

Fiscal Policy and Monetary Policy of the UK

Ceyue Gao^{1,* †}, Yimiao Que^{2,* †}

¹ University of Birmingham, Edgbaston, Birmingham, B15 2TT, United Kingdom

² Nanjing Agricultural University, No.1 Weigang, Xiaolingwei Street, Xuanwu District, Nanjing, Jiangsu Province

*Corresponding author. Email: 1296568298@qq.com

†These authors contributed equally

ABSTRACT

This article will describe the impact of British fiscal policy and monetary policy on the British economy. As an important trading entity, economic power, and financial center, the British economy is the sixth largest economic system in the world and one of the world's richest, most economically developed countries with the highest standard of living. The country is deeply mired in the quagmire of Brexit, and the prospect of Brexit after more than three years is even more unpredictable. While the UK's economic growth is showing a downward trend, the economy is facing multiple challenges such as Brexit, and future growth is expected to continue to decline. In this difficult situation, the British finance itself is not only facing the urgent problem of sustainable development that needs to be solved, but also needs to play an important role in stabilizing and regulating the economy. Among the major developed economies in the world, although the UK's economic growth trend is good, the continued downward trend has not changed. In the face of major changes unseen in a century, global growth is declining, and the problem of anti-globalization has become prominent. The future growth of the United Kingdom is facing many challenges.

Keywords: UK, Fiscal policy, Monetary policy

1. INTRODUCTION

1.1 Brief introduction

Fiscal and monetary policies are important tools to ensure the smooth running of the country and society, and play an active role in promoting national development and improving the quality of life of the people. At different stages of China's development, the state also introduces relevant policies according to the different needs of the country's development and people's lives. Therefore, a good analysis of the contribution of relevant fiscal and monetary policies to economic growth plays a good role in promoting the rational allocation of existing scarce resources and coordinating the overall development of various regions. From 1920 until the epidemic, the UK government had maintained a relatively consistent and stable fiscal and monetary policy, but the economic impact of the epidemic on the UK forced the government to introduce relevant short-term fiscal and monetary policies to counter the effects of the epidemic. This paper will analyse the impact of the relevant fiscal and monetary policies implemented in the UK during the period from 1920 to the epidemic on the

UK economy by analyzing macroeconomic indicators such as GDP, fiscal deficit and so on.

1.2 Fiscal policy

Fiscal policy refers to the government's measures to promote full employment, mitigate economic fluctuations, stabilize prices and regulate the macro economy by adjusting the level of government revenue and expenditure, taxation or debt. Fiscal policy tools mainly include government purchase expenditure, taxation and national debt. When social demand is low, governments usually raise government purchase expenditure and reduce taxes in order to stimulate consumption; conversely, when the economy is overheated, governments usually take the opposite approach, aiming to reduce consumption. Fiscal policy is a direct transmission mechanism, as it can deal directly with fiscal issues. Fiscal policy is determined by three main constituent instruments. One is government spending. Government spending on purchases directly affects the size of national income and is directly related to increases or decreases in the state of aggregate social demand. The impact of government spending on the economy as a whole consists of two channels.

Government purchase policy; and secondly, government transfer policy. This policy mainly refers to the livelihood policies such as the various government unemployment insurance and endowment insurance when previously. The second is tax collection and management policy. Taxation policy is a major part of government revenue. The adoption of taxation policy on the one hand affects the overall income level of society; on the other hand, it uses taxation policy to redistribute the goods and factors of production that affect society, thus providing incentives to all segments of society.

1.3 Monetary policy

Monetary policy refers to the use of monetary policy instruments by central banks to adjust the money supply, which in turn affects market interest rates and influences capital investment through changes in interest rates, thereby achieving macroeconomic regulation. The three common tools of monetary policy include the legal reserve ratio, open market operations and re-discounting. Under normal circumstances, the introduction of monetary policy tools allows the money supply in the market to be regulated. The money supply can influence changes in interest rates, which in turn can affect aggregate output for the purpose of increasing employment and promoting economic growth. Considering the situation we are suffering from, expansionary monetary policy should be used to stimulate economic recovery. Monetary policy is implemented by the central bank and it influences the money supply. The central bank adjusts the money supply to influence the interest rates, the extent of credit availability in the economy. And it also affects the aggregate demand indirectly, thus taking a series of measures to achieve the desired balance between aggregate demand and aggregate supply.

