AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



EXAM QUESTION PACK

3.2.3.3 INFLATION AND DEFLATION

SCORE	PERCENTAGE
/2020	%

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1. Between 2014 and 2018, the pound fell by more than 20% against the dollar and euro. Some argued that this would benefit the UK's macroeconomic performance, but others claimed that a lower exchange rate will cause problems.

Assess the view that a depreciation of the pound against other currencies is likely to improve the UK's macroeconomic performance.

[25 marks]

2. **Extract C** (lines 2 – 4) asks: 'Is it time the UK considered manipulating its currency directly and managing its exchange rate in order to reduce the ever-increasing trade deficit and to help improve its performance?'

Using the data and your knowledge of economics, evaluate the view that the UK should focus its monetary policy on managing the exchange rate in order to improve macroeconomic performance.

[25 marks]

3. In January 2009, £1 could buy approximately 1.04 euros on the foreign exchange market. By July 2015, £1 could buy approximately 1.44 euros.

Evaluate the impact on the UK's macroeconomic performance of a sustained rise in the value of the pound sterling against the euro.

[25 marks]

4. It is now nearly a decade since the financial crisis caused a recession in the UK. In March 2009, the Monetary Policy Committee (MPC) set the UK Bank Rate at 0.5%, which was a record low, in order to stimulate economic growth.

Discuss the importance of low interest rates in bringing about sustained economic growth in an economy such as the UK.

[25 marks]

5. It is now nearly a decade since the financial crisis caused a recession in the UK. In March 2009, the Monetary Policy Committee (MPC) set the UK Bank Rate at 0.5%, which was a record low, in order to stimulate economic growth.

Explain the main features of a recession.

[15 marks]

6. The Office for Budget Responsibility (OBR) forecast that government spending would account for 36% of GDP by 2020 compared to 45% of GDP in 2010.

To what extent do you regard a contraction of the public sector to be beneficial for the UK economy? Justify your answer.

[25 marks]

7. **Extract C** (lines 21 – 22) states: 'Any kind of deal between the EU and ASEAN economies is still a long way off, and the UK must wait to see how new trade deals affect its macroeconomic performance.'

Using the data and your knowledge of economics, evaluate the extent to which international agreements to increase free trade are likely to be beneficial to the UK's macroeconomic performance.

[25 marks]

8. **Extract F** (line 21) asks: 'Why are productivity rates in other economies important for the UK?'

Using the data and your knowledge of economics, evaluate the significance of productivity improvements in the UK **and** in other EU economies for the performance of the UK economy.

[25 marks]

9. **Extract E** (lines 9–10) states 'Improvements in productivity on the supply side of the economy could actually lead to more deflation.'

With the help of a diagram, explain how improvements in productivity could cause deflation.

[9 marks]

10. The table below shows the Consumer Prices Index for a country over a number of years.

Year	End of year prices index
1	100
2	98
3	103
4	105
5	106
6	104
7	107

Which one of the following statements is correct?

A The country suffered disinflation in Year 5 ⬭

B The inflation rate was highest in Year 7 ⬭

C The only time the country suffered deflation was in Year 2 ⬭

D Real incomes fell between Year 1 and Year 7 ⬭

[1 mark]

11. The information below shows the changes in key economic indicators for a country over a period of one year.

Money GDP	Rate of inflation	Population increase	Gini coefficient
+6%	+4%	+1%	–8%

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Which one of the following can be concluded from the data?

A External costs generated from economic activity have reduced the quality of life ⬭

B Real GDP per capita has fallen ⬭

C The distribution of income has become more unequal ⬭

D The standard of living of typical residents in the country has probably improved ⬭

[1 mark]

12. The Government has ruled out the possibility of a rise in VAT before 2020 but other indirect taxes may increase. It has also stated that the personal income tax allowance will be increased from £10 800 in 2015/16 to £12 500 by 2020, and plans to cut the main rate of corporation tax from 20% to 17%.

Evaluate the economic consequences for the UK economy of a significant shift in the burden of taxation from direct taxes to indirect taxes.

[25 marks]

13. Between 2011 and 2016, UK unemployment fell from a high of 8.5% to 4.8%. Some argue that government attempts to reduce unemployment inevitably lead to trade-offs with other macroeconomic policy objectives.

Discuss the view that falling unemployment will inevitably lead to trade-offs with other macroeconomic policy objectives.

[25 marks]

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14. The table below shows indices for real GDP and consumer prices in an economy over six quarters.

Quarter	Index of real GDP	Index of consumer prices
1	106	100
2	105	105
3	104	111
4	105	116
5	107	120
6	110	123

During these six quarters the economy experienced

A deflation and a recession. ⬭

B disinflation when in recession. ⬭

C disinflation when recovering from recession. ⬭

D rising inflation when recovering from recession. ⬭

[1 mark]

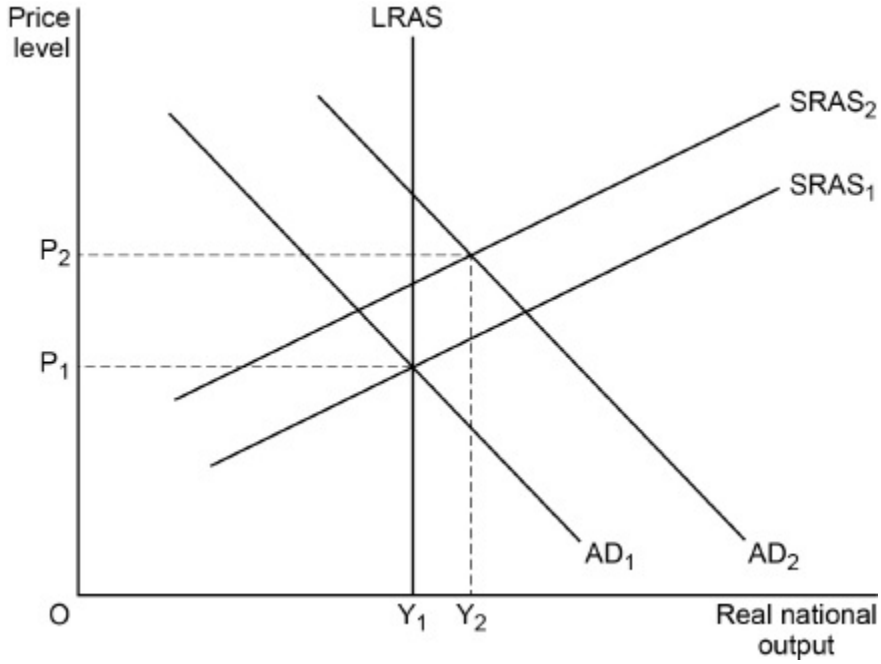
15. **Extract F** (lines 19–20) states 'What is not clear is what should be done if low inflation turns to bad deflation.'

Using the data in the extracts and your knowledge of economics, evaluate the view that monetary policy is the most effective way of tackling deflation in developed economies such as the UK and Japan.

[25 marks]

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16. The diagram below shows two aggregate demand (AD) curves, two short-run aggregate supply (SRAS) curves, and the long-run aggregate supply (LRAS) curve for an economy.



The increase in the price level from P_1 to P_2 raises the rate of inflation above the target rate set by the government. In an attempt to bring inflation back to its target rate, the central bank announces a change in interest rates. Other things being equal, this is most likely to

A create upward pressure on the exchange rate. ⬭

B increase bond prices. ⬭

C make business loans more affordable. ⬭

D reduce the cost of servicing the national debt. ⬭

[1 mark]

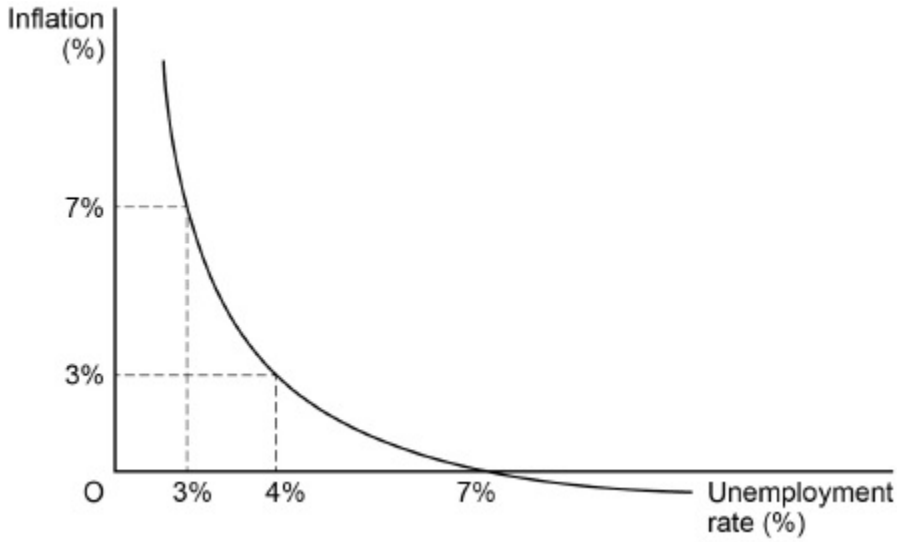
17. In the 2016 Autumn statement, the UK Chancellor of the Exchequer, Philip Hammond, officially abandoned the government's policy of trying to achieve a budget surplus by 2020. While some criticise the government for failing to achieve its fiscal target, others argue that the government should be doing more to help the supply side of the economy.

Evaluate whether achieving a budget surplus is a desirable objective of economic policy.

[25 marks]

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18. The short-run Phillips curve below illustrates the relationship between unemployment and inflation in an economy.



The Phillips curve shows that in this economy

A high inflation leads to high unemployment. ⬭

B there is an inversely proportional relationship between unemployment and inflation. ⬭

C the trade-off for reducing inflation from 7% to 3% is a 4% increase in unemployment. ⬭

D the trade-off for reducing unemployment from 7% to 4% is 3% inflation. ⬭

[1 mark]

19. **Extract F** (lines 10–12) states 'The Austrian economist, Friedrich Hayek, highlighted artificially low interest rates and excessive credit creation as being the main causes of cyclical instability.'

Using the data in the extracts and your knowledge of economics, evaluate the view that maintaining low interest rates for a sustained period of time may be damaging to the UK's macroeconomic stability.

[25 marks]

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20. Despite its central bank operating a policy of quantitative easing for several years, an economy has rising unemployment and a rate of inflation significantly below the target rate set by the government. All other things being equal, which one of the following actions is the central bank most likely to take in order to meet the target for inflation?

