement so as to raise the standard of living of its citizens. This can possible by ensuring that all the work force is well skilled and educated, there are all tools necessary for production and the best technology is available and easily accessible. Due to the prolonged level of unemployment of 4.9% in the economy in the US, it is assumed that the living standard of people in Europe is better off compared to that of citizens in the US. However, in the real sense the level of unemployment in both regions is relatively the same in the short run. Macroeconomics indices are statistics that show the prevailing status of the economy of a state in reference to a particular area of the economy, say labor market, trade or industry. The government is responsible for publishing it to the public. The consumer price index (CPI) is the most used indicator of inflation in an economy. It shows the changes in the level of the general prices of a basket of consumer goods. Different sub-indexes are calculated for different categories of goods and summed up for all to compute the overall CPI. A CPI can be used to index for regulating prices, the real value of wages, pension, or salaries. Inflation, being the general rise in price of goods is tied directly on the purchasing ability of a currency in the home country and the international market. An increase in the general price of goods in a basket of goods has an adverse effect on the interest levels if the economy develops in typical setting. In most countries, CPI computations are closely watched by the economic statistician to compare economic performance between countries. The Labor department in the US stated that the nonfarm payrolls rose by 215,000 the previous month whereas the unemployment rate hit the 5.0% mark. The payrolls were measured using the CPI. The increase in CPI indicates an increase in the general price of goods in the economy thus increased inflation. However the increase will not last for a long enough since the government would respond to the inflation increase.

Gross Domestic Product (GDP), on the other hand is the widest measure of a country’s economy as it shows the total market value of all goods and services that have been produced in a country for a specified time, a year. Nominal GDP is used mainly to estimate the economic performance and compare with other countries performance. To calculate “real” GDP, the nominal value must be adjusted to take into account price changes. This is in order to enable us to know if the value of output has gone up or it’s the general price increase. In an expansive language, an increase in real GDP is would be a signal that the economy is performing well. However, it would be in accurate to compare the welfare of citizens and inflation rates for different countries using GDP. GDP is determined using any of the three ways; income, output or expenditure approach. All the three methods give almost the same value. The output approach commonly referred to as production or value added approach, gives the summation of all the outputs in all levels of the business. It sums the value- added at each stage of production. For instance, the services of a lawyer would be intermediate input and buying land is the end product. The expenditure approach assumes that all products produced must be at one day bought by someone; hence the value of acquiring the good is the actual value of expenditure spent by the individual. It adds up the value of purchases made. The income approach on the other hand assumes that people income must be equal to the value of their total expenditure. GDP is therefore determined by summing all the producers’ income. As real GDP grows, employment may increase since firms have the ability to hire more workers and people have more income. However, if the GDP is declining, employment level falls as evident in many countries in the latest worldwide economic crisis. When comparing two countries using the GDP, it is advisable to convert the value of the GDP into the US dollars and then compare them. In conversion, the purchasing power of the currency is mostly used. It is vital to understand that the GDP cannot and have never indicated the standard of living of individuals in a country. The quality of life will highly depend on the distribution of the GDP among the citizens of a country. The main components of US GDP are government spending, consumption, inventories, net export and inventories. The individual consumption makes two thirds of the country’s GDP. Historically, the US and unemployment rates have been so different. The long term unemployment in Europe is the main difference from US. Layard points out that once the long term unemployment takes root in the country it would be hard to indeed eradicate it. The comparison of the unemployment rates between the two regions is calculated based on the region’s GDP.