2. FISCAL POLICY OF THE UK

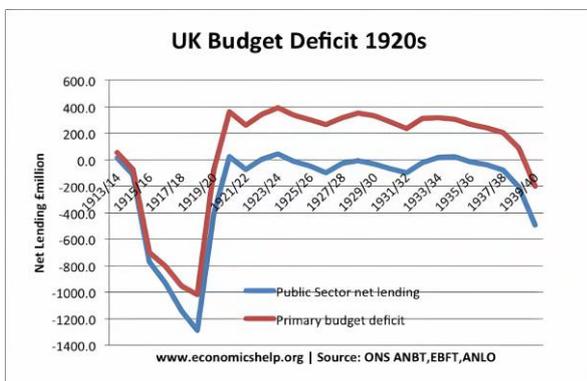


Figure 1. UK Budget Deficit 1920s

The red line shows that the primary budget deficit lasted until 1940, and the British government took many measures to address this primary budget deficit. The country experienced prolonged deflation and low growth

during that time due to the high unemployment rate in the economy. The government's lending capacity has also declined, and the peaks or troughs of public lending have been synchronized with budget deficits. Implementing Keynesian fiscal policy theory within the UK economy has to some extent followed by a huge increase in the unemployment level [1]. In 1945-1952, the British Labor government was deeply influenced by Keynesian-ism and believed that the role and influence of monetary policy was limited. Therefore, the British government resorted to fiscal policy to directly influence the level of total expenditure and thus employment internally, recovering the economy, protecting the pound externally and developing foreign trade. Fiscal policy in the UK has been relatively accommodate since the 1960s, working through fiscal budgets and reconciliation targets. In the 1980s, the main features of British fiscal policy included a policy of privatization of state-owned enterprises, tax reform and strict control of fiscal spending. At the end of the 1980s, when the UK economy was at the peak of its cycle and real output was well above the levels reported in the budget, the increase in fiscal surpluses made society forget the need for fiscal position to deteriorate from the early 1990s onwards, and the UK economy remained in the doldrums with a severe economic crisis. As per the mentioned theory, it was seen that aggregate demand of the country was falling and that in turn was reducing overall spending ability of the UK economy.

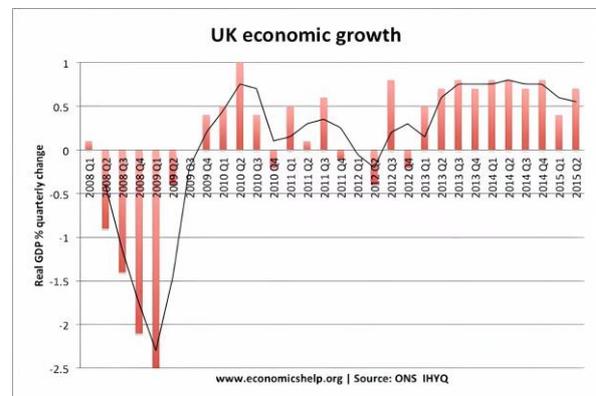


Figure 2. UK economic growth

Taking a deep look at the UK economic growth, in 1930, the real GDP of the country fell below 6% and due to this result, the interest rate fell from 5% to 0.5% making a huge downfall in new investments. This caused the British economy to plunge into a huge depression in 2009. In order to improve this situation, the government adopted an expansionary fiscal policy and relaxed the value-added tax in its policy. This has further widened the gap and deficit, and the situation has become worse. In 2010, the new government of the British economy made the situation worse by cutting government expenditures, resulting in a reduction in a large number of government procurement. The fiscal policy adopted by the British government has not actually helped this country, but has made the situation worse [2].

In contrast to the neutral fiscal policy that has always been adopted, since 17 March 2020, the UK government has announced a series of government support and emergency credit schemes totally up to £30 billion, in the form of assistance at two different levels: for businesses and for individuals. At the individual level, in addition to granting a three-month loan extension to individuals severely affected by the epidemic who have lost income, etc., relief ranging from £48-250 will be granted on a household basis, while welfare relief will also be increased to £1,000 for the next 12 months. At the same time, £7 billion of financial assistance will be used to protect people's livelihoods and to help the vulnerable who have been severely affected by the epidemic. For businesses, the government has introduced tax breaks and exemptions to reduce losses.