A A policy leading to an appreciation of the exchange rate. ⬭

B An increase in its base rate of interest and the reversal of its quantitative easing policy. ⬭

C Providing forward guidance indicating that the bank will continue with its programme of quantitative easing. ⬭

D Selling some of its stock of government bonds to other financial institutions. ⬭

[1 mark]

21. **Extract E** (lines 16–17) states 'However, some argue that trying to maintain stable prices and low unemployment could create trade-offs.'

With the help of a diagram, explain why a trade-off between price stability and low unemployment might occur.

[9 marks]

22. **Extract B** (lines 21) states 'Although some argue that a current account deficit is not a problem, others point to the worryingly large and persistent nature of the deficit.'

Using the data in the extracts and your knowledge of economics, assess the impact of a persistent current account deficit on the macroeconomic performance of the UK economy.

[25 marks]

23. An economy had a 3% increase in its real GDP over a one-year period. In the same period its population grew by 5% and its rate of inflation was 2.5%. From these data it can be inferred that

A its Human Development Index decreased by 2%. ⬭

B nominal GDP per capita increased. ⬭

C real wages fell due to inflation. ⬭

D the number of unemployed people increased. ⬭

[1 mark]

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24. Since 1998, the Bank of England has had responsibility for the operation of monetary policy and maintaining price stability. In response to the financial crisis of 2007–08, the Financial Services Act 2012 gave the Bank of England overall responsibility for financial stability. This was designed to reduce systemic risk and the impact on the real economy of problems that arise in financial markets.

Evaluate the view that strict rules and regulations on financial markets are essential to help create a more stable economy.

[25 marks]

25. All other things being equal, if the velocity of circulation is constant, the quantity theory of money based on Fisher's equation of exchange, MV=PQ, predicts that an x% increase in the money supply will always cause an x%

A decrease in the rate of interest. ⬭

B increase in nominal national income. ⬭

C increase in real national income. ⬭

D increase in the rate of economic growth. ⬭

[1 mark]

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26. The table below contains selected data on a country's macroeconomic performance over a 20 year period.

Year	Unemployment (%)	Rate of inflation (%)	Balance of trade on current account ($ bn)
1998	6.0	3.5	−20
2003	5.8	3.0	−19
2008	5.5	2.5	−12
2013	5.2	2.0	−2
2018	5.0	1.5	+3

All other things being equal, which one of the following, **A**, **B**, **C** or **D**, can be inferred from the above data?

A The natural rate of unemployment is falling ○

B The price level is increasing more slowly ○

C The volume of exports is increasing ○

D There is an inverse relationship between unemployment and inflation ○

[1 mark]

27. In the past few years, CPI inflation has often differed by more than 1% from its 2% target. In the winter of 2015 the UK experienced a brief period of deflation but, more recently, inflation has been over 3%.

Explain the main causes of a rise in inflation.

[15 marks]

28. In the past few years, CPI inflation has often differed by more than 1% from its 2% target. In the winter of 2015 the UK experienced a brief period of deflation but, more recently, inflation has been over 3%.

Evaluate the view that inflation is always preferable to deflation.

[25 marks]

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29. Since 1998, the Bank of England has had responsibility for the operation of monetary policy and maintaining price stability. In response to the financial crisis of 2007–08, the Financial Services Act 2012 gave the Bank of England overall responsibility for financial stability. This was designed to reduce systemic risk and the impact on the real economy of problems that arise in financial markets.

Explain how the monetary policy transmission mechanism works when the Monetary Policy Committee (MPC) raises Bank Rate.

[15 marks]

30. Using the data in **Extract D (Figure 1)**, calculate, to **two** decimal places, the mean inflation rate for Japan from 2010 to 2015.

[2 marks]

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1. **The Global Context Extract B** (lines 1−3) states: ‘some economists are predicting that the US will play a leading role in driving world economic growth and, as the country which is the UK’s main export partner, this may provide an injection into the UK’s circular flow of income.’

Explain the term ‘circular flow of income’ **and** analyse how economic growth in the US may lead to increased national income in the UK.

[9 marks]

2. **The Global Context Extract C** (lines 7−9) states: ‘These policies, however, have created greater divides in terms of the ‘haves’ and ‘have nots’ which may have consequences for the UK’s macroeconomic performance.’

Using the data and your knowledge of economics, assess the importance for UK macroeconomic performance of increasing income inequality, **both** domestically **and** in other economies.

[25 marks]

3. **THE EUROPEAN UNION CONTEXT**

Extract F: Ireland emerges from bailout

Whilst many of the Eurozone members still face instability in their own economies, Ireland became the first economy to emerge from its bailout since the Eurozone crisis began. In its final report on Ireland’s progress under the rescue scheme, the European Commission said: ‘With public sector debt at 122% of GDP in 2013, Ireland needs to continue with its fiscal reduction programmes, reduce private-sector debt and improve bank profitability to revive lending.’

Of the UK’s top ten European trading partners, Ireland is the only one with which the UK has a current account surplus. The importance of trade with Ireland is therefore of great significance. The Irish and UK economies are highly integrated and it is not yet clear how further cuts in Ireland might impact on the UK’s macroeconomic performance.

Public sector debt across many European nations is still at very dangerous levels and Ireland’s debt to GDP ratio is the second highest in the EU. Higher national debts may lead to problems such as crowding out, where private sector investment is reduced due to increased public sector borrowing. The EU introduced the Stability and Growth Pact (limiting total debt as a percentage of GDP to 60% and annual deficits to 3% of GDP) in order to prevent individual economies from creating instability across the EU. However, EU member countries have struggled to keep to the pact, with only four member countries not breaking the rules. Both Ireland and the UK have breached the pact since 2008. No doubt more problems lie ahead for the Eurozone.

Source: News reports, 2013

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4. **THE EUROPEAN UNION CONTEXT**

Extract E: The French economy faces problems

The International Monetary Fund (IMF) has warned the French government that, unless it makes major economic reforms to lower its labour costs and avoid tax rises, the economy is likely to experience reduced growth. This view was echoed in a recent survey of bankers, in which France was identified as the most serious threat to Europe's recovery from the debt crisis which has crippled growth and driven unemployment to record highs. The outlook for France, the Eurozone's second largest economy, is more worrying than that for Italy, Spain or Germany.

The Chief Executive officer of the Institute of International Finance said: 'There's a lack of concern about international competitiveness in France.' French President, François Hollande, is failing to revive business investment in the face of one of the world's highest tax burdens. Such investment could generate greater efficiency and higher productivity, especially important if the euro's exchange rate does not always work in France's favour.

An IMF spokesperson, Edward Gardner, also said that French unemployment, which currently stands at 11%, would continue to rise, despite President Hollande's vow to reduce it by the end of the year. 'It reflects in large part a general phenomenon in Europe that the recovery is slower in coming than we had expected.' The euro area's recovery almost came to a halt as the French economy unexpectedly shrank and German growth slowed.

The failure of the French economy to improve is in contrast to the overall success of the German economy and the stronger signs of recovery in the UK. President Hollande now faces difficult choices in reducing government spending to reach European budget deficit commitments. Furthermore, a recent announcement that VAT will rise, despite previous claims that there would be no significant tax rises, may cause further problems for the economy.

Source: News reports, 2013

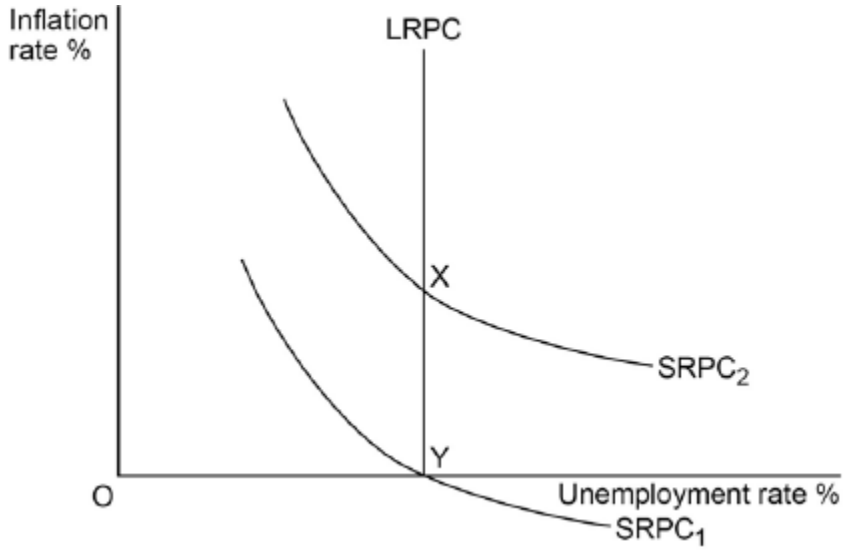
5. 'George Osborne talks about boosting exports and rebalancing the economy, but the Chancellor is not nearly as worried about the trade deficit as he is about the budget deficit.'

To what extent do you agree that a persistent trade deficit is more damaging to the UK's macroeconomic performance than a persistent budget deficit? Justify your answer.

[25 marks]

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6. In the diagram below, $SRPC_1$ and $SRPC_2$ represent short-run Phillips curves and LRPC represents the long-run Phillips curve.



Which one of the following would explain a movement from point X to Y?

A A fall in taxation ⬭

B An increase in government expenditure ⬭

C A cut in real interest rates ⬭

D Reduced inflationary expectations ⬭

[1 mark]

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7. THE GLOBAL CONTEXT

Extract B: Will growing inequality damage the US economy?

Some economists are predicting that the US will play a leading role in driving world economic growth and, as the country which is the UK's main export partner, this may provide an injection into the UK's circular flow of income. However, since the 2008 financial crash, there has been debate in the US over whether or not economic growth can be strengthened and, if so, how best to achieve this. Within this debate, there are growing concerns about the specific issue of income inequality. The top 1% of earners have received 95% of the increase in income since the financial crisis. Since 2009, the top 1% have seen their incomes rise on average by 31.4%, whereas the rest of the population has seen a rise of only 0.4%.

The economist, Joseph Stiglitz, has highlighted inequality as one of the prime reasons why the US has continued to struggle to recover. His basic argument is that the rich have a lower marginal propensity to consume (the proportion of any increase in income spent) and a higher marginal propensity to save (the proportion of any increase in income not spent) than the poor.

Such inequality also creates unsustainable 'property-price bubbles' as wealthy individuals increase the demand for property to let out on the rental market which further fuels inflation. Tax receipts, which could be injected into the economy, also end up being reduced, as the rich are able to exploit loopholes to avoid payment of tax. For this reason, Stiglitz argues that it is necessary for the US Government to intervene to deal with inequality. If the incomes of the poor were raised, increased consumption would occur. This argument is refuted by Paul Krugman, who states that there are some European economies with much lower income inequality which are also in a mess.

