1. If your income is £40,000, how much tax do you pay? What is the average tax paid per pound?

Pay 20% of £40,000 = £8000
Average tax = (£8000/£40,000)*100 = 20%

2. If your income is £80,000, how much tax do you pay? What is the average tax paid per pound?

Tax = (20% of first £40,000) and (50% on second £40,000) = £8000 + £20000=£28000
Average tax paid = (£28,000/£80,000)*100= 35%

3. Is this tax system progressive or regressive? Explain your answer.

Progressive; average rate of tax increases as you earn more

4. Why might a government want to have a progressive tax system? What will determine how progressive it is?

- May want to use to redistribute income
- May boost demand; extra pound earned by high income earner likely to be saved whereas if given to a low income earner it is likely to be spent

Which of the following is most likely to directly shift the long-run aggregate supply curve outwards?

- Growth in export demand: Increases demand
- A major increase in government spending on welfare benefits: Likely to reduce aggregate supply
- Improvements in the banking system to provide more funds for investment: Likely to increase aggregate supply
- An improvement in consumer demand: Increase in demand

Is an increase in government spending likely to be good or bad for business?

Depends what it is spent on e.g. may help develop infrastructure, may help train and educate workforce, may lead to direct demand for goods and services, may lead to multiplier effect.

Government spending can affect both supply and demand for businesses.
Business Analysis 13.2

Discuss these two differing view of how the government might respond to slow or negative economic growth.

Over to you to debate as the differences remain between economists and politicians. Whilst the general view seems to be that reducing borrowing is necessary there is considerable debate over the extent and speed of these cuts. Ultimately may be difficult to judge: will take time for effects to show through and there are so many factors changing that may be difficult to isolate the effect of government spending alone.

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Business Analysis 13.3

1. Why might the government in China want the banks to lend more?

*Answers might include:*
- May want to stimulate borrowing and spending to boost aggregate demand
- May be trying to stimulate economic growth

2. Why might lending not increase?

*Answers might include:*
- Banks may be reluctant to take risks and so even if they have the funds they may be cautious about lending
- Businesses and households may be reluctant to borrow if they are not confident of the future; even if banks making available firms and households may not want to take the risk

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Business Analysis 13.4

Do you think that this form of lending and borrowing poses a threat to the banking system?

*Answers might include:*
- Interesting development and again shows the power of the internet to bypass intermediaries
- Present levels of borrowing not a major threat but may develop although banks no doubt will adapt their offerings e.g. focus on professional advice to differentiate their service

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Business Analysis 13.5

1. Explain how a cut in the interest rate might help the UK economy in the circumstances described in the passage above.

*Answers might include:*
- Lower interest rates:
- Can increase borrowing (as it is cheaper) and spending by households and
firms boosting aggregate demand
  • Can lower the value of the exchange rate (as the lower interest rates will attract less savers from abroad); this should boost exports

2. Show the possible effects on prices and output in the economy of a cut in interest rates using aggregate supply and aggregate demand diagrams.

Answers might include:
  • The lower interest might stimulate demand shifting this outwards; this will boost prices and output
  • Over time it may also increase supply through more investment; an outward shift in supply may reduce prices and boost output.
  • Overall and over time output should increase but the effect on prices will depend on the relative effect on supply and demand

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Business Analysis 13.6

1. Do you think the UK government has got it right when it comes to economic policy?

Over to you! Much debate on this- is it pursuing austerity too vigorously and too inflexibly? Or will the pain lead to greater long term gain?

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Think About It 13.2

1. What determines the impact of greater competition in a market on a particular business?

Answers might include:
  • May depend on relative power of the business
  • May depend on the relative competitiveness of the business
  • Could affect the price, the pressure to innovate, the pressure to improve standards and service

2. How might greater competition in an economy affect different stakeholders?

Answers might include:
  • May impact on profits and rewards to investors
  • Will affect the jobs available in some businesses
  • Will affect which suppliers are used
  • Will affect links with the community (some businesses will see this as a way of increasing competitiveness; others will see it as distraction)

Suggested Answers to Short Answer Questions

1. Changes in government spending and taxation and benefits to influence the economy.
2. Automatic changes when the state of the economy changes e.g. less income tax revenue when the economy shrinks; more spending on
benefits when there are more unemployed. Discretionary fiscal changes are deliberate policy changes e.g. a change in the taxation rate or an increase in the demand for final goods and services by the government.

3. Occurs when government revenue is less than its spending in a given period.
4. Attempts by the government to reduce its deficit.
5. Changes in the money supply and interest rates to influence the economy.
6. Growth, stable prices, low unemployment, a healthy current account on the balance of payments.
7. Injections of money into the banking system by the Bank of England as it buys up assets.
8. May lead to more investment, may encourage borrowing, may reduce the exchange rate.
9. Increased government spending; lower income tax.
10. Lower unemployment benefits; subsidies for investment and training.