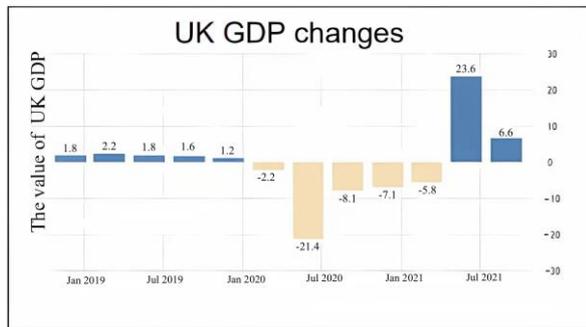


Figure 3. UK GDP changes from Jan 2019 to Jul 2021

It is clear that this series of expansionary fiscal and monetary policies have played a good role in the recovery of the UK economy. The rate of change in GDP rose from -21.4% to 23.6% in the year after the policy was enacted [3]. These data indicate that the series of fiscal and monetary policies adopted by the UK government in the context of the epidemic were extremely effective [4].

3. MONETARY POLICY OF THE UK

Monetary policy is mainly done by the UK reserve bank and the main objectives of the UK monetary policy is to control the level of inflation.

The objectives of monetary policy in the UK were mainly focused on the balance of payments in the 1950s and 1960s as monetary policy focused on controlling interest rates rather than on the money supply. After the 1970s, the focus on stabilizing inflation and a stagflation situation led to an increasing interest in monetarist policy ideas by the Bank. In the early 1980s, monetarist ideas were adopted and the intermediary objective of monetary policy shifted from interest rates to the money supply. In the 1990s, the inter-mediation of money supply was explicitly abandoned and more variables were monitored in the conduct of monetary policy, with a focus on price variables such as interest rates and exchange rates [5].

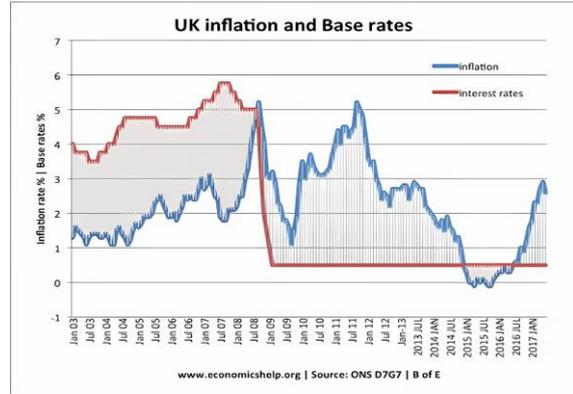


Figure 4. UK inflation and Base rates

The interest rate of UK is well below the inflation rate till 2017. The monetary policy has been as seen effective for the economy of UK as the inflation rate has been decreasing in the country for last few decades. To some extent, the overall quality of policies that is mainly sustaining within UK has reduced the inflation rate to 0.7% and the target interest rate is 2% (Pettinger, 2020). [6] Since the current rate is well below the expected or target range thus it can be said successfully that UK monetary policy is living in a comfortable position.

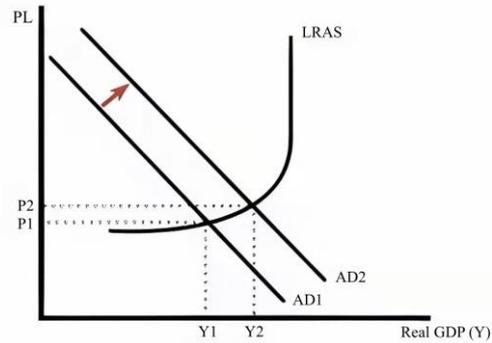


Figure 5. Impact of expansionary monetary policy to increase AD

The effect of easing monetary policy in the United Kingdom is an increase in total demand. The LRAS or long-term aggregate supply curve exhibits a u-curve. On the other hand, the aggregate demand or AD curve shifts to the right. Loose monetary policy actually includes a low tax policy that gives consumers in the economy the confidence to buy. Due to low taxes, they will have greater demand, which will actually bring more production to the economy. The low interest rate of borrowing will reduce the burden of borrowing and allow funds to circulate and reinvest. As more investment and income opportunities emerge, this will boost the economy. Countries like the United Kingdom are easing monetary policy to improve better investment opportunities in order to maintain the overall quality of investment [7]. However, in 2008 and 2011, monetary policy was more difficult, mainly due to cost-driven inflation and so-called inflation. In 2009, due to the impact of the global financial crisis, the interest rate was zero, which was

unable to increase the economy and investment.