Source: News reports, 2013

8. THE GLOBAL CONTEXT

Extract C: Incentives and economic performance

Could inequality be adversely affecting economic performance? According to some economists, capitalism is not working effectively. Reducing trade union power and creating more flexible labour markets have created greater income inequality. Successive governments have also reduced taxation on companies and high earners (such as the cut in income tax for those earning over £150 000 from 50% to 45%) in order to promote incentives and wealth generation, as well as focusing much of the UK's hopes on the financial services industry. These policies, however, have created greater divides in terms of the 'haves' and 'have nots' which may have consequences for the UK's macroeconomic performance.

There has been a shift, over the last generation, in the share of GDP from the workforce to shareholders of between 5% −7%, with many low earners finding it difficult to get onto the property ladder. Neo-classical economists cite the trickle-down effect as a way of improving the living standards of all by cutting taxes for upper income groups and business, stating that economic progress depends on saving and innovation which, in turn, depends on the ability to make high profits. However, research by the Tax Justice Network claims that, when there are high levels of inequality, to avoid tax, financial capital often leaves the country, rather than staying in the domestic economy.

It has been argued that other policies such as public sector pay rise limits of 1%, benefits rising at 1% rather than inflation-linked increases, and the removal of some housing benefit, as well as the culture of bankers' bonuses, have all contributed to growing inequality. This is likely to have consequences for consumer spending power, but may also help to contribute to reduced inflationary expectations. There has also been criticism of the UK banking system, in that it has been too focused on making quick financial returns rather than long-run investment. Ultimately, these factors may damage the UK's ability to achieve its macroeconomic targets.

Source: News reports, 2013

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9. It has been suggested that the NMW should be increased so that it is the same as the Living Wage.

Using **The National Minimum Wage After 15 Years**, explain the possible effects on individuals and the economy if the government were to adopt this suggestion.

[15 marks]

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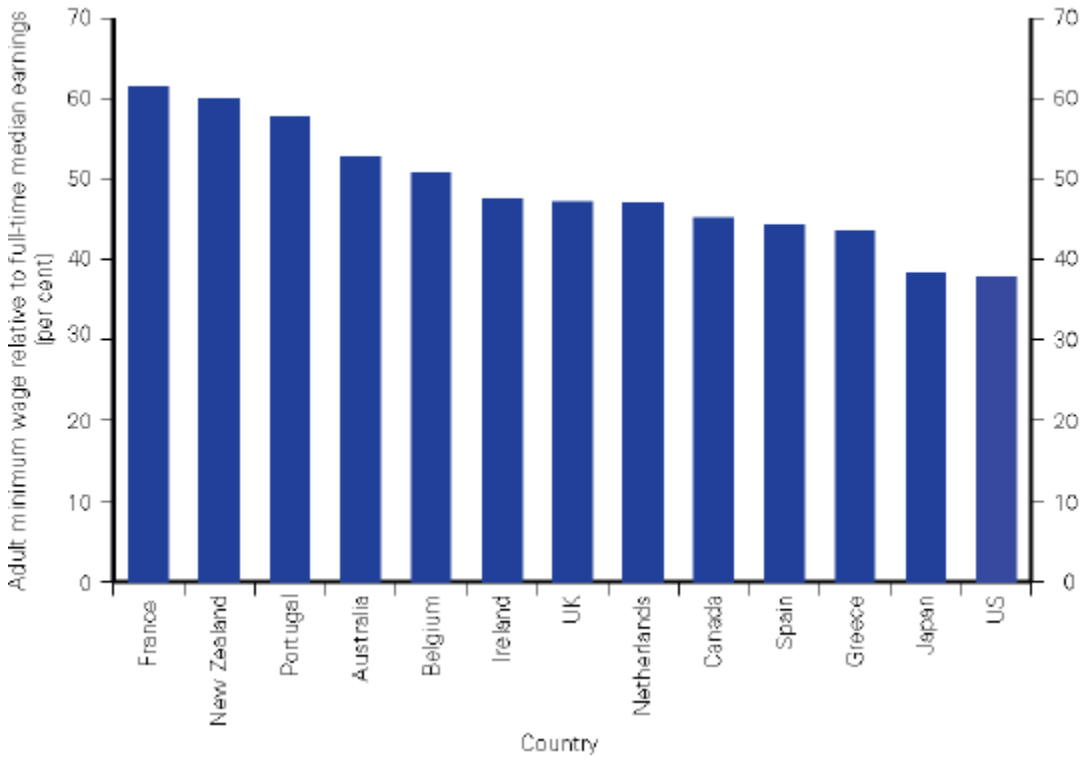
10. **The National Minimum Wage after 15 years**

Extract C: International comparison of adult minimum wages by country, December 2013

Country	**Minimum wage in UK £s, using purchasing power parity exchange rates**
Australia	7.79
France	7.77
Belgium	7.02
Netherlands	6.97
Ireland	6.80
New Zealand	6.35
UK	6.31
Canada	5.89
USA	5.31
Japan	4.80
Spain	3.48
Greece	3.40
Portugal	2.91

Source: Extracted from National Minimum Wage – Low Pay Commission 2014

Adult minimum wages relative to full-time median earnings, by country, 2012



Source: The Future Path of the National Minimum Wage - Low Pay Commission 2014

Some countries, such as China and India, do not have a single national minimum wage. In China, each province sets its own minimum wage to reflect local conditions. In November the hourly rate in Beijing was equivalent to approximately £1.74, whereas in Hunan it was around £0.93.

International comparisons of productivity, final estimates for 2012

Current price GDP per hour worked

UK = 100

Canada	105
France	132
Germany	131
Italy	111
Japan	89
UK	100
USA	135
G7 average	120

Source: ONS 20 February 2014

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11. **The National Minimum Wage after 15 years**

Extract E: The National Minimum Wage: silver bullet or poisoned chalice?

Since its introduction in 1999, the NMW has increased by 75%, whilst average earnings have risen by 61% and the Retail Price Index by 53%. A new report, published by the Institute of Economic Affairs, argues that the NMW should be abolished for apprentices and under 18-year-olds in the UK to tackle persistently high youth unemployment. The rate for 16 and 17 year olds is due to rise to £3.79 per hour in October 2014 and to £2.73 per hour for apprentices. The authors of the report also believe that setting a single NMW is likely to have adverse effects on private sector employment in the regions. In Wales, for example, the NMW is 70% of median hourly earnings in the private sector, compared to just 42% in London. The report recommends that the minimum wage should be regionalised. When determining the minimum wage for each region, differences in productivity and economic conditions should be taken into consideration.

Source: News Reports accessed May 2104

12. **The National Minimum Wage after 15 years**

Extract D: Calls for employers to commit to paying the Living Wage as the pay gap widens

The TUC, the Archbishop of Canterbury and Boris Johnson, the Mayor of London, are just a few of those who have called on employers to pay their workers a living wage. The Living Wage is defined as 'the wage that can meet the basic needs to maintain a safe, decent standard of living within the community'. The Living Wage differs from the minimum wage in that the latter is set by law and may fail to provide people with enough income to have a reasonable quality of life. It has been claimed that five million people are paid less than the Living Wage, which is estimated at £8.80 an hour in London and £7.65 elsewhere.

Proponents argue that paying the Living Wage means workers can live with dignity and not just exist. By paying the Living Wage, employers can lift their employees out of poverty, debt, and illness, which will improve family life. Employers benefit because it is easier to recruit and retain staff, productivity increases, and there is a reduction in sickness and absenteeism. Government spending on welfare is also reduced. Everyone is a winner.

Source: News Reports accessed May 2104

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13.

The National Minimum Wage after 15 years

Extract A: The role of the National Minimum Wage

The purpose of the NMW is to provide a wage floor, in order to protect low-paid workers against exploitation, without causing job losses. Many economists have been wary of statutory minimum wages: unless they raise the price of labour at the bottom of the wage distribution above what it would otherwise be they are pointless; but if they raise it then the fear is that they will curb demand for labour, and curb it to the particular detriment of the least skilled.

However, others have pointed out that labour markets are not perfectly competitive. There are costs and risks for workers who want to change jobs, and some employers enjoy a degree of monopsony power in local labour markets. As a result workers may be paid at levels below the market-clearing rate. The implication is that a statutory wage floor may raise the pay of the lowest earners without adverse employment effects. The challenge is to set the level as high as possible short of causing people to lose jobs.

Source: The Future Path of the National Minimum Wage - Low Pay Commission 2014

14.

The National Minimum Wage after 15 years

Extract B: The National Minimum Wage to rise to £6.50 in October 2014

Will a rise in the National Minimum Wage (NMW) damage the competitiveness of the UK economy? Representatives of businesses in the UK have claimed that the recently announced 3% increase in the National Minimum Wage is 'unwelcome in today's economic climate'. Critics of the increase maintain that 'it is essential that businesses remain competitive and that the above inflation increase in the NMW will add significantly to business costs'. Yet competitiveness is not just about wages, it also, for example, depends on productivity, the exchange rate and innovation.

Source: News Reports accessed May 2104

15.

In May 2014, the European Central Bank (ECB) President, Mario Draghi, warned that there was a risk of deflation across economies in Europe.

Evaluate the view that the UK government should give higher priority to preventing deflation rather than controlling inflation.

[25 marks]

16.

The Balance of Payments Extract F (lines 21−22) states: ‘The UK's large current account deficit cannot be ignored easily, and research shows that such deficits are reduced eventually through some combination of slower growth and currency depreciation’.

Using the data in the extracts and your knowledge of economics, evaluate the significance of a large and persistent deficit on the current account of the balance of payments for the UK economy.

[25 marks]

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17. In May 2014, the European Central Bank (ECB) President, Mario Draghi, warned that there was a risk of deflation across economies in Europe.

Explain why deflation may occur in an economy.

[15 marks]

18. The data below shows economic growth rates, unemployment rates and inflation rates for an economy.

Year	Real output growth rate (%)	Unemployment rate (%)	Inflation rate (%)
2010	2	4	6
2011	3	3	5
2012	4	3	4
2013	5	2	3

All other things being equal, which one of the following is the most likely explanation for the relationship between the rates of growth of real output, rates of unemployment and inflation between 2010 and 2013?

A A decrease in the money supply. ⬭

B An increase in innovation and productivity. ⬭

C A decrease in the savings ratio. ⬭

D An increase in the current account deficit. ⬭

[1 mark]

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19. **The Balance of Payments**

Extract F: Warning on UK's current account deficit

The UK is one of only eight countries to see its current account deficit increase since 2008, and its deficit has increased the most. Should overseas investors be worried? The UK has lived with large current account deficits for decades. From the 1940s to the early 1970s, when the country was operating a fixed exchange rate system, the UK was forced to use contractionary policies to keep the balance of payments in check and had to devalue the pound sterling in 1949 and 1967. From the 1980s onward, with the exchange rate floating, persistent current account deficits stopped being a cause for concern.

