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Business, Management

To what extent are government still able to exert meaningful control over the UK economy? The extent to which government are able to exert meaningful control over the economy is subject to the power government has. In most Mixed economy such as the UK, government usually has control over Fiscal policies, which is the use of government spending and taxation to influence the economy, however how much they spend depends on the party that is governing the economy at that time. Traditionally Labour is viewed as “ tax and spend” party, whilst Conservative encourages Free trade, deregulation of the economy, and lower taxes.

They aim to reduce government spending and national debt. Nevertheless, government has to consider the wider economy and the global financial market before resulting in polices as the policies they implant can result in an economy that is either booming or an economy which is on the verge to bust. Government may lack control over the UK economy, due to their membership with the European Union, which has created many legislation that has made it difficult for the UK government to entrench policies nationally. In additional, Government no longer has control over interest rates, which means they no longer have control over the supply and demand for money but The Bank of England is accountable to government, so if government wishes they could intervene. In this essay, I will outline few of the main reasons that enable government to exert control over the economy, I will also evaluate these points along with reasons that prevent government from controlling the UK economy.

Government controls fiscal and supply side policies in the UK, Fiscal policy is the control of the amount of public expenditure as well as the revenue they can create via taxation. Whilst supply side policies are government policies which increase the amount of ' supply' that is capable of being produced over the long term . Thatcher's monetarist government in the 80s were very keen on Supply Side polices, Thatcher argued that government intervention led to dependency culture, where there is no incentive for firms to improve efficiency and choice, so Thatcher wanted markets to be free from government, she wanted to increases productivity and competition in the economy. Thus the thatcher government applied various polices such as privatisation, deregulation, etc… to encourage competition and decrease long run average cost for firms. Before the 1997 election, the Tories had portrayed the Labour party as being irresponsible (in terms of their fiscal and monetary policy) and incapable of running the economy effectively, they were viewed as tax and spend party in government which supported nationalisation of key institutions. However, when New Labour came into power, they were more responsible and had more control of the UK economy, they took supple side economics further than the Tories, introducing market forces and competition in the utilities and telecommunications, they took steps to maintain and increase labour flexibility, they were no longer dependent on the Trade Unions, and Labour took the social chapter and established Minimum wages, which were set very low. Labour stressed the importance of highly trained and educated workforce, hence focused on improving education. The aim was enable the workforce to compete and handle new tasks, thus standards in education

was increased, they introduced schemes such as EMA to increases more teenagers to stay on education, they also presided over an expansion of nursery education and pledged to put at least 50% of 18-30 year olds in higher education.

Brown was seen as the first Labour Chancellor who had been successful in avoiding economic disaster, he managed to keep low inflation, unemployment and interest rate all in his first term, showing control over the economy. New Labour had pledged in their manifesto to maintain Tory spending limits for the first two years of the government, which meant that public spending actually went down from 41. 2% of GDP in 1996 to 38. 9% in 1999.

This led to a surplus of 2% of GDP. Brown set out " Golden Rule" to underpin economic policy, the golden rule states that government may only borrow to invest over the course of an economic cycle. The rule is judged on whether the current budget is in surplus, averaged out over the economic cycle as a whole, Brown estimated the duration of the economic cycle and this meant that he can choose when to take stocks of the figures. The golden rule was not controversial in Labour's first term as spending was held to Tory level, however during Labour's second term Conservative were very critically of Labour, Labour had spending rose to £61 billion pounds, which caused Government debt to soar and the golden rule was suspected of being breeched. Tories argued that Labour had broken there golden rule, Cable described the golden rule as " setting his own test and marking it" and this helped to ensure he is successful in meeting it. Brown was seen to be a

Victim of his own success, he believed that the economy would continue to grow when he was borrowing and spending, he was certain he had vanished BOOM and BUST by delivering steady economic growth but the worsening of global trade market crisis lead the UK economy to recession. The rise in globalisation means that economies are interdependent and this limits the government's availability to control the economy.

For example, When HSBC announced loses linked to US sub-prime mortgages. As the number of mortgage defaults in the US increased, pressure grew on UK banks that have indulged in risky speculative banking practices. Huge banking intuitions in the US announced losses, this led to low confidence amongst the Banking sector, the rate at which banks were lending to each other also rose significantly which froze liquidity (free flow of funds between banks) leaving banks heavily exposed.

In the UK, Northern Rock granted emergency financial support from the Bank of England, which meant that government had to intervene in the market to stop banks from failing. In February 2008, Labour Government intervened in the banking system by nationalising Northern rock and Bradford and Bingley, and propping up RBS and HSBOS. In 2008 budget, Darling increased the top rate of tax to 50%, and announced a delay in the increases of VAT to avoid a further shock on the high-street. Originally, Conservative claimed this was Labour returning to their roots. Liberal Democrats and the Conservative blamed Brown for failing to regulate the banking sector more strictly, however Conservative eventually had to accept government intervention in helping the banking system.