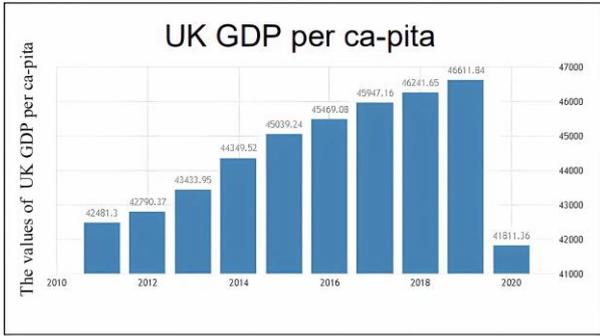


Figure 6. the values of GDP per ca-pita for the UK from 2010 to 2020

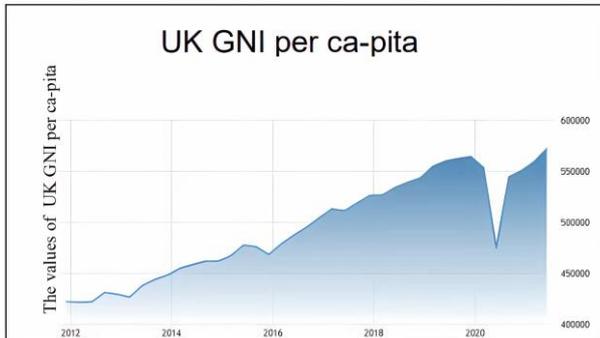


Figure 7. the values of GNI per ca-pita for the UK from 2012 to 2020

The chart shows the values of GDP, GDP per ca-pita and GNI per ca-pita for the UK from 2010 to 2020. As can be seen, from 2010 to 2019, the UK's economic situation is relatively stable, maintaining the economic and fiscal policies that have been customary [8]. By 2020, the economies of all countries have been hit hard by the outbreak and spread of the new global epidemic. The World Economic Outlook published by the World Monetary Fund (IMF) in April 2020 predicts that the new corona-virus pneumonia epidemic will cause the global economy to shrink by 3% and global trade to plummet by 13% in 2020[9]. The "embargo" measures taken by countries in response to the epidemic are expected to cause a world economic downturn of greater magnitude than the negative impact of the 2008 global financial crisis. The uncertainty over the severity, duration and spread of the epidemic has led to significant downward pressure on the global economy in the future. In view of its tertiary sector-based economic structure, the UK has chosen to support and assist the service sector in the face of the epidemic, which is less difficult to revive due to its highly developed financial sector, robust market trading mechanism and highly global financial chain. In addition to the service sector, the UK has also introduced a series of policies to revive its manufacturing sector, etc. By July 2020, the UK government has issued a total of £150 billion bailout plan, which is also known by many as the modern version of Roosevelt's New Deal [10].