In the boom years before the global financial crisis, the current account deficit remained large, exceeding 3% of GDP in 2006. With hindsight, this should have rung alarm bells that the economy had become seriously unbalanced, with foreign money flowing into the UK to fund unsustainable public and private sector consumption rather than investment. After the crash, it was widely assumed that the UK economy would recover through higher exports and higher business investment. Indeed, the government's 2010 budget forecasted a current account surplus of 0.9% in 2013, driven by a surge in exports. This forecast proved highly inaccurate as the current account deficit increased.

Although surveys show that business confidence is high, investment fell in the year to the end of September 2013, and the UK's export performance has been poor, despite the depreciation of sterling by approximately 25% in the immediate aftermath of the financial crisis. In contrast, other European economies have seen strong export growth.

The UK's large current account deficit cannot be ignored easily, and research shows that such deficits are reduced eventually through some combination of slower growth and currency depreciation.

Source: news reports, February 2014

20. In recent years, growth rates in the UK have been low and unemployment has risen. For example, in 2012 output was still below its peak of 2008 and unemployment had risen from 6.4% from 7.8%.

Explain why economic growth is a key objective of UK Government economic policy.

[15 marks]

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21. According to the Quantity Theory of Money, as illustrated by the equation of exchange MV = PQ, a rise in the money supply will have most effect on inflation when which one of the following combination of events occurs?

	Velocity of circulation (V)	Final output (Q)	
A	Decrease	Decrease	⬭
B	Decrease	Increase	⬭
C	Increase	Increase	⬭
D	Increase	Decrease	⬭

[1 mark]

22. In 2013, two key aims of the UK Government were: to move the budget deficit towards a surplus over the course of the Parliament and to ensure that the main burden of deficit reduction would be through reduced government spending, rather than increased taxation.

Evaluate the view that the UK Government's policy of deficit reduction through lower government spending is unnecessary and undesirable.

[25 marks]

23. In 2013, two key aims of the UK Government were: to move the budget deficit towards a surplus over the course of the Parliament and to ensure that the main burden of deficit reduction would be through reduced government spending, rather than increased taxation.

Explain the possible demand-side consequences of an increase in taxation in the UK.

[15 marks]

24. Which one of the following is most likely to cause demand-pull inflation?

A An increase in indirect taxation. ⬭

B An increase in productivity. ⬭

C A decrease in interest rates. ⬭

D A rise in oil prices. ⬭

[1 mark]

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25. **Government policy Extract F** (lines 14−17) states ‘Investment forecasts are being revised downward and on top of speculation of interest rate rises and criticism of the UK’s quantitative easing programme, the outlook is not looking as good as forecasts first indicated.’

Using the data in the extracts and your economic knowledge, evaluate the effectiveness of monetary policy in achieving macroeconomic stability in the UK.

[25 marks]

26. **Government policy**

Extract F: Austerity remains

The Chancellor, George Osborne, has ruled out the possibility that the UK's improving economy will lead to immediate tax cuts or spending increases when he said reducing the budget deficit would be the priority of his Autumn Statement. The Chancellor said that the UK was still borrowing too much and that any increase in tax revenues generated from faster growth would be used to reduce the budget deficit and the national debt.

The move comes as no surprise, with the Chancellor stating, "I would just remind everyone that I still sit down at the table at the G20 with one of the highest budget deficits. The UK still continues to have some very serious public finance challenges that need to be addressed."

This week, the IMF revised up its forecasts for UK growth in both 2013 and 2014, six months after its chief economist, Olivier Blanchard, warned Osborne that he might cause more damage with his austerity plan. However, Osborne responded, “We have a clear plan and we are sticking to that plan."

The Chancellor's announcement may not be good for UK firms. It is common for business investment to lead the way when emerging from recession, but not this time. Investment forecasts are being revised downward and, on top of speculation of interest rate rises and criticism of the UK's quantitative easing programme, the outlook is not as good as forecasts first indicated.

In explaining its forecast downgrades for net investment over the last three years, the Office for Budget Responsibility (OBR) cites two main factors. Firstly, problems in credit markets have made it difficult for firms to borrow to invest. This may have particularly affected small and medium-sized firms that tend to be more reliant on bank financing. This will only be made worse if interest rates rise. Secondly, the uncertainty generated by the eurozone crisis and other events has stifled investment.

Source: News reports, 2013

27. After a period of inflation below the target rate, the Consumer Price Index (CPI) inflation rate was recorded as −0.1% in early 2015. The Governor of the Bank of England wrote: ‘A temporary period of falling prices, driven by large adjustments in a few specific components of the CPI, is a fundamentally distinct phenomenon from ‘deflation’...The UK is not experiencing ‘deflation’.’

Evaluate the possible consequences for the performance of the UK economy of the actual rate of inflation being below the Monetary Policy Committee’s (MPC’s) target rate.

[25 marks]

28. In 2014, the UK's contributions to the European Union (EU) budget rose by £2.7bn, making it the second largest net contributor. However, it is argued that the UK benefits much more from the trade and the job creation that EU membership brings.

Explain how membership of a customs union, such as the EU, affects the pattern and volume of trade between countries.

[15 marks]

29. After a period of inflation below the target rate, the Consumer Price Index (CPI) inflation rate was recorded as −0.1% in early 2015. The Governor of the Bank of England wrote: 'A temporary period of falling prices, driven by large adjustments in a few specific components of the CPI, is a fundamentally distinct phenomenon from 'deflation'...The UK is not experiencing 'deflation'.'

Explain the possible causes of deflation in an economy.

[15 marks]

30. **The European Union Context Extract F** (lines 14−18) states: 'The EU introduced the Stability and Growth Pact …in order to prevent individual economies from creating instability across the EU. However, EU member countries have struggled to keep to the pact, with only four member countries not breaking the rules.'

Using the data and your knowledge of economics, evaluate the likely impact on the UK economy of other EU countries attempting to reduce their public sector debt at the same time.

[25 marks]

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1. Since the start of the financial crisis of 2007−2008, the UK, the Eurozone and the USA have adopted quantitative easing (QE) in an attempt to stimulate their economies.

To what extent do you agree that maintaining inflation at the target rate of 2% should be the top priority of UK macroeconomic policy? Justify your answer.

[25 marks]

2. 'The avoidance of price deflation must always be the major macroeconomic objective.'

Explain how changes in the price level in the UK are measured through the use of price indices such as the RPI and CPI.

[15 marks]

3. In March 2011, the UK Office for Budget Responsibility (OBR) forecast that the budget deficit would fall from 7.9% of GDP in the financial year 2011-2012 to 1.5% in 2015-2016.

Discuss whether the UK Government should **either** raise taxes **or** cut government spending to achieve its 2015-2016 fiscal objective.

[25 marks]

4. 'Economic shocks can bring with them significant consequences for macroeconomic performance, as the UK knows only too well.'

Evaluate the likely impact of world economic growth **both** on the UK economy **and** on individuals in the economy.

[25 marks]

5. 'Economic shocks can bring with them significant consequences for macroeconomic performance, as the UK knows only too well.'

Using at least **one example of each**, explain how demand-side and supply-side shocks might harm a country's economic growth.

[15 marks]

6. **The European Union Context Extract E** (lines 8−9) states: 'There's a lack of concern about international competitiveness in France.'

Explain what is meant by 'international competitiveness' **and** analyse how the international competitiveness of France might be improved.

[9 marks]

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7. In July 2012, the Office for Budget Responsibility concluded that UK Government measures to cut the budget deficit have improved the UK's long-term economic prospects.

To what extent do you agree, if at all, that the implementation of a budget deficit reduction programme will improve the UK's long-term economic prospects? Justify your answer.

[25 marks]

8. **The European Union Context Extract E** (lines 1−2) states: 'In recent years, growing disenchantment with the EU has led to calls for the UK to leave the organisation.'

Do you agree with the view that the UK economy would benefit if the UK left the EU? Justify your answer using the data and your economic knowledge.

[25 marks]

9. In July 2012, the Office for Budget Responsibility concluded that UK Government measures to cut the budget deficit have improved the UK's long-term economic prospects.

Explain possible economic reasons why a government might prefer to cut government spending to reduce a budget deficit rather than raise taxes.

[15 marks]

10. **The European Union Context Extract E** (lines 12−14) points out that UK trade with the EU has created 3.5m jobs in the UK 'either within the export sector or, more widely, through the operation of an export-led multiplier'.

Explain the term 'export-led multiplier' **and** analyse **two** possible economic reasons for an increase in UK exports to the EU.

[9 marks]

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11.

THE EUROPEAN UNION CONTEXT

Extract E: Would the UK be left out in the cold by saying goodbye to the EU?

In recent years, growing disenchantment with the EU has led to calls for the UK to leave the organisation. Supporters and opponents of UK membership have presented coherent arguments.

A study by the so-called Bruges Group, which opposes the EU, estimated the annual cost of UK membership to be £65bn. This included an estimated cost to businesses of £28bn to comply with EU regulations and an annual net contribution to the EU Budget of £14.6bn. A member of the EU Commission in 2011 estimated that the Common Agricultural Policy (CAP) causes the UK consumer to pay up to three times as much for food than if the CAP did not exist. The common external tariff raises prices of imports into the EU, including the prices of consumer goods and resources used by businesses. It also protects inefficient, high-cost EU producers.

Those supporting UK membership point, for example, to the 3.5 million UK jobs created from trade with the EU, either within the export sector or, more widely, through the operation of an export-led multiplier. The Single European Market has helped trade creation and has allowed EU labour to move to the UK, to the benefit of UK businesses. Despite not being in the eurozone, the UK has continued to attract a large share of the world's investment funds so that it is now the third largest recipient internationally. It is claimed that a large part of this is due to EU membership. The EU as a whole has also exerted much greater influence than could any individual EU country in negotiations to further global free trade. One business organisation has argued that non-membership would be like 'sitting outside in the corridors rather than at the decision table'.

Sources: various, 2012

12.

The Global Context Extract B (lines 15−16) argues: 'An increasing global inflation problem could have serious consequences for all aspects of UK macroeconomic performance, including the balance of payments and employment.'

Using the data and your economic knowledge, discuss the possible impact on the UK balance of payments of an increasing rate of inflation throughout the global economy.

[25 marks]

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13. **THE GLOBAL CONTEXT**

Extract A: UK Inflation (%) as measured by the Retail Prices Index (RPI) and the Consumer Prices Index (CPI), 2004−2011

Year	RPI	CPI
2004	3.0	1.3
2005	2.8	2.1
2006	3.2	2.3
2007	4.3	2.3
2008	4.0	3.6
2009	−0.5	2.1
2010	4.6	3.3
2011	5.2	4.5

Source: ONS, accessed on 8 August 2012

14. **The Global Context Extract C** (lines 12−13) states that the Quantity Theory of Money 'predicts a direct relationship between increases in the money supply and increases in the price level'.

