Government and the Economy

The economic tools of the government

- Monetary Policy
  - Those actions by a central bank which influence the money supply, interest rates and the availability of credit. In Ireland our monetary policy is **controlled by the European Central Bank.**
- Exchange Rates
  - Refers to the devaluing or revaluing a currency in terms of other currency. It can be done through quantitative easing (printing more currency), or taking currency out of circulation through open market operations. The is **controlled by the ECB.**
- Fiscal Policy
  - Any action taken by the government which influences the timing, magnitude and structure of current revenue & expenditure. The Irish government still maintain control of this policy.
- Direct Intervention
  - Setting up semi-state bodies to provide goods or services on the open market. Bus Eireann, Failte Ireland, Irish Rail.
  - Deregulation is also a form of direct intervention. It involves the changing of laws and practices which limit competition.

The economic aims of the government

- **Achieve Full Employment**.
  - Pursue policies which will improve our competitiveness, boost exports and so help create jobs in Ireland. Usually considered around 4% unemployment rate. Government must ensure that we maintain our competitiveness and so maintain jobs in Ireland. Unemployment currently stands at 11.8%. The government have introduced a number of initiatives to improve employment prospects e.g. Job Bridge for the long term unemployed/provision of SOLAS courses. The government aims to reduce unemployment to 10% by 2016.
- **Control price inflation**.
  - The government must try to reduce the pressure on rising prices within the economy. While oil prices are outside its control it can try to limit wage increase and through the introduction of competition encourage price competitiveness in services.
- **Achieve moderate economic growth**.
  - By economic growth we mean an increase in output per person in the economy (expansion of the productive capacity of the economy). Thus an increase in output per person implies an increase in income per person. The government must try to manage current downturn in economic activity and ensure that we return to a position of some economic growth. Appropriate fiscal policy may help towards achieving this.
- **Boost exports / improve competitiveness / attracting investment**
  - By taking steps to improve competitiveness, the government hopes that Irish exports will continue to grow and so help create jobs. They also

aim to reduce cost of utilities. This may make Ireland more attractive for FDI. Trade missions by the IDA and Enterprise Ireland to China etc. to encourage FDI.

- **Control government finances / reduce borrowing / manage the national debt**
  - The government must continue to reduce spending. It must also widen the tax base so as to increase taxation revenues. These measures will help reduce borrowing and help reduce the national debt. Irish debt currently stands at 124% of GDP and the government must aim to reduce this. Although we have exited from the bailout, we are still under the direction of the Troika and they will continue to monitor our national debt reduction efforts. The funds from the sale of state assets may be used to reduce the debt. Restraint and discipline is required. The Government aim is to bring the fiscal deficit to 3% of GDP by 2015.
- **Broaden the tax base / greater tax revenue certainty**
  - Many believe that we relied too much on the property boom for taxation revenues. The government must now plan to introduce new taxes, eliminate tax evasion; bring more workers into the income tax net and so generate a greater flow of tax revenues. The government has introduced the local property tax, septic tank tax inspection charge and plans to introduce a water tax. These taxes will provide stability and increased certainty for the collection of government revenue.
- **Promote balanced regional development**.
  - This tries to ensure that employment opportunities and development is distributed throughout the country. The IDA has had advance factories built outside of the Dublin region. It is hoped that employment will be created in the regions so as to boost economic activity.
- **Improve infrastructure.**
  - The further development of the road infrastructure, provision of public transport, development of the airports and seaports etc.
- **Improve state services: health/education services / achieve a just social policy**.
  - Increasing emphasis is being placed on the improvement in health services, the provision of further places in primary schools, improvement in school buildings and the development of third level education.
- **Achieve a more equitable distribution of income**.
  - The government must continue to ensure that social welfare recipient's standard of living is maintained, that it provides adequately for future pensions and helps to redistribute income within the state, given the current constraints on government current spending. Increasing the levels of pensions and improving social welfare payments are attempts by the government to help re-distribute wealth.

