Principles of Macroeconomic Coursework – Pre-Budget Report 2003

1. What are the Government's main economic objectives?

As ever, the government holds a number of ongoing, long-term objectives: high, stable and long-term levels of economic growth and employment; low and controlled levels of inflation; fiscal rules, concerning the current account and net national debt. Additionally they aim to achieve more short-term objectives, such as supporting war in Iraq. Although these objectives may remain constant from year to year and between parties, approaches to achieving these goals may vary.

The Government and the Chancellor of the Exchequer may aim to achieve economic growth and employment through a number of means. Their chosen route will to a large extent depend on their economic tendencies: whether they favour Keynesian demand management or classical theory. If they follow Keynesian beliefs then growth and employment is likely to be achieved through increasing aggregate demand by controlling fiscal and monetary policy. As interest rates are now controlled by the Bank of England, this leaves increased consumer spending and reduction in taxes as their likely options. By increasing investment the government would hope to use the multiplier affect to increase output, thus representing growth and also create increased employment opportunities. Taxes may be reduced to increase the level of disposable incomes and increase consumption. Lower income tax levels would also encourage more people to take up work especially those looking for lowly skilled work, which pay poorly.

On the other hand if Gordon Brown is a strict classical economist he's likely to adopt supply side policies. This means he will attempt to stimulate growth and create more jobs by increasing aggregate supply. There are obviously a number of ways this could be done, but they broadly fall into four groups. Firstly the government could increase investment in physical capital. This may mean direct investment into infrastructure or alternatively offering incentives to those companies who operate above efficiency/productivity standards. The second option is to invest in human capital to increase the workforce's productivity. Here there are essentially two areas the government could look to target. Improvements in the wellbeing of the workforce, through health and safety regulations and improvements to the health service, would help reduce absenteeism and accidents in the work place. Obviously bettering the health service is likely to be a government objective of its own and is unlikely to be targeted with the aim of purely improving the performance of labour within the UK. A more realistic course of action is to try and improve the skills base of the labour force. This may be through better education or through encouraging businesses to offer further training to their employees. Thirdly the Chancellor could try to bring about technological changes and progressions through encouraging innovation within the workplace. This may be achieved through incentive schemes to promote new business start-up and the welcoming of new technologies. The final option open to the government is they could increase the size of the workforce, this is largely linked to improved education and training. Basically they need to encourage more people to enter work and increase the opportunities open to those currently seeking jobs.

Inflation is a very important economic goal as it can have considerable affects on unemployment levels and standards of living. Since 1997 The Bank of England has had responsibility for setting interest rates with the aim of meeting the governments 2.5 per cent inflation target. Since then inflation rates have fluctuated little. Consequently the government's policy is likely to remain unchanged regarding this matter.

The Government holds two rules concerning fiscal policy. The first, '*The Golden Rule that over the cycle the current budget will be balanced*[1]', the second *The Sustainable Investment Rule* that debt will never exceed 40 per cent of national income. Should the Chancellor adhere to these rules then the level to which they can invest in areas of the economy will be limited. This may have a bearing on the type of policies they adopt to achieve they're main macroeconomic objectives of growth and unemployment.

One of the governments sort-term aims is to support the war in Iraq and the fight against terrorism. To date the exploits involving the war against terror (Afghanistan, Iraq etc.) has cost around £6billion. Inevitably the government will continue to spend huge amounts in this area. This may mean the government altering fiscal policy. The level to which they will borrow should be limited by their fiscal

[1] Gordon Brown, Pre-Budget Report 2003

rules, not wanting to accumulate extensive national debt. Consequently, should the government want to maintain current investment in the economy, taxes may be risen at some point in the future to finance the expense on defence.

2. Critically examine how the measurers discussed in the report might influence the achievement of the Government's objectives.

In the Pre-Budget Report Gordon Brown outlined a large variety of policies which should help progress growth of the economy. A number off issues where discussed not only to help new businesses become established but also to help progress those already in practice. Plans to widen the availability and access to Venture Capital Trusts, as well as extended tax relief's, should help new businesses in their start-up and encourage more investment in new ventures. Small companies are to be helped in attracting investment by incentives which should follow successful schemes established in America. It was also announced that the government wants 'Britain to be the best location for science and Research and Development[2]' in the world. To help achieve this there are plans to increase the availability of R&D credit, and also to make available further funds for Higher Education. The hope is these measures will help improve innovation and encourage modernisation within UK industries. Although all these ideas sound beneficial in theory, until exact details of such initiatives are finalised we can be unsure of their likely success. Exactly how many firms will be eligible to benefit from these incentives? Will methods tried and tested in the USA be as attractive to British business mentalities?