Explain the term 'price level' **and** analyse how increases in the money supply of an economy may bring about increases in the price level in that economy.

[9 marks]

15. Using **The Global Context Extract A**, calculate the difference between the annual average value of RPI and the annual average value of CPI for the years 2005 to 2008.

[2 marks]

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16. THE GLOBAL CONTEXT

Extract C: Is money the root of all evil in the UK?

In September 2011, UK inflation, as measured by the CPI, was 5.2%. By June 2012, it was down to 2.4%. This fall has resulted from reductions in global energy and food prices, as well as a stronger pound and significant price reductions by retailers. The fear of some economists is that these factors will be of a temporary nature, especially when recovery gets under way nationally and globally, and inflation will prevail once more.

Such fears have led these economists to criticise the Bank of England for continuing with its loose monetary policy of low interest rates and quantitative easing. They accept that this policy was pursued in good faith in order to generate economic recovery and prevent deflation, but point to continuing disappointing performance. They fear that the main consequence will be inflation and point to the Bank's own view in its Inflation Report of August 2012 that 'considerable uncertainty surrounds the inflation outlook'.

The Quantity Theory of Money is relevant here. It predicts a direct relationship between increases in the money supply and increases in the price level. Increases in the money supply can begin to influence such factors as interest rates and the exchange rate, as well as business and consumer confidence. When the feared impact of increases in the money supply is added to the anticipated global inflationary forces, it is argued that UK inflation will inevitably rise. As for the global economy, rising inflation could also be a major obstacle to any UK economic recovery.

Source: news reports, 2012

17. THE GLOBAL CONTEXT

Extract B: Inflation never quite goes away

Governments around the world seeking a cure for inflation accept that such a cure may never be achieved. They recognise, therefore, that the next best thing is effective control in order to secure economic stability and sustained economic growth. Even then, past experience suggests that inflation will never be fully under control. Governments recognise that there may be both national and international forces at work which have a bearing on prices. International causes of inflation are inevitably going to be more difficult, or impossible, for a country to control than those whose origins are from within that country.

Some economists might argue that a weak global economy can help to suppress inflation but this weakness, if it persists, will have costs in terms of jobs and living standards. In any case, there may still be pessimism about inflation in the long term. As growth strengthens both in emerging and advanced economies, consumer demand, energy costs, primary commodity prices and wage costs are certain to rise. Agricultural commodity prices, for example, have fallen in recent decades but a significant upward trend could occur. Such a trend will be reinforced by the growth of a global population, now over 7 billion. An increasing global inflation problem could have serious consequences for all aspects of UK macroeconomic performance, including the balance of payments and employment. It breeds uncertainty for government, consumers and businesses and raises expectations of future inflation. Because it affects competitiveness and can disrupt trade and investment flows, the impact on both the current and the capital accounts of the balance of payments needs to be assessed. It is also likely that worsening inflation can halt any hesitant recovery. Overall, economic instability can be expected.

Source: news reports, 2012

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18. Savings often provide the funds for investment. In 1997, the UK saving ratio stood at 13%, at the beginning of the financial crisis in 2007 it was only 5% and by 2014 it had risen slightly to 7%.

Evaluate the likely impact of a fall in the saving ratio on the performance of the UK economy.

[25 marks]

19. Savings often provide the funds for investment. In 1997, the UK saving ratio stood at 13%, at the beginning of the financial crisis in 2007 it was only 5% and by 2014 it had risen slightly to 7%.

Explain why the saving ratio may fall.

[15 marks]

20. In 2014, George Osborne revived the idea of 'full employment' as a macroeconomic goal but what is actually meant by full employment is often debated by economists, with some arguing that a natural rate of unemployment exists.

Evaluate the view that reducing unemployment inevitably has trade-offs with other macroeconomic objectives.

[25 marks]

21. Globalisation and outsourcing of manufacturing provides several potential benefits to economies. However, some countries, such as the UK, continue to suffer persistent trade deficits but are unable to resort to import controls.

Assess the view that, for the UK, the economic benefits of globalisation outweigh the costs.

[25 marks]

22. In 2014, George Osborne revived the idea of 'full employment' as a macroeconomic goal but what is actually meant by full employment is often debated by economists, with some arguing that a natural rate of unemployment exists.

Explain the factors which might determine the natural rate of unemployment.

[15 marks]

23. **The European Union Context Extract E** (lines 20−22) states: '…it becomes very difficult to further stimulate domestic demand as real interest rates approach zero. On the other hand, low interest rates contributed to the Swedish currency, the Krona, falling sharply in value...'.

Explain the term 'real interest rates' **and** analyse why low interest rates may lead to a fall in the value of a currency on the foreign exchange market.

[9 marks]

24. **The European Union Context Extract F** (line 1) states: 'Deflation is the new economic menace threatening European economies including the UK.'

Using the data and your knowledge of economics, evaluate the view that deflation in the EU's economies would inevitably be damaging to the UK's macroeconomic performance.

[25 marks]

25. The economies of Mexico, Indonesia, Nigeria and Turkey (MINT) have all been identified as the next main emerging market economies with high rates of growth. However, there are warnings that what goes up will eventually come down.

Explain why economies may go from periods of economic growth to recession.

[15 marks]

26. Calculate (to 2 decimal places) Sweden's Consumer Price Index (CPI) figure in December 2015 if the CPI figure stood at 314.05 in December 2014, and the annual rate of inflation was minus 0.3% **and** using **The European Union Context Extract D**, identify **one** significant comparison between the inflation rate for Sweden and the UK.

[2 marks]

27. **THE EUROPEAN UNION CONTEXT**

Extract F: Is deflation a bad thing?

Deflation is the new economic menace threatening European economies including the UK. In the Eurozone in particular, the European Central Bank is considering the use of quantitative easing to help avoid deflation; but why is it such a problem? Firstly, there is the argument that deflation delays spending. However, this does not relate to all forms of consumption. Another reason is the effect on debtors. Prices and perhaps incomes may fall, but the real value of debt increases. For firms experiencing falling revenues, and households with declining incomes, debt repayments become more of a burden. Governments can be caught in the same trap, because if prices and incomes fall, so does tax revenue.

There is an alternative view that moderate deflation is not a bad thing, especially if it is the result of innovation that reduces production costs. Also, some comfort is to be had from falling or barely rising prices as this goes some way to improve competitiveness. Some of the Eurozone's economies desperately need to become more competitive and they need to either reduce costs or increase productivity. However, falling prices deter investment, which makes productivity improvements far more difficult.

Source: news reports, 2014

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28. THE EUROPEAN UNION CONTEXT

Extract E: Sweden's economic fortunes

Only a few years ago, the Riksbank (the central bank of Sweden) was the envy of the world. The Swedish economy was a star performer early in the global recovery following the 2008 economic crisis. Sweden's economy grew three times faster than the Eurozone's in 2010. Even better, the Riksbank felt confident enough in recovery to start raising interest rates. Its main interest rate reached 2% by July 2011, while rates in most other rich economies stayed nearer to zero.

However, some economists argue that, from the beginning, Sweden's interest rate increases looked premature. When the first rate increase came, unemployment stood at 8.2%, while the inflation rate was 1.1%, well below the central bank's target. Concerns about financial stability influenced the decision to maintain higher interest rates, even though economic conditions deteriorated. The Riksbank was worried that rising household borrowing and soaring house prices could lead to adverse consequences in the long run. Yet the strategy did not go as planned and no doubt contributed to deflation in 2013.

Unemployment in Sweden has remained high and private sector debt as a share of GDP is higher now than it was in 2010 but, at the same time, house prices have continued to climb. In October 2014, the Riksbank announced it was cutting its main interest rate to zero in an effort to stimulate the economy.

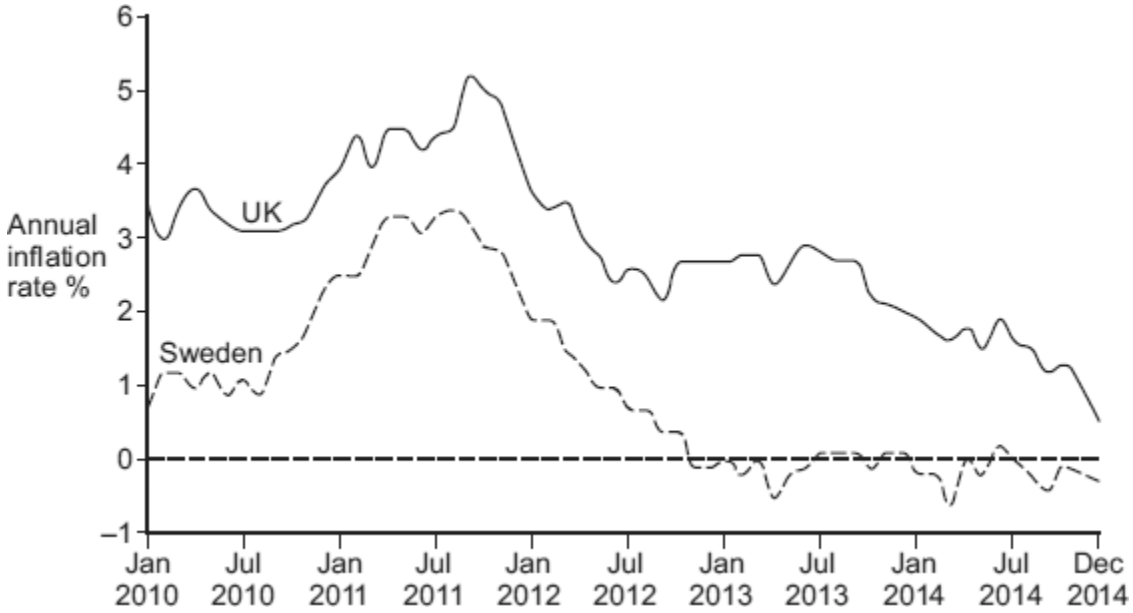
However, the effectiveness of the central bank's ability to respond to avoid deflation is a concern because it becomes very difficult to further stimulate domestic demand as real interest rates approach zero. On the other hand, low interest rates contributed to the Swedish currency, the Krona, falling sharply in value, which helped exports and provided some cushion against weak global demand and further deflation.

Source: news reports, 2014

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29. **THE EUROPEAN UNION CONTEXT**

Extract D: Annual inflation rates of the UK and Sweden using the Consumer Price Index (CPI)



Source: iEconomics http://ieconomics.com/inflation-rate-sweden-uk accessed 16/01/15

30. Since the start of the financial crisis of 2007−2008, the UK, the Eurozone and the USA have adopted quantitative easing (QE) in an attempt to stimulate their economies.