- Outline, with Irish examples, conflicts between the aims of the Government
  - Control of national finances v. full employment / economic growth.

- Full employment v. balance of payments equilibrium.
- Full employment v. price stability.
- Economic growth v. balanced regional development / price stability.
- Economic growth v. balance of payments equilibrium.
- Control of national finances v. Economic growth.
- Just social policy v. broadening the tax base.
- Balanced regional development v maintaining state services.
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<u>Privatisation and Nationalisation</u>

- **Privatisation**
  - This is the **sale of a state owned company** to private owners.
- **Nationalisation**
  - The purchase of privately owned assets by the government/exchequer

- **The advantages of privatisation**
  - **Improved quality / choice of services**
    - Privatised firm may improve the quality / efficiency / choice of the service provided.
  - **More competitive prices**
    - Consumers may be offered more competitive prices on goods / services.
  - **Continuity of supply**
    - The newly privatised companies may have access to new sources of funds and as they are not subject to government interference their long term prospects for survival may improve –ensuring continuity of supply for consumers.
  - **Employment opportunities**
    - If the new firm increases its market share then this may result in a growth in employment within the industry / additional job security for existing employees.
  - **More rewards/Incentives for innovation**
    - Employees may reap more rewards for their innovations within the privatised industry e.g higher bonuses etc.
  - **Revenue from sale /reduce borrowing**
    - The government could **use** the revenue from the sale of the firm to help reduce its level of borrowings.
  - **Shedding of loss making companies**
    - By selling loss making companies the financial burden on the state / taxpayers is removed.

- **The disadvantages of privatisation**
  - **Loss of non-profit making services**
    - Non-profit making services may be discontinued in an effort to reduce costs.
  - **Standards of service / increased prices**
    - The quality of services provided by the new company may deteriorate in an effort to save costs. Prices may be increased to increase revenue. Charges for services which were considered ‘free’ may be introduced.
  - **Curtailment in Pay / Pensions increases /Changes to working conditions**

        - The new owners may limit the pay / pension increases due to its employees or change its employees' conditions of employment resulting in a worsening of these.
    - **Loss of jobs / reduced job security /increased social welfare bill**
        - Jobs may be lost through rationalisation of services, meaning higher social welfare costs.
    - **Loss of a state resource / critical infrastructure**
        - This company has been financed by taxpayers in the past. With its sale, taxpayers now lose critical infrastructure, which they once owned.
    - **Costs of the Sale**
        - All costs in preparation for the sale such as legal work must be paid for by the taxpayer.
    - **Foreign ownership**
        - Overseas buyers can become owners of a previously Irish company and so control of the asset can go outside the state.

- **Advantages of Nationalisation**
    - **Stability to economy / investor confidence**
        - It may signal to domestic and international investors that the state seeks to protect an important resource and so attract investment.
    - **Availability of credit**
        - It may ensure that credit would flow to those individuals and businesses which require it, unlike at present where credit restrictions apply.
    - **Rationalisation of banking services**
        - It may lead to a rationalisation of banking services within the state, the elimination of wasteful practices / cost efficiencies.
    - **Employment / consumer protection**
        - Jobs currently under threat may be protected by state intervention. Consumers may be offered better protection by state banks.
    - **Development of ethical banking practices**
        - With nationalisation, banking practices may be less motivated by the generation of profit and more towards the provision of those services required by consumers.
    - **Continued provision of banking services to the community/ prevent foreign ownership**
        - The nationalised bank may continue to provide retail services to those communities which in the past were only provided if the branch was profitable/social objective.

Social Costs and Private Costs

- Private costs are costs to the individual/company as a result of decisions they make
    - For example – The cost of purchasing your groceries, or a business buying a new machine, or health costs associated with smoking
- Social cost includes all the costs of production of the output of a particular good or service. We include the third party (external) costs arising from the decision
    - For example: - a chemical factory emits wastage as a by-product into nearby rivers and into the atmosphere. This creates negative

externalities which impose higher social costs on other firms and consumers. e.g. clean up costs and health costs.