Expansionary Monetary Policy – Lower Interest Rates

1) In response to the economic crisis from Coronavirus, the Monetary Policy Committee (MPC) of the Bank of England enacted dual expansionary monetary policy, reducing interest rates from 0.75% to 0.1% and pumping an extra £450bn of money into the **UK** economy through quantitative easing. The intention of this policy move was to promote economic growth and employment thus reducing the overall impact of the recession on UK macro performance. However, as interest rates were already very low before the cuts took place, this avenue of monetary policy was limited in its effectiveness forcing huge increases in quantitative easing to provide further stimulus to the economy. But with extremely weak consumer and business confidence the idea of lower interest rates promoting greater borrowing, spending and investment was unlikely. In reality, businesses used borrowed funds to protect jobs and continue paying bills thus preventing mass bankruptcy and sky rocketing rates of unemployment. Critics argue that these policies, especially the quantitative easing expansion, stoked inflation far beyond target by increasing the money supply without a corresponding rise in production to match.

Economic Significance

- Expansionary Monetary Policy
- Lower interest rates and quantitative easing
- Policy to boost growth and reduce unemployment
- Determinant of consumption, investment and exchange rate thus boosting AD

Where to Use in Exams

- Application of Expansionary Monetary Policy
- Application of Interest Rates and QE
- Analysis of AD Increase to Growth and Unemployment
- Evaluation – Consumer/Business Confidence
- Evaluation – Size of the Cut
- Evaluation – Impact on Savers and Debt Levels
- Evaluation – Inflation Tradeoff

2) The People's Bank of **China** cut interest rates several times from 2022-2024 amid a slowing economy due to a housing market crash and severe Coronavirus restrictions that hampered economic growth considerably. Lower interest rates were to boost consumption and investment but also to bolster the housing market creating a positive wealth effect but low confidence has limited these effects.

3) The **Polish** Central Bank cut interest rates multiple times in 2023 to stimulate the economy given lowering inflation and stagnating growth. Many economists considered this premature with inflation still above target but growth was indeed strengthened in 2024 and inflation continued to fall.

4) The **US** Federal Reserve reversed their path of interest rates rises in 2019 given slowing growth but with the extreme Covid recession in 2020 causing unemployment levels to rise rapidly and growth to contract enormously, interest rates were cut all the way back down to 0.25% by the end of year.

Current Account Deficit – UK

The **UK** has, in the last decade, run a substantial current account deficit averaging 4% of GDP in this time, made up of a large trade deficit. Despite running a trade in services surplus, the trade in goods deficit is far greater caused by domestic income growth, a weak domestic manufacturing base and a lack of international competitiveness due to high relative unit labour costs (high relative minimum wages and low productivity) and poor investment. Once more, the UK's primary income (investment income) balance has recently run into deficit indicating that UK investments abroad are providing lower returns than foreign investments in the UK.

The current account deficit, more precisely, the trade deficit has been a drag on growth for the UK, taking 1.2% off economic growth in 2016. There is also pressure to run a financial account surplus with debt issued to finance the current account deficit. Some economists are concerned over Britain's ability to attract FDI and foreign buyers of British debt to run consistent financial account surpluses given the uncertain Brexit climate and macro performance concerns, with some even going so far to say a collapse of the pound could result.

However some economists have dismissed concerns over the UK's current account deficit citing that the main driver is income growth in the economy creating a large sucking in of imports effect, a by product of prosperity in the country. Once more they argue that Britain has no problem in attracting FDI and foreign lenders given the strength, size and stability of the economy even in a post Brexit environment, whilst policies to try and reduce the deficit could have nasty unwanted tradeoffs on macroeconomic performance. Nevertheless, the deficit remains uncomfortably large and has structural, supply side issues at its root, which could cause problems for the economy in the long run if it persists. Well targeted, effective supply side policies are needed to reduce the deficit over time. Throughout 2024, the UK's current account deficit rose in spite of a weak pound with a ballooning trade deficit the greatest driver and amidst a backdrop of fragile government finances, ever growing household indebtedness and lower economic credibility on the international stage there are major concerns as to whether persistent borrowing to fund this deficit is sustainable or not.