Explain how the process of quantitative easing in the UK might increase the rate of inflation.

[15 marks]

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1. ‘The avoidance of price deflation must always be the major macroeconomic objective.’

Evaluate the view that the avoidance of price deflation should always be the major macroeconomic objective.

[25 marks]

2. ‘For a strong recovery there is a need to encourage spending, ideally by businesses but also by households in the short term.’

Discuss the importance of low interest rates in bringing about a recovery from recession in an economy such as the UK.

[25 marks]

3. ‘Oil, as a form of energy, reigns supreme but it has brought significant problems to economies in terms of inflation in particular, and the potential for economic instability in general.’

Discuss how rising oil prices might affect the macroeconomic performance of an economy.

[25 marks]

4. ‘Oil, as a form of energy, reigns supreme but it has brought significant problems to economies in terms of inflation in particular, and the potential for economic instability in general.’

Explain the main causes of inflation.

[15 marks]

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5. THE EUROPEAN UNION CONTEXT

Extract D: Is European Union (EU) unity threatened?

In March 2009, the Hungarian Government asked Germany for €190 billion to prevent what it saw as a new economic 'Iron Curtain' from going up across Europe. The term 'Iron Curtain' was intended to remind Europeans of the Soviet-era divide between the poorer Communist East and the more prosperous, free, democratic West. Hungary argued that, without such help, the contrast between the richer and poorer members of the EU would only widen further. Germany's refusal of Hungary's request symbolised, for many, the deepening divide between the EU's richer and poorer members.

The contrast in fortunes is seen by newer members of the EU, such as Latvia, Lithuania and Hungary, as one which can only worsen during the recession and which may threaten the EU's existence in the long term. On the other hand, some people in the more−established members of the EU, such as the UK and France, have become increasingly disillusioned with the EU and especially with the level of assistance now expected from these more-established members by the newer members.

At the Brussels Summit of March 2009, the Czech Prime Minister warned of 'the greatest crisis in the history of European integration'. Gordon Brown, for the UK, spoke of the need for unity and common policies. The Single European Market, for example, is seen as an evolving policy which can foster prosperity for all and bring closer integration.

Cyclical unemployment is now widespread, however, and has been growing faster in the Eastern members of the EU than in those of the West. This could increase tensions between Eastern and Western members of the EU. The impact of cyclical unemployment on both individuals and whole economies can be serious, as incomes and output fall and welfare-dependency becomes more widespread.

Nevertheless, it would be wrong to argue that the wealthier members of the EU have been totally immune to the problem. The Netherlands, the worst affected Western member, experienced a 34% rise in unemployment between January 2008 and March 2009. There was a much greater rise in Latvia and Lithuania, both in the East.

During a recession, questions are likely to be asked about the future of the EU as policy disagreements emerge. Supporters claim that the EU is a force for good and needs to be strengthened, rather than weakened or abandoned. In this way, it is argued, East-West tensions can be kept at bay.

Such supporters feel that an enlarged EU, with open markets based on the Single European Market policy, helps spread benefits of membership across the whole organisation and offers the best chance of rapid recovery. In the UK, however, many see openness as a threat to jobs and to living standards.

In the current climate, it has also been argued that a more ambitious set of common macroeconomic policies would help speed recovery in the EU. Fiscal and supply-side policies come into this category, as well as monetary policy, even though only 16 members of the 27-member EU have adopted the euro. Even so, limited agreement on monetary policy, such as interest rates, could be of benefit.

The UK has not had the leading role in EU recovery policies that it has had globally, but it has shown a willingness to play its part in fostering unity and economic revival so that Europe can make a vital contribution to international recovery. Talk of disunity and the break-up of the EU can only cause instability and hinder economic recovery. This is something that members can ill-afford, particularly the UK. Growth, jobs and stable prices are desperately needed.

Source: various sources

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6. **The European Union Context Extract D** (lines 35-36) argues that 'a more ambitious set of common macroeconomic policies would help speed recovery in the EU'.

Using the data and your economic knowledge, assess the impact on the UK economy of a recovery in the EU as a whole.

[25 marks]

7. 'UK government policy might not always be able to achieve fully all the macroeconomic objectives which are regarded as important.'

Explain how budget deficits in an economy might help to influence the rate of inflation in that economy.

[15 marks]

8. In 2009, the World Bank described the Chinese economy as a "relative bright spot in an otherwise gloomy global economy" (**The Global Context Extract B**, lines 34-35).

Using the data and your economic knowledge, assess the consequences for the UK economy of China's continued economic growth during a global recession.

[25 marks]

9. **The Global Context Extract B** (lines 4-5) refers to global investment undertaken by China.

Explain the term 'global investment' **and** analyse **two** economic consequences for an economy receiving such investment.

[9 marks]

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10. **THE GLOBAL CONTEXT**

Extract B: China: a bright spot in a gloomy world

China, despite its recent rapid growth, has not remained immune to the economic downturn as some economists had hoped. However, it remains an economy which is looking to the future with some optimism. It continues to invest in the production of raw materials and resources in other countries. The consequent increased global investment should give a much-needed boost to jobs and growth in countries benefiting from it. Despite this investment, growth in demand from China is likely to continue to push up world raw material prices in the long term.

Certainly, China has shown an increased recognition of the need to play its part in bringing about global recovery. For example, in a recent international agreement to boost the funds of the International Monetary Fund (IMF) by $500 billion, China has agreed to contribute $40 billion, compared to the UK's $15 billion. The IMF can now fulfil its promise of loans to such countries as Poland and Mexico, which should contribute to the greater global stability needed for recovery.

Nevertheless, China, fearing inflation, has expressed its concern about the policy of some leading central banks, including the Bank of England, of quantitative easing (increasing the money supply) in order to bring about economic revival by increasing aggregate demand. China also knows that its policy of holding down the external value of its currency in order to boost export-led growth is only likely to be successful if a global revival of demand is achieved. For example, China saw a 25% decline in exports in 2008. The depressed UK market will have contributed to this decline.

The other major world economies are keen to keep talking with China and win its approval for a host of measures to bring about recovery. They want to engage China in more long-term talks as well. These will include international financial reforms and environmental policies, especially as China's industrial growth continues to create negative externalities.

China has every reason to be optimistic about its future prospects. In June 2009, the *Organisation for Economic Co-operation and Development* (OECD) forecast growth for that year of 7.7% and 9.3% for 2010. To a country used to double-digit growth figures, this may seem like a recession. However, such figures are a far cry from the negative growth seen in many parts of the global economy, including the UK economy.

Nevertheless, the ongoing concern of the Chinese Government is reflected in the decision to give a $565 billion fiscal stimulus to its economy in 2009. It is also considering protectionist policies, which may impact on those countries hoping to increase exports to China. For the World Bank, however, the Chinese economy remains a 'relative bright spot in an otherwise gloomy global economy' and countries such as the UK are keen to see China help pull the global economy out of recession.

China has reacted coolly to suggestions that a solution to the world's economic problems lies in the hands of two powers: itself and the US. Although the UK has played a leading role in international discussions on recovery, such an assertion may yet prove to have a ring of truth. What is certain is that co-operation is vital in ensuring that appropriate policies are followed to bring about a new era of sustained growth.

Source: various sources, 2009

11. 'UK government policy might not always be able to achieve fully all the macroeconomic objectives which are regarded as important.'

Evaluate the view that, in the long run, conflict between the major macroeconomic objectives can be avoided.

[25 marks]

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12.

The European Union Context Extract D (lines 33 −34) argues that the ‘UK must not be blind to the potential problems of Turkey’s possible membership of the EU and must also be in a position to grasp the opportunities which are sure to appear’.

Using the data and your economic knowledge, assess the potential economic consequences for the UK if Turkey joined the EU.

[25 marks]

13.

Sustained economic growth can often benefit a country’s living standards through higher income per head. In the UK from 2001 to 2007, the annual average growth in real income per head was +3%.
For 2008 and 2009, it was −3%.

Explain how supply-side factors might help to achieve sustained economic growth.

[15 marks]

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14. THE EUROPEAN UNION CONTEXT

Extract D: Turkey − gateway to Asia

Turkey has been in talks since 2005 regarding possible membership of the European Union (EU). While further enlargement of the EU causes some concern, serious consideration needs to be given to Turkey. Its geographical position links Europe and Asia. Since Asia is currently driving world economic growth, Turkey can be an important strategic gateway to Asia for the EU.

The UK Government supports Turkey's application for EU membership but questions still persist. If Turkey joins the EU, can the UK successfully take up the resulting trade and investment opportunities? Will the UK be overwhelmed by imports and cheap migrant labour? Will UK businesses be determined enough to grasp any opportunities?

Turkey has a population of 75 million, which is expected to rise to 100 million by 2020. The average age is just 27 and it has vast economic potential. Turkey's GDP is ranked 18th in the world, and GDP per capita is £7163. Like the UK, there has been some negative growth in recent years but the economy recovered to achieve 11% growth in the first quarter of 2010. Between 2002 and 2007, Turkey's annual average economic growth of 7% was far greater than that of the UK.

About 50% of Turkey's exports are to Europe, with textiles being particularly important. Machinery and semi-manufactured goods are major imports. The UK does not yet rank alongside countries such as Germany, Italy, China and the US as important exporters to Turkey, but opportunities certainly exist.

Turkey has had a reputation for economic instability. Since 2005, for example, inflation has been between 5% and 12%. Unemployment has remained in double figures: 10% of the labour force in 2005 and 14% currently. However, Turkey now boasts a relatively modest budget deficit of between 4% and 5% of GDP.

Despite a degree of instability, Turkey is seen as an attractive centre for investment. For example, the country received £115 bn in foreign direct investment in 2009. However, Turkey's infrastructure still leaves much to be desired.

UK businesses need to consider the potential economic opportunities. Lord Digby Jones, formerly of the *Confederation of British Industry* (CBI), points out that Turkey's recent economic growth is from a low base. According to Lord Jones, "Whereas a little bit of growth in a prosperous country such as Germany does not make much difference, in a developing country such as Turkey millions of people get richer". This is perhaps an exaggeration, especially in the short run, but a valid point is being made.

The UK must not be blind to the potential problems of Turkey's possible membership of the EU and must also be in a position to grasp the opportunities which are sure to appear.

Source: news reports, 2010

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15.

THE GLOBAL CONTEXT

Extract B: Winners and losers

The debate over the consequences of globalisation for individual countries continues. Inevitably, there will be benefits and costs, winners and losers. For example, whilst the UK has experienced deindustrialisation, its service sector has been successful in world markets.

