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, has stoked inflation far beyond target rates 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 in 2022 and 2023 amid a slowing and faltering economy due to a housing market crash and severe Coronavirus restrictions that hampered economic growth considerably. Lower interest rates were aimed at boosting consumption and investment but also to propel the housing market creating a positive wealth effect.

3) The **Polish** Central Bank cut interest rates several times in 2023 to stimulate the economy given lowering inflation and stagnating growth. Many economists consider this premature with inflation still above target questioning the timing and politicised nature of rate cuts with an election planned in 2024.

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 strong 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 high 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 2023, the UK's current account deficit rose in spite of a very 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 June 2018 the Scottish government announced a minimum price of 50p per unit of alcohol 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 with almost half of all alcohol in shops priced at less than the 50p per unit before the minimum price was enacted. The burden of alcoholism on hospitals, employers through absenteeism and low productivity is significant hence the introduction of 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 are concerns however that those in high purchasing, low income households have not changed their buying habits and the policy has had no noticeable impact on reducing alcohol related crime. Alcohol minimum pricing followed two years later Wales with similar effects experienced and from 2022 in Ireland.

Key Facts

- Minimum Price of 50p 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, some calling for 65p per unit
- Evaluation – Retailers receiving extra revenue not the government
- Evaluation – Consumer shoplifting

Monopoly Regulation – Pharmaceuticals and COVID Testing

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) **Private Covid testing companies** faced regulation by the CMA in 2021 to lower the price of PCR tests in the UK closer to cost thus aiding consumers travelling abroad.

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) **Internet service providers** are forced to pay automatic compensation to consumers if there are faults with broadband services or sudden blackouts which go unrepaired for 2 days or more.

Monopoly Regulation – Merger Policy

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) In 2019, the EU Competition Commission blocked a proposed merger between train manufacturers **Alstom of France and Siemens of Germany** given competition concerns against the public interest and higher prices expected for signals and trains. The merger was blocked to ensure that lower cost non EU producers such as those in China would not be able to compete in the EU ahead of domestic firms.

3) In 2016, the **Celesio AG** (operator of Lloyd's Pharmacy group) and **Sainsbury's Pharmacy** merger was approved but flagged for the lessening of competition in 13 areas in the UK. Branches had to be sold in those areas as a result. The CMA's investigation of a merger between high street betting companies **Ladbrokes and Coral** in 2016 was also given the green light but on the condition that 400 shops were sold off in local areas where competition would be significantly lessened.