Employment indicator is another index that shows the overall state of the economy and its fluctuations. These indicators shows the economic drivers regarding to employment. Unemployment rates in the US had increased to 5%, thus indicating that the number of unemployed people who are seeking for jobs had raised. This measure is commonly referred to as U- 3 by the US Bureau of Labor Statistics. Other measure of the employment indicator is the number of the people who are not utilizing their full potential in term of time spent as they would have liked and as well the workers who have been discouraged from searching jobs. It is essential to know how many jobs are being created and as well being destroyed. This index shows the percentage of work force that is actively working and as well the level of unemployment in a country. To compute inflation, it is important to look at the employment indicator so as to show the rate at which jobs are being created. The U3 unemployment number as seen by Tom Worstall in the article, looks quite good since its at that point that inflation is expected to start rising again. Those in U6 measure do not get unemployment insurance and others are discouraged from going back to employment. Therefore, the call by fed not to raise interest rates is essential in aiding to see whether any shortage of workers in U3 measure would attract more to go back into the work force. On the other hand, employers opt to consider taking those who have been out of employment for a less period compared to the long term unemployed people. The long term unemployed do not only find it hard to apply a job but also getting hired. (Darby, M. 1976).

Government fiscal and monetary policy constitute of another major economic index that is covered in the article. The state is responsible for the stabilization of the economy. Some of the major activities by the government in stabilization of the economy may include full employment, an equitable balance of payment and control of inflation. The goal of the government is to achieve all these by manipulation of monetary and fiscal policies. In trying to achieve full employment, the government may opt to increase the amount of real money balances. However, in achieving this, inflation level will rise. It is therefore the government’s mandate to ensure there is stability in the economy in reference to the unemployment and inflation levels (Truman, E. M. 2003). The Federal Reserve in an attempt to ensure stability in the labor market opted to increase the prevailing interest rates so as to lower employment levels. The policy of Fed to delay interest rate for the time being and watch the behavior of the labor market would help the economy in achieving stability of the economy. This is due to the low interest rates and the increase expansion. This will discourage workers in long term unemployment from coming back to work force (Darby, M. R. 1976). The government however should ensure that this state of affairs does not exist for long so as not to cause instability in the economy. (Frank, R. H., & Bernanke, B.2004).

As CPI increases, the market basket cost level has increased and so has the consumer spending. The increase in consumer spending increases the GDP level. This however, does not necessarily indicate that increase in CPI leads to an increase in GDP. CPI can either under or overestimate the cost of living. As the price levels increases, firms are motivated to employ more workers to take advantage of the prevailing condition (Darby, M. R. 1976). This in turn will lead to a reduction in the unemployment level. However, the general increase in prices of commodity leads to an increase in the level of inflation. The government, in turn, comes in to save the instability in the economy. It may manipulate the fiscal and monetary policies to ensure there is stability. (Taylor, J. B.1999). In the article, the general payroll of the nonfarm increased by 215,000, an increase in CPI and the Federal Reserve opted raising the interest rates as a monetary policy by the government. With the continuous increase in the influx of American workers in the labor market, there is a possibility of increased unemployment level.

In conclusion, the prevailing state of the US economy indicates a state of stagnation of the unemployment level. The recent increase in unemployment rates is good news since it shows an indication of increased trust in the labor market. It would be advisable for the government to acts quickly in tackling the current state of the market by manipulating monetary policies. The economic principles stated explains the overview state of the economy. (Frank, R. H., & Bernanke, B. 2004).

References

Darby, M. R. (1976). Macroeconomics: The theory of income, employment, and the price level. New York: McGraw-Hill.

*Economic indicators* as Retrieved from <http://www.lib.sfu.ca/help/research-assistance/subject/economics/economic-indicators>

Mankiw, N. G. (1998). Principles of economics. Fort Worth, TX: Dryden Press.

Marshall, A. (1920). Principles of economics: An introductory volume. London: Macmillan.

O'Connor, D. E., & Faille, C. C. (2000). Basic economic principles: A guide for students. Westport, CT: Greenwood Press.

Taylor, J. B., & Woodford, M. (1999). Handbook of macroeconomics. Amsterdam [etc.: Elsevier.

Truman, E. M. (2003). Inflation targeting in the world economy. Washington, DC: Institute for International Economics.

Frank, R. H., & Bernanke, B. (2004). Principles of economics. Boston, MA: McGraw-Hill.

*Pre-recession Pattern of Six Economic Indicators in the USA* 2000 as retrieved from http://scholar.harvard.edu/files/stock/files/prerecession\_pattern\_of\_six\_economic\_indicators\_in\_the\_usa.pdf