FACTFILE:
GCE BUSINESS STUDIES

UNIT A2 2: THE COMPETITIVE BUSINESS ENVIRONMENT
ECONOMIC INSTRUMENTS

Learning Outcomes

Students should be able to:

- analyse and evaluate instruments that the government uses to achieve policy objectives

Economic Instruments

UK Treasury:
In the UK, economic policy is designed and implemented by national government and supporting government departments and institutions. The main economic policy-making department in the UK government is the Treasury department. The Chancellor of the Exchequer is responsible for this government department and a key financial statement referred to as the Budget.

The Budget:
In the UK, the Budget is a summary of the government's current financial position and financial plans for the following fiscal year(s).

Economic Instruments:
In order to achieve policy objectives, the UK government employs a number of policy tools, or economic instruments. These include:

Fiscal Policy:
This policy addresses issues related to changes in taxation or government spending policies in relation to economic objectives. Such policies focus on various fiscal matters, including:

(i) changes in rates of personal income taxes and personal allowances (which in turns affects levels of disposable income);

(ii) changes in rates of corporation tax (which in turn affects company profitability);

(iii) changes in levels of other direct/indirect taxes, such as VAT (which in turn affects consumer spending levels and imposes administrative 'tax collecting' responsibilities on businesses);

(iv) other duties (such as import duties/levies, including tariffs, local taxes). Government spending levels are adjusted depending on government priorities, which in turn will impact business priorities (e.g. reductions in welfare expenditure, would imply less disposable income available for claimants in the local economy).

Monetary Policy:
This policy focuses on the supply of money or the use of interest rates to achieve economic objectives. Interest rate increases make the 'cost of money' (or credit) more expensive, thus may reduce consumer spending. This is useful if the government wish to control or reduce consumer spending and prevent the economy 'overheating'.

Exchange Rate Policy:
An exchange rate is the amount of a foreign currency which Sterling (£) will translate to at a given point in time, such as US Dollar and Euro. Generally speaking, the exchange rate is a function of a number of factors, including:

(i) laws of supply/demand for specific currencies;
(ii) key market participants in the foreign currency markets, e.g. MNE's, national government, financial institutions;
(iii) general economic conditions.

The key aim is to ensure stability in the exchange rates between major world currencies, as businesses need financial stability in order to plan, manage costs and trade globally.

Supply-side Policies:
Alternative economic policies which are employed to achieve government economic policy objectives include:

Managing competition and efficiency in product markets:

This might include adjusting the operating conditions in specific industries, appointment of industry regulators to monitor competition and enhance efficiency in market operations.
Improving competition and productivity in factor markets:

This might involve adjustments to the conditions affecting the employment of labour across the economy. It might include the imposition of national minimum wage rates, working time directive and discussions with employee representatives (e.g. trade unions).

Incentives for households to work or save:
This might include the use of incentives to encourage increased working by specific groups of the working population. This might include: Provision of tax credits for childcare (Child Tax Credit), to allow mothers to return to work, or tax credits for disabled people to encourage them to par-ticipate in the workplace (Working Tax Credit).

Incentives for firms to produce and invest:
This might include financial assistance and/or non-financial assistance to specific businesses to encourage investment in the local economy. Examples include:

(i) financial incentives to facilitate location of business premises outside the Greater Belfast Area;

(ii) financial assistance aimed at facilitating staff training;

(iii) non-financial assistance aimed at promoting local businesses in overseas markets, including participation in trade fairs, overseas missions, market reports, language services and country/market specialists.

SUMMARY

The UK Government uses a number of economic instruments to achieve key economic objectives. These include a range of (i) demand side policies; and (ii) supply side policies.

REVISION QUESTIONS

1. Explain what is meant by the term 'government expenditure'.

2. Explain the term 'Supply-side Policies' and analyse three ways in which they might impact a business.

3. Analyse the impact of the exchange rate movements between sterling and the euro for a local business involved in global trading activities.

4. Evaluate the impact of the following key aspects of Monetary Policy on a local business which is experiencing a period of sustained growth in profits:

   a. A reduction of corporation tax rate
   b. A reduction in government expenditures nationally
   c. An increase in bank base interest rates by two percentage points.

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