4.CONCLUSION

In the next few years, if the macro policy can be fully implemented, it will greatly improve the economic development of the UK. A stable economic environment can make enterprises and individuals full of confidence in the future economic prospects, so that they can make long-term and effective plans, which can promote long-term projects for the entire country's economy. Improve the quantity and quality of long-term investments and improve infrastructure. Increased investment can make full use of idle assets. If the fiscal policy is effectively implemented and at the same time coordinated with the correct monetary policy, the British economy will be able to change the previous low-speed growth situation, enter a faster growth stage, and lay a better foundation for the sustainable development of the British economy. The United Kingdom was also affected by the slowdown in world economic growth in 2001, but the United Kingdom performed better than other OECD countries. Its economic growth was faster than that of the Eurozone countries and avoided a massive contraction in output similar to the United States. Since mid-2003, domestic demand has been strong. Although there are factors contributing to the increase in housing demand, government spending is also increasing and investment is recovering. Therefore, the growth of domestic demand is widespread. Therefore, interest rates have been raised earlier than in other countries. Increased interest rates and raised interest rates 5 times. Now these policies have produced results. Growth has become moderate this summer, housing price growth has slowed down, and it is likely to fall. The pre-taken actions can successfully prevent the economy from overheating and make the United Kingdom. The economy has achieved stable and balanced growth. The responsible government seeks a long-term balance between supply and demand and sustainable development, and will not forgo the interests of the next generation for short-term gains. In the face of an unpredictable and highly uncertain epidemic, the best way to recover the economy is to actively prevent and control the epidemic and avoid its spread on a wider scale. In this worldwide battle, there is no final victor, and only the countries that are most successful in fighting the epidemic will be able to minimize their losses. The short-term policies enacted by the UK government may deviate to some extent from the long-term policies of the UK government in the face of the continued downward international economic situation ahead, but overall they all have the same goal, to enable the UK economy to recover from the blow of the epidemic and to be able to maintain long-term stability and health. In order to cope with the impact of the new epidemic on the world economy in the coming decades, the UK government should strengthen its ability to co-ordinate and adjust its fiscal and monetary policy choices in the short term in accordance with the situation, strong commitment to spending according to need and ensuring efficiency of

expenditure and at the same time give more flexibility to fiscal spending to play the role of "insurance of last resort".

REFERENCES

- [1] Pettinger, T., 2018. Monetary And Fiscal Policy In The UK - Economics Help. [online] Economics Help. Available at: <<https://www.economicshelp.org/blog/113/uk-economy/monetary-and-fiscal-policy-in-the-uk/>> [Accessed 30 November 2020].
- [2] Pettinger, T., 2020. UK Fiscal Policy - Economics Help. [online] Economics Help. Available at: Information from <<https://www.economicshelp.org/macroeconomics/fiscal-policy/uk-fiscal-policy/#:~:text=Fiscal%20policy%20involves%20changing%20the,the%20rate%20of%20economic%20growth.>> [Accessed 30 November 2020].
- [3] Liu Jiahao, Zhou Minghao, Ma Chunhui, Zou Zhen. Analysis of the choice and transmission effect of fiscal and monetary policies in China under the influence of the new crown epidemic[J]. *Economist*,2021(10):22-24.
- [4] Li Xin. The adjustment of the UK fiscal policy under the shock of the new crown epidemic and its inspiration[J]. *Research on Finance and Economics*,2020(12):125-133.DOI:10.19654/j.cnki.cjwtyj.2020.12.014.
- [5] Pettinger, T., 2020. UK Monetary Policy - Economics Help. [online] Economics Help. Available at: <<https://www.economicshelp.org/macroeconomics/monetary-policy/>> [Accessed 30 November 2020].
- [6] Crown epidemic and assessment of green economy recovery policies[J/OL]. *Systems Engineering Theory and Practice*:1-18 [2022-01-12]. <http://kns.cnki.net/kcms/detail/11.2267.N.20210906.1110.006.html>.
- [7] Liu Jiahao, Zhou Minghao, Ma Chunhui, Zou Zhen. Analysis of the choice and transmission effect of fiscal and monetary policies in China under the influence of the new crown epidemic[J]. *Economist*,2021(10):22-24.
- [8] Sheng, Liu R., Tan, Y. Xi. Epidemic response: a comparative analysis of fiscal and monetary policies in China and the United States[J]. *International Finance*,2021(08):67-75.DOI:10.16474/j.cnki.1673-8489.2021.08.009.
- [9] Yan Mengjie. Fiscal policy practices, characteristics and reflections of countries during the New Coronary Pneumonia epidemic[J]. *Economic Research Reference*,2020(13):29-43. doi:10.16110/j.cnki.issn2095-3151.2020.13.004.
- [10] Sun Yagang, Xu Jing, Wei Chunfei, Zhu Baofang, Xu Xi. Study on the synergistic effect of fiscal and monetary policies--a case study of Qinghai Province[J]. *Qinghai Finance*,2021(09):33-38.