Reinforcing the governments attempts to promote investment in new start up businesses, they are to offer incentives to local authorities who themselves successfully help promote the creation of new businesses within their region. It was announced local authorities seen to be actively doing so, could collectively be eligible to receive an extra £150 million in 2005, with this amount rising over the following years. This should help to see further growth in the economy, although whether this will result in long term growth remains to be seen. This is likely to depend on the attitudes of the local bodies. If they fail continue to aid new businesses to progress in the ensuing years the growth could be

[2] Gordon Brown, Pre Budget Report 2003

short lived. Nevertheless further gains could be made if the authorities use the extra funds resourcefully to help improve local infrastructure, business links and public services.

The government have made further attempts to improve the productivity and efficiency of firms by announcing a number of deregulations. Initially 147 regulations are to be reformed or removed, increasing to 650 over the next two years. The removal of ‘red tape’ should eliminate some unnecessary costs, freeing capital and time which may be reinvested in many areas of business hopefully improving productivity. The extent of the effect this may have on the growth the economy, which is likely to slight at best, will depend on the attitudes of the businesses who benefit and whether they reinvest efficiently. The magnitude of the deregulations will also be reduced by the addition of further regulations entrenched in incentives and initiatives introduced in the near future.

Whilst Gordon Brown announced that the government was closer than ever to achieving full employment throughout the UK, he explained the second stage of Britain’s New Deal. Formally the plan aimed to move people from welfare to jobs; it now aims to help people move from low skilled work to higher skilled work. This means the government is to now encourage employers to give employees time of work for skills training and development courses. They plan to help fund this with £190 million to be provided over the coming year. Extra skills should not only help people become increasingly employable in the future but also improve their productivity in the relative short term.

The New Deal will also continue to help those out of work. All those people currently seeking jobs will have their skills measured and made to attend obligatory skills courses. These will come in a wide range of areas and aim to help all those unemployed achieve employment in some area of work. However the government cannot consider this alone to help reduce unemployment. They must ensure there are the jobs available for these people to fill. Indeed they have made steps to do this by encouraging the start-up of new businesses and also by announcing plans to help finance redevelopment/renovation of vacant commercial premises in high unemployment communities. Nevertheless, if long-term unemployment is to be reduced both plans for creating jobs and those to train those without jobs must work concurrently.

Also included were plans to help those families with children. As well as being social policies they have important economic benefits. Firstly the plans aim to target those with both work and family responsibilities. It is the government's intention to make it possible for every working family to receive £50 a week for approved child care costs. They hope this should help more parents stay in work, thus improving productivity and reducing unemployment. However the number of families eligible for this may be limited due to the fact the child care must be approved. Also announced were plans to invest an additional £15 billion in education. This would hopefully go towards improving the skills of future workers and improve unemployment and help achieve long term growth. This however may not be necessarily be the case. Unfortunately these funds do not always reach the right areas and don't help those who need it the most. Other problems such as teacher shortages must also be addressed if there is to be long term success.

There were few plans concerning inflation. With the Bank of England controlling interest rates there is little the government can do to alter inflation levels directly. However there was a new method introduced for measuring inflation. Instead of the old RPIX measure, the Consumer Price Index (CPI) will be adopted. The CPI is recognised to be more precise ad reliable, taking better account of factors neglected under the RPIX. It is also internationally recognised and makes the UK rates comparable with the rest of the Euro Zone and America. This change means the new target level for inflation will be two per cent.

With respects to the fight against terror and the war in Iraq, the government has set aside a further £800 million over the next two years. Despite these allocations the net borrowing figures remain under the government target level of 40 per cent of national income. However these debt figures are a lot higher than earlier anticipated and may result in tax rises in the future. Tax rises could cause limitations to both growth and employment figures, with disposable incomes falling along with investment levels.

In conclusion at face value the policy announcements made in the Pre-Budget report should all help growth and employment levels, and there be little change in inflation. However the extent to which they will benefit these objectives is unclear. In many cases it is how well these measures are implemented that will determine their long term success. Overall the report describes a thriving economy, outperforming all of Britain's major competitors and suggests that these policies can only help improve that situation. In truth the picture may not be so favourable. It must be taken into account that a general election is only 18 months away and the government will be very aware of this. Consequently the costs of these policies may be unclear at this moment in time, especially in terms of possible tax rises. It may well be that the true impact of current policies on the discussed objectives does not become apparent until 2005, after the election.