As the debate continues, one aspect of globalisation cannot be disputed: that the greater integration of economies has meant that major events occurring in one part of the world will have an impact not just on the affected country or region but are now much more likely to have global significance.

Some events are known about well in advance of them actually happening. Major sports competitions are an example. In 2012, for instance, the UK will host the Olympic Games. Similarly, Russia and Qatar will host the football World Cup in 2018 and 2022 respectively. The economic impact of such events on host countries is likely to be positive. For other countries, the immediate impact is likely to be more limited. However, the UK and other economies could benefit if these events make the host countries more open to trade and investment in the long term.

Other events are far less predictable or are completely unpredictable. For example, how might the UK cope with a disruption to gas and oil supplies if relations with Russia deteriorate or political turbulence in the Middle East escalates? What path to recovery will the UK take following the devastating effects of the 2008 US financial crisis?

Generalisations about the economic impact of natural disasters are often unhelpful. Hurricane Katrina in 2006, which caused billions of dollars of damage in the New Orleans area of the USA, had minimal economic impact on the rest of the world. However, the Japanese earthquake and tsunami in 2011 are on a different scale. Japan accounts for 7% of world GDP. There are fears that the scale of the damage may lead to a return to recession in Japan, as fearful Japanese consumers spend less and save more. Global supply chains originating in Japan, such as car components supplied to the rest of the world, have been severely disrupted. The UK, as well as Japan's other trading partners, will struggle to maintain exports to the Japanese market until stability is restored.

Like any other country, the UK needs to have a strong economy to be able to respond successfully to all types of global event and to secure sustained economic growth. Important factors include high productivity, resource mobility, innovation, skilled labour, a strong infrastructure in its widest sense and general flexibility in the economy. The ability to make use of these supply-side qualities will, however, also depend on aggregate demand. The impact of major global events on UK aggregate demand will inevitably vary considerably, positively or negatively, with unknown consequences for macroeconomic performance.

Source: news reports, 2010/11

16.

The Global Context Extract B (lines 29 −30) states that 'the UK needs to have a strong economy to be able to respond successfully to all types of global event …'.

Using the data and your economic knowledge, assess the significance to UK macroeconomic performance of major global events such as sports competitions, natural disasters and economic downturns.

[25 marks]

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17. UK exports of goods which, in 2002, were valued at £187 billion, had risen to £228 billion in 2009.
The deficit on the UK balance of trade in goods rose from £48 billion in 2002 to £82 billion in 2009.

Evaluate the view that an increasing deficit in UK trade in goods is a major problem for the UK economy.

[25 marks]

18. The global economic slowdown in recent years saw UK unemployment, as measured by the claimant count, rise from 870 000 in 2004 to 1.5 million in 2009.

As unemployment rises, explain **two** possible economic problems which might affect individuals in the UK **and two** possible economic problems which might affect the UK economy as a whole.

[15 marks]

19. **The European Union Context Extract D** (lines 16−18) suggests that France and Germany would like the EU to have 'the power to impose an EU-wide fiscal policy on all member states and not just the eurozone'.

Using the data and your economic knowledge, assess the possible economic consequences for the UK economy of an EU-wide fiscal policy requiring all member states to balance their budgets.

[25 marks]

20. **The Global Context Extract B** (lines 2−3) states that 'India's economic success could help to bring some relief to the UK economy and speed the recovery process through increased exports'.

Using the data and your economic knowledge, assess the importance to the UK economy of continued economic growth in India.

[25 marks]

21. In November 2011, the UK inflation rate was 4.8%, the rate of unemployment was 8.3%, while Bank Rate remained at 0.5%.

To what extent are low interest rates appropriate in the UK at a time of high inflation?

[25 marks]

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22.

THE EUROPEAN UNION CONTEXT

Extract D: The fiscal remedy for recession

The recession of 2009 brought renewed interest amongst EU governments in a so-called Keynesian approach to spending their way out of recession. They were desperate to avoid a prolonged period of negative growth and the accompanying mass unemployment.

In the UK, as well as within the eurozone, fiscal rules were abandoned as the fight for economic recovery began. The Stability and Growth Pact of the eurozone, to which the UK had also adhered in an informal way before the recession, limited budget deficits to 3% of GDP and a nation's debt to 60% of GDP. Such constraints were often far exceeded and increasing concerns were being expressed. In May 2010, the new UK Government became a prominent voice within Europe for a reversal of fiscal policy, with public spending cuts and tax increases.

The UK Government's policy was given some support by the economic crisis unfolding in Greece, a member of the eurozone. The Greek Government needed to be 'bailed out' by fellow member states if it was not to default on its debts. It had a budget deficit of 14% of GDP and a national debt of 115% of GDP in 2009, a year when its GDP also fell by 2%.

There was concern in the EU that such a situation had been allowed to develop, with increasing calls for EU-wide controls. France and Germany were pressing for an EU institution such as the European Commission to provide such a role, with the power to impose an EU-wide fiscal policy on all member states and not just the eurozone.

The UK Government opposed any such powers over member countries. However, it had gone as far as to establish an Office for Budget Responsibility (OBR), intended to keep the Government's tax and spending plans under control by providing a reality check on the state of the nation's finances. The OBR, however, does not have the powers that some were envisaging for the EU.

In a climate of greater stability in 2010, some still believed that an EU-wide fiscal policy needed to be a key part of the evolution towards a federal state. It cannot be denied that the best way forward must be that which delivers macroeconomic stability across the EU. Whether this comes about through member governments each developing a policy of fiscal responsibility or through a fiscal policy imposed by the EU on all member states remains open to debate.

Source: various sources, 2010

23.

The Global Context Extract B (line 10) suggests that 'there is often a trade-off' between inflation and economic growth.

Explain why there might be a trade-off between inflation and economic growth **and** analyse **one** cause of inflation.

[9 marks]

24.

Weaknesses in the UK balance of trade in goods persist, with a deficit of £27.6 bn in the third quarter of 2011, compared, for example, to £23.3 bn in the same quarter in 2010.

Discuss the possible contribution of supply-side reforms to achieving an improvement in the UK balance of trade in goods.

[25 marks]

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25. THE GLOBAL CONTEXT

Extract B: A passage to India

In July 2010, the UK Prime Minister led a Government delegation to India. The hope was that India's economic success could help to bring some relief to the UK economy and speed the recovery process through increased exports.

India's growth in 2010 is expected to be about 9%. Its GDP per capita is $3100, although over 400 million Indians live below the international poverty line of $1.25 per day. It has a labour force of almost 500 million but an official rate of unemployment of 11%. Quarterly sector growth is impressive: 1.8% in services, 2.2% in manufacturing and 1.7% in agriculture between January and March 2010.

For the Indian Government, inflation and economic growth are top of the agenda. Unfortunately, there is often a trade-off between these two macroeconomic indicators. Inflation jumped from 1.3% in October 2009 to almost 5% in November 2009. However, food inflation was 19%. As in other countries, rising oil costs are also amongst the causes of inflation for the Indian economy.

The UK Government still hopes to promote increased UK economic involvement in India. Certainly Indian business has become more involved in the UK. *Tata*, one of India's oldest companies, is now the UK's leading manufacturer through its ownership of *Corus Steel and Jaguar Land Rover*. India is now more likely to be creating jobs in the UK through direct investment rather than 'stealing' them, for example through call-centre activity relocated from the UK. UK business needs to rise to the challenges and opportunities presented in India. Companies such as *Vodafone* (telecommunications) and *BAE Systems* (defence and aerospace) are amongst the recent success stories and it is widely believed that India's increased demand for world-class services, for example financial and legal, can be met by the UK.

Infrastructure investment is urgent. Each year, about 40% of India's agricultural produce rots before arriving at market because of inadequate storage facilities and poor road and rail links. The Indian Government's plans to spend $500bn between 2010 and 2013 on new ports, roads, rail links and airports will help to improve the situation. This investment is an export opportunity for UK firms specialising in infrastructure projects. The growth of the Indian economy will also help UK service exporters such as banking, education and health-care businesses. Currently, India accounts for only 1% of UK exports.

However, India remains fiercely protective, and investment and trade flows from the UK could remain limited. Progress will depend on whether a long-awaited EU-India trade deal becomes a reality and on the outcome of the *World Trade Organization's* global trade talks. Many argue that India can only benefit from increased international trade.

The UK Government said at the time of the Prime Minister's July 2010 visit to India that the UK had a vital stake in India's rise to becoming a global power and in its future prosperity. At the same time, a view was also expressed that the UK needs India much more than India needs the UK. It is hoped that all aspects of the UK's macroeconomy can eventually benefit as India develops further.

Source: news reports, 2010

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26. Weaknesses in the UK balance of trade in goods persist, with a deficit of £27.6 bn in the third quarter of 2011, compared, for example, to £23.3 bn in the same quarter in 2010.

Explain **three** reasons for a country such as the UK experiencing persistent deficits in the balance of trade in goods.

[15 marks]

27. **The European Union Context Extract D** (lines 39–41) argues that the 'best hope for stronger UK economic growth must therefore surely rest with the EU, but this requires the eurozone to be stabilised and macroeconomic conditions to improve throughout the EU'.

To what extent would you agree that the EU is likely to offer the 'best hope for stronger UK economic growth' over the next few years? Justify your answer, using the data and your economic knowledge.

[25 marks]

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28. THE GLOBAL CONTEXT

Extract B: A decade of change, challenge and opportunity

This year, ten years will have passed since the downfall of Saddam Hussein in Iraq. Over these years the Middle East and North African countries (MENA) have continued to witness economic and political instability, culminating in the recent so-called 'Arab Spring' uprisings in countries such as Egypt, Libya and Syria.

The *Organisation for Economic Cooperation and Development (OECD)* distinguishes two groups within the MENA region. The resource-rich economies, such as Iraq, Saudi Arabia and Dubai, are recognised as being different from those seen as resource-deficient, such as Egypt and Jordan. For both groups, however, and despite the political problems for some, the OECD is optimistic about future growth.

The OECD argues that, as the global economy recovers, demand for goods and services from European and emerging markets in particular will encourage development of MENA's manufacturing and service sectors. Just as the UK, for example, enjoys a comparative advantage in financial services, some MENA economies are now developing attractively priced manufactured goods. Tourism is also ripe for further development.

However, although the OECD points to economic progress having been made, recent years have highlighted challenges which need to be faced in the MENA economies if there is to be further progress. Improvements in labour productivity and hence competitiveness are essential for increased trade with the rest of the world. More foreign investment in infrastructure and manufacturing plant is desperately needed, with advanced countries such as the UK having a role to play here. Unemployment remains persistently high in some MENA countries, as does inflation.

