Government economic objectives and policies

Government economic objectives

- Low inflation
- Low unemployment
- Economic growth
- Balance of payments between imports and exports

Low Inflation

- Inflation is the increase in the average price level of goods and services over a period of time
- Problems resulting from rapid inflation:
  i. Workers' wages will not buy as many goods as before. This means that people's real incomes (the value of income, and it falls when prices rise faster than money income), workers may demand higher wages so that their real incomes increase.
  ii. Prices of the goods produced in the country will be higher than those in other countries. People may buy foreign goods instead. Jobs in that country will be lost.
  iii. Businesses will be unlikely to want to expand and create more jobs in the near future. The living standards are likely to fall
- Therefore low inflation can encourage businesses to expand and it makes it easier for a country to sell its goods and services abroad

Low Unemployment

- Unemployment exists when people who are willing and able to work cannot find a job
- Problems resulting from unemployment:
  i. Unemployment people do not produce any goods or services. The total level of output in the country will be lower than it could be
  ii. The government pays unemployment benefit to those without jobs. A high level of unemployment will cost the government large amounts of money which can be spent on other areas
- Therefore, low unemployment will help increase the output of a county and improve workers' living standards

Economic Growth

- Economic growth is when a country's Gross Domestic Product increases- more goods and services are produced than in the previous year
- Gross Domestic Product (GDP) is the total value of output of goods and services in a country in one year
- When a country's GDP is falling there is no economic growth, resulting in the following problems:
  i. As output is falling, fewer workers are needed and unemployment will occur
  ii. The average standard of living of the population, the number of goods and services they can afford to buy in one year will decline. In effect, most people will become poorer
  iii. Business owners will not expand their firms as people will have less money to spend on the products they make
- Economic growth, makes a country richer and allows living standards to rise

The business cycle/ trade cycle

- Growth- this is when GDP is rising, unemployment is generally falling and the country is enjoying higher living standards. Most businesses will do well at this time
- Boom- this is caused by too much spending. Prices start to rise quickly and there will be shortages of skilled workers. Business costs will be rising and forms will become uncertain about the future
- Recession- often caused by too little spending. This is a period when the GDP actually falls, most businesses will experience falling demand and profits. Workers may lose their jobs
- Slump- a serious and long-drawn out recession. Unemployment will reach very high levels and prices may fall. Many business will fail to survive this period

Governments will try to avoid the economy moving towards recession or a slump, but will want to reduce the chances of a boom. A boom with rapid inflation and higher business costs can often lead to the conditions that result in a recession.

Balance of payments

- Exports are goods and services sold from one country to other countries. These bring money (foreign currency) into a country.
- Imports are goods and services bought in by one country from other countries. These must be purchased with foreign currency so these lead to money flowing out of a country
- Governments will aim to achieve equality or balance between these over a period of time.
- The difference between a country's exports and imports is called the balance of payments
- If the value of a country's imports are greater than the value of its exports then it has a balance of payments deficit.
- The problems that could result are:
  - The country could run out of foreign currencies and it may have to borrow from abroad
  - The price of the country's currency against other currencies- the exchange rate-will be likely to fall. This is called exchange rate depreciation. The country's currency will now buy less abroad than it did before depreciation.
- Exchange rate is the price of one currency in terms of another
- Exchange rate depreciation is the fall in the value of a currency compared with other currencies

Government economic policies

Fiscal policy

- Fiscal policy is any change by the government in tax rates or public sector spending
- Governments spend money in order to improve the standard of living in a country and provide necessities to citizens
- Governments raise money through taxes on individuals and businesses
- Direct taxes are paid directly from incomes, for example income tax or profits tax
- Indirect taxes are added to the prices of goods and tax payers pay the tax as they purchase the goods, for example VAT

Impact of taxes

Income Tax

- This is tax on people's incomes
- The higher a person's income, the greater percentage of tax they will have to pay
- Income tax is a set percentage of income
- An increase in the rate of income tax leads to individual taxpayers would have lower disposable income
- Disposable income is the level of income a taxpayer has after paying income tax
- Individuals would have less money to spend and save
- Manager may decide to produce fewer goods as sales are lower
- Some worker could lose their jobs

Rate of tax increases → Individual taxpayers have less disposable incomes → Less money to spend → Businessses see falling sales → businesses produce fewer goods → Unemployment increases

Profits tax (Corporation tax)

- This is tax on the profits made by businesses-usually companies
- An increase on the rate of corporation tax will lead to:
    i. Businesses having lower profits after tax, less ploughed back profit, businesses will find it difficult to expand, and new projects may have to be cancelled.
    ii. Less money to pay back to investors, fewer people starting businesses since government takes large portion of profits. Share prices depreciate.

