BUSINESS STUDIES H/W 2

Q: "If faced with rising inflation, the government might apply a severe contradictory economic policy. What might that involve and what might be the effects upon a business of your choice?"

Inflation is the general rise in prices across a wide range of goods and services. Inflation is also the loss in the purchasing power of money.

The government may apply a contradictory policy; this may include changing the interest rates. This will mean it becomes more expensive for people and businesses to morrow money. Therefore, businesses will invest less. Individual will consume less because they will be paying more else where in mortgages reducing the amount of surplus money that would have normally been available. The cuts in investment and the cuts in spending will mean a reduction in the level of demand in the economy. The second method is by increasing Taxes, this reduces purchasing power and consumption generally. The third method to reduce inflation is by cutting government spending.

The business is a small drinks warehouse outlet by the name of Bay Distribution. This company is growing and each year it makes more investments. I rise is interest rates would affect this company a lot because it trying to invest by increasing it sales. I rise in the interest by the government will affect the consumers as the cost of borrowing money increases, meaning people will be paying more than they did and so will be left will with less money each month. So the paying back of mortgages and credit card bills becomes expensive. Leaving more people with less money to spend and so soft drinks as the ones sold by Bay Distribution, which is a luxury gives way to other options such as water. The demand for the drink will fall having a direct effect in that the sales of bay distribution will fall too. The company results to reducing costs by making people redundant and this mean more people being redundant everywhere leading to more decline in demand . This slows down inflation as the competition reduces and cost rises. Further more since the company started with a huge loan this increase will mean more to pay for the loan in interest each month. Making it very hard for the company to survive and may mean bankruptcy.

This is just one part of the affect upon Bay Distribution, but because it wants to expand it will have to do this at some other time because investments becomes more costly and with reduce sales the company already has to cut cost and this expansion plan has to be delayed or cancelled.

Interest rates have a significant effect and are the main way in which the government operates its macro economic policies.

The other two mean of controlling inflation is not very suitable but government as art of their policies uses that. Direct taxes, which include income tax and national insurance for the comsumers and corporation tax for companies, are the main way in which government can influence demand. To reduce inflation the demand has to decreases and a raise I these direct taxes reduces the spending power of the taxpayers. This affect the firm as to it will have to pay more tax on the profit that it makes. However, the effect it will have on consumers will be more significant as to the taxpayers will also pay more leaving them with less to spend reducing demand of all goods.

Indirect taxes however are taxes on spending such as VAT, Value Added Tax meaning that for every drink that the company will sell it pay the government 17.5% in tax. This means more money goes to the government, which in turn can hold back this money to cut spending.

This brings us to the last part of the policy, which is reducing government expenditure. When the government spends it increases the money flow on the market meaning people have more money to get there hands onto and increases the demand for goods overall. This leads to over trading and leads to inflation. This means that the demand reduces as the government reduces the cash in the market and meaning another factor reducing demand for drinks as consumer spending reduces.

The last two policies affect the demand levels in the market and so do not really have as much affect as interest rates, which reduces the cash in people pockets. This eventually decreases demand.

A company like Bay Distribution, which is trying to expand, will fail as is will be affected by the rising levels of interest rates and this will mean that it has to pay back more money for the money borrowed in the beginning. The company will fail to expand because investment becomes expensive as the cost of investment becomes high. The reason it is affected is because drink are price elastic and will be affected by the change In demand as it may be seen by most mid class people as a luxury and because the main customers are mid class people it does have a massive affect on the firms sales.