Other examples of countries with concerning current account deficits; 2) **Turkey** 3) **Sri Lanka**

Economic Significance

- Causes of a Current Account Deficit
- Consequences of a Current Account Deficit
- Policies to Rectify a Current Account Deficit
- Financial Account Importance
- Borrowing
- Role of FDI

Where to Use in Exams

- Application and Analysis of Current Account Deficit, Causes and Consequences
- Evaluation – Size of the Deficit
- Evaluation – Cause of the Deficit
- Evaluation – Long Term Borrowing Impact
- Evaluation – FDI Impact
- Evaluation – Policies to use with Minimal Macroeconomic Tradeoffs

Tradable Pollution Permits and Market Failure – The ETS

The ETS (emissions trading scheme) in the EU is a cap and trade response to the Kyoto Protocol where countries agreed to reduce carbon emissions in a fight against climate change. In the ETS, EU countries are set a cap on allowed levels of pollutant emissions with firms faced with a choice of either reducing pollution or, if they pollute beyond their allowed level, to purchase permits (equivalent to one CO_2 ton) from firms who have successfully reduced pollution more than needed. At the end of each year firms must trade in their permits and face heavy fines if actual pollution exceeds the number of permits they hold. Since the scheme's introduction in 2005 carbon emissions across the trading bloc have fallen and are 21% lower in 2020 compared to 2005 levels. Similar ETS schemes exist in the **UK and South Korea**.

Minimum Pricing and Market Failure – Alcohol in Scotland & Wales

In 2018 the Scottish government announced a minimum price of 50p per unit of alcohol, increased by 30% to 65p in 2025, as a radical way of reducing the consumption of alcohol. In Scotland, every adult on average drinks 20 units of alcohol a week, much more than the maximum recommended level of 14 units. The burden of alcoholism on hospitals, employers through absenteeism and low productivity is significant hence the minimum pricing policy.

Since its introduction, minimum pricing has reduced alcohol consumption in Scotland by around 8% with the highest reductions in consumption amongst households that bought the most alcohol. There has been a 13.4% reduction in alcohol related deaths and a 4.1% reduction in hospital admissions compared to if the policy wasn't enacted. There are concerns however that overall alcohol deaths remain high, rising year on year and that those in high purchasing, low income households have not changed their buying habits with the policy having no noticeable impact on reducing alcohol related crime. Alcohol minimum pricing also features in Wales and Ireland with similar effects experienced.

Key Facts

- Minimum Price of 65p per unit of alcohol
- Alcohol responsible for 22 deaths and 697 hospital admissions per week
- Most deprived areas see hospital alcoholism burden 8 times greater
- Alcohol related admissions are 4.4 times higher than in the 1980s
- Excess revenue kept by retailers

Where to Use in Exams

- Policy to deal with negative externality in consumption
- Evaluation – Price Inelastic Demand
- Evaluation – Level of Minimum Price too low
- Evaluation – Retailers receiving extra revenue not the government
- Evaluation – Consumer shoplifting

Monopoly Regulation – Pharmaceuticals, Big Tech and Energy

1) Pharmaceutical company **Advanz** was fined £100m in 2021 for monopoly abuse, increasing the price of thyroid drugs by 6000% over a ten year period. Prices rose from £4.46 in 2006 to £259.19 by 2017 with NHS spending increasing from £600,000 to £30m. As a result, many GPs stopped prescribing it with patients forced to fund their own treatment.

2) The EU Digital Markets Act aims to reduce the power and exploitation of large tech firms like **Google, Amazon, Apple and Microsoft**. The core aim of the regulations is to prevent companies prioritising their own services over others whilst hiding or unfairly reducing opportunities for competitors.

3) **Energy manufacturers** in the UK face a 38% windfall tax on their profits from oil or gas extraction up until 2030 meaning the overall tax rate that applies to their profits is 78%. The revenue raised is used to support households struggling to pay rising energy bills. Since introduction, this tax has reduced investment in the industry and is threatening jobs as a result.

Monopoly Regulation – Performance Targets/Quality Standards

1) **Train companies and airlines** have performance targets to limit the amount and length of consumer delays. Train companies must pay compensation to passengers for delays of 30 minutes or more and airlines too if delays mean passengers arrive at their destination 2 hours or more later than scheduled. The problem with this type of quality control regulation is that companies game the system, increasing the scheduled length of journeys on tickets to minimise the risk of paying compensation if delays occur.

2) **Energy companies** are regulated where they cannot cut off gas or electricity supplies in the winter to vulnerable households (the elderly and those on low incomes).

3) **Royal Mail** is legally required to deliver letters and parcels six days a week at a fixed price and to meet delivery targets for both first and second class mail.

Monopoly Regulation – Mergers

1) In 2018, supermarket giants **ASDA and Sainsbury's** proposed a merger which would have given the two firms a combined market share of 30%. Whilst these firms argued that consumers could have faced lower prices and higher quantity given the monopsony power this merger would have resulted in, the CMA blocked its go ahead given serious competition concerns in 463 areas of the UK. Even the prospect of selling stores in these areas did not convince the CMA of this merger being in the public interest.

2) A merger between UK mobile phone network providers **Vodafone and Three** was accepted by the CMA that will reduce the number of providers from four to three in a highly concentrated market raising the risk of market abuse. The CMA have however imposed legally binding conditions to the merger including upgrades to the network, short term price caps for customers and pre-set prices to wholesalers who offer their own services (usage plans) whilst sharing the network.