Indirect taxes

- Added to the prices of products we all buy
- Make goods and services more expensive
- Governments avoid putting these taxes on essential items
- An increase in an expenditure tax could lead to:
    i. Prices of good rise. Consumers buying fewer items, fall of demand.
    ii. Workers' wages buy less, real incomes decline, businesses under pressure to increase wages forcing costs to rise

Import tariffs and quotas

- An import tariff is a tax on an imported product
- An import quota is a physical limit to the quantity of a product that can be imported
- Many governments try to reduce the import of products from other countries by putting special taxes on them
- Businesses in a country can be affected by tariffs in the following ways:
    i. Firms will benefit if they are competing with imported goods. These will now become more expensive, leading to an increase in sales of the home produced products
    ii. Businesses will have higher costs if they have to import raw materials or components for their own factories. These will now be more expensive
    iii. Other countries may now take the same action and impose import tariffs as well, called retaliation. A business trying to export to these countries will have fewer sales than before
- Another method to limit imports is to introduce an import quota
- Quotas can be used selectively to protect certain industries from foreign competition that may be seen as unfair or damaging to jobs

Changes in government spending

- Governments spend tax revenue on programmes such as: education, health, law and transport
- When governments want to boost economic growth they spend more on these programmes
- This will create more demand in the economy, more jobs and the GDP will increase
- If the governments want to save money, they will reduce spending
- These cuts will have considerable impact on businesses who:
    - Produce equipment for schools, hospitals and defence
    - Build roads, bridges and railways

Monetary Policies- Interest Rates

- Monetary policy is a change in interest rates by the government or central bank
- The following are likely to be the main effects of higher interest rates:
    - Firms with existing variable interest loans may have to pay more in interest in the banks. This will reduce profits
    - Managers thinking about borrowing money t0 expand their businesses may delay their decision. New investment in business activity may be reduced. Fewer new factories and offices will be built. Entrepreneurs hoping to start a new business may not now be able to afford to borrow the capital needed
    - If consumers have taken out loans such as mortgages, then the higher interest payments may reduce their available income. Demand for all goods and services could fall as there is less money available to spend
    - Businesses who make expensive consumables will notice that demand for their products will fall. Consumers will be unwilling to borrow money to buy these expensive items if interest rates are higher. The businesses may have to reduce output and make workers redundant
    - Higher interest rates in one country will encourage foreign banks and individuals to deposit their capital in that country. They will be able to earn higher rates of interest on their capital, by switching their money to this country's currency they are increasing demand for it. This will cause the exchange rate to rise-called exchange rate appreciation. This will male imported goods appear cheaper and exports will be more expensive.

Supply Side Policies

- Governments aim to make the economy of their country more efficient
- They aim to increase the competitiveness of their industries against those from foreign countries
- This would allow home businesses to expand, produce more and employ more workers
- Some of the policies have been implemented are:
    1. Privatisation- the aim is to use the profit motive to improve business efficiency
    2. Improve training and education-governments plan to improve the skills of the country's workers. This is partially important to those industries such as computer software which are often short of skilled staff
    3. Increase competition in all industries- this may done by reducing government controls over industry or by acting against monopolies
- They are called supply side policies because they are trying to improve the efficient supply of goods and services

How businesses might react to changes in economic policy

Government policy change	Possible business decision	Problems resulting
Increases income tax- reduces amount the consumers have to spend	Lower prices on existing products to increase demand Produce cheaper products to allow for lower prices	Less profit will be made per item Brand image will be damaged
Increase tariffs on imports	Focus more on the domestic market as local products seem cheaper Switch from buying imported materials and components to locally produced ones	It might still be more profitable to export Foreign materials and components might be of higher quality
Increase interest rates	Reduce investment so future growth will be less Develop cheaper products that consumers will be better able to afford Sell assets for cash to reduce existing loans	Other companies might still grow so market share could be lost Depends on the product but could consumers start to think that the quality and brand image are lower? The assets might be needed for future exapnsion