Jordan is beginning to show what can be done to bring about a more successful economy. Through productivity improvements, it is now one of the most competitive MENA countries. This has helped it to negotiate a number of significant free trade agreements, including those with the EU and the US. Exports have brought increased economic growth to Jordan, as has domestic investment.

One of the benefits of economic success can be a higher standard of living. The Human Development Index (HDI) allows international comparisons of living standards. The Arab states of the Middle East have seen an improvement in the index from 0.444 in 1980 to 0.641 in 2011. The latter figure can be compared with 0.862 for the UK.

Income per head, access to healthcare and education, life expectancy, the quality of the environment and a fair distribution of income are key factors in any assessment of living standards. The UK and other developed countries need to remember that higher living standards can mean bigger markets for goods and services.

In many of the MENA economies, there is still much to be done to achieve sustained economic success. But, where Jordan leads, others will begin to follow. To do so would see a significant strengthening of MENA's economic importance in the global economy.

Source: news reports, 2012

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29. THE EUROPEAN UNION CONTEXT

Extract D: Economic growth or a double-dip recession?

In the third quarter of 2011, UK real GDP rose by 0.6%. Within this, manufacturing output increased by just 0.1%, while services such as banking and finance showed a 0.7% increase. Unemployment was around 8% of the labour force.

Such weak growth figures are a reflection of the economic situation within the European Union (EU) as a whole. The likelihood is that the next few years for the UK economy will be bleak. This pessimism is shared by other EU countries.

Prospects do not look good for the EU economy as a whole but, of course, the detailed picture varies between member countries. There has been a general deterioration in confidence. Intense financial turmoil in money and capital markets is affecting both investment and consumption. Deficit-reduction programmes are also suppressing domestic demand. Weaknesses in the global economy are holding back UK and EU exports. In mid-2011, the hope had been expressed by some economists that exports would be a major driver of economic growth, but such optimism proved groundless.

Attention has again turned to domestic demand within the EU. The projected decrease in inflation in the UK and in other member countries, coupled with limited wage growth, should at least limit any further significant erosion of real disposable income. However, there is continuing concern over the level of household debt which may yet constrain demand. Overall, the fears of a double-dip recession still loom large.

Within the UK, there is a debate over the relative importance of the various potential sources of growth in the next few years. There is a view that tightening of fiscal policy in the UK, together with similar policies in other EU countries, is damaging consumer demand and business confidence unnecessarily. The UK think-tank, the Institute for Public Policy Research (IPPR), argues for changes to be made to UK fiscal policy, and supports more severe spending cuts only when the economy improves.

The Institute therefore points to three possible solutions to the problem of slow UK and EU growth. These are: increases in government spending; substantial increases in global demand; and households and firms being given stronger incentives to spend more, for example through tax cuts. While growth in demand is seen as an important determinant of economic growth over the next few years, elements of government spending and incentives to business can make important contributions to the strengthening of the supply side of the economy.

None of the solutions offered by the IPPR seems likely to occur at the moment. The UK Government appears to be determined to maintain its tight fiscal policy, arguing that it is the only basis for sustained long-term growth. The global economy is far from stable, with increased talk by some of greater protectionism, although the emerging markets, such as India and Brazil, offer some hope for UK and EU exports. Households lack the confidence, and often the ability, to increase spending, while companies lack the optimism to invest. It needs to be borne in mind that the EU remains the UK ’s most important single trading partner by far. The best hope for stronger UK economic growth must therefore surely rest with the EU, but this requires the eurozone to be stabilised and macroeconomic conditions to improve throughout the EU.

Sources: news reports, 2012

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30. **The Global Context Extract B** (lines 36–37) states that, if other MENA economies were to follow Jordan's lead, there would be a 'significant strengthening of MENA's economic importance in the global economy'.

To what extent, if at all, should developed countries such as the UK be concerned about a significant strengthening of the economic importance of MENA countries in the global economy? Justify your answer, using the data and your economic knowledge.

[25 marks]

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1. ‘While it is necessary to have macroeconomic policy objectives, such as price stability and full employment, they can sometimes prove difficult to reconcile.’

Explain the various macroeconomic policy objectives **and** their importance to an economy.

[15 marks]

2. ‘Failure to get a new trade deal would put another dark cloud over the world economy.’

Source: PETER MANDELSON, EU Trade Commissioner, July 2008

Explain the main economic determinants of a country’s demand for imports.

[15 marks]

3. **The European Union Context Extract D** (lines 35-36) argues that ‘a more ambitious set of common macroeconomic policies would help speed recovery in the EU’.

Using the data and your economic knowledge, assess the impact on the UK economy of a recovery in the EU as a whole.

[25 marks]

4. ‘Oil, as a form of energy, reigns supreme but it has brought significant problems to economies in terms of inflation in particular, and the potential for economic instability in general.’

Discuss how rising oil prices might affect the macroeconomic performance of an economy.

[25 marks]

5. The Budget Report of April 2009 estimated that UK government borrowing for 2009-10 would be £175 billion, or about 12% of GDP.

To what extent should government borrowing be a cause for concern?

[25 marks]

6. ‘Oil, as a form of energy, reigns supreme but it has brought significant problems to economies in terms of inflation in particular, and the potential for economic instability in general.’

Explain the main causes of inflation.

[15 marks]

7. ‘Failure to get a new trade deal would put another dark cloud over the world economy.’

Source: PETER MANDELSON, EU Trade Commissioner, July 2008

Evaluate the significance for the UK balance of payments on current account of increased use of protectionist policies around the world.

[25 marks]

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8. ‘It is better to do everything you can to prevent deflation before it begins, even if there is only a small chance of it occurring.’

Explain how monetary policy might be used to prevent a period of deflation.

[15 marks]

9. ‘It is better to do everything you can to prevent deflation before it begins, even if there is only a small chance of it occurring.’

Assess the impact on UK macroeconomic performance of a prolonged period of deflation.

[25 marks]

10. **The Global Context Extract B** (lines 35–37) concludes: ‘Globalisation must surely have played its part in the success of the UK economy…whatever problems it may also have created.’

Using the data and your economic knowledge, to what extent do you agree with the view that globalisation has been of benefit to UK macroeconomic performance?

[25 marks]

11. ‘Inflation needs to be avoided at all costs but it is nowhere near as damaging to an economy as deflation.’

Explain how inflation is measured in the UK through indices such as the Retail Prices Index (RPI) and the Consumer Prices Index (CPI).

[15 marks]

12. An economy which is enjoying rapid economic growth experiences a significant rise in the external value of its currency within a floating exchange rate system.

Evaluate the possible macroeconomic consequences for an economy of a rise in the exchange rate of its currency.

[25 marks]

13. ‘Inflation needs to be avoided at all costs but it is nowhere near as damaging to an economy as deflation.’

To what extent might it be argued that infl ation is preferable to deflation?

[25 marks]

14. ‘While it is necessary to have macroeconomic policy objectives, such as price stability and full employment, they can sometimes prove difficult to reconcile.’

Discuss ways in which government economic policies can be used to try to reconcile conflicts between macroeconomic objectives.

[25 marks]

15. ‘The UK economy has recently been in the grip of its worst recession for 60 years.’

Assess the contribution which supply-side reforms might make in helping avoid major recessions.

[25 marks]

16. ‘The UK economy has recently been in the grip of its worst recession for 60 years.’

Explain possible reasons for an economy moving from a period of prosperity to one of recession.

[15 marks]

17. **The Europena Union Context Extract Extract D** (lines 27−28) states that ‘the impact of the increased government borrowing arising from budget deficits across the EU is of concern amongst some economists’.

Using the data and your economic knowledge, assess the impact on the UK economy of increased government borrowing by EU governments.

[25 marks]

18. The deficit on the UK balance of trade in goods and services rose from £26 billion in 2003 to £44 billion in 2008.

Explain the main factors which might help determine the volume of UK exports and imports.

[15 marks]

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19. THE EUROPEAN UNION CONTEXT

Extract D: Is EU unity threatened?

Europe, and indeed much of the world, was shaken by the depth of the economic downturn from 2008. Many countries, including the UK, saw the solution to be a return to Keynesian economics and, therefore, tolerance of large budget deficits. This was coupled with significant monetary expansion, so that, in the UK for example, the Bank of England Bank Rate was cut to 0.5% in 2009, accompanied by a policy of 'quantitative easing' (increases in the money supply).

The UK pressed other EU governments to embark on fiscal expansion. Not all shared the UK's enthusiasm and, at best, wanted only a much more modest fiscal stimulus than was the case in the UK. However, events sometimes overtook such wishes. Ironically, given the scale of the UK fiscal stimulus, until the latter part of 2009 the UK was the only major economy to remain in recession. This may reflect the greater significance of the housing and financial sectors in the UK compared to other EU countries.

The fiscal position of many EU countries has given rise to concern. Italy, for example, now has a national debt (the total outstanding debt of central government) of around 120% of GDP, even though its annual budget deficit is not exceptionally large. Some countries have shown a greater determination than Italy to cut their deficits. In December 2009, for example, Ireland announced sharp cuts in public sector wages. But it is certainly not just Italy which has shown complacency. The EU's Stability and Growth Pact limits annual borrowing to 3% of GDP. EU governments are under increasing pressure to return to this target by 2014.

The short- to medium-term benefits of fiscal expansion during downturns cannot be denied. Government spending can initiate a powerful stimulus to an economy through the multiplier process. Aggregate demand therefore rises. The UK Pre-Budget Report put government spending at £676 billion. Tax cuts will give households more spending power. Coupled with cheap credit and retail price discounts, recovery can therefore be helped through increased consumption.

However, the impact of increased government borrowing arising from budget deficits across the EU is of concern amongst some economists. It may eventually force the authorities to increase interest rates, lead to 'crowding-out' of private sector activity and make public spending cuts and tax increases an inevitability. In the UK, for example, a VAT rate of 17.5% was restored in January 2010 following a temporary cut to 15%. Equally, the 2009 Pre-Budget Report announced an increase in National Insurance contributions.

The problem in trying to assess the impact of fiscal expansion is, of course, not knowing what might have happened without it. Certainly, some economists are quick to attribute the end of recession in France and Germany in 2009 to such fiscal loosening. Indeed, it is difficult to argue that, for any country in the EU, economic growth and employment cannot be beneficial to some extent at a time when business and consumer confidence are both at a low level.

Whether such a policy eventually causes inflation to make an unwelcome return remains to be seen. At that point, EU members may experience a greater urgency to balance budgets and reduce monetary expansion.

Source: various sources, 2010

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20. The deficit on the UK balance of trade in goods and services rose from £26 billion in 2003 to £44 billion in 2008.

Evaluate government policies which might bring about a reduction in the UK deficit on the balance of trade in goods and services.

[25 marks]

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