Business studies Test Questions

Inflation is a sustained rise in prices. Inflation is measured by retail price. It measures the average price level of a basket of goods. The effect of inflation on consumers is very significant:

- Reduces purchasing power and standard of living if wages do not ride at the same rate.

- Reduces value of savings – if interest rates are lower than inflation, but loans would be worth less so some consumers may benefit.

If inflation occurs, it will reduce purchasing power because you will have the same amount of cash before the inflation; however it will be worth less. Standard of living will decrease due to needs increasing in price, due to inflation.

The value of your savings would lose value because the cost of living is higher. I.e. if I have saved £1 to buy 2 loaves of bread, each loaf is 50p. However, recently inflation has doubled prices. Now the loaf of bread is £1 and I still only have £1 savings. Therefore, my savings have decreased from 2 loaves of bread, to just 1.

Businesses are largely affected by inflation in the UK. E.g.:

- Money used may be reduced
- Admin costs may rise due to constantly changing prices
- Uncertainty – planning permission becomes difficult
- If inflation is higher than abroad it will harm UK businesses' competitiveness

Businesses savings may be reduced due to inflation; this is the same case as consumers. The cost of running the business would increase. Therefore less profit for businesses. Wages may also be forced to rise to match inflation rates. If these wages are not raised, this may de-motivate employees, allowing them to believe that they have indirectly received a cut in their salaries, as their pay rise has not matched their inflation rate.

For large businesses, e.g. Tesco, admin costs would rise due to prices constantly having to be changed. Prices would frequently change due to inflation rates increasing.

If inflation rates were higher than abroad, businesses would have to increase their prices OR accept the fact that indirectly their prices have decreased in value. Rates

would be lower in other countries causing the competitiveness of the UK's businesses generally, to decline. This may cause the economy to decline slowly too.

The Government may try to smooth out the business cycle by using the Fiscal Policy and the Monetary Policy. The Fiscal Policy affects Government spending and Government taxation. In an economy's boom, the Government increases taxes because people have more money to spend, and in a recession the Government cuts taxes, to encourage spending. The Governments spending part, is that it cuts spending in a boom to save money for the recession. So that when the economy is in recession they can afford to cut the taxes, and use the savings from a boom to even out the financial side. The Government can dramatically change the course of the economy by taxing more and spending less or spending more and taxing less. Fiscal budget is the national shortage.

The Monetary Policy is more difficult to carry out, than the Fiscal Policy because the Government cannot let the economy slip into recession and cannot allow themselves to trigger inflation rates. The Monetary Policy involves 'Open Market Operations' and 'Discount Rates'.

Open market operations involves the buying and selling of Government securities that make up the Government's debt. These securities are traded regularly by financial markets. The government has realised that when it buys securities it adds money to the economy and when it sells securities, it takes money out. This is an alternative than printing money.

Discount Rate is where banks' discount rates are raised. A high discount rate discourages borrowing, while a low discount rate encourages it. The lack of borrowing is a way of 'pumping' money into the economy.

The monetary policy shows effect immediately and is a lot quicker than the fiscal policy, where its results are represented quite a while later.