Aggregate supply and demand

The Warwick MBA Assignment Cover Sheet Submitted by: 1267499 Date Sent: 15 April 2013 Module Title: Economics For Business Environment Module Code: EBE Date/Year of Module: 2013 Submission Deadline: 17 April 2013 Word Count: 1180 Number of Pages: 8 (including this) Question: Mid Module Assignment for EBE " This is to certify that the work I am submitting is my own. All external references and sources are clearly acknowledged and identified within the contents. I am aware of the University of Warwick regulation concerning plagiarism and collusion.

No substantial part(s) of the work submitted here has also been submitted by me in other assessments for accredited courses of study, and I acknowledge that if this has been done an appropriate reduction in the mark I might otherwise have received will be made. " Mid-module assessment Please note that this mid-module assessment counts for 20% of your final EBE module mark. 1. Use the AS/AD framework to show the separate effects on GDP, inflation and public sector borrowing on any single national economy of: a. a cut in the rate of corporation (profits) tax . an increase in the rate of VAT (sales tax) c. a slowdown in the GDP growth of world trade. Make sure that you include clear and appropriate diagrams for this question 2. Choose an economy. Analyse the main effects of a large cut in its government spending Question 1 counts for 45 marks and question 2 counts for 55 marks. The guide TOTAL word limit (for both Questions 1 and 2 inclusive) is 1, 000 words. The deadline for submitting this assignment is 17th April 2013. Answers: A. A cut in the rate of Corporation (Profits) Tax

The reduction of Corporation tax rate on profits will enhance the reserves of the business by less liability towards the Exchequer and more reserves will be maintained for the shareholder’s equity or the growth of the business leading to increased capital spending and efficient production. Please refer to Fig 1 Below. Impact of the above on: a) GDP The Aggregate demand is expected to improve thus causing a shift of the curve to shift out wards (AD1 to AD2). This will result in Production levels to improve (Y1 to Y2) and thus improving the GDP.) Inflation With the Aggregate Supply to the economy remaining constant will result in increased demand (AD1 to AD2) this will shift the Economic Equilibrium and thus stimulating the price level rise from ? 1 to ? 2 which will move the inflation upwards. c) Public Sector Borrowing The adverse impact to the tax cuts will mainly be towards the tax revenue generation by the Government resulting in deficit towards the public spending which can cause the Public sector borrowing to increase in order to meet the regular requirement of public sector market.

Refer Fig. 4 for understanding as T2 as initial collection while T1 as reduced collection. B. An increase in the rate of VAT (sales tax) This will have a negative impact on the consumer Market as well as it will discourage the small to medium sized industry where they might not be able to pass on the burden to the consumer – resulting in narrower profits resulting in cutting costs which would eventually effect the labor market. Impact of the above on (REF : FIG 2) a) GDP The impact of this change on GDP is likely to be negative (Shift from Y1 to Y2).

However, this is highly dependent upon the way the additional resource will be deployed in the economic cycle as the additional spend as a result level of output from the increased economic activity against the reduction in collection of the Tax revenues. b) Inflation The rising prices will result in higher prices and extra currency flow resulting in rising inflation.? 1 to ? 2 c) Public Sector Borrowing The Revenue collections for the Government are expected to increase as we are assuming that the demand remains constant.

Public sector borrowing is likely to reduce as Government results are likely to improve with this change. Refer Fig. 4 for understanding as T2 as initial collection while T1 as reduced collection. C. Slowdown in the GDP growth of world trade. Global recession or slowdown of world trade can have a negative as well as a positive impact on National economies. This is directly related to the dependency of the National economy on the foreign supplier, foreign buyers, internal resources and internal demand.

The slowdown in global trade is an opportunity for the national suppliers as they are now required to meet demand. This scenario is also positive for local suppliers because the market is adaptive to the alternative or complementing products thus improving the chances of local suppliers to create demand for their products. In this Scenario(FIG 3) the Aggregate Supply is expected to move inwards provided that all other factors remain constant. a) GDP If all the other factors remain the same there will be improved GDP due to the rise in demand being met by the national production (Y1 to Y2)) Inflation Since there will be reduction in the imports and the currency circulation will be within the National Economy the inflation is expected to reduce. c) Public Sector Borrowing Public sector borrowing is likely to reduce as Government results are likely to improve with this change. Due to the improved production levels and improved national economy will open avenues for improved revenue (Tax) collections. 2. Choose an economy Analyse the main effects of a large cut in its government spending. Large cut in Government spending can generally be related to Austerity Measures by an economy.

For the purpose of this analysis, the economy under review is Brazil. The Government Spending trends are as per below chart (Source: www. tradingeconomics. com) This is the 7th Largest Economy of the world and largest of Latin America. With 193Million of population it is pivotal that the Government spending is given the right attention. Due to the cuts there will be effects on The main elements which will be affected by a large cut are: 1. Health 2. Education 3. Infrastructure Health: Almost 64Mn of Brazil's 193Million (30%) population are above 40 years of age (Wikipedia).

There are more than 16. 5Mn people who are considered to be in extreme poverty (BBC report of June 2011) these demographics require proper Health care attention. Due to the sex trade being legal (adults) an extra care is required. Significant Health cuts will result in destabilizing the country. Any reduction or cut in the funds towards healthcare can result in the destabilization of the country – In terms of economics there will be an out flow of the population to the neighboring countries resulting in the increased demand of the healthcare facility resulting in increased inflation.

Education: Education is an important pillar for an economy to grow. Brazil has always been short of the educated and well trained managers. According to the OECD report of 2011 Brazil spends 106% per capita GDP per Tertiary student. However the tertiary students represent only 3% of the total enrolled students. With this effort the GDP has seen an increase of 1. 8%. In a scenario where there are significant cuts of spending in the education sector the GDP of the country will fall and the rise of Jobless numbers will be inevitable resulting in lawlessness and lack of investment in the country.

Infrastructure: Infrastructure plays the role of a backbone of the economy of any country. With the 2014 FIFA world cup and then Olympics of 2016 – Brazil is bound to spend more on infrastructure to make the games a success as the international events such as World Cup and Olympics brings significant traffic of foreigners to the country which will result in imports being increased thus improving the GDP of the country. Any significant cut in the government spending on the infrastructure can ruin the image of Brazil which can be a permanent scar for Brazil.