

## Economy – Government Spending and Taxation

The government's main economic aims are:

- ▶ **Economic growth** – more goods and services produced in the economy.
- ▶ **Low inflation** – prices that are not rising too fast.
- ▶ **Low unemployment** – as many people employed as possible.
- ▶ **Fair distribution of income**

The main policies used by government to achieve these aims are:

- ▶ **Fiscal policy** – government spending and taxation. Government spending is also known as **public expenditure**.
- ▶ **Monetary policy** – interest rates (the cost of borrowing money and rewards for saving).
- ▶ **Legislation** – laws that affect the way that a person or business can act.

The UK Government spends over £400bn a year and takes about the same in taxes. It also passes legislation. These affect the way business can act, e.g. what it can produce, how much it costs and who it can employ. It also affects the way that consumers spend their money.

## Taxation

Taxation comes in two forms:

- ▶ **Direct taxation** – taxation on income and profits (income tax, National Insurance and corporation tax).
- ▶ **Indirect taxation** – taxation on spending (VAT, excise duty).

Some examples of UK taxation are shown in the table below:

Example	Type of tax/how it works	Effects on business if the tax rises
<b>Income tax</b>	A percentage of an individual's income is taken in tax.	A reduction in disposable income (money available to spend after tax); therefore households will not be able to spend as much, reducing sales.
<b>VAT</b>	A percentage (17.5% currently in the UK) is added to the price of the item. It does not apply to all goods, e.g. children's clothes.	Increases the cost of the product, leading to fewer sales.
<b>Tax on beer (excise duty)</b>	An amount is added to the cost of beer.	Increases the cost of the product, leading to fewer sales.

Example	Type of tax/how it works	Effects on business if the tax rises
<b>Corporation tax</b>	A tax on profits made by businesses.	Reduces the amount of profit available at the end of the year to be either distributed to the shareholders or to pay for more investment.
<b>National insurance</b>	A tax on incomes (like income tax). BUT also a tax on businesses who have to pay a portion of the tax on behalf of the worker	The same as income tax and corporation tax but added to together.

## Government Spending

The UK government spends approximately £400bn a year. Over a third of this money goes in welfare benefits such as pensions, unemployment benefit and other forms of income support. The rest is spent on health, education, defence, roads, law and order and on supporting businesses and local communities.

Businesses can benefit direct or indirectly from the rest of the spending.

Governments provide money in the form of grants, subsidies and tax breaks (paying less tax than you should) to encourage businesses in certain areas of the economy. A business that is starting out, or is going to provide employment in a depressed area may be able to benefit from such help.

Examples of government assistance are:

- ▶ **Regional selective assistance** that gives help to businesses wanting to set up in areas of high unemployment.
- ▶ **Enterprise zones** aim to attract businesses to inner city areas.

Governments also provide support through advisory bodies coordinated by the Department of Trade and Industry, especially for small businesses.

Other bodies also provide information and support such as the Chambers of Commerce. This organisation represents businesses in a local community, acting as a source of advice from the experiences of other businesses and exploiting the connections within these businesses.

Businesses can also benefit indirectly because of the huge spending that governments undertake. For instance the increases in health spending will benefit businesses that produce medical products or services to hospital (e.g. cleaning).

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