Cameron blamed Brown and Labour government for the credit crisis, saying that profligate borrowing has led to huge and unsustainable public debt and a deficit which was more often referred to as a black hole. He blamed Brown for not " mending the roof" when the sun shone on the UK economy. However, some would argue that Intervention was crucial for the economy, Labour nationalising banks means that there is still competition in the banking system and people still have choice, but also Labour claimed that Banks would be sold back to private sector as soon as possible. This was crucial, as they did not want to be seen as traditional Labour, which were seen to be favouring nationalisation. Arise of the Banking crisis shows that Government still has huge control over regulatory agencies, and the banks are ultimately answerable to government. The government's ability to affect the UK economyis perhaps limited, due to the transfer of Monetary Policy to Monetary Policy Committee. Previously government could control interest rate, and thus could be a tool of particular ideas, however, in 1997 when New Labour came in power, they announced that the Monetary Policy Committee now had control over interest rate, and made the decision to make the Bank of England independent. They made this decision to establish fiscal responsibility and economic competence, by allowing the MPC to set interest rates, they were promoting to develop business confidence and attract investment in the UK.

Transfer of power over interest rates to the Bank of England means government can no longer regulate the financial sector, Nevertheless, Bank are accountable to parliament and the wider public. The legislation provides

that if, in extreme circumstances, the national interest demands it, and the Government has the power to give instructions to the Bank on interest rates for a limited period. The economy is very unpredictable which means that government could only control financial forces to a certain extent, some financial forces can have impact on dictating government policy. The implementation of certain government policies can have a huge effect on how the economy operates, For example, during the beginning of the Thatcher period, the government were attracted to monetarist policies as they could be implanted without the cooperation or consent of the trade union movement.

By the mid-1980s the economy began to BOOM but by 1988 the economy was overheating, the UK economy was facing a massive balance of payments crisis accompanied by rising inflation and rising interest rates. When Major became Chancellor, to engineer a soft landing for the economy sterling joined the exchange rate mechanism (ERM) of the European Community. Thatcher was against this, as she did not believe in fixed exchange rates, but eventually allowed herself to be persuaded, The idea of the ERM was that finally UK firms and workers would have to adapt to the inflexibilities of the international market and could no longer expect government to bail them out if they were inefficient however this kept the exchange rate of sterling too high, which meant that instead of introducing stability to the economy it ended making conditions for exports more difficult, firms went bankrupt or closed at the rate of one every six minutes. This meant that government were forced to intervene to support the

currency to keep it in the ERM bands. Within hours, interest rates were raised from 10 to 15 per cent to defend the falling pound. Almost all of UK's foreign reserves were spent in an unsuccessful defence of sterling, All this contributed to ' Black Wednesday' where John Major's government were forced out of the ERM and interest rates returned to 10 per sent the next day. This shows how In the short run, leaving the ERM benefitted the economy, as it devalued pounds which led to a flow in export profits and an improvement in the balance of trade. The economy grew; wages grew steadily but without risking higher inflation.

By autumn, 1997 employment was below 1. 5 million for the first time in 17 years. There is also the argument that since UK's membership of the EU, means that UK has had to sacrifice some of its legal sovereignty to the EU. For example, it has been sacrificed to supranational bodies such as the European Court of Justice and in those policy areas decided on by Qualified Majority Voting in the Council of Ministers. Laws made by the EU are binding on the UK and cannot be overruled or contradicted by UK law.

Therefore the constitutional feature of obeying the rule of law is undermined. For example, the Factortame Case in 1990 where parts of the UK Merchant Shipping Act breached EU law, and was therefore overruled. Regulations take immediate effect and do not require parliamentary approval. With directives, the results are binding but how these are achieved is left to the discretion of national governments, which means that UK still has some control on the economy. Europhiles would like this to be mutual control instead, since UK representatives are involved in the EU legislative process

on an equal basis to all other member states and take policy decisions which affect other states. On the other hand, UK still has control over the economy, as they can choose to withdraw from the EU in a strictly legal sense at any time. It also can be argued that the significance of EU law has restricted the dangers of an elective dictatorship.

Additionally, national governments are still the most powerful actors within the EU and retain the veto on new developments in the treaties. However there are also other issues to consider. UK judges can act on behalf of the European Court of Justice and suspend UK laws until a ruling is made. To conclude, it can be said that since the late 1980s the change form Keynesian policy (based on demand management) to monetary policy has limited government’s control. However, by the end of Major’s government period the economy was booming, the change helped to bring about stability and economic growth.

However, Governments ability to control monetary policy has been further limited, when Labour came into power in 1997 and removed interest rates policy (MPC) from political hands, this means that government no longer has control over the economy financially, But government still has the power to intervene in extreme circumstances. It is very difficult to estimate how much control government has over the UK economy, since all economy are interdepended, and the polices implanted by one economy could have indirect effect on all other economies, thus from the reason I have provided, it can be said that it is only to a moderate extent that the government can exert meaningful control on the economy.