

Managing the UK Economy

The four main macro-economic problems the government faces:

Problem	Fiscal policy	Monetary policy	Exchange rate policy	Supply-side policy
Inflation	<ul style="list-style-type: none"> ↑ tax rates → ↓ disposable income → ↓ C, ↓ I (AD↓) ↓ government discretionary spending → ↓ G (AD↓) 	<ul style="list-style-type: none"> ↑ Interest rates → ↓ C (↓ disc. Income) → ↓ I (↑ opp. cost) ↓ Money supply → credit less available. → C ↓. 	<ul style="list-style-type: none"> ↑ Appreciate → Raise interest rates. → Spend foreign. currency reserves for GBP. → Lower imported inflation. 	<ul style="list-style-type: none"> ↑ AS in LR → Increase private or public investment. → Increases competition, incentives and competitiveness. (short run problem of inflation)
Unemployment	<ul style="list-style-type: none"> ↓ tax rates → ↑ disposable income. → ↓ C, ↓ I (AD↓) → U↓. → ↓ disincentives to work. ↑ government discretionary spending → ↑ G (AD↑) → U↓. 	<ul style="list-style-type: none"> ↓ Interest rates → ↑ C (↑ disc. Income) → ↑ I (↓ opp. cost) ↑ Money supply → credit more available → C ↑ 	<ul style="list-style-type: none"> ↓ Depreciate → Lower interest rates. → Sell GBP for foreign currency. → Increased demand for UK exports → U ↓. → Imports more expensive so UK firms setup in the domestic economy → U ↓. 	<ul style="list-style-type: none"> ↑ AS in LR → As above focusing on training of workforce to increase occupational mobility and affordable housing to increase geographical mobility.
Balance of payments deficit	<ul style="list-style-type: none"> ↑ tax rates → ↓ disposable income → ↓ C of luxury imports ↓ government discretionary spending → ↓ G → AD↓ → U ↑. → total NY ↓. → ↓ C of luxury imports. 	<ul style="list-style-type: none"> ↑ Interest rates → ↓ C (↓ disc. Income) → ↓ I (↑ opp. cost – could cause long run problems) ↓ Money supply → credit less available. → C ↓. 	<ul style="list-style-type: none"> ↓ Depreciate → Exports cheaper so X ↑, but I ↓ as opp. cost is higher so there is a conflict. 	<ul style="list-style-type: none"> ↑ AS in LR → Increase competitiveness abroad by investment and by private firms and government.
Lack of growth	<ul style="list-style-type: none"> ↓ tax rates → ↑ disposable income. 	<ul style="list-style-type: none"> ↓ Interest rates → ↑ C (↑ disc. Income). 	<ul style="list-style-type: none"> ↓ Depreciate → Overall increase in 	<ul style="list-style-type: none"> ↑ AS in LR → Increase AS so AS

	<p>→ ↓ C, ↓ I (AD↓) → U↓ → ↓ disincentives to work ↑ government discretionary spending → ↑ G (AD↑) → U↓. → GDP ↑.</p>	<p>→ ↑ I (↓ opp. cost). ↑ Money supply → credit more available. → C ↑.</p>	<p>economic activity causes an increase in growth.</p>	<p>expands by LR potential. Use in combination with demand management policies to allow the UK to achieve its LR potential.</p>
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...and a variety of situations to consider:

Problem	Fiscal policy	Monetary policy	Exchange rate policy	Supply-side policy
3% Growth 2% Inflation 4% Unemployment	-	-	-	To decrease the natural rate of unemployment increase training and cheaper housing to reduce occupational and geographical immobility. <i>(See p. 40 of the study guide)</i>
10% Unemployment BoP Deficit	Expansionary.	Expansionary.	Depreciate → X more competitive so X ↑. → M more expensive so M ↓.	↑ AS in LR → Increase occupational and geographical mobility → U ↓. → Make UK businesses more competitive. → Increase labour participation.
4% Inflation 1% Growth	<i>In the short run only growth or inflation can be targeted, a priority choice needs to be made. Supply side policies will help in the long run but will not cure short run problems.</i>			↑ AS in LR <i>(See p. 40 of the study guide)</i>
BoP Surplus 8% Unemployment	Change tariffs.			Aim for freer trade.